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Journal of Tax Administration

ABOUT THE JOURNAL

The Journal of Tax Administration is a peer-reviewed, open access journal concerned with all aspects of tax administration. Initiated in 2014, it is a joint venture between the University of Exeter and the Chartered Institute of Taxation.

JOTA provides an interdisciplinary forum for research on all aspects of tax administration. Research in this area is currently widely dispersed across a range of outlets making it difficult to keep abreast of. Tax administration can also be approached from a variety of perspectives including, but not limited to, accounting, economics, psychology, sociology and law. JOTA seeks to bring together these disparate perspectives within a single source, to engender more nuanced debate about this significant aspect of socio-economic relations. Submissions are welcome from both researchers and practitioners on tax compliance, tax authority organisation and functioning, comparative tax administration and global developments.

The editorial team welcomes a wide variety of methodological approaches including analytical modelling, archival, experimental, survey, qualitative and descriptive approaches. Submitted papers are subjected to a rigorous blind peer review process.

SUBMISSION OF PAPERS

In preparing papers for submission to the journal, authors are requested to bear in mind the diverse readership, which includes academics from a wide range of disciplinary backgrounds, tax policy makers and administrators and tax practitioners. Technical and methodological discussion should be tailored accordingly, and lengthy mathematical derivations, if any, should be located in appendices.

MESSAGE FROM THE CHARTERED INSTITUTE OF TAXATION

The Chartered Institute of Taxation is an education charity with a remit to advance public education in, and the promotion of, the study of the administration and practice of taxation. Although we are best known for the professional examinations for our members, we have also supported the academic study of taxation for many years and are pleased to widen that support with our involvement with this journal.

WEBPAGE

The Journal of Tax Administration website can be found here:
www.jota.website

Editorial note

We are pleased to present the second issue of this new journal, jointly sponsored by the Chartered Institute of Taxation and the University of Exeter's Tax Administration Research Centre (TARC). We are grateful to all of the contributors to this issue, both authors and reviewers.

The first paper is a modified version of a keynote speech presented by Professor Owens at the Tax Administration Research Centre Workshop, held at the University of Exeter, 21-22 April 2015. After reprising developments in cooperative compliance, Professor Owens reflects on the administrative dimensions of BEPs and speculates on future developments in this regard.

The second paper is a contribution from a team of researchers at the University of Vienna who present findings from two studies, one in Austria and one in the Netherlands, exploring from a psychological perspective the relationship between different forms of motivations to comply and reported compliance. The paper offers some policy recommendations for tax authorities and raises some interesting issues for follow up research.

The third paper explores recent developments in South Africa, in relation to the tax system as a whole and more specifically its administration. The authors, Sally-Ann Joseph and Chris Evans, find a lack of resilience which constrains administrative developments but nonetheless identify opportunities to address the fiscal challenges.

The fourth paper is from John Bevacqua and presents a comparative analysis of the important issue of taxpayers' rights to fair treatment in Australia and the UK. This paper is also published in a forthcoming volume Contemporary Issues in Taxation Research Volume 2, published by Fiscal Publications[1]. We are grateful to the author and the publisher of that volume for allowing the paper to be reproduced in this journal.

Two reviews complete this issue of JOTA. The first, by Nigar Hashimzarde, reports the proceedings of the joint Internal Revenue Service and Tax Policy Center conference held in Washington on 18 June 2015: Improving Tax Administration through Research Driven Efficiencies. The second is a review by Adnan Isin of a selection of recently published peer reviewed academic journal papers dealing with various aspects of tax administration.

One final point is to welcome the addition of two new members of the JOTA editorial board, Professor Allison Christians from McGill University and Professor Hans Gribnau, University of Tilburg.

Lynne Oats
On behalf of the Managing Editors

[1] ISBN 978-1906201067, see http://www.fiscalpublications.com

Tax Transparency and BEPS

Jeffrey Owens[1]

The following is a modified version of a keynote speech presented by Professor Owens at the Tax Administration Research Centre Workshop, held at the University of Exeter, 21-22 April 2015.

We are moving into a new era where the traditional relationships between tax administrations, tax advisors and companies are changing: moving away from confrontation to cooperation. At the same time, there remains some hope that a new consensus will emerge from the OECD's Base Erosion and Profit Shifting (BEPS) project on a revision to the international rules of the tax game. This paper explores these issues.

Cooperative Compliance

The concept of cooperative compliance was initially launched in 2008, with a lot of help from Her Majesty's Revenue and Customs (HMRC), but it was referred to by the term, "enhanced relationship". It would not have been my choice of name for this concept. The Dutch and the Koreans refer to it as "horizontal monitoring". I don't like that either. That gives the suggestion that one party lies down and the other party walks over you, which is not what cooperative compliance is about. So today we have the term, "cooperative compliance". Whilst it is better, I suspect it will evolve. The concept is all about a change in the dynamics of the relationship between these three key players in the tax world. Moving from a relationship that is characterized by reference only to the legal requirements to one where multinational enterprises (MNEs) comply with the spirit of the law. You can argue what that means in practice, but it isn't that difficult to determine. You move from a relationship that is characterized just by reference to the legal obligations and with limited disclosure, with no signals of uncertainty. In other words, the taxpayer is not going to ask HMRC, "you know, we're not quite sure this scheme's going to work. What do you think"? That seems kind of a strange thing to ask, but if you have a dialogue it can be done. You try to move away from that non-constructive dialogue to a relationship where you have mutual trust; a relationship where the taxpayer is prepared to disclose what they're doing, it's prepared to help the tax administration to understand their business model, why they're changing it, why they're undertaking business restructuring. At the same time, the tax administration is open with the taxpayer. And that has to start at the level of policy formulation, where you have a dialogue with business, you tell them what you're thinking of; at the level of implementation of the policy decisions that you make; and in monitoring to ensure that the laws are actually implemented in a consistent way. It sounds simple but it's not easy to achieve.

What does it require if we're going to move in that direction? The first thing is building up trust and, as we all know, it takes a long time to build up trust,

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particularly in the tax area. On the other hand, you can lose trust very quickly. And if you're going to get this change in culture – because we are talking about a culture change here, you may have to also have legislative changes as well to make it work. But essentially it's cultural change, which has to start at the top. The tax Commissioner and his deputies must firmly commit to the programme. You also have to have the CEO and the board committed. No MNE should go into a cooperative compliance programme unless the board has had a discussion. "Is this something we want to do, and do enthusiastically?" But even that is not enough. It then has to percolate down to the operational level, and that has been a problem, and it's where the cultural change comes in. Because if the auditors on the ground don't understand that there has been a change in the climate, it's not going to work. The same applies to MNEs. If the people that design the tax planning schemes, including the advisors, do not realise that things have changed, then they just continue in their old ways, not being afraid to cross the red line of acceptability and so cooperative compliance is not going to work. In practice, even for countries like the Netherlands or the UK, it takes a long time for the change to percolate down. And that's where it really is a cultural change; a generational change. So be patient. It will take time, but it is worthwhile persevering.

The other thing cooperative compliance requires is that tax administrations have commercial awareness: that they understand how business operates; and that business in turn understands what drives the tax administration. One thing that can help here is that many countries are moving to a situation where there's much more of an exchange of personnel between the business sector and the government sector. I don't think we want to get to the US situation, where you design schemes; then two years later you are in the private sector and you exploit those same schemes. That's perhaps not where you want to go. But I think having more movement of staff between the private sector and the tax administration is a positive thing. There are some countries where that is just not accepted. In France, for example – if you are a senior tax official and you leave the tax administration, it's a one-way exit; you can't come back. That's the wrong approach, in my view anyway.

A further issue that has to be addressed in the cooperative compliance space is confidentiality. Because when you provide information in the context of the cooperative compliance programme, you can't take it back; you can't suddenly forget it. So you have to be sure that the tax administration will not exploit it. And also, on confidentiality, there is the question of how widely information should be shared. Some MNEs may be happy that, say, the UK gives information they get under the cooperative compliance programme to the US; they may be far less happy if it ends up in Sudan.

Where does this programme of cooperative compliance currently stand? I would say that there are probably less than 8 countries that have actually implemented true cooperative compliance programmes. There are many other countries that say, "we have it", but it is more rhetoric than reality. They think, "Ah, now we have an occasional lunch with a tax director, this is cooperative compliance". That's not the way it works. Genuine cooperative compliance requires a fundamental change in the way the tax administration works, and it requires legislative change, it requires cultural change, it requires a change in the way information is handled. This is not something that can be put in place overnight. It takes a long time – and it does require resources; significant resources of high-level staff at the beginning – but once you have it in, it pays for itself.

Where are we going today? It's difficult. In some ways, cooperative compliance is suffering from collateral damage from the BEPS project. There are very few Commissioners that are going to be prepared to stand up and say, "I love the taxpayer. Let's sit down and have a nice conversation." And there are very few companies that are prepared to take the risk of being very open in the current environment. So we need to know how to kick start this process. Because I believe, quite strongly, that many of the issues in the Base Erosion and Profit Shifting project are going to be much easier to solve if we have this type of dialogue. And I think this is not just the case for the OECD countries; it is also the case for developing countries. So I hope we can move forward. The WU Global Tax Policy Center at the Institute for Austrian and International Tax Law (part of WU Vienna University of Economics and Business) has just launched a project on cooperative compliance with support from the Tax Administration Research Centre (TARC) at the University of Exeter. We aim to get two or three countries in Africa and two or three multinationals to volunteer to go into this programme. I did this successfully in Russia. At the end of two years' negotiation, we managed to get in place a cooperative compliance programme. There are five multinationals in the programme and it seems to be working. If you can do it in Russia, you can probably do it anywhere.

BEPS

And now to BEPS; you can't go to any tax conference these days without using the word, "BEPS". I'm sure you are all familiar with BEPS, so I'll just give you some high-level comments.

Launched in 2013 by the OECD, it is the biggest tax game in town. It poses an enormous reputational risk for the OECD; if they don't succeed in this, they're going to have a problem moving forward on the broader tax agenda. If you want to see the first BEPS report, go back to the 1998 report of the OECD on Harmful Tax Competition. Almost everything that's in the BEPS project is there. And almost everything that is being worked on in BEPS was being worked on by the OECD over the last 20 years: so what's the difference? There are three distinguishing factors. First, BEPS is a package. That was not traditionally the way the OECD worked. You looked at a particular issue, isolated it, you had a long period of technical discussions, you came up with proposals and within five years you had a couple of recommendations. That's not the way it is happening today. All these issues are part of a package. That has its advantages and disadvantages. The advantages: as a package, you can get trade-offs. The disadvantages are that you don't always get the right technical solutions. The second distinguishing feature of the BEPS project is the political support. This is very much a project that is a top-down rather than bottom-up project. Thirdly, the timelines: basically the OECD was given until November 2015 to deliver on the 15 Action points. That is a very tight deadline. What was pushing it? A lot of people say it was the global financial crisis, the need for money. Obviously, those are important drivers. But I think there were also at least two or three other drivers that were perhaps equally important. One was this feeling that, if we're going to build up support for exiting from the crisis from citizens – citizens who are seeing their benefits cut, and their taxes increase – you must be able to show them that everybody is paying their fair share of tax. It is an important political driver. Another driver was the feeling that, for companies that were prepared to push the envelope that would give them a competitive advantage. Our American friends are very good at pushing the envelope. It's no coincidence that most large US multinationals have effective tax ratios which are significantly lower than European multinationals. The US system was set up in such a way that some, not all, of its MNE do get a big competitive advantage, despite its high nominal rate of corporate income tax.

So what is the BEPS project trying to achieve? There are three broad objectives that are set for BEPS. One is to get a fairer sharing of the tax base between countries. The second is the counteraction of non-compliance, particularly by means of MNEs using tax havens. And the third is to update the rules of the game that the OECD has been working on for the last 50 years. The 15 Action points can be conveniently grouped into three groupings. There are those that are primarily concerned with transparency: the disclosure provisions, the country-by-country reporting, even the master file of transfer pricing. There are those that look at substance: this whole idea that, if a tax scheme doesn't have substance behind it, then somewhere something's gone wrong. And substance is not having one highly-paid lawyer with a lovely sun tan in a Caribbean island, sitting behind 600 brass plates. So there's a whole debate going on of what do we mean by substance? And that's not going to be easy – as you can see from the CFC discussion draft. And then, the third theme that runs through the whole programme is coherence. We need a greater coherence in the way that different parts of the international tax system interact.

In terms of what has been achieved so far, my ex-colleagues in the OECD, have managed to deliver on time high quality technical products. Seven of the Action plans resulted in recommendations to the G20 heads of government when they met in Brisbane in 2014, although many were what I call, "qualified". There was no clear consensus saying "this is what must be done"; it was more analysis and then options about each issue. The remaining eight Action points are to be delivered by November 2015. This is the point where the rubber hits the road, because up until now BEPS has been about analysing problems, putting forward options; now they're going to have to say "hey, this is what you heads of government have to agree to do". And that's where it gets difficult. And it partly gets difficult because different countries have gone into the project with different objectives. The BRICS were entering the project primarily because they saw it as an opportunity for revising the international rules of the game, particularly the division of tax between source and residence countries. The US and some other big countries went into the project primarily because they were tired with the way their multinationals were using tax havens to minimize their tax burden. Countries like France and Italy were more concerned with digitalization. So lots of different objectives, which meant it was going to be difficult to get a consensus on the 15 Action points.

BEPS is not going to finish in November 2015 at the Turkish summit. This is just going to be another staging point in the process. After November 2015, there'll be much more emphasis on implementation, and much more emphasis on the tax administration aspect, which brings it back to the type of work that is being done at TARC. This is a project that is worthwhile looking at on a longer-term basis. The other comment is if governments were primarily interested in more money, they've chosen the wrong tax. In a typical OECD country, the corporate income tax yield is about eight per cent of total tax revenue, with about 70 per cent of the revenue coming from multinationals and of that 70 per cent, maybe a third potentially related to Base Erosion and Profit Shifting. So even if BEPS is fully successful, maybe it's a one or two per cent increase in overall taxes. Now look at VAT: 20 per cent; tax gap 15 per cent. So maybe what we need is a BEPS VAT programme the next time round.

In developing countries, the reliance on corporate income taxes tends to be much higher; 18 to 25 per cent. But a lot of the issues that are coming out of the BEPS project may not be a priority for developing countries. For developing countries, the priority has to be improving the capacity of tax administrations. If you do not have a good tax administration, there is little you can do about BEPS.

Exchange of Information

The other change that has occurred is the whole question of exchange of information. And it's rare in the tax world that you have a revolution, but I think this is one example where there is a revolution. I spent 20 years of my life trying to get countries to agree to give up their bank secrecy. Look now at the change. Ministers in Switzerland saying, "we will now move into the automatic exchange of information scheme". I haven't heard a finance minister stand up recently and say, "we defend bank secrecy as the barrier to effective exchange of information". And that is one of the legacies that former UK Primer Minister Gordon Brown can be proud of, because without him and his pushing at the April 2009 G20 Summit, we wouldn't be where we are. So we have seen a revolution in terms of exchange of information (EOI) on request. And keep in mind that for tax administration, information is the life blood. Deny a tax administration access to information, and it can't operate effectively. We have now got that in place – and it's beginning to work.

But what is interesting from my perspective is that, despite not having completed the EOI on request process, the G20 have now said the new standard is going to be automatic exchange of information. You want to have all forms of exchange of information on the table: spontaneous, automatic and on request. It is much more challenging, the automatic exchange. And if you don't believe that, ask the EU countries how long it took them to implement the savings directive. Ireland, a pretty sophisticated tax administration: five years. It's a big investment for a tax administration. The EU now said that once all this is operational, the savings directive will disappear. Because that's what you want; because you need to work towards global standards; because without the global standards, you can't take advantage of the technology that's coming in place to minimize the compliance costs to the taxpayers, and to maximize the usefulness of the information for tax administrations. So, there's a big challenge there.

Once we've gone through this process of increased cooperation between tax administrations on the assessment side, the elephant in the room then is what do we do about collection? Because very few countries are prepared to help other countries claim tax. And the amount of tax debt: at one point I think the OECD estimated it at somewhere at 450-500 billion dollars' worth of uncollected tax. And that's just in the OECD area. You extrapolate that to developing countries, it's probably a multiple of that figure. So it's great having assistance in assessment, but can we move to the next stage of assistance in collection? And there is now a provision, Article 27 in the OECD model for that. But let's put it this way, there's not much enthusiasm on the part of countries to move in that direction, because they are still in the old world of national sovereignty, and that's something I will come to.

Country by country reporting and other reports

The other issue that is a BEPS-related issue but I wanted to pick out is the question of country-by-country reporting. Again, that was a concept that we launched at the OECD in 2010. We did a feasibility report. It was a great report. It began by analysing what the issue was. It then looked at what were the options and what were the consequences. And it made recommendations. It was so good a report that the OECD refused to publish it. But we managed to get Mike Devereux, Director of the Oxford Centre for Business Taxation to publish it, without any reference to the OECD. That really kicked the debate off, and it was part of a response to the tax campaigning non-government organisations (NGOs). Eventually it came back on the agenda of the G20 and now it's a reality. A lot of companies refuse to recognize that, but I say to them, "look you have to start preparing for country-by-country reporting". It means that multinationals will have to provide a lot more information to the tax administrations in which they operate, and it's got to be done.

This was the most contested part of the BEPS project. There were a lot of multinationals that really didn't want it. Why didn't they want to do this? They said, "we don't have the information". It is a little bit difficult building up the picture for the legal entities, but it's not impossible. There is a compliance cost, but that's inevitable when you change some of the rules. The one area where I do share some of their concerns is on the confidentiality issues, although a lot of this information I don't think is commercially sensitive. But I can see that they are concerned about the potential for the information to be misused; there is also concern that this is a first step away from the arms' length principle towards global formulary re-apportionment. The OECD has tried to address this by saying the information would only be given to tax administrations. Let's get real. When the review is undertaken in 2020, what's the first thing they're going to decide? The information has to go public. So I say to multinationals, "if you're preparing this information, prepare it on the basis that everything you put there is going to get in the public domain." And maybe that's not a bad thing. If we want sensible debate on tax policy, the citizens need information. And yes, it's complicated, but you need to then explain it; that's the role of politicians and it's the role of tax advisors as well. It's going to be an interesting debate.

There is a risk that the information will be misused, particularly by non-OECD countries, to adopt the more aggressive approach; one that is more based on profit-split, more based perhaps on some sort of transitional pre-decided formulary re-apportionment as well. But in many ways, I think, that's a healthy debate to have. It does mean that you have information in the public domain, and that is only to the good. Better transparency is the first step towards getting that trust into the system.

The one thing that may be a mistake is that the information on the country-by-country reporting will be exchanged via the treaty network. It's cumbersome; it's not in real time; and it's going to effectively exclude many developing countries. There is another way it can be done, and that is to put the information into the cloud. Registered multinationals and registered tax authorities would have access to the cloud. Are there more confidentiality risks in that? No. confidentiality issues remain the same. What new technology people tell me is actually it's probably *more* secure. We had a meeting in Vienna in April 2015 with a mix of service providers, businesses, tax administrations, academics and government – and that was the conclusion they came to. Or as somebody suggested, why do we need to have all of these different pipelines? Why can't tax administrations just have direct access into the accounts of multinationals? Revolutionary idea! Think how easy that would be. And who owns the data of the multinationals? Such an approach would minimize compliance costs.

Now let's go to the Master File. It sounds a very Orwellian concept, the Master File, but it is actually quite a useful concept because it really sets out what type of information should be provided by multinationals to tax administrations. This information will be provided by subsidiaries to the tax administrations within which they operate. There's not much new that's here, but I think what is interesting is it's in a standard format. The idea was to combine country-by-country reporting with Master File. That was split. Why? Because of the concerns about formulary re-apportionment. So if you put all this together: a combination of country-by-country reporting, the Master Files, Exchange of Information – the tax administrations are going to have much more information than in the past for transfer pricing and that can only be a force for good.

Impact for Tax Administrations

Technology: I won't spend very much time on this, but if you want to be serious about a tax administration reform, you need to get into the technology. Commissioners are scared when it comes to technology, because they know it costs a lot of money and, once you make the decision and invest the funds, you are blocked. The US Internal Revenue Service has one of the poorest technology systems in the world and it is very hard to change because of the legacy issues there are. So you've got to get it right. And every day you get proposals coming across the Commissioner's desk: "why don't you do this?" and "why don't you do that?" How do they choose? Some administrations have begun appointing data analyst advisors; not tax people. But I think there is an enormous potential for technology to change the way that tax administrations work. And as I said, if you look at putting country-by-country reporting in the cloud, you've got a really effective tool. And it is not just using technology to get the information, it's using technology to analyse the information – big data. Because all of that – the combination of better access to information, a better capacity to analyse the information, using big data – what do you get? Better risk assessment and better risk management. So you move away from a blanket audit approach to one that is much more selective. Developing countries can benefit significantly from such an approach.

How do governments and business take advantage of this more open, more transparent environment? To me, the key is for government to think very carefully how they exploit all the information. For tax administrations and for business the key message is the old days of deals being done in the back room have gone. If you're a big multinational, you have to now see that any information that you give to one tax administration is going to get around the world. So the days when you could play off the UK against the US by giving one set of information to one country and another to another have gone. And the implication is that multinationals are going to have to have a much more globally consistent approach to information sharing and compliance. And some MNEs are appointing a global tax policy officer – not a bean counter, but somebody that actually takes a global view: "what are we doing in terms of our approach to tax planning on a global basis?" So, lots of interesting things happening there.

Let's move to ask what sort of vision we could form in terms of where tax administrations will be by 2030. We will continue to see a tendency to strip out the policy function from tax administrations, so that they do focus on implementation, although the borderline between tax administration and policy is fluid. We will see tax administrations that are leaner, meaner and smaller: and yet, they will be asked to do more things – more things that are not linked with revenue collection. The way they'll resolve this conflict is by using technology. And perhaps that's not a bad thing, the fact that there is some shrinking of some of the bigger tax administrations. So, we will see a lot of the assessment functions outsourced. In other words, you will be using third-party intermediaries not just to collect the tax, but also to assess the tax. Russia is quite a good example of that. You'll see more use of withholding taxes. We will see more countries moving into the cooperative compliance space, because that is the answer to a lot of the issues that we face today. There'll be more emphasis on protection rather than detection; or, put another way, a lot of the issues that arise in a debate between the tax administration and a company, there'll be a real effort made to resolve these before you get into the audit – the compliance assurance programme (CAP) in the US, for example. And that has advantages for tax administrations and for the taxpayer. We'll continue to see the spread of special units. Most countries now have large business units; many – not enough in my view- have high net wealth individuals, while some countries have SME units. And of course, countries that are rich in natural resources have units that specialize just in the extractive industries. That's a good thing because it builds up expertise of the tax administration.

We will see a more sophisticated approach to risk management. 25 or 30 years ago, the attitude of most tax administrations was to audit. (50 per cent of enterprises was not uncommon). The typical audit rate in OECD countries today is less than two per cent. You say, "how can we do that"? You can do it if you get good risk management. And we need to get the developing countries into this mentality, because they waste a lot of resources at the moment.

Another point is that we see a new emphasis on the work being done by behavioural scientists, tax psychologists, tax sociologist on how to influence attitudes towards compliance. And I am glad to see that's something that you're working on here at TARC. I also think that, with all the information technology that we have and all the additional information that tax administrations will get, particularly from third parties, that we'll see a massive move towards pre-populated tax returns. Ten years ago it was only the Nordics that had this in place; today there are a few more countries, but there are still too many OECD countries that don't – the US, for example. I think one of the reasons in the US is that you have 460,000 tax assessors that will basically lose their jobs. That's a pretty powerful lobby. But we *will* get there so that paying your tax becomes almost a pleasure! You get your tax return from the tax administration, it is all completed, you look through it, the information is right, you then tick it and automatically the amount is deducted from your bank account. It works in Norway: 90 per cent of the returns that are dealt with in this way are correct, and 90 per cent end up by paying the tax automatically. It is a painless system. Now, if you believe in the small government, you may not like that. As Milton Friedman once said to me, "I like to make tax as painful as possible." Not sure it's the right way to approach it, but that's the US. We will see a greater integration of audit of VAT and of corporate income taxes. Some countries have got there already, like Australia; but many countries still have separate reporting, even when you have large business units. But if you think about it, the information you need for a VAT audit is extremely similar to the information that you need for a corporate tax audit.

You will also see the move from bilateral to multilateral approaches. You'll see this in audits already. You've got a number of countries undertaking multilateral simultaneous audits, multilateral joint audits and I hope, we will see the same in a dvance pricing agreements (APAs). I've never liked unilateral APAs. If you can't tell your treaty partner what you've done in the APA, there is something wrong with it. So I like the idea that more countries are moving to the bilateral APAs; the next move is multilateral. There are one of two companies and one or two countries that have begun that process. It's not easy, but it can be done, and it is a more effective way, both from the perspective of the tax administrator and the perspective of the company. This move to multilateralism is spear headed by the OECD multilateral convention on administrative assistance in tax matters. It has something like 80+ signatures now. It is a massive change.

I also hope we will see a move towards tax arbitration. I do not understand why tax people are so against – well, I *do* – mandatory arbitration. Why is it that the investment people can go in that direction? Why do the financial people go in that direction? Free Trade Agreements including the proposal between Europe and US have dispute resolution mechanisms. The WTO has done it. And we the tax people, it's not our culture. So what do you get? Unresolved tax disputes. The UK/US Glaxo Smith case that took fifteen years to get a solution. In a post-BEPS environment we will need a guaranteed outcome. But in mutual agreement procedures, there is no obligation on the tax administration for a final agreement; it's just to try their best endeavour. That's not enough today. And that's why, at

Vienna, one of the things I've launched is a project on the tax disputes. The report the OECD put out in their Discussion Draft on Action 14 threw down the glove. It was giving up too easily under pressure from the BRICS. We need to move forward on that since BEPS, at least in the transitional period, is going to generate a tsunami of tax disputes.

So overall, what are we going to see in ten years' time? We will see tax administrations that are smaller; that are much more comfortable using new technologies to deliver service, to deliver enforcement; that interact with the treaty partners much more effectively; that interact with other government law enforcement agencies – financial intelligence units, justice departments – to counter all forms of illicit activities; and that have much greater commercial awareness of what's happening in the private sector. You will find that multinationals will, slowly, perhaps painfully, get used to operating in a much more transparent environment. What I predict is that in ten years' time, when we look back at this debate we will say: "Country-by-Country, what was all the fuss about? What was it all about?" Information sharing.

Taxpayers' Motivations Relating to Tax Compliance: Evidence from Two Representative Samples of Austrian and Dutch Self-Employed Taxpayers

Katharina Gangl , Eva Hofmann, Manon de Groot, Gerrit Antonides, Sjoerd Goslinga, Barbara Hartl, & Erich Kirchler[1]

Abstract

Tax compliance is assumed to be shaped by three main motivations to comply: enforced, voluntary, and committed motivation. Taxpayers, who hold an enforced motivation to comply, only pay taxes because of audits and fines for non-compliance. Voluntary motivated taxpayers respect the law and pay taxes because it is the easiest option. Committed motivation represents an intrinsic motivation, whereby taxpayers feel a moral obligation and responsibility to be honest. However, little and inconsistent empirical research exists on the relationship between motivations and tax compliance. The present paper empirically examines the connection between motivations and reported tax compliance based on data from two representative samples of 500 self-employed Austrian taxpayers and 1,377 Dutch entrepreneurs. Results show that an enforced motivation is negatively related to tax compliance, whereas a committed motivation is positively related to compliance. Contrary to expectations, voluntary motivation is not related to tax compliance. Based on the present outcomes it is suggested that tax authorities should present themselves as legitimate and benevolent in order to decrease enforced motivations and to foster committed motivations and subsequent high tax compliance.

INTRODUCTION

Taxpayers differ in their motivation to pay taxes (Braithwaite, 2003a; Kirchler, Hoelzl, & Wahl, 2008). Whereas some might be motivated to pay taxes because of audits and severe fines, others might pay taxes because they feel a moral obligation to contribute their fair share. Theoretically, it is assumed that these different motivations also determine differences in tax compliance (Braithwaite, 2003a; Kirchler et al., 2008; Kirchler, Kogler, & Muehlbacher, 2014). Taxpayers with dismissive motivations are expected to see it as less important to pay taxes correctly than taxpayers who are morally motivated to comply with the tax law (Braithwaite, Murphy, & Reinhart, 2007). However, little empirical research has been conducted on the relationship between motivation and tax compliance and in addition, this research is contradictory (Hartner, Rechberger, Kirchler, & Schabmann, 2008; Kirchler & Wahl, 2010).

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Consequently, it cannot be determined if and how tax authorities should respond to taxpayers' motivations. The present paper sheds light on the relationship between motivations and reported tax compliance by examining data of two representative samples of self-employed taxpayers in order to determine the relevance of taxpayers' motivations for tax authorities' policies.

The slippery slope framework originally differentiated between enforced and voluntary motivation (Kirchler, 2007; Kirchler et al., 2008) and after an extension, now distinguishes between three different qualities of tax compliance motivations defined as enforced, voluntary and committed motivation (Gangl, Hofmann, & Kirchler, 2015). This categorization corresponds to research on general psychological reactions towards influence differentiating between compliance, identification, and internalization (Kelman, 2006). Enforced, voluntary, and committed motivation could be seen as representing a continuum between the two broad angles of extrinsic and intrinsic motivation (Feld & Frey, 2007; Frey & Jegen, 2001; Ryan & Deci, 2000). Extrinsic motivation emphasizes outcomes of behavior, e.g., working for pay, whereas intrinsic motivation reflects an inherent interest in the actual activity, e.g., working because of curiosity (Ryan & Deci, 2000). Generally, it is assumed that tax compliance motivations develop within individuals based on their experiences, attitudes, and feelings towards taxpaying and the tax authority (Braithwaite, 2003a; Kirchler, 2007). This implies that tax authorities, through their activity, may also influence and change taxpayers' motivations (Feld & Frey, 2002; Gangl et al., 2015; Kirchler et al., 2008). In the following, the three main motivations of tax compliance are presented according to the slippery slope framework (Gangl et al., 2015).

Motivations of tax compliance

Enforced motivation is based on the deterrent effect of audits and fines (Kirchler, 2007; Kirchler et al., 2008). Taxpayers holding an enforced motivation only pay taxes when they fear audits and fines and therefore think there is no alternative to compliance. Such a motivation is related to the broader concept of extrinsic motivation (Ryan & Deci, 2000). Taxpayers comply because it leads to a comparatively better financial outcome than non-compliance, i.e., not being fined (Ryan & Deci, 2000). Enforced motivated taxpayers feel a large social distance between themselves and the tax authorities and the state (Braithwaite, 2003a). Consequently, enforced motivated taxpayers likely have negative attitudes and feelings towards paying taxes (Kirchler, 1998). They may even condemn the tax collecting state as a thief (Sloterdijk, 2010). The state and its tax authorities are perceived as taking money in terms of taxes from taxpayers with the help of coercion and force (Kirchler et al., 2008).

Voluntary motivation to pay taxes is based on positive reciprocity (Gangl et al., 2015; Kelman, 2006). The tax law is respected and tax authorities are perceived as service providers who should assist taxpayers to comply with the law. Taxpayers in turn reciprocate and are voluntarily motivated to pay their taxes without the need of enforcement. However, the voluntary motivation does not represent a true intrinsic motivation to be compliant (Ryan & Deci, 2000). Taxpayers do not value the tax system itself, they rather accept its necessity, give in and capitulate (Braithwaite, 2003a). Voluntary motivation reflects a view that taxpayers are compliant because of the law and because of tax authorities who collect taxes within a professional bureaucratic system. Taxes are paid voluntarily because this is easier than to evade them (Gangl et al., 2015). Nonetheless, voluntary motivated taxpayers are interested in engaging in tax avoidance and in reducing their tax payments within the legal framework.

Committed motivation is an intrinsic motivation to be tax compliant (Feld & Frey, 2002; Gangl et al., 2015; Kelman, 2006). Tax compliance is internalized and seen as a moral obligation. Tax authorities are perceived to share the same values as the citizens and the way taxes are collected and spent is appreciated. Taxpayers feel committed to the tax system and have the feeling that they actively contribute to societies' well-being. Committed taxpayers do not need explicit rules and strict bureaucracy, because they follow the spirit of the law and not just the letter of the law (Gangl et al., 2015). For committed taxpayers honest taxpaying is seen as a natural and automatic activity.

Relationship of tax motivations to tax compliance

The different qualities of taxpayers' motivations are assumed to be related to different types of tax compliance (Braithwaite, 2003a; Kirchler et al., 2008). Tax compliance can be defined as the opinion that one should cooperate with tax authorities and that it is important to pay taxes honestly and in time (OECD, 2001). Taxpayers with an enforced and dismissive motivation are assumed to be not tax compliant. They feel it is not important to cooperate with the tax authorities, to pay taxes honestly or in time. In contrast, voluntarily motivated and committed taxpayers in particular want to pay taxes honestly and thus, should show high tax compliance (Braithwaite, 2003a; Gangl et al., 2015). Survey studies in different countries showed that taxpayers differ in their reported motivations to pay taxes (Braithwaite et al., 2007; Muehlbacher, Kirchler, & Schwarzenberger, 2011). However, little empirical research exists that relates different motivations of taxpayers to tax compliance (Hartner et al., 2008; Kirchler & Wahl, 2010). Moreover, research has inconsistent results. A survey study among 300 self-employed Austrian taxpayers indicated that both voluntary and committed motivations are positively related to tax compliance. No relation between enforced motivation and tax compliance was found (Kirchler & Wahl, 2010). In contrast, in two survey studies, conducted among more than 2,000 Australian citizens, enforced motivations assessed as defiance motivations towards tax paying were negatively related to tax compliance whereas committed motivations were not associated with tax compliance (Hartner et al., 2008). Hence, it is neither clear whether enforced, voluntary, and committed motivations are at all related to tax compliance nor which of these motivations might have negative or positive connections to the willingness to comply with tax obligations.

Insights into the relation between tax motivations and tax compliance have a high practical relevance for tax authorities. If the exact relation between motivations and tax compliance is known, tax authorities could apply their strategies in a more efficient and tailored way, as suggested by the responsive regulation theory (Braithwaite, 2003b) and the slippery slope framework (Kirchler et al., 2008). The responsive regulation theory argues that taxpayers should be treated differently by tax authorities depending on their motivation, i.e., applying audits and fines for enforced motivated taxpayers and assistance and respect for voluntary and committed motivated taxpayers (Braithwaite, 2003b). As most taxpayers are assumed to be voluntarily and committed motivated, tax authorities' major task is to be perceived as service-oriented and respectful (Braithwaite, 2003a). The slippery slope framework claims that tax authorities should apply a specific mix of coercive power and legitimate power to reduce enforced and to enhance voluntary and committed motivations among taxpayers (Gangl et al., 2015; Hofmann, Gangl, Kirchler, & Stark, 2014; Kirchler et al., 2008). However, as it is not clear whether motivations are at all relevant for tax compliance, it cannot be determined whether tax authorities should respond to motivations or should influence motivations of taxpayers.

The aim of the present study is to examine the relation between different motivations to pay taxes and tax compliance. We seek to gain robust results by conducting two studies in countries, which are similar concerning tax compliance measured by the extent of the shadow-economy (Buehn & Schneider, 2012). Further, to gain results with high external validity we used representative samples of self-employed taxpayers. In contrast to employed taxpayers whose taxes are often deducted by the employers, self-employed taxpayers have to provide all relevant information themselves. Hence, they are more experienced regarding tax paying and have more opportunities to engage in tax avoidance and tax evasion than employed taxpayers (Antonides & Robben, 1995). We assessed motivations towards taxpaying with two different methods. In Study 1, we examine the relationship between enforced motivation, voluntary motivation, committed motivation and tax compliance in a representative sample of 500 self-employed Austrian taxpayers. In Study 2, we confirm results of Study 1 in a representative sample of 1,377 Dutch entrepreneurs by using the variables "Something is taken from me" as a proxy for enforced motivation, "I give up something" as a proxy for voluntary motivation and "I contribute something" as a proxy for committed motivation.

STUDY 1

Sample

The sample consisted of 500 self-employed taxpayers representative for the Austrian population of self-employed with respect to sex (49.9% women) and age (M = 44.46, SD = 10.55). Table 1 presents a detailed description of the sample concerning socio-demographic characteristics.

Procedure and material

A market research agency sent out an online questionnaire to self-employed Austrians who received 1.50 EUR (approximately 2 US-Dollar) for participation. The questionnaire consisted of several scales on tax-related issues. Four of them are used in the present paper: tax compliance intention, enforced compliance, voluntary cooperation, and committed cooperation. Tax compliance intention was assessed with the average of answers to six questions from Gangl et al. (2013) following the OECD (2001) definition of tax compliance (e.g., "To what extent do you think it is important that the Tax Administration receives correct and complete tax returns?"; 1 = very important, 7 = absolutely not important; Cronbach α = .77, M = 5.44, SD = 1.11). Scales to measure tax motivations were adapted from Hofmann et al. (2014). Enforced compliance was assessed with the average of answers to four items ("When I pay taxes, I do so because a great many tax audits are carried out," "When I pay taxes, I do so because I know I will be audited," "When I pay taxes, I do so because the tax authority often carries out audits,", "When I pay taxes, I do so because I feel forced to pay my taxes"; Cronbach α = .87). Voluntary cooperation was also assessed with the average of answers to four items ("When I pay taxes, I do so because the tax authority will probably reciprocate my cooperation," "When I pay taxes, I do so because the tax authority treats me correctly as long as I admit mistakes," "When I pay taxes, I do so because the tax authority supports taxpayers who make unintentional mistakes," "When I pay taxes, I do so, because it is easier than to deceive the tax authority"; Cronbach α = .79). Finally, committed cooperation was assessed with four items ("When I pay taxes, I do so because it is the right thing to do," "When I pay taxes, I do so because it is ultimately in everyone's interest," "When I pay taxes, I do so because I feel a moral obligation to pay taxes," "When I pay taxes, I do so, because it is an important civic duty"; Cronbach α = .92; M = 5.04, SD = 1.56). All questions on tax motivations were assessed on seven-point Likert scales with labeled endpoints 1 (I totally disagree) and 7 (I totally agree).

Table 1: The relation between motivations and compliance intention in the Austrian sample

	f / *M*(*SD*)	Block 1	Block 2	
		β	β	*r*
Female	49.0%	0.11^{*}	0.10^{*}	0.08
Age	44.46 (10.55)	0.19^{***}	0.16^{***}	0.18^{***}
Low education	2.6%	-0.02	-0.02	-0.04
Medium education	66.8%	0.04	0.04	0.02
0- 25,000 Euro turnover	35.6%	0.00	0.03	0.02
25,001– 50,000 Euro turnover	26.2%	-0.01	-0.00	0.01
50,001 – 100,000 Euro turnover	15.0%	0.00	-0.01	0.01
100,000 – 1,000,000 Euro turnover	18.0%	-0.05	-0.06	-0.04
1-4 employees	19.2%	0.05	0.05	0.02
5-49 employees	5.2%	0.02	0.02	-0.01
50 < employees	0.4%	-0.07	-0.04	-0.09
Information technology	10.6%	0.01	0.00	-0.04
Tourism	7.0%	-0.03	-0.01	-0.04
Creative industries	6.4%	0.02	0.01	0.01
Education	5.8%	0.10^{*}	0.08^{*}	0.10^{*}
Financial services	5.6%	0.06	0.10	0.06
Consulting & engineering	3.2%	-0.01	-0.04	-0.01
Enforced motivation	3.83 (1.61)		-0.13^{***}	-0.15^{**}
Voluntary motivation	3.56 (1.43)		0.04	0.05
Committed motivation	5.04 (1.56)		0.47^{***}	0.48^{***}
R^2		0.07	0.31	
ΔR^2			0.23^{***}	
F		2.18^{**}	10.55^{***}	
ΔF			53.91^{***}	
Max. VIF		6.06	6.06	

Note: Reference groups: male, high education, turnover of more than 1 million Euro, no employees, other sectors; *f* = frequency, *M* = mean, *SD* = standard deviation, *r* = Spearman or Pearson correlation; ΔR^2 and ΔF refer to a change in R^2 and F statistics; max. *VIF* refers to the largest variance inflation factor; asterisks denote significance at the 0.1% (∗∗∗), 1% (∗∗), and 5% (∗) level.

Results

To examine the relation between personal motivations and tax compliance intention an OLS regression analysis was conducted. In a first step, we included socio-demographic characteristics of entrepreneurs as control variables (Block 1) into the regression model and in a second step, enforced motivation, voluntary motivation, and committed motivation (Block 2) to explain the tax compliance intention from motivations. Results in Table 1 show that enforced compliance was associated with lower tax compliance intentions whereas committed cooperation was related to higher tax compliance intentions. Voluntary cooperation was not related to tax compliance intentions.

STUDY 2

Sample

The sample consisted of 1,377 entrepreneurs representative of the Dutch population of entrepreneurs with respect to sex (31.7% woman), age (M = 48.67, SD = 11.22), number of employees, and startups versus existing companies. A detailed sample description can be found in Table 2 and in Gangl et al. (2013).

Procedure and material

Within the Dutch Fiscal Monitor 2010, mostly conducted via online questionnaires, entrepreneurs were asked to indicate their motivation to pay taxes ("Which describes your personal feeling about paying taxes best?") by choosing one of three statements: "Something is taken from me" (15.9%), "I give up something" (46.6%), and "I contribute something" (37.5%). Tax compliance intention was assessed with the same six items as in Study 1 except that a five-point Likert scale (1 = very unimportant, 5 = very important) was used (M = 4.07, SD = 0.60). This tax compliance scale was used in a previously published study (Gangl et al., 2013), where detailed descriptions of the scale can be found. Sex, age, education, turn-over, number of employees, and sector were included as socio-demographics (Table 2).

Results

To examine the relation between personal motivations and tax compliance intention an OLS regression analysis was conducted. In a first step, we included socio-demographic characteristics of entrepreneurs as control variables (Block 1) into the regression model and in a second step the motivations to pay taxes (Block 2) to predict the tax compliance intention by motivations. Results in Table 2 show, similar to Study 1, that an enforced motivation measured with the feeling "Something is taken from me" was negatively related to tax compliance intentions. Likewise, the feeling "I contribute something" as a proxy for committed cooperation was positively related to tax compliance intentions.

Table 2: The relation between motivations and tax compliance intention in the Dutch sample

	f / *M*(*SD*)	Block 1	Block 2	
		β	β	*r*
Female	31.7%	.01	0.01	-0.01
Age	48.67 (11.22)	0.06^{*}	0.02	0.06^{*}
Low education	7.6%	-0.00	0.01	-0.01
Medium education	41.8%	-0.02	-0.00	-0.04
0- 25,000 euro turnover	28.5%	-0.07	-0.07	-0.01
25,001– 50,000 Euro turnover	11.3%	-0.04	-0.04	0.00
50,001 – 100,000 Euro turnover	12.1%	-0.03	-0.04	0.01
100,000 – 1,000,000 Euro turnover	29.6%	-0.08^{*}	-0.08^{*}	-0.04
1-4 employees	26.4%	-0.19^{*}	-0.16^{+}	0.01
5-49 employees	19.1%	-0.15^{+}	-0.13	-0.01
50 < employees	2.7%	-0.16^{*}	-0.14^{*}	-0.02
Financial services	26.9%	0.07^{*}	0.07^{*}	0.09^{**}
Retail	26.9%	0.01	0.01	0.01
Health care	7.0%	0-.01	-.01	-0.01
Construction	6.4%	-0.03	-0.03	-0.03
Agriculture	4.9%	-0.08^{**}	-0.08^{**}	-0.10^{***}
Something is taken from me	15.9%		-0.11^{***}	-0.15^{***}
I contribute something	37.5%		0.09^{**}	0.14^{***}
R^2		0.03	0.05	
ΔR^2			0.03	
F		2.38^{**}	4.14^{***}	
ΔF			17.77^{***}	
Max. VIF		12.10	12.11	

Note: Reference groups: male, high education, turnover of more than 1 million, no employees, other sectors, I give up something; *f* = frequency, *M* = mean, *SD* = standard deviation, *r* = Spearman or Pearson correlation; ΔR^2 and ΔF refer to a change in R^2 and F statistics; max. VIF refers to the largest variance inflation factor; asterisks denote significance at the 0.1% (∗∗∗), 1% (∗∗), 5% (∗), and 10% ($^{+}$) level.

DISCUSSION

The present paper shows that different motivations to pay taxes correspond to different levels of reported tax compliance. As predicted, negative feelings related to dismissive and enforced motivations seem to correspond to lower tax compliance than positive feelings related to committed motivations (Braithwaite, 2009; Braithwaite & Braithwaite, 2001; Kirchler et al., 2008). In contrast with existing studies (Hartner et al., 2008; Kirchler & Wahl, 2010), the present outcomes suggest that both enforced and committed motivations relate to tax compliance, the former in a negative and the latter in a positive way. Voluntary motivation was unrelated to tax compliance. Therefore, the present paper suggests that enforced and committed motivations play an important role for tax decisions and should be considered by tax authorities.

As expected, taxpayers holding an enforced motivation to pay taxes also report being less tax compliant (Braithwaite, 2003a; Kirchler et al., 2008). They seem to pay taxes only if they are forced to do so. The present results on voluntary motivation and tax compliance suggest that the relation between voluntary motivation and tax compliance could be two-fold. Voluntary motivation might lead to both positive and negative correlations with tax compliance which in turn mutually dissolve each other. Voluntary motivated taxpayers may pay taxes according to the law but at the same time try to utilize legal tax holes if possible. Hence, overall there might be no connection between voluntary motivation and tax compliance. Committed motivation as an intrinsic acceptance of taxpaying and a felt responsibility seems to be the only motivational force which increases tax compliance in the present study. This outcome suggests that initiatives which reduce enforced motivations and foster committed motivation seem to be important factors to enhance tax compliance.

The present result extends previous theoretical and empirical findings. As predicted by the responsive regulation theory, taxpayers holding an enforced motivation likely need more audits and fines to pay taxes than voluntarily, or committed motivated taxpayers (Braithwaite, 2003b). As assumed by the slippery slope framework, it seems a worthwhile strategy of tax authorities to change motivations in order to increase tax compliance (Gangl et al., 2015; Kirchler et al., 2008). Experiments indicate that severe audits and fines which are perceived as applied by illegitimate and unfair authorities produce enforced motivations whereas audits and fines which are applied by legitimate, fair and trusted tax authorities lead to voluntary motivations (Hartl, Hofmann, Gangl, Hartner-Tiefentahler, & Kirchler, 2015; Hofmann, Hartl, Gangl, Hartner-Tiefentahler, & Kirchler, 2014; Kirchler & Wahl, 2010; Verboon & van Dijke, 2011). Thus, the present results strengthen the assumptions of previous research and suggest that tax authorities should react to different motivations with tailored enforcement programs and should apply strategies in such a way that voluntary and especially committed motivations are enhanced.

To change taxpayers' motivations, the slippery slope framework suggests application of a tailored mix of coercive power (i.e., audits and fines) and legitimate power (i.e., fair procedures, information services, etc.). Tax authorities should apply coercive audits and fines in a legitimate and fair way to enforced motivated taxpayers in order to change their motivation into voluntary motivation (Hofmann, Gangl, et al., 2014). Tax authorities should avoid coercive audits and fines for voluntary and committed motivated taxpayers and should focus on legitimate services procedures to maintain and foster the positive motivations of these taxpayers. Examples of initiatives which foster committed motivations are fair procedures of tax collection and tax spending, enhanced service initiatives (telephone hotlines, websites, etc.), communication strategies presenting public goods such as schools which are financed with tax money, and the establishment of trust-based relationships with taxpayers (Alm & Torgler, 2011; Gangl et al., 2015; Gangl et al., 2013). In the enhanced relationship program of the OECD (2013), tax authorities dispense with auditing taxpayers going back for several years. Instead, they try to resolve and settle uncertainties on tax issues immediately when taxpayers ask for advice. On the other hand, taxpayers agree to fully disclose their tax files and to sign a voluntary contract of fair play in which they agree to refrain from aggressive tax planning (OECD, 2013). This enhanced relationship involves trust, which can be harmed. However, it pays off in lower costs of auditing for tax authorities and importantly in enhanced planning reliability for taxpayers. As a consequence, taxpayers are assumed to feel respected as honest taxpayers and gain trust towards the tax authorities (Gangl et al., 2015). Thereby, taxpayers are assumed to develop a committed motivation to pay taxes, which means a felt responsibility to be tax compliant. The present results provide evidence for these assumptions.

The present paper has limitations. The present results only apply to developed countries with relatively high rates of tax compliance. To confirm and expand the generalizability of the present results, future studies should investigate the relationship between motivations and tax compliance in developed countries with relatively low rates of tax compliance. The explained variance of tax compliance differs in the Austrian and in the Dutch study. A reason for this difference might be the different way in which motivations were assessed. In the Austrian study seven-point Likert scales were used for each motivation whereas participants in the Dutch study had to choose between one of the three motivations. However, the direction of results is the same in both studies and the different measures applied to assess motivations also indicate that motivations have a robust relationship to tax compliance.

Based on two studies on representative samples the present paper indicates that the distinction between different motivations to pay taxes seems to be a relevant factor for tax compliance. Tax authorities can be recommended to avoid actions which produce an enforced motivation and to foster initiatives which enhance a committed motivation to pay taxes in order to increase the number of citizens that comply.

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The South African Tax System: Fit for Purpose?

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Abstract

Is the South African tax system 'fit for purpose'? This article addresses this and related questions by considering the fiscal outlook in South Africa in comparison to OECD, BRIICS and other developing countries. Trends are analysed from the perspectives of tax revenue, tax mix and tax administration. The approach adopted in this paper is neither purely doctrinal nor empirical. Rather, it is analytical, practical and applied, effectively a 'conspectus' located within the broader comparative tax literature. The article suggests that South Africa has not recovered from the global financial crisis as readily as most developed countries, and that it also does not have much capacity to increase existing tax rates. Its current tax system is stretched to the point where further demands on existing tax bases could cause economic distortions and other systemic failures. Some sensible tax administrative reforms have already taken place, but more can be done to increase capacity in the current bout of tax reform. Such measures could include broadening and safeguarding the existing tax bases, improving tax compliance and tackling corruption. An efficient and effective tax system can provide sustainable sources of revenue, assist economic growth and increase employment and alleviate income inequality through its redistributive function. Although the system is not entirely 'fit for purpose' in its present form, the opportunities are there for South Africa to address its fiscal challenges.

INTRODUCTION

In 2014 South Africa celebrated 20 years since the end of apartheid, and reinforced its democratic credentials as a result of the fifth general election conducted under universal suffrage. But the nation stands at something of a crossroads so far as its fiscal outlook is concerned. On some macroeconomic fronts the country is doing very well. It continues to match, and sometimes outperform, comparable countries in many respects. And yet on other indicators there may be considerable scope for improvement (OECD, 2013c).

The purpose of this article is to evaluate South Africa's current fiscal performance, benchmarking it against those countries with whom it is often most readily compared – the five other so-called BRIICS countries[2] – as well as against the 34 apparently 'developed' countries of the Organisation for Economic Cooperation and Development (OECD), and also, on occasion, against other, non-BRIICS, developing nations.

The subtext of the article is to address a simple, but ambitious, question: to what extent is the South African tax system 'fit for purpose'? Of course that, in turn, begs a series of further questions. What is the purpose of the South African tax system? What criteria should be adopted for any such assessment of 'fitness'? How such criteria are objectively evaluated? Which countries have appropriately

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[2] Brazil, Russia, India, Indonesia, China and South Africa.

comparative tax regimes? What are the broader trends in tax system development? In the light of the analysis and global trends, how might South Africa seek to reform its tax system?

Some of these, and related, questions will be addressed in the article. The overarching motivation for the article is to identify the sorts of fiscal opportunities – particularly as they relate to policy and to administration – that will help to ensure a 'nation at the crossroads' chooses wisely in the direction it takes. The approach adopted in the article is neither purely doctrinal nor empirical. Rather it is analytical, practical and applied, effectively a 'conspectus' located within the broader comparative tax literature (Ault & Arnold, 2010; Sartori & Marian, 2011; Albi & Martinez-Vasquez, 2011; Sandford, 2000).

The analytical task is undertaken with some degree of caution. Comparative analysis can easily make the mistake of seeking to claim too much. Generalising about tax systems is always a hazardous and unreliable business (Sandford, 2000). A second word of caution relates to the lack of reliable and up to date statistics in some cases in the preparation of the article. Whilst detailed information is readily available (albeit with some time lag) in respect of the OECD countries, the sometimes lack of reliable and up to date information relating to BRIICS and to developing countries acts as a constraint in the development of the article.

So what is the purpose of the South African tax system? It is, obviously, no different from the purpose of most tax systems, whether in developed or in developing nations. In the first place it is clearly there to raise sufficient revenue to permit the government to discharge its many spending responsibilities, whether development, social welfare, education, defence, infrastructure building or whatever else. But tax systems are much more than simply revenue raising mechanisms. They also have a role to play in tackling income inequality, fostering economic growth and well-being and in building state legitimacy.

Indeed, tax systems are a fundamental component of any attempt to build nations. As Brautigam (2008, p.1) has noted, '(t)axes underwrite the capacity of states to carry out their goals; they form one of the central arenas for the conduct of state-society relations, and they shape the balance between accumulation and redistribution that gives states their social character'. In short, taxes build capacity (to provide security, meet basic needs or foster economic development) and they build legitimacy and consent (helping to create consensual, accountable and representative government) (McKerchar & Evans, 2009).

The article is structured as follows. The next section identifies key fiscal patterns and trends in OECD, BRIICS and other developing nations. After an initial discussion of the broad challenges facing developed and developing countries, it considers these trends from three key perspectives: tax revenue, tax mix (sometimes referred to as tax structure) and tax administration. Some preliminary analysis of how South Africa fits within these broad patterns and trends is made here, but the more detailed analysis of South African performance, challenges and opportunities takes place in the following section. Concluding comments are contained in the final section.

FISCAL TRENDS: THE BIG PICTURE

Developed and developing countries

Even a superficial analysis suggests there are marked differences in the tax systems of developed countries (such as those in the OECD) and developing countries. In developed economies the tax system is more likely to be reliant upon, and to focus upon, direct taxes, and particularly the personal income tax as a major source of revenue. In contrast, in developing countries there is more likely to be a greater reliance upon indirect taxes, and especially excise duties. To a significant extent these differences emanate from the very different sets of challenges faced by developed countries compared to those of developing nations (Norregaard & Khan, 2007).

There are a number of critical tax challenges facing developed countries. In the very broadest terms, those challenges relate to safeguarding the revenue bases to preserve and enhance the well-being of the nation's citizens. The threats to the tax base are both international (for example, the challenges of globalisation, debates about territoriality and the allocation of taxing rights between countries including transfer pricing issues, supra-national harmonisation of tax regimes, disputes about exchanges of information) and national (the ageing of populations, the deepening stress between human growth-fuelled activities and their impact upon wider eco-systems including damage to the environment etc, fiscal federalism issues as national and sub-national bodies each strive to get their slice of the national tax revenue to fund their expenditures). Some challenges have both international and national dimensions, such as the challenges of changing technology (for example, how do you tax e-commerce?).

Some of the tax challenges that are currently being faced by developed countries will obviously also be of concern to developing countries. But developing countries generally face significantly different priorities in confronting the challenges of taxation. As noted by the OECD (2012, p.23)

> "Taxation is key to promoting sustainable growth and poverty reduction. It provides developing countries with a stable and predictable fiscal environment to promote growth and to finance their social and physical infrastructural needs. Combined with economic growth, it reduces long term reliance on aid and ensures good governance by promoting the accountability of governments to their citizens."

For developing countries, therefore, the key challenges are likely to be those that relate to attracting overseas aid and investment to assist in the push for development and—more importantly—the need to build state capacity and legitimacy so that appropriate revenues can be raised from their own resources without having to rely too much on foreign aid and investment. These are very different from the issues that are faced by those charged with responsibility for the structure and design of tax systems in developed countries.

There are four major areas where developing countries differ from developed countries in terms of the issues they face (Norregaard & Khan, 2007; Heady, 2009):

1. Developing countries are (by definition) at lower levels of development with weaker institutions, higher dependency on agriculture, larger informal (shadow) economies and fewer tax handles (instruments that can be used by the state to control tax behaviour);
2. Many developing countries are highly dependent upon natural resources;
3. Inequality is much more of an issue for developing countries; and
4. Developing countries face a different set of global pressures and influences compared to richer countries: more aid-dependency; higher levels of debt; less political influence.

However this neat classification into developed and developing economies becomes much more blurred when it comes to a consideration of the six BRIICS nations, a bloc which straddles the divide between developed and developing and which does not comfortably fit within either. While OECD countries still dominate the global economy, their share of world trade is decreasing in favour of the BRIICS (OECD, 2008). The BRIICS countries are emerging national economies, uniquely positioned globally by their large, fast growing economies. Due to each country's geographical location, each has a significant influence on regional, as well as global, affairs. While they share the characteristics of low labour costs and youthful populations with other developing countries, what sets the BRIICS apart are their growing middle classes and improvements in communications and transport. Indeed, on many indicators they outperform many developed countries.

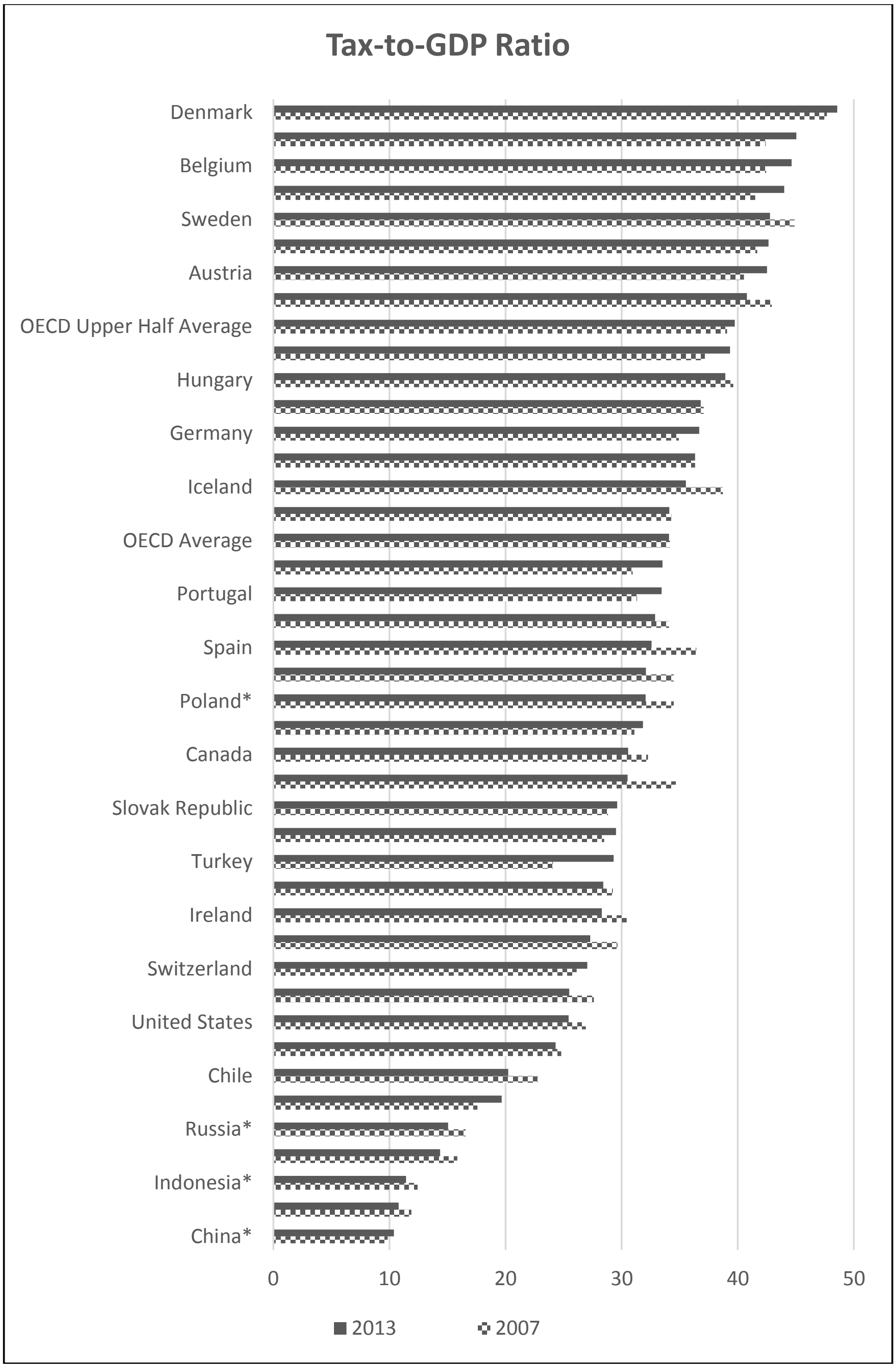
Armed with this background, the following analysis considers the major fiscal trends in developed, BRIICS and developing countries in relation to three components of their overall tax systems: tax revenue; tax mix; and tax administration. These components are key elements in the composition of any tax system, covering the core elements of tax policy and tax administration. In each case sufficient detail is established in order to provide a basis for the more detailed analysis in the following section.

Tax revenue

The tax-to-GDP ratio is a measure of a country's tax burden. However, this 'burden' is also the source of funding for government services; the lower the ratio the more likely significant fiscal deficits will exist. The tax ratio, or tax revenue as a share or percentage of GDP, is a simple average. This assigns the same weighting to all countries, irrespective of their size or level of development. Tax ratios vary by income levels, on average rising as per capita income rises (Bird & Zolt, 2008; Bird & Zolt, 2003).

Tax ratios allow for country and regional comparisons to be made, and the tax ratios for OECD and BRIICS countries for selected recent years are summarised in Figure 1. In OECD countries, tax revenues, as a percentage of GDP, are recovering from the financial and economic crisis of 2008 and 2009. The average ratio in OECD countries was 34.1 per cent in2013, nearly back to the average of 35 per cent in 2007 after falling in the intervening period (OECD, 2014). However, the tax burdens between OECD countries are disparate, ranging in 2013 from 19.7 per cent in Mexico to 48.6 per cent in Denmark.

Figure 1: Tax ratio of OECD and BRIICS countries 2007 and 2013



* Data for 2012
Source: OECD Revenue Statistics 1965-2013 for OECD countries; The World Bank Database for BRIICS countries

South Africa's tax ratio in 2012 was 25.5 per cent, down from 27.6 per cent in 2007 (World Bank, n.d.). Marginally below the OECD lower half average of 29.3 per cent in 2007, South Africa's tax ratio was nevertheless higher than seven OECD countries. By 2012 it was considerably lower than the OECD lower half average (28.4 per cent) and only exceeded four OECD countries. This indicates that it has not recovered from the financial and economic crisis as readily as most developed countries. The impact of the global financial crisis is also more evident and pronounced in the BRIICS countries, with only China having a higher tax ratio in 2012 than in 2007.

However, using the share of taxes in GDP as a measure of comparing the tax burdens of different countries is only meaningful when those countries have similar economic structures and levels of income. Factors such as macroeconomic, demographic and institutional constraints also affect how efficiently taxes can be collected. It is these factors that determine a country's predicted value of tax collection, or tax capacity (Moreno-Dodson & Bayraktar, 2012; Kesner-Skreb, 2014).

Thus, another method of measuring the taxation performance of countries is to consider 'tax effort'. Tax effort is an index measure of how well a country is doing in terms of tax collection, relative to what could be reasonably expected given its economic potential. The concept, which has been developed by economists at institutions such as the International Monetary Fund and the World Bank, relates the actual tax revenues of a country (as measured by the share of taxes in GDP) to its tax capacity (Chelliah, Baas & Kelly, 1975; Le, Moreno-Dodson & Bayraktar, 2012). It undertakes a sophisticated empirical estimation process using a regression methodology based upon the impact of such variables as macroeconomic factors (the income level of a country, its GDP, trade openness, agricultural contribution) demographic factors (the growth rates of the population and its age dependency) and institutional governance quality (based upon bureaucracy and corruption indices). When the tax effort index exceeds one, that country is considered to have a 'high tax effort'. This means that the country fully utilises its tax base to increase tax revenues, indicating there is little scope or potential to raise further tax revenues (Le et al, 2012).

Tax effort studies and methodologies have not been immune to criticism, and caution must be exercised in interpreting tax effort indices (Hope, 1996). For example, in an insightful analysis, Bird (1976) has identified a number of criticisms of tax effort studies, including a lack of justification for the variables used in the regression analyses and the use of poor data. Despite these criticisms, however, the general tendency has been to use these studies as the background for policy decisions" (Hope, 1996, p.35). The use of tax effort and actual tax collection benchmarks allows the classification of countries into four different groups and can provide insights as to how reform in such countries might take place by reference to tax capacity and tax revenues collected. The four possible rankings or classes, based upon the work of Le et al (2012, p.7), are:

Low tax collection and low tax effort

In this group of countries, the collection of taxes is currently low and lies below their taxable capacity. The group principally comprises low income (developing) countries (and particularly Asian countries), and also three of the six BRIICS countries (China, India and Indonesia). It also includes (somewhat surprisingly) Canada, Japan, Korea and the United States (US). The direction of reform in countries in this group, it is suggested, should be in 'deepening comprehensive tax policy and administration reforms focusing on revenue enhancement' (Le et al, 2012, p.24).

Low tax collection and high tax effort

Countries in this group tend to be low and middle income countries (for example Ghana, Kenya, Pakistan and Zambia), typified by low levels of taxation despite high tax rates on a few over-exploited revenue sources. Rampant evasion, skewed and narrow bases (as a result of widespread preferential treatment to various economic sectors) and inefficient tax administration prevent the revenues collected being commensurate with the tax effort involved. It is suggested that short term tax reform measures should include the streamlining of tax policy and tax administration procedures to reduce compliance costs, encourage formality and lower tax barriers to firms' entry and operations, while medium to long term reforms may expand the scope for raising revenue by broadening the effective tax base and enhancing the functioning of the tax system.

High tax collection and low tax effort

Countries in this group tend to be middle (for example Bulgaria, Estonia, Latvia, Turkey, Ukraine) and high (for example, Denmark, Germany, Ireland, Spain, Sweden and Switzerland) income countries, almost exclusively European and with a predominance of transitional countries from the former soviet bloc. Whilst these countries collect high taxes relative to the world average, their macroeconomic and demographic features lead to a low tax effort. Reform focus in these countries, it is suggested, should be upon implementing changes to reduce distortions and reach a higher level of efficiency in tax collection. This may involve restructuring the tax mix and improving the quality of governance.

High tax collection and high tax effort

Being in this category means that the country fully utilises its tax base to increase tax revenues, indicating there is little scope or potential to raise further tax revenues. This group comprises, primarily, middle and high income countries, including Australia, the United Kingdom (UK), New Zealand and South Africa. Le at al. (2012, p.26) note that, given the already high revenue collections which are above taxable capacity, further increases in tax revenue collection may lead to unintended economic distortions. Their suggestion is therefore that tax reform should not focus on revenue, but should rather aim at raising the efficiency of tax collection, including reducing tax-induced distortions and improving the business climate through further rationalizing the tax regimes, rebalancing the tax mix and simplifying administration procedures. Any further improvements in the quality of governance (lower corruption or higher bureaucratic quality) can increase the efficiency of the tax system of this group of countries.

Figure 2 shows the classification of OECD, BRIICS and various developing countries into these four categories on the basis of revenue collections and tax effort for the period 1994 to 2009. Three BRIICS countries (China, India and Indonesia) are considered to be low tax collection, low tax effort while Russia is classified as high tax collection, low tax effort. South Africa, Brazil and many OECD countries are in the high tax collection and high tax effort category.

Figure 2: Classification of selected countries based on tax collection and tax effort, 1994-2009

Classified 1994-2009		Tax Effort	
		Low	High
Tax Collection	Low	37 countries including China, Ethiopia, India, Indonesia, Japan, Mexico, Thailand and the United States.	12 countries including Cote 'd'Ivoire, Ghana, Kenya, Mali, Pakistan, Sri Lanka, Togo and Zambia
	High	20 countries including Bulgaria, Estonia, Germany, Latvia, Russia, Spain, Switzerland, and Turkey	34 countries including Australia, Botswana, Brazil, France, Netherlands, New Zealand, South Africa and the United Kingdom

Source: Adapted from Le et al, 'Tax Capacity and Tax Effort: Extended Cross-Country Analysis from 1994 to 2009' p. 25.

The implications for South Africa's inclusion in the high tax collection and high tax effort category are considered in more detail in the section below.

Tax mix

As noted by Heady (2009), one of the major choices facing governments in the design of the tax system is what reliance to place on the different potential sources of tax revenue Some countries rely primarily on consumption taxes; others on income and capital taxes; in some countries social security contributions are the main source of revenues. Nevertheless, as can be seen from Table 1 below, in OECD countries the vast bulk of tax revenue comes from just three main sources: income tax, taxes on goods and services and social security contributions.

Table 1 suggests that the tax mix has been remarkably stable in the OECD over the period. South Africa's tax mix, on the other hand, has tended to fluctuate more. On average, OECD countries collect about 33 per cent of their tax revenues from personal and corporate taxes on income and profits. However, the averages conceal very significant differences. For example, in 2012 the share of the personal income tax ranged from a low of 9 per cent in the Slovak Republic and 11 per cent in the Czech Republic, through to highs of 39 per cent in Australia and 51 per cent in Denmark. For the corporate income tax the range in 2012 is from 3 per cent in Hungary, Greece and Slovenia, through to 19 per cent in Australia and 25 per cent in Norway (OECD, 2014, pp28-30).

Table 1: Tax Mix in South Africa and the OECD (percentages)

	2005		**2010**		**2012**	
	South Africa	**OECD Average**	**South Africa**	**OECD Average**	**South Africa**	**OECD Average**
Personal income tax	32	24	35	24	34	25
Corporate income tax	22	10	25	9	24	9
Social security contributions	0	25	0	26	0	26
Payroll taxes	0	1	0	1	0	1
Property taxes	6	6	4	5	4	5
General consumption taxes	28	20	25	20	26	20
Specific consumption taxes	9	11	8	11	9	11
Other taxes	3	3	3	3	3	3

Source: OECD 'Revenue Statistics 1965-2013', p.29; South African Revenue Services Annual Report, various years.

The share of consumption taxes in the OECD is also consistent over the period at about 31 per cent, with the larger part of that revenue accounted for by general consumption taxes such as the (nearly) ubiquitous value added tax (VAT). Nonetheless, countries such as Mexico (around 35 per cent) and Turkey (around 22 per cent) still collect a relatively large part of their tax revenues by way of taxes on specific goods and services rather than through a general consumption tax (OECD, 2014, pp28-30).

For South Africa, a far larger proportion of tax revenue than is the case on average in the OECD, comes from income taxes: roughly 58 per cent in 2012 in South Africa compared to the 34 per cent OECD average. South Africa also relies more heavily on its VAT as a significant part of its tax mix 26 per cent in 2012 compared to the OECD average of 20 per cent). This South African tax mix, with over 80 per cent of total tax revenue coming from taxes on income and VAT, matches that of countries like Australia, Denmark and New Zealand and contrasts sharply with those OECD countries where there is far heavier reliance on social security taxes. Again this has implications for the sorts of fiscal opportunities that can be appropriate in the South African context, discussed in more detail in the following section.

Tax administration

While there have been significant changes in relation to broader tax policy (including in relation to tax revenues and tax mix and typified by the mantra of lower rates and broader bases) in most countries over the period since the 1980s, dramatic changes have also taken place in the way that taxes are administered. Most notably there have been significant changes in the way that revenue authorities have been organised and the manner in which they have approached the tasks of administering the law and collecting the tax revenue that is properly due – 'extracting the maximum amount of feathers [from taxpayers] with the minimum amount of hissing.' Major trends in this sphere have included (D'Ascenzo, 2015; OECD, 2015):

1. The modernisation and professionalization of tax administrations in OECD (and other) countries, promoting increased flexibility in human resource organisation and pay scales with greater emphasis on externally validated merit based performance targets;
2. The introduction of autonomous and semi-autonomous structures whereby tax administrations operate independently, or more independently, of their political masters;
3. The growth of the internal organisation of revenue authorities by reference to market segments (eg, Large Taxpayer Units) rather than solely by reference to the type of tax being collected or the function being performed by revenue officers;
4. An increased reliance on self-assessment as opposed to official assessment;
5. Far greater use of technology in all aspects of revenue administration work; and
6. Above all, a shift away from a command and control regulatory frameworks reliant on penalties and enforcement to ensure compliance to a risk management approach designed to foster voluntary compliance – making it easy for those who wish to comply and providing plausible and effective deterrence to those who do not.

Many of these trends apply specifically to South Africa, largely as a result of the introduction of the *Tax Administration Act* 2011. This legislation modernised, integrated and made other enhancements to the common administrative elements of tax law. South Africa has also been engaging on a regional level with the ratification of the African Tax Administration Forum Agreement in 2012 and has entered into a number of Memorandums of Co-operation which enable the close co-operation and sharing of expertise between administrations.

In addition there has been a trend, in evaluating the effectiveness of revenue bodies, towards measuring outcomes (the total tax yield secured) rather than measuring output (such as the frequency of audit interventions and the resulting yield) (OECD, 2013a; OECD, 2015). Nonetheless, the latter are still useful measures of efficiency and therefore still have a role to play in assessing the overall effectiveness of tax administration.

Three specific aspects of tax administration are considered in more detail here. Firstly, a key role for tax administration is to minimise the tax gap. The tax gap is the difference between what a revenue authority theoretically should collect and what it actually does collect (McKerchar & Evans, 2009). While often associated with tax evasion and avoidance, the concept is broader than that and may embrace both intentional and non-intentional non-compliance with tax rules. A full discussion of the tax gap is beyond the scope of this article. Thus the only aspect of the tax gap discussed below relates to one particularly important aspect, very relevant in the South African context: the shadow economy.

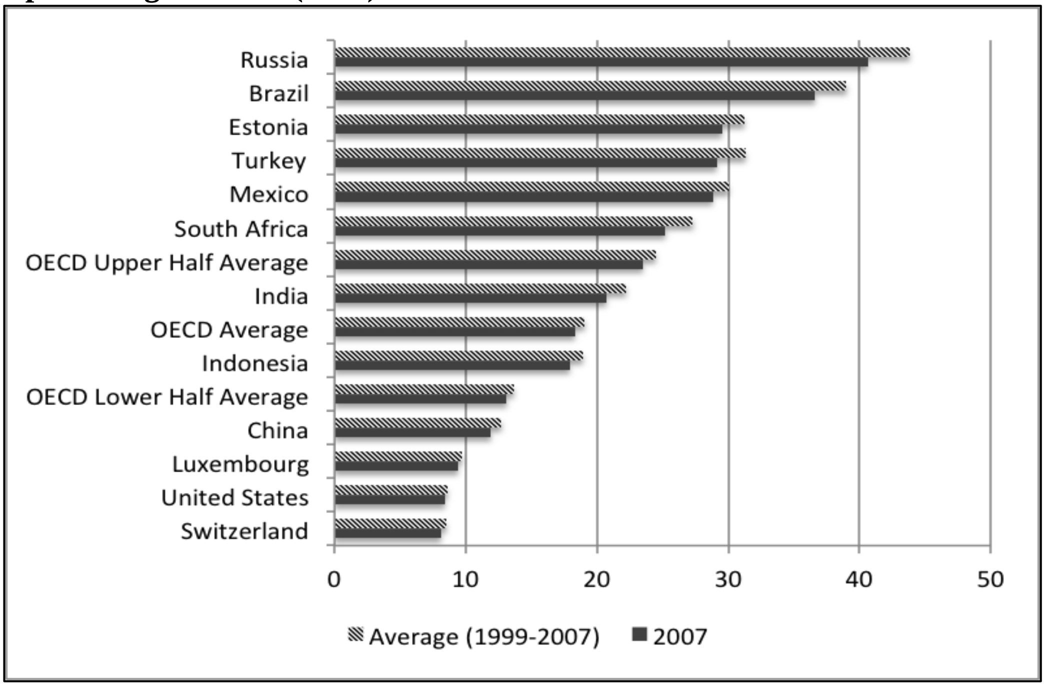
The second aspect discussed in this section is the tax operating costs of the tax system, from both the administrative (revenue authority) and compliance (taxpayer) perspectives. Given the critical role played by small and medium enterprises (SMEs), in the South African context, special mention is made of these (Smulders, Stiglingh, Franzsen & Fletcher, 2012). Finally, the concept of corruption is also canvassed, together with perceptions and measures, although this discussion is not restricted to corruption solely in tax administration. It will be appreciated that there are many other aspects of tax administration that potentially could have been covered. These three areas, however, provide an appropriately representative coverage of tax administration in its broadest sense, and are therefore relevant for the purposes of this article.

The shadow economy

There is compelling evidence that the level of tax is a main driver of shadow economic activity (Schneider & Williams, 2013; Schneider, Buehn & Montenegro, 2010). This is followed, in order, by tax morale, the quality of state institutions and labour market regulation (Schneider & Williams, 2013).

Data suggests that over the last decade the size of the shadow economies (expressed as a percentage of GDP) in all OECD and BRIICS countries appears to be falling (Schneider et al, 2010). This is shown in Figure 3 for selected OECD countries and for the six BRIICS countries. Whilst in OECD countries the average has decreased by less than one per cent of GDP in the period concerned, the BRIICS have decreased by between one per cent (Indonesia) and 3.2 per cent (Russia).

Figure 3: The shadow economy for selected OECD and BRIICS countries as a percentage of GDP (2007)



Source: Schneider et al, (2010) 'New Estimates for the Shadow Economies of the World', Table 2.

The size of South Africa's shadow economy has apparently decreased by 2.1 per cent over the last decade, slightly above the average of the BRIICS countries. Nonetheless, at 25.2 per cent, the shadow economy is currently around one quarter of the total economy. This puts it well above the 2007 OECD average of 18.3 per cent and slightly above the OECD upper half average of 23.5 per cent. According to these figures, South Africa's shadow economy is also larger than China's (11.9 per cent), Indonesia's (17.9 per cent) and India's (20.7 per cent). It is nevertheless smaller than both Brazil (36.6 per cent) and Russia (40.6 per cent).

The figures are not entirely reliable for a number of reasons. In the first place, there is little or no agreement as to what should, or should not, be included in calculations of the size of the shadow economy, or indeed, what the shadow economy actually is. This uncertainty is reflected in the large variety of terms that refer to the existence of the shadow economy, often referred to alternatively as the non-observed, cash, hidden, underground, invisible, unrecorded, or black economy. By its very nature, and given such difficulties of definition, it is difficult to establish the size of the problem with any ease.

This initial uncertainty is compounded by fundamental differences in the methods used to calculate the shadow economy. For example, Ahmed and Rider suggest there are at least five identifiably different 'top-down' methods for measuring the shadow economy (the national accounts method, the labour force method, the monetary transactions approach, the currency demand method and the electricity consumption method), as well as a number of 'bottom-up' methods (Ahmed & Rider, 2008). Unfortunately the different methods produce widely converging results, with the result that researchers and policy makers can have little faith in the integrity of the measurements (Feige & Urban, 2008).

Notwithstanding such concerns, the estimates that are available do at least suggest that the size of the shadow economy in South Africa, particularly relative to other comparable countries, represents a real challenge for policy makers in that country.

Tax operating costs

Another means by which the efficiency of the tax system can be assessed is by looking at the tax operating costs of the system. There are two components to tax operating costs: the administrative costs incurred by revenue authorities in collecting tax revenue and administering the tax system; and the compliance costs incurred by taxpayers in order to meet their tax obligations.

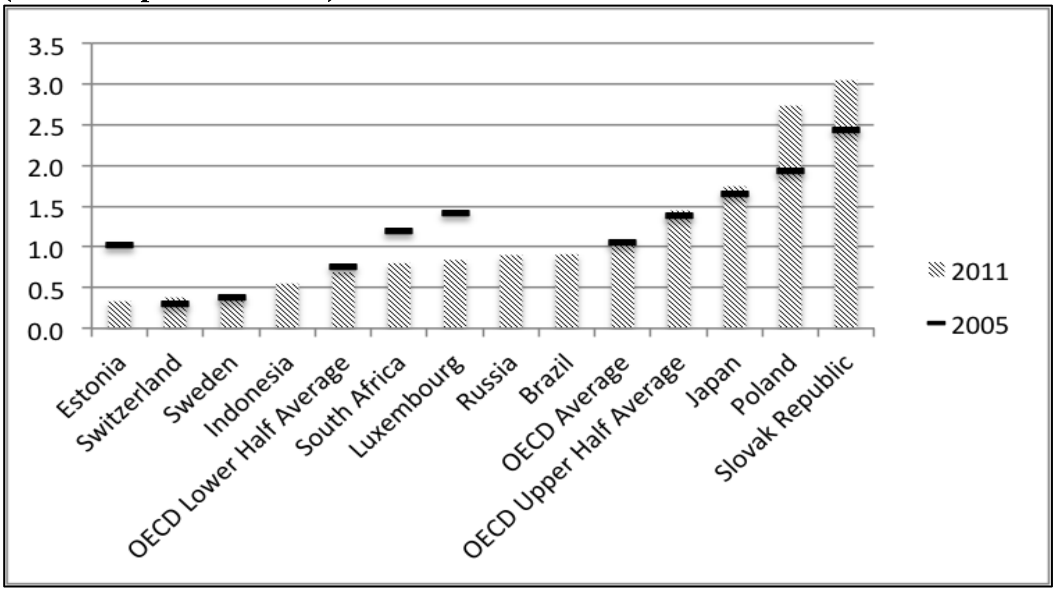
Various measures have been used to identify such costs, although it is slightly surprising how few truly international comparative studies have taken place in recent years (Chittenden, Kauser & Poutziouris, 2003; Evans, Hansford, Hasseldine, Lignier, Smulders & Vaillancourt, 2014). The dangers of international comparisons are well known to most researchers. Sandford (1994, pp.291-309) identified a number of reasons why such comparisons are more likely to mislead than enlighten, and offered the advice that 'comparisons of … operating costs should be used sparingly, with the greatest care and with a comprehensive statement of their limitations'. Such caution is duly noted in the following analysis.

Administrative costs

The cost of collection ratio is a commonly used standard measure of administrative costs, or more particularly of the efficiency with which revenue authorities collect tax (Evans, 2003). It compares the annual costs of administration with the total revenue collected for a particular fiscal year. A downward trend is associated with reduced administrative costs (or improved efficiencies) or improved tax compliance (or improved effectiveness) (OECD, 2013b).

Figure 4 compares the cost of collection ratio for OECD and most BRIICS countries for 2011 with the 2005 year. On this measure, South Africa has done exceptionally well, reducing its ratio by 0.40 points from 1.20 per cent to 0.80 per cent. Only Estonia and Luxembourg have done better, decreasing their ratios by 0.68 and 0.58 points, respectively.

Figure 4: Cost of collection ratio for selected OECD and BRIICS countries (2011 compared to 2005)



Note: No data for China or India.
Source: OECD, 'Government at a Glance 2013', Table 2.24.

However, it is important to note that many factors can influence this ratio, including differences in tax rates and structures, and prevailing economic conditions. For example, an increase in the ratio may be due to a reduction in tax revenue as a result of the financial and economic crisis rather than to any improvement in tax administrative efficiency. Conversely, a downward improvement in the ratio may be the simple result of increased taxes collected as the result of a rate rise or base broadening rather than any improvement in administrative practice.

Tax compliance burden

There are a number of ways that tax compliance costs can be assessed. For example, the compliance burden can be measured by the time taken to comply with the tax law and the number of tax payments required. The PricewaterhouseCoopers (PwC) (2015) 'Paying Taxes' annual publication does this, assessing both the tax cost and tax compliance burden of business taxes. Countries are effectively ranked according to the ease of paying taxes.

Table 2 Ease of paying taxes ranking OECD and BRIICS countries (2013)

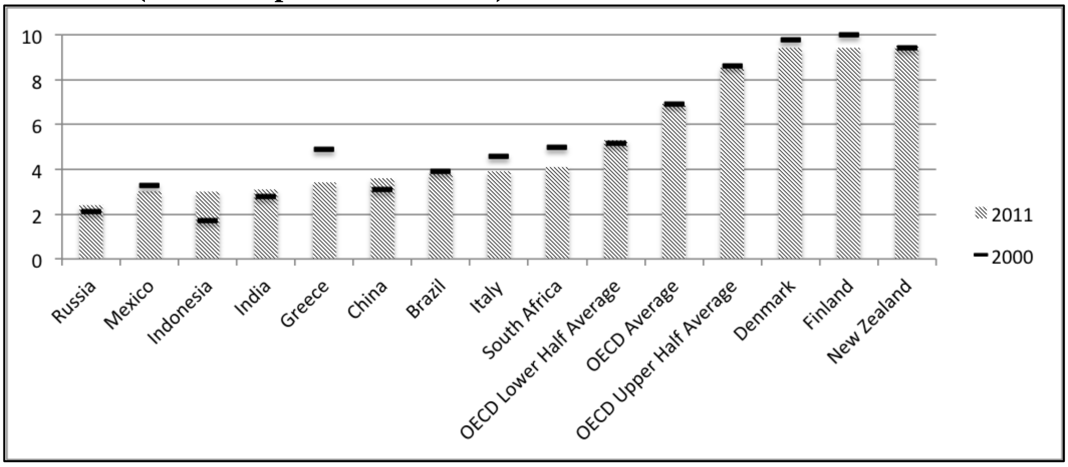
Economy	Overall ranking	Total tax payments	Time to comply (hours)	Total tax rate (%)
Ireland	6	9	80	25.9
Canada	9	8	131	21.0
Denmark	12	10	130	26.0
Norway	15	4	83	40.7
United Kingdom	16	8	110	33.7
Switzerland	18	19	63	29.0
South Africa	19	7	200	28.8
Luxembourg	20	23	55	20.2
Finland	21	8	93	40.0
New Zealand	22	8	152	34.4
Netherlands	23	9	123	39.0
Korea, Rep.	25	10	187	32.4
Estonia	28	7	81	49.3
Chile	29	7	291	27.9
Sweden	35	6	122	49.4
Australia	39	11	105	47.3
Slovenia	42	11	260	32.0
Iceland	46	26	140	29.7
United States	47	11	175	43.8
Russian Federation	49	7	168	48.9
Turkey	56	11	226	40.1
Greece	59	8	193	49.9
Portugal	64	8	275	42.4
Germany	68	9	218	48.8
Austria	72	12	166	52.0
Spain	76	8	167	58.2
Belgium	81	11	160	57.8
Poland	87	18	286	38.7
Hungary	88	11	277	48.0
France	95	8	137	66.6
Israel	97	33	235	30.1
Slovak Republic	100	20	207	48.6
Mexico	105	6	334	51.8
Czech Republic	119	8	413	48.5
China	120	7	261	64.6
Japan	122	14	330	51.3
Italy	141	15	269	65.4
India	156	33	243	61.7
Indonesia	160	65	254	31.4
Brazil	177	9	2600	69.0

There are a number of limitations of the measures used in this index, not the least of which is the very restrictive 'snapshot' that is used – effectively it is based upon data in relation to one medium sized company in each country. So, for example, the 'time to comply' ranking only takes into account the time taken to comply with corporate income, labour and consumption taxes. Nonetheless the results can be taken as indicative even if not entirely reliable. The results for the latest year available (2013) has South Africa with an overall ranking of 19, which puts it ahead of most OECD countries and all of the other BRIICS countries, as shown in Table 2. South Africa was ranked 24 in 2012 and 32 in 2011, and its decrease in compliance burden is largely attributable to the abolition of the secondary tax on companies. However, the PwC report notes that new withholding taxes, enhanced disclosure requirements and increased gathering of third party information may increase compliance obligations and impact future rankings (PwC, 2015).

Corruption

'Corruption' is defined as 'the abuse of entrusted power for private gain' (Transparency International, n.d.). The Corruption Perception Index is based on experts' opinion of government corruption. On a scale of 0 (highly corrupt) to 10 (very ethical), one third of OECD and BRIICS countries scored below 5 in 2011, roughly the same as in 2000 (Transparency International, n.d.). Figure 5 shows the corruption 'scores' for selected OECD and all BRIICS countries.

Figure 5: Corruption Perception Index for selected OECD and all BRIICS countries (2011 compared with 2000)



Source: Transparency International, Corruptions Perception Index 2011, 2000.

The OECD average has remained steady over that period at a score of 6.9. All of the six BRIICS countries are in the bottom ten for 2011, and all with a score of below 5 points. South Africa was ranked 34th in the world in 2000 but slipped to 64th position in 2011, although only dropping 0.9 points (2011: 4.1; 2000: 5.0). Indeed, South Africa was the only country in the BRIICS bloc that did not maintain or improve its rating.

Corruption, therefore, is still perceived as an issue for South Africa although this does not necessarily mean it applies to its taxation system or administration thereof. Rather the measurement of perceived corruption pertains to all government functions combined. However, the pervasiveness of the South

African Revenue Service (SARS) in South African society means that it has an important role to play in modelling best practice in the fight against corruption. Armed with this necessary background, the article now explores specific fiscal challenges and opportunities for South Africa.

SOUTH AFRICA: FISCAL CHALLENGES AND TAX OPPORTUNITIES

Fiscal challenges

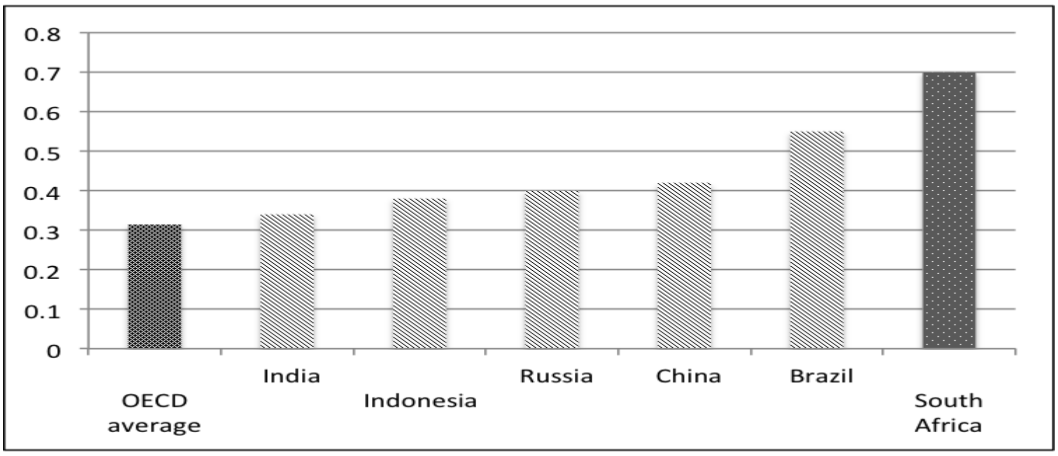
According to the 2013 Economic Survey for South Africa (OECD Report), public finances are in reasonable shape and core inflation is stable. However, the ‘extremely high’ income inequality, the ‘extremely high’ unemployment rate, the sluggish output growth and the fact that environmental challenges are threatening the sustainability of economic growth were all identified as key fiscal concerns (OECD, 2013c). The OECD Report also found that the macroeconomic policy mix had been ‘insufficiently supportive of economic growth while allowing large budget deficits to persist’ (OECD, 2013c, p.8).

These fiscal challenges – income inequality, high unemployment, sluggish economic growth and environmental concerns are now considered in more detail, along with an analysis of the specific constraints and opportunities that exist as a result of regional considerations. As will be shown, these regional considerations are particularly relevant in determining South Africa’s capacity to respond to its fiscal challenges.

Income inequality

Income inequality, as measured by the Gini coefficient, is shown for South Africa, the other BRIICS countries and the OECD average in Figure 6. It averages around 0.70 in South Africa compared with the OECD average of 0.314 (OECD, 2013c). This makes it among the highest in the world. This can be contrasted with 0.55 in Brazil, 0.42 in China, 0.40 in Russia, 0.38 in Indonesia and 0.34 in India (World Bank, n.d.). In 2008 the world income inequality Gini, at a global level, was estimated at 0.62 (OECD, 2013c).

Figure 6: Income inequality: Gini coefficient for OECD average and BRIICS countries 2013



Source: World Bank, ‘World Development Indicators: Distribution of income or consumption’ Data Catalogue.

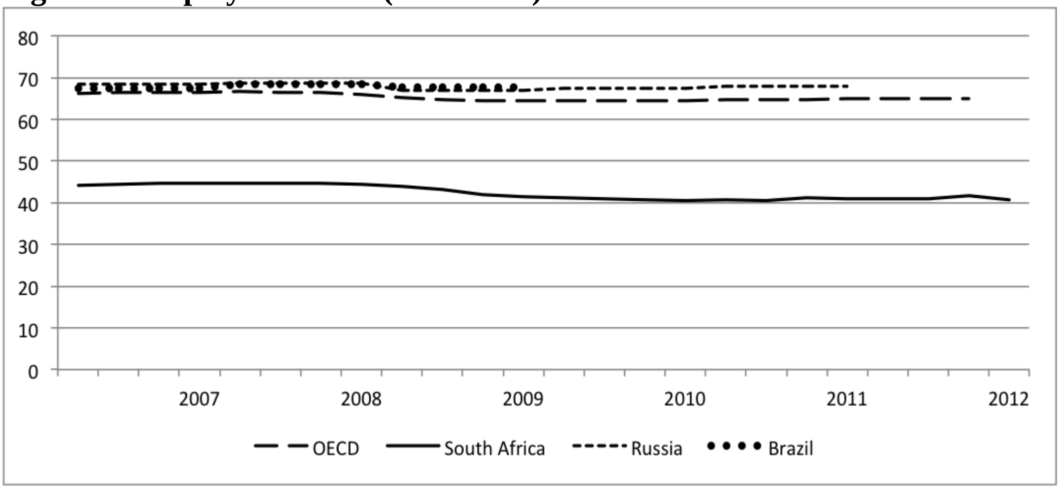
Thus, it would appear that the income differences are greater within South Africa than at the global level. This is confirmed by the large income ratio between top and bottom deciles. The OECD calculated this in 2010 to be around 20, compared with a level of 5 for the US, considered to be one of the most unequal countries in the OECD (OECD, 2013c).

There has been some impact from the government's use of the tax and benefit system to alleviate inequality. It is estimated that redistributive policies, particularly social transfers, have reversed around 40 per cent of the increase in income inequality (Leibbrandt, Woolard, Finn and Argent, 2010). However, notwithstanding an increase of progressivity in income taxes and an increase in social transfers, income inequality is arguably South Africa's number one issue.

High unemployment

Labour market outcomes are closely related to income inequality. Indeed, much of South Africa's income gap is explained by high rates of unemployment. An OECD study has found that labour market income contributes between 85 per cent and 90 per cent of income inequality each year (Leibbrandt, Woolard, Finn and Argent, 2010). This is largely due to high unemployment where less than half the working-age population (15-64) are in employment (40.8 per cent compared with OECD average of 64.9 per cent) (OECD, 2013c). From the data available, even Brazil (up to 2009) and Russia (up to 2011) have higher employment rates than the OECD average. This is illustrated in Figure 7.

Figure 7: Employment rate (2007-2012)



Source: OECD, 'OECD Economic Surveys: South Africa 2013', p. 13.

Increasing the employment rate is central to both the National Development Plan and the New Growth Path. The National Development Plan is a government-endorsed strategy whose central objectives are the eradication of poverty and to greatly reduce income inequality by 2030 (National Planning Commission, 2010). In order to meet its intermediate and end targets, the action plan involves a number of institutional and structural reforms. The New Growth Path establishes an economic framework for the period 2010 to 2020 (Economic Development Department, 2010). It is tasked with the creation of a new economic plan to replace the Accelerated Share Growth Initiative for South Africa (AsgiSA) which had been criticised for failing to deliver on increased employment and reduced inequality (OECD, 2013c).

Sluggish economic growth

Since the end of apartheid little investment has been made in infrastructure, creating a backlog that is now deemed imperative to address. In his State of the Nation speech in February 2012, President Zuma (2012) announced a major infrastructure program, covering electricity, water and transport, to be overseen by the specially created Presidential Infrastructure Coordinating Commission. The need for investment in infrastructure is contained in both the National Development Plan and New Growth Path. The 2013 Medium Term Expenditure Framework outlines the Government's plan to divert more public expenditure to capital spending over the medium term (National Treasury, 2012).

Revenue is also required to reduce the cyclically adjusted deficit as well as to fund spending in high priority areas such as education and the national health insurance being phased in. This requires policies to encourage economic growth. Indeed, the 2014 National Budget recognises that higher levels of growth are required to address the challenges of unemployment and inequality (National Treasury, 2014). Economic growth needs to be sufficiently vigorous not only to absorb the growing labour supply but also to absorb current excess labour supply. Small businesses play a large role in most economies (Freedman, 2009). In the 2012 National Budget, the Treasury increased the tax-free threshold for firms, in order to encourage the growth of small businesses (National Treasury, 2012).

Environmental challenges

Economic growth is impacted by environmental challenges. South Africa is ranked among the top twenty countries measured by absolute carbon dioxide emissions (National Treasury, 2013a). However, the Government is committed to action and is a signatory to the United Nations Framework Convention on Climate Change. At the World Climate Business Summit President Zuma (2011) reiterated South Africa's commitment to support efforts dealing with the challenges posed by climate change, stating: 'We are forging ahead with our programme of greening the economy to improve the economic, social and environmental resilience of the country in the face of climate change'.

The KPMG Green Tax Index, shown in Table 3, analyses those economies seen as representing a major share of global corporate investment activity, that use their tax systems to achieve green policy objectives (KPMG, 2013).

Of the 21 economies analysed, South Africa has an overall ranking of 13. With respect to tax incentives only, it ranks joint twelfth and is ranked joint ninth for tax penalties only. South Africa performs strongly in energy and water efficiency, scoring joint fourth and joint third ranking, respectively. Most countries included in the analysis use either incentives or penalties. The most notable exceptions are China and the United Kingdom who use both extensively.

Table 3: Green Tax Index country ranking (2013)

Overall ranking		Tax incentives only		Tax penalties only	
United States	1	United States	1	France	1
Japan	2	South Korea	2	Japan	2
United Kingdom	3	China	3	United Kingdom	3
France	4	India	4	Finland	4
South Korea	5	United Kingdom	5	China	5
China	6	Canada	6	Ireland	6
Ireland	7	Netherlands		Spain	
Netherlands	8	Japan	8	Australia	
Belgium	9	Ireland	9	Netherlands	9
India	10	Belgium	10	South Korea	
Spain	11	Singapore	11	South Africa	
Canada		Brazil	12	Belgium	
South Africa	13	South Africa		Germany	
Singapore	14	Argentina	14	United States	14
Finland	15	Spain	15	Singapore	15
Germany		France	16	Canada	16
Australia	17	Germany	17	Russia	17
Brazil	18	Mexico	18	India	
Argentina	19	Australia	19	Argentina	19
Mexico	20	Russia	20	Brazil	
Russia	21	Finland	21	Mexico	

Source: KPMG, 'The KPMG Green Tax Index 2013' p. 4.

Thus, South Africa already uses environmental taxes extensively with a carbon tax scheduled to be implemented in 2016. First proposed in 2010, it has been subsequently revised and repeatedly postponed. However, with the initial rate expected to be very low, it is unlikely to have a significant impact on behaviour until rates increase (OECD, 2013c). It is also unlikely to aid in economic growth (OECD, 2013c).

Regional considerations

There are also regional considerations. South Africa is a member state of the Southern African Development Corporation (SADC) and a signatory to the Memorandum of Understanding on Co-operation in Taxation and Related Matters. This provides for a publicly accessible tax database containing detailed tax information, building capacity and expertise among tax officials, and harmonising policies on tax incentives, tax treaties and indirect taxes. The objective of harmonising tax regimes and cooperating on tax matters is to improve regional economic performance by minimising disparities in tax systems that could cause inequities between national and regional strategies. The coordination of direct and indirect taxes is seen as especially important for achieving the policy objectives for finance and investment as well as to facilitate trade (SADC, 2003).

South Africa is also a member of the African Tax Administration Forum (ATAF). This was established as a platform for sharing best practices on taxation matters in the region (ATAF, n.d.). The Agreement on Mutual Assistance in Tax Matters covers areas such as exchange of information, cooperation in 'examinations' or audits and providing assistance in collection of tax revenue. From a review of major issues, challenges and current needs, a number of priorities have been identified. These include the automation and promotion of integrated tax systems, strengthening audit skills in specialised industries and in specialised areas of taxation, promoting voluntary compliance, and finding suitable solutions to deal with the predominance of the informal sector (ATAF, 2012).

Compared with the other members of the SADC and ATAF, South Africa has arguably the most advanced tax regime. While there are undoubtedly advantages in its membership of these regional bodies, South Africa is also bounded and constrained by them. In a way, its progress is dependent on how rapidly the region can mature to a comparable level. Yet it can also be contended that South Africa has a responsibility to lead by example.

Tax opportunities

With budget deficits, and hence public debt, becoming increasingly unsustainable, raising taxes, whether through introducing new taxes or increasing the rate of existing taxes, is often considered a viable solution. It is generally more difficult to cut public spending than to increase taxes due to the latter generally relating to a large number of dispersed and heterogeneous economic entities (Kesner-Skreb, 2014). However, increasing the tax burden has its limits.

One way of assessing whether the tax burden can be increased is to compare the share of total tax collected in GDP with comparable countries. If South Africa's tax burden is higher than the others, this may indicate that there is little room for more tax increases. Another method is the tax effort index, discussed above. As noted, South Africa is a high tax collection, high tax effort country. This means its share of actually collected taxes in GDP exceeds its estimated tax capacity and hence South Africa does not appear to have much capacity either to introduce new taxes or to increase existing tax rates.

There are a number of factors affecting this. Firstly, the income level of a country is expected to be a significant factor determining actual tax collection. As a result, it is expected that GDP per capita will have a positive and significant impact on tax collection, as well as on fiscal revenue (Bahl, 1972; Fox & Gurley, 2005). Secondly, higher age dependency and higher population growth are expected to distort a country's tax collection capacity and decrease the proportion of production population (Bird, Martinez-Vazquez & Torgler, 2004). These factors are expected to have a negative impact on both taxes and fiscal revenue. A third factor is trade openness (Aizenman & JinJarak, 2009; Norregaard & Khan, 2007). While increased trade openness can have a negative impact on taxes and fiscal revenue by lowering taxes collected on imports and exports, the more dominant effect is that trade openness is associated with increased economic growth, thus with increasing tax collection and increasing the tax base (Hines & Summers, 2009). An increasing agricultural sector in relation to GDP is expected to narrow the tax base, thereby decreasing tax collection and fiscal revenue. This is due to the fact that it is relatively harder to tax the agricultural sector (Leuthold, 1991; Tanzi, (1992). Finally, institutional and governance quality are essential factors in determining the efficiency and adequacy of tax collection (Gupta, 2007; Bird et al, 2004).

In summary, tax revenue is positively correlated with GDP per capita and trade openness and negatively correlated with an aging population, population growth and the size of agricultural sector. The efficiency of a country's tax administration can go either way. Thus, for South Africa, successful tax reform means addressing all of these factors.

Where the amount of taxes collected exceed tax capacity, any additional increases in taxes, whether by way of new taxes or increases in tax rates, will result in undesirable macro-economic distortions and undermine international competitiveness (Kesner-Skreb, 2014). Consequently, tax reforms should focus on improving the efficiency of collecting tax revenue. The establishment of autonomous or semi-autonomous revenue bodies such as SARS provides a platform for initiating deeper tax administration reforms that have made possible improvements in both tax operations and service delivery (Kidd & Crandall, 2006; Fjeldstad & Moore, 2009). South Africa has also undertaken major tax administration reforms including improving compliance management and small taxpayers' administration (International Tax Dialogue, 2010).

But more than just building capacity and legitimacy is required. Tax capacity needs to be increased. Revenue bases need to be broadened as well as safeguarded, further improvements in efficiency are required to reduce tax compliance costs and corruption needs to be tackled. These are the essential tax opportunities for South Africa which are now considered.

Broaden the tax base

One way to broaden the tax base is – subject to the constraints already identified – to introduce new taxes. South Africa is doing this with the proposed carbon tax. Introducing an annual wealth tax would be counter to most of the trends in developed and developing countries (Chatalova & Evans, 2013) and would also be unlikely to gain political traction. The existence of an estate duty in South Africa does at least raise the possibility of some wealth redistribution, at least once in a generation.

Removing concessions and exemptions (the so-called tax expenditures that litter so many tax systems) can also broaden the base. With a large informal sector, presumptive taxation is attractive. It is estimated that the informal sector costs up to 55 per cent of total tax revenues in some countries (Joshi & Ayee, 2008), and in South Africa it may account for one quarter of the economy as noted above. Conventional tax reforms do not address the issue, often failing to even take it into consideration. Yet spreading the tax net contributes to the state-building capacity and the legitimacy of developing economies (Joshi & Ayee, 2008; Fjeldstad & Moore, 2008). Base-broadening measures also have efficiency benefits as they usually improve compliance, reduce tax compliance costs and opportunities to engage in tax-minimising behaviour (Brys, 2011).

Improve tax compliance

While South Africa has done well in reducing its cost of collection ratio (see Figure 4), there is nevertheless still room for improvement. The tax gap exists as a result of a number of possible factors. These may be demographic (including age, gender and level of education), personal (including attitudes, experiences, morale and financial circumstances) or result from aspects of the tax system itself (such as tax rates, penalties and complexity) (Kornhauser, 2007).

As McKerchar and Evans (2009) note, ‘many of these factors are not constant, [and] it is to be expected that compliance behaviour can change over time’.McKerchar and Evans (2009) have outlined a number of strategies available to developing economies, and some of these resonate in a country such as South Africa. These are (1) creating a more effective tax administration; (2) fostering voluntary compliance and taxpayer morale; (3) strengthening and enforcing compliance; and (4) tackling the shadow economy.

Tax administrative reforms

South Africa has already made considerable progress on this front. For example, it established its autonomous revenue authority (SARS) in 1997 and more recently has passed its Taxation Administration Act in October 2012. These structural reforms create a more effective tax administration and this has been shown in South Africa’s case (Taliercio, 2004; OECD, 2015). One cause of South Africa’s success in this area is that SARS is supported by political champions and mentors. This enables a strong and continuing management team to be entrenched. But the administrative burden is inevitably increased when a revenue authority such as SARS is required to support the implementation of the government’s social security and wage subsidy interventions, and to administer a cash reimbursement system for employers (SARS, 2009; African Development Bank Group, 2010).

It is said that ‘[t]he taxpayer registry is the backbone of all tax administrations’ (Gallagher, 2005, p.125). As a result of the Taxation Administration Act this has been established. However, it is in the area of verification that South Africa, as with all economies, both developed and developing, can do better. This involves increasing both the amount and quality of information collected. Sources include both internal (central registry, tax returns, information about other taxes) and external or third party (government agencies, financial institutions, trade associations) data points. As D’Ascenzo (2015) notes, ‘The effective use of digital information and the employment of analytics - including data and text mining and visualisation tools - are at the centre of modern tax administration. Optimising the potential of data can also help spur innovative thinking and new approaches’.

Fostering voluntary compliance and taxpayer morale

As a result of the growing recognition that cooperative and positive engagements are more productive than adversarial and antagonistic approaches, tax administrations are adopting two broad and mutually supportive strategies: building positive taxpayer and tax community morale; and making compliance both simpler and cheaper for taxpayers (Hoffman, Gangl, Kirchler & Stark, 2014).

The relationship involves more than just the revenue authority and the taxpayer. It must also encompass tax practitioners, industry associations, trade unions and other key stakeholders. A network of trusted alliances will enhance the success of any strategy addressing compliance issues (OECD, 2004).

It is recognised that the small business sector has the potential to be a major employer and strategies need to continue to be developed to promote this. It is also known that tax compliance costs are regressive, falling more heavily on small businesses rather than on large businesses (Evans, 2003). As noted by Smulders et al (2012), reducing the compliance costs for its small business sector is one area where South Africa can make a substantial difference.

Strengthening and enforcing compliance

The third strategy noted by McKerchar and Evans is to strengthen and enforce compliance. This is, by definition, more resource intensive. Nevertheless, having escalating levels of sanctions increases the risk perception and demonstrates both the capacity and willingness of tax authorities to combat non-compliance (Gill, n.d.). Further, according to Ayers and Braithwaite (OECD, 2004), the threat of severe penalty is most effective when used in conjunction with a scale of lesser sanctions. Methods that can be used effectively are audits and investigations, customised letters and prosecution.

Tackling the shadow economy

Tackling the shadow economy, the last strategy noted by McKerchar and Evans (2009, p.197), is notoriously seen as ‘too difficult, requiring considerable effort with few returns’. However it has to be a priority. If it is not, legitimate businesses are disadvantaged in that the playing field is not level and confidence in the tax system is undermined. Prevention, detection and deterrence strategies designed to encourage compliance are relevant here (McKerchar & Evans, 2009). The network of trusted alliances could play an important role in uncovering elements or aspects of the shadow economy.

Tackling corruption

While South Africa has apparently improved its own position in relation to its scoring on perception of corruption indices since 2000, it has deteriorated in relation to other countries (see Figure 5). This is seen as an increasingly important barrier to improved public service delivery (OECD, 2013c). Indeed, corruption is identified as one of nine primary challenges facing the economy (National Planning Commission, 2011), and the African Development Bank Group is of the view that corruption is one of three main factors that will play out in the fiscal governance of South Africa in the short to medium term (African Development Bank Group, 2010). Approaches to combating corruption in tax administration generally aim at addressing the main drivers of corruption. Many of these are the trends discussed above and, in South Africa’s case, include increased use of technology as in electronic filing of tax returns and increased reliance on self-assessment (Martinin, 2014).

It is commendable that tackling corruption is entrenched in SARS's strategy (SARS, 2009). A policy of zero tolerance for corruption is incorporated into its value statement. It established an Anti-Corruption and Security Unit in 2007 that has prevention, detection and investigation activities, informed by research and analysis activities.

These efforts need to be continued, even stepped up, as corruption also contributes to the composition of the tax gap and increases both administrative and compliance costs. Corruption is not only an institutional issue; it is also a moral and political issue.

CONCLUSION

For a tax system to be deemed to be successful it must provide a sustainable source of revenue, adequate for the needs of the government, and meet the three further objectives of assisting economic growth, providing for the appropriate distribution of income and performing a stabilisation function (Bird, 1992). In doing so it must also meet the evaluative criteria of efficiency, equity and simplicity.

Tax systems need to be sustainable. As they exist primarily to raise revenue to fund government operations and services, they need to raise an adequate amount of such revenue. A lack of revenue may result in budget deficits which generally have adverse consequences such as increased inflation and decreased private investment. It will also impact on what services can be provided by the government. Alternative sources of revenue, which can include: printing money (with its inflationary implications); domestic and foreign borrowing (which create interest and repayment obligations); and relying on foreign aid (which can have many other deleterious consequences) are not attractive.

The sustainability of the tax system includes widening the tax base and improving revenue collection through tax compliance. Of a South African population of around 51 million in 2012 according to the World Bank, only 5.9 million or approximately 12 per cent are registered as taxpayers (ATAF, 2012). While policies that only affect those in employment can have only a limited effect when a significant portion of the working-age population is unemployed, there is nevertheless still a role for tax policy in addressing the fiscal challenges facing South Africa.

The tax system needs to promote economic growth so as to increase employment and productivity levels. This may also assist in identifying informal economies and bringing them into the tax net. The small business sector is vital to economic growth and further tax measures should be considered to assist. Further, it is recognised that the threat of climate change is 'an opportunity to develop our green, inclusive, sustainable and shared growth' (Juma, 2011). Indeed, the New Growth Path recognises that the opportunity may come from the global effort to address climate change (Economic Development Department, 2010).

Foreign direct investment (FDI) is also often viewed by developing countries as a means of stimulating economic growth. Such investment is encouraged through the use of tax incentives or preferential rates (Shihata, 1991; Bird, 1992). However, their effectiveness is uncertain and a sufficient link between such policies and economic growth is lacking (Shihata, 1991; OECD, 2002). Indeed, the conventional wisdom is that tax incentives are bad in theory because they distort investment decisions and bad in practice because they are often ineffective, inefficient and prone to abuse (Easson & Zolt, 2003). Yet they are used by all countries, both developed and developing, as they are politically attractive.

The redistribution role of taxes is especially important in emerging countries such as South Africa where disparities in income can prevent development and increase demand on government spending. A progressive tax system that takes ability to pay into account (where the tax rate increases as taxable income increases) is possibly the most significant tool available to counteract income inequality. Indeed, because of the concern about inequality, any tax change will need to be scrutinised on the basis of its effect on the distribution of the tax burden. The main explicitly redistributive tax in most tax systems is the personal income tax (Zee, 2005). However, where there are large disparities in income as is the case in South Africa progressivity can be an illusion.

So what role can and should the tax system play in ensuring the fiscal needs of South Africa can be met and to what extent is the current tax system ‘fit for purpose’? Traditionally emerging and developing countries have focused on increasing their tax-to-GDP ratios in order to reduce budget deficits, fund the services they provide and optimise the effectiveness of their tax systems. South Africa has undertaken significant tax reform over the past two decades, and is currently undertaking a further systematic and comprehensive review of its tax system. Although its revenue performance has improved over the period, it is still comparatively low and does not meet South Africa’s needs as outlined above. Yet it is also clear from its tax effort index that South Africa does not have the scope to increase taxes. Thus any tax reform must increase revenue in a way that gives due consideration to its prevailing social, environmental and economic conditions. The key focus has to be on the efficiency gains that can be derived from broadening the base, improving compliance and tackling institutional corruption.
Tax policy and tax administration are fundamentally linked. As the Minister of Finance recently commented, “…the issue of tax morality is critical to the success of implementing our tax policies…” (Nene, 2015, p.2) It was also acknowledged that “[t]ax policy is also about effective tax administration. Hence an important policy consideration is to ensure that taxes are collected where and when they were due” (Nene, 2015, p.2). To this end the Tax Review or Davis Tax Committee has an ongoing role in advising government on future refinements to the tax system.

The current South African tax system performs remarkably well on many indicators. But it is stretched to the point where further demands may cause economic distortions and other systemic failures. It is not entirely ‘fit for purpose’ in its present form, but it is to be hoped that the current reform process will successfully identify those areas where it can be improved in order to play the most effective possible role in ensuring a “nation at the crossroads” takes the right path forward in addressing the underlying macro-economic problems of sluggish economic growth, massive income and wealth inequality and high unemployment.

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From Moral Duty to Legal Rule – A Blueprint for Reform of Taxpayer Rights to Fair Treatment in the UK and Australia

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Abstract

Tax authorities both in the UK and Australia aspire to treat taxpayers fairly. This article assesses the extent to which these aspirations have been recognised in formal legal rules in both countries. It shows that neither jurisdiction has imposed on the Revenue any broad express legal obligation to treat taxpayers fairly. The legislatures in both jurisdictions have largely left the matter to the judiciary. As a consequence, neither country is far advanced along the path to translating the moral duty of tax officials to treat taxpayers fairly into a clear and certain legal right. This chapter proposes a number of reforms which, taken together, set out a blueprint for addressing this situation. The proposed reforms comprise legislative clarification of taxpayer rights to fair treatment, taxpayer rights to compensation for serious failures to treat taxpayers fairly and formal monitoring and sanctions to ensure compliance with Revenue commitments to treat taxpayers fairly.

INTRODUCTION

Tax authorities in the UK and Australia share a common aspiration to treat taxpayers fairly. The Australian Commissioner of Taxation refers to fairness in his preamble to the Australian *Taxpayers' Charter*, pointing to an aspiration to be "professional, responsive and fair".[2] The Australian *Charter* itself contains a commitment by the Australian Taxation Office (ATO) to treat taxpayers "fairly and reasonably"[3]. In the UK, Her Majesty's Revenue and Customs (HMRC) have also recently adopted a new Charter which incorporates an aspiration to provide "even-handed" treatment, tantamount to a commitment to treat taxpayers fairly.[4] In that document HMRC further expressly refer to their desire to provide "a service that is even-handed, accurate and based on mutual trust and respect."[5]

These revenue authority aspirations to treat taxpayers fairly are, in part, motivated by self-interest. Judges have recognised that fair treatment of taxpayers is in the

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[2] Australian Taxation Office, "Taxpayers' Charter: What You Need to Know" available at http://www.ato.gov.au/content/downloads/cor63133_n2548.pdf [Accessed 20 April 2012], foreword.

[3] Australian Taxation Office, "Taxpayers' Charter: What You Need to Know", above fn. **Error! Bookmark not defined.**, 2. This includes the following specific commitments under that heading: "We will:

- treat you with courtesy, consideration and respect
- behave with integrity and honesty
- act impartially
- respect and be sensitive to the diversity of the Australian community
- make fair and equitable decisions in accordance with the law
- resolve your concerns, problems or complaints fairly and as quickly as possible."

[4] Many of the commitments captured under the heading of the right to be treated fairly set out above at fn. 3 are also contained in the HMRC Charter, albeit under different headings.

[5] Her Majesty's Revenue and Customs, "Your Charter" available at http://www.hmrc.gov.uk/charter/charter.pdf [Accessed 12 April 2012].

"interests not only of all individual taxpayers…but also in the interests of the Revenue."[6] The OECD Centre for Tax Policy and Administration explains why, noting that "[t]axpayers who are aware of their rights and expect, and in fact receive, a fair and efficient treatment are more willing to comply."[7] Research into compliance behaviour is rapidly extending to examination and confirmation of various aspects of the link between fair treatment and tax compliance.[8]

Given this accepted link between tax compliance and fair treatment, it is pertinent to assess the extent to which aspirations to treat taxpayers fairly have been legally recognised in Australia and the UK as legally enforceable rules.[9] This chapter makes this assessment and draws on it to propose a blueprint for effectively dealing with the common challenges and obstacles in the way of translating a moral commitment to treat taxpayers fairly into enforceable legal requirements.

Part I discusses the recognition of the right to fair treatment in the UK. It focuses predominantly on the cases which have developed the UK doctrine of legitimate expectations. That doctrine has its roots in a requirement that taxpayers are treated fairly. The discussion extends to consideration of the potential extension of taxpayer rights to fair treatment facilitated by the application within the UK of law emanating from the Human Rights Act 1998 and European Union law.
Part II discusses the Australian position. The emphasis is on demonstrating how Australian courts, while recognising the desirability of treating taxpayers fairly, have avoided setting precedents imposing on the Commissioner a legal duty to treat taxpayers fairly. This judicial trend extends to the rejection of the UK doctrine of legitimate expectations in Australia, and an overriding concern to ensure duties to individual taxpayers do not impinge on Revenue duties to the Crown.

Part III sets out guidelines for both countries in translating the right to fair treatment from a mere moral duty into an enforceable legal right. Specifically, it makes three recommendations which, taken together, could be used as a blueprint for effectively dealing with the common challenges inherent in striking the appropriate balance between taxpayer rights to fair treatment and tax official public law duties. These recommendations are: (1) legislative clarification of

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6 *Vestey v Inland Revenue Commissioners* [1977] STC 414, 439 per Walton J.

7 OECD, Centre for Tax Policy and Administration, *Principles of Good Tax Administration* (2001), OECD, Practice Note GAP0013, 154. The UK Treasury also recently acknowledged that "the service standards provided by HMRC cannot be treated as a separate issue from the collection of tax revenues and the level of tax compliance." House of Commons. Treasury Committee, *Administration and Effectiveness of HM Revenue and Customs - Sixteenth Report of Session 2010-12* (2011), (Session 2010-11), Vol. 1, 47.

8 See, for example, Robert Mason and Lyle Calvin, "Public Confidence and Admitted Tax Evasion" (1984) 37 *National Tax Journal* 489; Michael Roberts and Peggy Hite, "Progressive Taxation, Fairness and Compliance" (1994) 16 *Law and Policy* 27; Steven Sheffrin and Robert Triest, "Can Brute Deterrence Backfire? Perceptions and Attitudes in Tax Compliance" in Joel Slemrod (ed), *Who Pays Taxes and Why? Tax Compliance and Enforcement* (1992) 193; Josef Falkinger, "Tax Evasion, Consumption of Public Goods and Fairness" (1995) 16 *Journal of Economic Psychology* 63; and Frank Cowell, "Tax Evasion and Inequity" (1992) 13 *Journal of Economic Psychology* 521. Typically, such studies focus on the positive compliance effects of fostering a relationship of trust and confidence between taxpayer and tax authority. For a good Australian example of such a study see Jenny Job and Monika Reinhart, "Trusting the Tax Office: Does Putnam's Thesis relate to Tax?" (2003) 38 *Australian Journal of Social Issues* 307. See also Kristina Murphy, "The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders" (2004) 28 *Law and Human Behaviour* 187. There has also been significant international focus on the relationship between treatment of taxpayers and compliance behaviour. See, for example, John Scholz, "Trust, Taxes and Compliance" in Valerie Braithwaite and Margaret Levi (eds), *Trust and Governance* (1998), 135.

9 This mirrors the question posed by UK judge Lord Scarman in *Inland Revenue Commissioners v National Federation of Self-Employed and Small Business Ltd* (*Fleet Street Casuals*) [1981] UKHL 2, 18; [1981] STC 260, 280: "Is it [fairness] a mere moral duty, a matter for policy but not a rule of law?"

taxpayer rights to fair treatment; (2) rights to compensation for serious failures to treat taxpayers fairly; and (3) formal and independent avenues for enforcement and oversight of Revenue commitments to treat taxpayers fairly.

Part I – Fairness in the UK

There is no express statutory recognition of taxpayer rights to fair treatment in the UK. There has, however, been judicial recognition of limited legally enforceable taxpayer rights to fair treatment, particularly in cases where HMRC has sought to resile from conduct or representations reasonably relied upon by taxpayers. The focus in this Part is on explaining these judicial developments. The examination also extends to consideration of further enhancements of taxpayer rights to fair treatment due to the increasing influence of European Union law in the UK.

Judicial recognition of UK taxpayer rights to fair treatment

The right to fair treatment has been discussed in the UK in a number of relatively recent cases which have recognised and developed a doctrine of legitimate expectations in judicial review proceedings against the Revenue. This doctrine, which recognises a right to substantive as well as procedural justice, has been judicially described as "rooted in fairness".[10] In this context, in 1982, Lord Scarman in *Inland Revenue Commissioners v National Federation of Self-Employed and Small Business Ltd*[11] (*Fleet Street Casuals*) stated that "modern case law recognises a legal duty owed by the revenue to the general body of the taxpayers to treat taxpayers fairly."[12]

His Lordship pointed out that this duty is more than simply a matter of "desirable policy or moral obligation"[13] and that the duty extends to ensuring HMRC officials:

> "...use their discretionary powers so that, subject to the requirements of good
> management, discrimination between one group of taxpayers and another does
> not arise; to ensure that there are no favourites and no sacrificial victims."[14]

Subsequently, in *R. v Inland Revenue Commissioners Ex p. Preston*[15] (*Preston*) Lord Scarman, while falling short of suggesting that fairness, on its own, could constitute a basis for judicial review, confirmed that fairness is a key consideration in determining whether a statutory power has been abused or

[10] Bingham LJ in *R. v Inland Revenue Commissioners Ex p. MFK Underwriting Agencies Ltd* (*MFK Underwriting*) [1990] 1 WLR 1545, 1569-1570; [1989] STC 873, 892-893.
[11] *Fleet Street Casuals*, above fn. 9, [1981] STC 260. This case involved a special arrangement under which the Revenue agreed not to collect back taxes owed by certain casual workers. The Federation respondent alleged this arrangement unfairly discriminated against the Federation's members who were typically vigorously pursued by the Commissioner for non-payment of taxes. The case has become popularly known as the "Fleet Street Casuals" case.
[12] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 280. His Lordship cites a number of authorities in support of this proposition including *Latilla v Inland Revenue Commissioners* (1943) 25 TC 107 (CA); *Vestey v Inland Revenue Commissioners (No. 2)* [1978] STC 567 (HC); and *Congreve v Inland Revenue Commissioners* (1948) 30 TC 163 (HL).
[13] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 280.
[14] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 280.
[15] *R. v Inland Revenue Commissioners Ex p. Preston* [1984] UKHL 5; [1985] STC 282.

exceeded by the Revenue.[16] In *Preston* Lord Templeman also further elaborated on the link between unfairness and abuse of power:

> "...[A] taxpayer cannot complain of unfairness merely because the commissioners decide to perform their statutory duties... The court can only intervene by judicial review to direct the commissioners to abstain from performing their statutory duties or from exercising their statutory powers if the court is satisfied that 'the unfairness' of which the applicant complains renders the insistence by the commissioners on performing their duties or exercising their powers an abuse of power by the commissioners."[17]

Lord Templeman also made it clear that unfairness could form the basis for successful judicial review proceedings against HMRC by a taxpayer where HMRC conduct is equivalent to a breach of contract or breach of representation capable of sustaining a common law estoppel action. Such circumstances could also be considered so unfair as to constitute an abuse of power.[18]

However, UK courts have also been quick to point out the practical factual limitations of the doctrine. For instance, taxpayers cannot complain of unfairness if they have not themselves acted in a transparent and open manner. Nor can they complain of unfairness if they rely on qualified or indefinite representations made and ultimately resiled from by HMRC. Bingham LJ in *R. v Inland Revenue Commissioners Ex p. MFK Underwriting Agencies Ltd*[19] pointed out that:

> "...fairness is not a one-way street. It imports the notion of equitableness, of fair and open dealing, to which the authority is as much entitled as the citizen. The Revenue's discretion, while it exists, is limited. Fairness requires that its exercise should be on a basis of full disclosure... Nor, I think...would it be fair to hold the Revenue bound by anything less than a clear, unambiguous and unqualified representation."[20]

As a consequence of factual limitations such as these, no taxpayer succeeded in any substantive legitimate expectations claim against HMRC until *R. v Inland Revenue Commissioners Ex p. Unilever plc*[21] (*Unilever*). In *Unilever* the taxpayer had lodged claims taking advantage of loss relief provisions contained in the *Income Incorporation Taxes Act 1988* outside of the statutory time limit - as it had done for over 20 years. HMRC's past practice had been to allow the claims, despite being out of time. However, HMRC now sought to resile from that practice and enforce the statutory time limit. In finding for the taxpayer, the Court of Appeal concluded that to reject the taxpayer's claim in this instance was so unfair as to amount to an abuse of power.[22]

The finding in *Unilever* was also significant in that it established that in appropriate cases, fairness demands that the Revenue be bound by previous

[16] *Preston*, above fn. 15, [1985] STC 282, 298.
[17] *Preston*, above fn. 15, [1985] STC 282, 293.
[18] *Preston*, above fn. 15, [1985] STC 282, 294.
[19] *MFK Underwriting*, above fn. 10, [1989] STC 873.
[20] *MFK Underwriting*, above fn. 10, [1989] STC 873, 892-892.
[21] *R. v Inland Revenue Commissioner Ex p. Unilever plc* [1996] STC 681 (CA).
[22] Simon-Browne LJ, in *Unilever*, above fn. 21, [1996] STC 681 at 695, elaborated on the link between unfairness and abuse of power, observing that "it is illogical or immoral or both for the public authority to act with conspicuous unfairness and in that sense abuse its power."

practices or conduct falling short of express and unqualified statements made to, and relied upon by, particular taxpayers - even where the relevant practice is evidenced only by passive acquiescence. The Court of Appeal in *Unilever* also pointed out that the potential categories of unfair treatment capable of sustaining a taxpayer claim against the Revenue remain open, with precedent acting "as a guide not a cage"[23] requiring each case to be judged on its own facts.
In recent years, numerous attempts have been made to expand the categories of recovery, including attempts to hold HMRC to erroneous oral advice. While none of these cases have succeeded, the possibility of success remains open. However, in *Bourne v HMRC*[24] it was noted that "it will usually be difficult or impossible to prove such a claim unless the guidance given by HMRC is recorded in writing."[25]

In addition to these practical challenges, numerous commentators have called for a clearer account of the general standards and role of fairness in judicial review proceedings. The observations of Bamforth are typical:

> "No real attempt has been made…to clarify what – as a general matter – counts as 'fair' or 'unfair', or the role which fairness plays in the overall scheme of judicial review."[26]

Despite the practical challenges and continuing uncertainty as to the precise role of fairness in judicial review proceedings, it is clear that the right to fair treatment remains an important consideration in weighing up public and private interests to determine whether a taxpayer can succeed in judicial review proceedings against HMRC.[27]

European influences on UK taxpayer rights to fair treatment

As already noted, there is no direct statutory recognition of a taxpayer right to fair treatment in the UK. However, arguably, statutory recognition of human rights via enactment of the *Human Rights Act 1998* (HRA) "has caused fundamental changes to the Constitutional structure of England and the relationship between the courts and government"[28] which have facilitated judicial dynamism allowing the development of the doctrine of legitimate expectations described above.
The HRA brings into law the provisions of the European Convention for Protection of Human Rights and Fundamental Freedoms (Convention).[29] Section

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[23] *Unilever*, above fn. 21, [1996] STC 681, 690.
[24] *Bourne v HMRC* (*Bourne*) [2010] UKFTT 294 (TC).
[25] *Bourne*, above fn. 24, [2010] UKFTT 294 (TC) at [27]. For similar reasoning see also *Watson v HM Customs and Excise* (2004) (VAT18675) and *Corkteck Ltd v HMRC* [2009] EWHC 785 (Admin).
[26] Nicholas Bamforth, "Fairness and Legitimate Expectation in Judicial Review" (1997) 56 *Cambridge Law Journal* 1, 1. See also Richard Clayton, "Legitimate Expectations, Policy and the Principle of Consistency" (2003) 62 *Cambridge Law Journal* 93: and Cameron Stewart, "Substantive Unfairness: A New Species of Abuse of Power?" (2000) 28 *Federal Law Review* 617.
[27] This weighing up process was explained by Lord Woolfe MR in *R. v North and East Devon Health Authority Ex p. Coughlan* [1999] EWCA Civ 1871, at [57]: "Where the court considers that a lawful promise or practice has induced a legitimate expectation of a *benefit which is substantive*, not simply procedural, authority now establishes that … the court will in a proper case decide whether to frustrate the expectation is so unfair that to take a new and different course will amount to an abuse of power. Here, once the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy."
[28] Matthew Groves, "Substantive Legitimate Expectations in Australian Administrative Law" [2008] 32 *Melbourne University Law Review* 470, 492.
[29] The HRA came into force on 2 October 2000.

6(1) of the HRA provides that "[i]t is unlawful for a public authority to act in a way which is incompatible with a Convention right."[30]

There have been numerous attempts to apply the provisions of the HRA in cases of alleged unfair treatment of taxpayers. For instance, arguments concerning the potential infringement of the right to a fair hearing in Article 6 of the Convention[31] have been raised in a number of cases where HMRC have sought to use coercive powers against taxpayers accused of tax evasion.[32] In one of these cases - *R. v Allen*[33] - the Court acknowledged that HMRC's coercive powers to compel the disclosure of information must be exercised in a manner which does not violate the right against self-incrimination.[34]

Allegations of unfair treatment have also been central to numerous cases in which allegations of breaches of the Convention Article 14 right to non-discrimination on grounds of sex have been levelled against HMRC.[35] For example, in *R. v Commissioners of Inland Revenue Ex p. Wilkinson*[36] the taxpayer alleged discrimination through being denied a tax deduction known as a "widow's bereavement allowance" simply because he was a widower rather than a widow.[37] The taxpayer's claim was ultimately unsuccessful.[38] However, subsequent successful challenges by widowers on grounds of discrimination have been made direct to the European Court of Human Rights.[39] These taxpayer successes demonstrate that unfairness amounting to discrimination by the Revenue is now clearly actionable in the UK by virtue of the influence of the HRA and related jurisprudence of the European Court of Human Rights.

The influence of EU law in the UK is also likely to further specifically aid taxpayers in cases alleging unfairness constituting a breach of the doctrine of legitimate expectations. The protection of legitimate expectations is recognised in

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[30] Section 6(2) qualifies this general principle: "Subsection (1) does not apply to an act if— (a) as the result of one or more provisions of primary legislation, the authority could not have acted differently; or (b) in the case of one or more provisions of, or made under, primary legislation which cannot be read or given effect in a way which is compatible with the Convention rights, the authority was acting so as to give effect to or enforce those provisions."

[31] Article 6(1) provides (among other things) that: "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."

[32] See, for example *R. v Allen* (*Allen*) [2001] UKHL 45; [2001] STC 1537 and *R. v Dimsey* [2001] UKHL 46; [2001] STC 1520. For discussion of these cases see Graham Virgo, "Cheating the Public Revenue" (2000) 59 *Cambridge Law Journal* 42 and Graham Virgo, "Cheating the Public Revenue: Fictions and Human rights" (2002) 61 *Cambridge Law Journal* 47.

[33] *Allen*, above fn. 32, [2001] STC 1537.

[34] The taxpayer did not succeed on factual grounds in this case. The taxpayer had been compelled to supply certain ultimately self-incriminatory information pursuant to the Commissioners' exercise of power pursuant to section 20(1) of the *Taxes Management Act 1970* (UK).

[35] Article 14 provides: "The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

[36] *R. v Commissioners of Inland Revenue Ex p. Wilkinson* [2005] UKHL 30; [2006] STC 270.

[37] The widows' allowance was set out in section 262 of the *Income and Corporation Taxes Act 1988* (UK). In challenges taken to the European Court of Human Rights prior to enactment of the *HRA* the Commissioner had settled similar claims. These included two separate similar claims by widowers Crossland and Fielding in 1997.

[38] The court held that the case fell within the exception to the general requirement to comply with the Convention (contained in section 6(2)(b) of the HRA) because HMRC were acting so as to give effect to a statutory provision which could not reasonably be read or given effect so as to make it compatible with the Convention rights. Section 6(2) is set out in full above at fn. 30.

[39] In 2006, in *Hobbs, Richard, Walsh and Geen v United Kingdom* [2006] ECHR 63684/00, four widowers took their cases to the European Court of Human Rights. The court found that the denial of the widows' allowance to widowers was discriminatory and violated the Convention.

EU law.[40] In *Mavridis v Parliament*[41] the European Court of Justice has observed that "...the right to rely on the principle of the protection of legitimate expectation ...extends to any individual who is in a situation in which it appears that the administration's conduct has led him to entertain reasonable expectations."[42] However, the approach under EU law is more expansive than the UK doctrine. For example, a plaintiff may recover even in some cases where upholding a legitimate expectation would result in a breach of a statutory duty imposed on the relevant offending authority.[43] Such an approach is yet to be applied in the UK. It is conceivable that this approach could influence and embolden UK judges to eventually expand the circumstances in which taxpayer rights to fair treatment are recognised as legally enforceable.

Part II – Fairness in Australia

There are a number of informal acknowledgements of a right to fair treatment of Australian taxpayers but, similar to the UK, none of these have legislative backing, the breach of which is enforceable against the Australian Commissioner of Taxation.[44] Given this absence of any legislative recognition of a right to fair treatment of Australian taxpayers, the focus of this Part is on judicial attitudes to the recognition and legal enforceability of such a right.

In Australia, the concept of a duty to treat taxpayers fairly was first judicially flagged by Isaacs J in his 1926 judgment in *Moreau v FCT*[45] (*Moreau*). His Honour stated in that case that the Commissioner's function "is to administer the Act with solicitude for the Public Treasury *and with fairness to the taxpayers*"[46] (emphasis added). While these views have been positively received in a number of subsequent Australian tax cases, there has been no express confirmation of their correctness. Generally, the effect of subsequent cases has been to qualify the general right to fair treatment recognised by Isaacs J.

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[40] The principles of legitimate expectation were applied by the European Court of Justice in the tax context in a case involving Dutch VAT: *Gemeente Leusden v Staatssecretaris van Financien* (C-487/01 and C-7/02) [2004] ECR I-5337; [2007] STC 776.

[41] *Mavridis v Parliament* (*Mavridis*) (C-289/81) [1983] ECR 1733.

[42] *Mavridis*, above fn. 41, [1983] ECR 1733 at [21].

[43] The European doctrine is derived from the German concept of *Vertrauenschutz*. In the development of that concept in German law it has been recognised that requiring an administrator to act illegally is not necessarily a bar to legal protection of a citizen's substantive legitimate expectations that the administrator will so act. Legality needs to be weighed against the expectation of certainty in determining whether a legitimate expectation should be remedied in these circumstances. Forsyth describes this weighing up process as follows: "There had to be a weighing of the principles to determine whether the public interest in the legality of the administration outweighed the need to protect the trust placed by the citizen in the validity of the administrative act. Only in that event was an unlawful administrative act revocable." Christopher Forsyth, "The Provenance and Protection of Legitimate Expectations in Administrative Law" (1988) 47 *Cambridge Law Journal* 238, 244.

[44] As noted in the Introduction of this article, Australia has a *Taxpayers' Charter* which recognises a taxpayer right to fair treatment. However, the Charter remains a document without any legislative force and which does not purport to create any new legal rights. This is contrary to the recommendations of the Australian Joint Committee of Parliamentary Accounts, *Report 326 - An Assessment of Tax* (1993); and OECD, Committee of Fiscal Affairs Working Party, "Taxpayers Rights and Obligations - A Survey of the Legal Situation in OECD Countries" (Paper Number 8, OECD, 1990). The legal enforceability of the Charter was keenly debated prior to its adoption in 1997, with many commentators critical of the non-binding nature of the Charter and most commentators at the time calling for legislative entrenchment of the Charter rights. See, for example, Karen Wheelright, "Taxpayers' Rights in Australia" in Duncan Bentley (ed), *Taxpayers' Rights: An International Perspective* (Gold Coast: Revenue Law Journal, 1998), 57; and Duncan Bentley, "A Taxpayers Charter: Opportunity or Token Gesture" (1995) 12 *Australian Tax Forum* 1.

[45] *Moreau v FCT* (1926) 39 CLR 65.

[46] *Moreau*, above fn. 45, (1926) 39 CLR 65, 67.

For example, in *David Jones Finance & Investments Pty Ltd v FCT*[47] (*David Jones*), the Commissioner resiled from his usual practice of allowing inter-corporate dividend rebates, contrary to a decision of the Australian High Court in *FCT v Patcorp Investments Ltd*.[48] The taxpayer unsuccessfully argued that this was unfair and constituted an abuse of process by the Commissioner. O'Loughlin J, in the first instance hearing of the case, distinguished the remarks of Isaacs J in *Moreau*, by confining them to the specific statutory provision in question in *Moreau*.[49]

His Honour was, however, prepared to concede that the mandate given to the Commissioner under s8 of the *Income Tax Assessment Act 1936* (Cth)[50] (ITAA36) "requires him to exercise his statutory powers with 'procedural fairness'"[51].

Similarly, in *Bellinz v Federal Commissioner of Taxation*[52] (*Bellinz*) Hill, Sundberg and Goldberg JJ recognised a taxpayer right to fair treatment in principle, but similarly imposed clear boundaries on this right, observing that:

> [t]here is little difficulty in accepting that, where a decision-maker, including the Commissioner of Taxation, has a discretion, a principle of fairness will require that that discretion be exercised in a way that does not discriminate against taxpayers… But … it is difficult to see how the Commissioner can properly be said to have acted unfairly, even if there is an element of discrimination, where he has acted in accordance with the law itself.[53]

However, the key limitation on the development of any recognition of rights to fair treatment in Australian Courts either in judicial review proceedings or in common law proceedings has been the judicial interpretation of the various express or implicit statutory protections of the Australian Commissioner of Taxation.

In judicial review proceedings the key limitations are the privative clauses contained in sections 175 and 177 of the ITAA36. These were acknowledged in *David Jones* as the main obstacles barring the possibility of the taxpayer succeeding in its claim against the Commissioner. According to section 175, an assessment is not invalid merely because the Commissioner has not complied with any provision of the ITAA36. Further, section 177(1) provides that where the Commissioner produces a notice of assessment, that assessment will be conclusive evidence of the due making of the assessment and that the amount and details of that assessment are correct.[54] These provisions have been interpreted as prohibiting judicial review except in cases where the complaint is either not

[47] *David Jones Finance & Investments Pty Ltd v FCT* (1991) 21 ATR 1506.
[48] *FCT v Patcorp Investments Ltd* (1976) 6 ATR 420.
[49] His Honour observed (*David Jones*, above fn. 47, (1990) 21 ATR 718, 722) that in "In assessing the significance of these remarks and the introduction of the concept of 'fairness' it is, in my opinion, relevant to note that Isaacs J, was discussing a provision of the legislation which was dealing with the Commissioner having 'reason to believe' that the taxpayer had defrauded or attempted to evade the revenue law. Hence the obligation to act fairly related to the activities of the Commissioner and his officers in determining whether there was 'reason to believe.'"
[50] This section provides that "[t]he Commissioner shall have the general administration of this Act."
[51] *David Jones*, above fn. 47, (1990) 21 ATR 718, 723.
[52] *Bellinz v Federal Commissioner of Taxation* (1998) 155 ALR 220.
[53] *Bellinz*, above fn. 52, (1998) 155 ALR 220, 233-234. There is a striking contrast between this reasoning and the European approach to application of the doctrine of legitimate expectations which expressly recognises the potential for recognising taxpayer rights even where that would result in the administrative official being required to act outside the law, as discussed in Part I.
[54] The section does preserve the rights of taxpayers to seek a review or appeal against the assessment using the procedures contained in Part IVC of the *Taxation Administration Act 1953* (Cth) (ADJR). These procedures too, however, make no allowance for unfairness as a sufficient ground for appeal.

directly related to a tax assessment or there is evidence of bad faith, illegality or improper purpose.[55] Mere unfairness is not enough.
Express statutory restrictions on reviewability of tax assessment decisions in the *Administrative* Decisions *(Judicial Review) Act 1977* (Cth)[56] and the restrictive interpretation by courts of the availability of judicial review pursuant to section 39B of the *Judiciary Act 1903* (Cth)[57] have further hindered the possibility of development of any principle of any enforceable taxpayer entitlement to fair treatment – either procedural or substantive.

Consequently, the only instances in which taxpayers have succeeded in administrative law proceedings against the Commissioner on grounds of unfairness have been cases in which the facts of the case allowed a finding for the taxpayer without breaching these statutory limitations. For instance, in *Darrell Lea Chocolate Shops Pty Ltd v Commissioner of Taxation*[58] (*Darrell Lea*), Spender Burchett and Hill JJ had no difficulty confirming that "the extensive powers conferred upon the Commissioner in connection with the assessment and collection of sales tax, or for that matter any other tax, must be so exercised as to deal fairly with each taxpayer."[59] The Court freed itself of the constraints of the privative clause in the sales tax legislation in question (which protected from review decisions concerning ascertainment or calculation of tax) by holding that there was no genuine assessment in this case as the Commissioner had made his "assessment" on facts known by him to be untrue. Hence, the taxpayer was able to succeed in its claim of unfair treatment by the Commissioner.[60] However, as most taxpayer complaints concern bona fide tax assessment activities such successes are likely to remain exceedingly rare.

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[55] Walpole more fully expands on the circumstances in which judicial review might be available to a taxpayer generally: "The major ground on which an action for review might be based would be: that the Commissioner did not have jurisdiction to make the decision; that the decision was not authorized by the Act; that the making of the decision was an improper exercise of the power conferred by the Act, because the Commissioner failed to take a relevant consideration into account or exercised the power in a way that constitutes an abuse of power; or that the decision was otherwise contrary to the law." See Michael Walpole, "Taxpayer Rights and Remedies - Australia, New Zealand and China" in *Second World Tax Conference* (Dublin: Institute of Taxation, 2001).

[56] Paragraph (e) of Schedule 1 of the *Administrative Decisions (Judicial Review) Act 1977* (Cth) excludes from review decisions forming part of the process of making of, leading up to the making of, or refusing to amend, an assessment of tax. The exclusions in paragraph (e) of Schedule 1 have been interpreted as clearly prohibiting review of decisions dealing with the calculation of tax, irrespective of whether the decisions are unfair. See the comments of Beaumont J in *Constable Holdings Pty Ltd v Federal Commissioner of Taxation* (1987) 72 ALR 265 at 268-269; Ellicott J in *Tooheys Ltd v Minister for Business & Consumer Affairs* (1981) 36 ALR 64 at 78; and Smithers J in *Intervest Corporation Pty Ltd v FCT* (1984) 3 FCR 591 at 595–596.

[57] Section 39B of the *Judiciary Act 1903* (Cth) provides the Federal Court of Australia with original jurisdiction in respect of any matter in which a writ of mandamus or prohibition or an injunction is sought against an officer of the Commonwealth. The Federal Court generally allows applications under both section 39B and the ADJR to be made and heard concurrently. In tax proceedings, the section 39B jurisdiction may be preferred given the absence of any express tax-specific limitations on review similar to those contained in paragraph (e) of Schedule 1 of the ADJR. However courts have broadly interpreted sections 175 and 177 of the ITAA36 to restrict their jurisdiction to review tax cases under section 39B. Aside from *Moreau*, above fn. 45, (1926) 39 CLR 65, all of the cases discussed above in this Part concerned applications for judicial review under section 39B.

[58] *Darrell Lea Chocolate Shops Pty Ltd v Commissioner of Taxation* (1996) 141 ALR 713. In this case the Commissioner issued four separate assessment for sales tax of the same taxpayer in respect of the same transactions in the same goods made under a four different assessment Acts - and all without making any genuine attempt to assess the sale value of particular goods under each Act and on a factual basis which the Commissioner knew was wrong.

[59] *Darrell Lea*, above fn. 58, (1996) 141 ALR 713, 726. For similar comments, made in the context of discussing the line of UK legitimate expectation cases discussed in Part I of this article see *Pickering v Deputy Commissioner of Taxation* (1997) 37 ATR 41; *Ando Minerals NL v Deputy Federal commissioner of Taxation* (1994) 94 ATC 4163; and *Federal Commissioner of Taxation v Biga Nominees Pty Ltd* (1988) 88 ATC 4270.

[60] The High Court recently re-examined the issue in *Commissioner of Taxation v Futuris Corporation Ltd* (2008) 237 CLR 146, with the Court confirming that judicial review is only available in cases involving a tax assessment decision where the assessment is tentative or provisional or there has been conscious maladministration by the Commissioner. Again, no room was allowed for mere unfairness as a sufficient ground for review of an assessment.

There has also been no judicial recognition in Australia of any legal right to fair treatment in the equally rare cases involving taxpayer attempts to invoke the common law to enforce their rights. Australian judges have refused to impose any common law duties alongside the Commissioner's duties to the Crown for fear of contradicting an implicit legislative intent that the Australian Commissioner of Taxation owes duties only to the Crown. For example, in *Lucas v O'Reilly*[61] a case involving allegations of tortious breach of statutory duty by the Commissioner of Taxation,[62] Young CJ, in comprehensively rejecting the taxpayer's submissions, stated:

> "If the cause of action relied upon by the plaintiff is based upon a breach of statutory duty, the plaintiff must show...that the statute creating the duty confers upon him a right of action in respect of any breach...However, it is, I think, clear that the defendant owes the plaintiff no such duty. The duty of the Commissioner is owed to the Crown."[63]

This confinement of the Commissioner's duties to the Crown is a recurring theme in Australian tax cases and extends to equitable as well as common law taxpayer claims against the Commissioner.[64] This prevailing judicial attitude allows little scope for recognition of any private law taxpayer right to fair treatment in Australia in the foreseeable future.

Australian judges have also rejected the UK doctrine of legitimate expectations. While cases such as *Bellinz*, *Darrell Lea* and *David Jones* discuss the UK legitimate expectation cases, the doctrine has clearly been rejected in Australia.[65] Further, as former High Court Chief Justice Sir Anthony Mason has extra-judicially observed; "[i]t would require a revolution in Australian judicial thinking to bring about an adoption of the English approach to substantive protection of legitimate expectations."[66]

This suggests that, in the absence of legislative intervention, any significant legal recognition of Australian taxpayer rights to fair treatment in the foreseeable future is highly unlikely.

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[61] *Lucas v O'Reilly* (*Lucas*) (1979) 79 ATC 4081.

[62] Breach of statutory duty was also separately unsuccessfully pleaded by the taxpayer in *Harris v Deputy Commissioner of Taxation* (*Harris*) (2001) 47 ATR 406.

[63] *Lucas*, above fn. 61, (1979) 79 ATC 4081, 4085. This is very similar to the stance taken in *Harris v Deputy Commissioner of Taxation*, above fn. 62, (2001) 47 ATR 406. In that case, Grove J asserted, at 408, that "[t]here is no basis upon which to conclude that there is a tort liability in the Australian Taxation Office or its named officers towards a taxpayer arising out of the lawful exercise of functions under the Income Tax Assessment Act."

[64] For example, similar views, strongly suggestive of the extreme judicial sensitivity to encroaching on statutorily imposed duties of the Commissioner, were plainly stated by Hill J in the equitable estoppel context in *AGC (Investments) Ltd v Federal Commissioner of Taxation* (1991) 91 ATC 4180, at 4195: "[T]here is no room for the doctrine of estoppel operating to preclude the Commissioner from pursuing his statutory duty to assess tax in accordance with law. The *Income Tax Assessment Act* imposes obligations on the Commissioner and creates public rights and duties, which the application of the doctrine of estoppel would thwart."

[65] In accordance with the approach taken by the High Court in *Re Minister for Immigration & Multicultural & Indigenous Affairs: Ex parte Lam* (2003) 214 CLR 1. Gummow and McHugh JJ stated in that case, at 21, that "…nothing in this judgment should be taken as … adoption of recent developments in English law with respect to substantive benefits or outcomes." The approach of Gummow and McHugh JJ is consistent with earlier High Court authority such as *Attorney-General (NSW) v Quin* (1990) 170 CLR 1.

[66] Sir Anthony Mason, "Procedural Fairness: Its Development and the Continuing Role of Legitimate Expectations" (2005) 12 *Australian Journal of Administrative Law* 103, 108. Another former High Court Chief Justice, Sir Michael Kirby has recently written a paper outlining the increasing influence of human rights law in Australia, but there is no evidence of such reasoning being applied in Australian tax cases to indicate that the revolution alluded to by Sir Anthony Mason has begun. See Sir Michael Kirby, "Australia's Growing Debt to the European Court of Human Rights" (2008) 34 *Monash University Law Review* 239.

Part III – Fair treatment of taxpayers as a legal rule – A blueprint for reform

The preceding analysis reveals a number of common challenges inherent in translating the moral duty to treat taxpayers fairly into an enforceable legal right which does not unduly impinge on the Revenue's tax administration duties to the Crown. This Part proposes a blueprint in the form of three recommendations for addressing these challenges. These recommendations are:

(A) An express legislative pronouncement on the issue;
(B) Extending the availability of compensation as a remedy for taxpayers treated unfairly; and
(C) Establishing mechanisms for independent oversight to monitor and sanction tax officials for unfair treatment of taxpayers.

Each of these recommendations is discussed in turn below:

Legislative pronouncement

It is evident from the analysis in the preceding Part that one of the primary impediments in the way of entrenching the moral duty to treat taxpayers fairly in enforceable legal rules is a judicial concern with interfering with the legislature and executive by imposing duties to taxpayers on the Revenue which are inconsistent with legislatively-imposed primary public duties to administer and collect taxes. The preceding analysis reveals that this concern is particularly prominent in Australia. This concern is evident both in Australian administrative law cases and private law cases involving claims of unfair treatment of taxpayers by tax officials.

However, this judicial concern with justiciability and offending the doctrine of separation of powers by imposing private law duties to individual taxpayers which might conflict with Revenue duties to the Crown is also evident in the reasoning of UK judges in considering claims of unfair treatment of taxpayers.[67] For example, in the UK, some judges have conceded that the duties of HMRC are owed exclusively to the Crown, hence judicial recognition of duties to individual taxpayers might be considered "subversive to the whole system"[68].

This is very similar reasoning to that often used by Australian judges to deny relief to taxpayers complaining of unfair treatment.[69] Further, the development of the doctrine of legitimate expectations in the UK requires judges to specifically weigh up private duties to taxpayers against the public responsibilities of the Revenue.[70] Inherent in such a weighing up are questions of justiciability and separation of powers which have deeply troubled many Australian judges.

[67] For discussion about the prevalence of such concerns in tax cases see John Bevacqua, 'Public Policy Concerns in Taxpayer Claims against the Commissioner of Taxation – Myths and Realities' (2011) 40 *Australian Tax Review* 10.
[68] Lord Wilberforce in *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 266. Cf the comments of Lord Scarman who, in the same case, at 280, directly rejected the suggestion that "the duty to collect 'every part of inland revenue' is a duty owed exclusively to the Crown."
[69] See, for example, the comments of Young CJ in *Lucas*, above fn. 61, (1979) 79 ATC 4081, reproduced above in the text accompanying fn. 63.
[70] As explained by Lord Woolfe MR in *R. v North and East Devon Health Authority Ex p. Coughlan* [1999] EWCA Civ 1871, at [57]. This explanation is reproduced above at fn. 27.

Despite these common threads of judicial concern, direct comparisons are difficult as the different constitutional frameworks and conventions in each country underpin the various judicial approaches. For example, in explaining the rejection of any administrative law recognition of a right to substantive fairness in Australia, it has been observed that:

> "...notions of 'good administration' and 'fairness' inform English administrative law. Australian administrative law reflects more of a separation of powers approach, perhaps influenced by the character of the Australian Constitution as a delineation of government powers rather than as a charter of citizen's rights."[71]

Similarly, the specific legislative frameworks establishing and regulating the ATO and HMRC also significantly influence the willingness and ability of courts to recognise legally enforceable rights to fair treatment of taxpayers. This fact also makes generalisations difficult. For example, UK judges are guided by the "care and management" provisions contained in section 5(1) of the *Commissioner for Revenue and Customs Act 2005*.[72] Australian judges have less legislative guidance but, as discussed in Part II, must be mindful of provisions such as the privative clauses protecting tax assessment decisions contained in sections 175 and 177 of the ITAA36.

Nevertheless, there is a clear lesson which can be extrapolated from the preceding analysis: the desirability of express and clear legislative guidance to assist courts to reconcile taxpayer rights to fair treatment with the Revenue's primary public tax administration and collection duties. A detailed and comprehensive legislative statement setting out when (if at all) taxpayers have a legal right to take action for unfair treatment by tax officials would enable judges to proceed with greater confidence as to the intent of the legislature than presently possible for judges in either the UK or Australia.

In Australia, the absence of express legislative guidance on these issues has seen judges consistently err on the side of caution by denying the existence of any enforceable taxpayer rights to fair treatment in almost every case in deference to unstated legislative intent to confine the duties of the Commissioner to the Crown.[73] This may at first seem counter-intuitive as it could be argued that a legislative vacuum such as that in Australia leaves scope for judges to fill that vacuum by confirming rather than denying taxpayers legal rights to fair treatment. However, this result depends on the prevailing judicial culture and the various degrees of judicial deference to the legislative law-making function. Most

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[71] Sir Anthony Mason, "Procedural Fairness: Its Development and Continuing Role of Legitimate Expectations" (2005) 12 *Australian Journal of Administrative Law* 103, 109. These comments echo the sentiments expressed by Gummow J in *Re Minister for Immigration and Multicultural Affairs ex parte Lam*, above fn. 66 at 24 where His Honour, in rejecting the recognition of the UK doctrine of legitimate expectations in Australia, observed that "a written federal constitution, with separation of the judicial power, necessarily presents a frame of reference which differs both from the English and other European systems ..."

[72] This subsection requires the Commissioners for Revenue and Customs to be responsible for the "collection and management of revenue". The Act imputes the same meaning on this phrase as in the express references to "care and management" contained in the *Taxes Management Act 1970* (UK) which was repealed in 2005 and replaced with the *Commissioner for Revenue and Customs Act 2005* (UK). This care and management requirement was a focus of significant judicial consideration in cases such as *Fleet Street Casuals*, above fn. 9, [1981] STC 260.

[73] See for example, the cases discussed above at fn. 61 to fn. 63.

Australian judges have not been willing to adopt the expansive approach to judicial activism advocated by Lord Scarman in *Fleet Street Casuals*:

> "Are we in the twilight world of "maladministration" where only Parliament and the Ombudsman may enter, or upon the commanding heights of the law? The courts have a role, long established, in the public law ... I would not be a party to the retreat of the courts from this field of public law merely because the duties imposed upon the Revenue are complex and call for management decisions in which discretion must play a significant role."[74]

Of course, the legitimate expectations cases in the UK show that many UK judges also do not share Lord Scarman's permissive attitude to judicial activism.[75]

This variability in judicial attitudes is natural. It also illustrates that the development of judicially recognised rights to fair treatment of taxpayers will necessarily be slower, more uncertain and more piecemeal than considered legislative action. Neither taxpayers nor the Revenue are likely to benefit from the uncertainty and cost associated with this type of incremental judicial development. Given the recognised link between voluntary taxpayer compliance and fair treatment, delay and uncertainty are especially insidious. Consequently, this fact also advances the case for clear and express legislative guidance on the question of taxpayer rights to fair treatment by tax officials. Judges in both Australia and UK would benefit from such guidance, as would Revenue officials, taxpayers and other tax administration system stakeholders.

A right to compensation for unfair treatment

A second recommendation for addressing the challenges in recognising taxpayer rights to fair treatment evident from the preceding analysis is the desirability of a taxpayer right to compensation for unfair treatment by the Revenue. There are a number of reasons for considering compensation as a particularly effective tool for striking an appropriate balance between ensuring fair and proper treatment of taxpayers and the public duties of revenue officials.

The primary reason is that an express right to damages would provide a more nuanced approach to dealing with the continuing separation of powers and other public policy concerns expressed by judges in taxpayer claims asserting unfair treatment at the hands of tax officials.

For example, there has been much debate in the UK and in Australia centred on the desirability of recognising a right to *substantive* fairness as distinct from a right to procedural fairness alone. The concern judges express in many such cases is that allowing substantive relief comes dangerously close to engaging courts in matters which offend the longstanding administrative law principle in both of those countries that judges do not engage in merits review.[76]

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[74] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 280.
[75] The various judicial approaches have resulted in the uncertainty as to the role of unfairness in judicial review proceedings in the UK, as discussed in the articles cited in fn. 26.
[76] For detailed discussion see Groves (2008), above fn. 28.

A more nuanced approach to such cases is possible if a right to damages for substantive unfairness is conceded.[77] Presently, courts in such cases typically respect any separation of powers and other administrative law policy concerns by not overturning the substantive discretionary decision of the Revenue in such a case even where the result would be patently unfair on the taxpayer. However, the same result could be achieved through leaving the Revenue's substantive decision unchanged but recognising resulting unfairness to taxpayers through an award of damages. Such an award could be considered a "price" for upholding the Revenue's stance. Fordham provides an example of how such a system might operate:

> "Take, for example, the situation of a 'substantive legitimate expectation', but where it is said to the Court that there is some 'overriding public interest' by virtue of which the State should be able to interfere with the expectation. It may very well be that, in such a case, the Court could … reconcile (a) the need to vindicate the claimant's expectation and (b) the public interest in the State defeating it, by ensuring reparation, as the 'price' for upholding the state action, whether offered to or exacted by the Court."[78]

Monetary compensation awards used in this way serve a dual purpose in that they can act as a "powerful incentive to improve service"[79] and treat taxpayers fairly without, strictly speaking, being directive in the sense of imposing changes in decisions or behaviour on the Revenue. The relevance of this distinction can be appreciated with an example utilising the facts in *David Jones*.[80] It will be recalled from Part II that in this case, the Australian Commissioner resiled from his usual practice of allowing inter-corporate dividend rebates. The taxpayer unsuccessfully argued that this was unfair and constituted an abuse of process by the Commissioner.[81]

Despite the apparent unfairness to the taxpayer, the Australian Court's decision has a logical appeal. For the court to have directed the Commissioner to revert to his previous practice would have been tantamount to restricting or fettering the Commissioner's legislatively sanctioned discretion in applying the tax laws.[82] The Court would have potentially faced the criticism of having overstepped its role and infringed the principles of justiciability and the underlying doctrine of

[77] Forsyth suggests that the availability of damages has been one of the reasons for the more expansive European approach to recognising substantive legitimate expectations. See Forsyth (1988), above fn. 43.
[78] Michael Fordham, "Reparation for Maladministration: Public Law's Final Frontier" (2003) 8 *Judicial Review* 104, 107.
[79] Office of the Commonwealth Ombudsman, Commonwealth of Australia, *To Compensate or Not to Compensate? Own Motion Investigation of Commonwealth Arrangements for Providing Financial Redress for Maladministration* (1999), 11.
[80] *David Jones*, above fn. 47, (1991) 21 ATR 1506.
[81] The factual similarity with the UK case of *Unilever*, above fn. 21, [1996] STC 681, is striking. It will be recalled from the discussion in Part I that the taxpayer succeeded in that case.
[82] Similar reasoning is applied in both Australia and the UK to generally deny the availability of an estoppel action against the Revenue. In Australia, the traditional position has been bluntly and concisely stated by Kitto J in *FCT v Wade* (1951) 84 CLR 105: "No conduct on the part of the Commissioner could operate as an estoppel against the operation of the Act." See also the comments of Wade J in *AGC (Investments) Ltd v FCT* (1991) 91 ATC 4180. The broader principle underlying this restrictive approach is known as the "non-fetter" principle that "government should not be shackled in exercising its power to make decisions in the public interest in the future." See Margaret Allars, "Tort and Equity Claims Against the State" in Paul Finn (ed), *Essays on Law and Government* (North Ryde: Law Book Company, 1996) Vol. 2, 49, 86. For further discussion of the non-fetter principle see Chris Hilson, "Policies, the Non-Fetter Principle and the Principle of Substantive Legitimate Expectations: Between a Rock and a Hard Place?" (2006) 11 *Judicial Review* 289; and Chris Hilson, "Judicial Review, Policies and the Fettering of Discretion" [2002] *Public Law* 111.

separation of powers. Accordingly, it is understandable that the Court left the taxpayer with no remedy.

However, if the option of an award of damages was open to the Court in *David Jones*, the result could have been very different. An award of damages in such a case could not be seen as a substitution of the Court's decision for that of the Commissioner. It would, however, place a "price" on the Commissioner changing his long-standing practices where such changes would unfairly cause loss to taxpayers. While the public expectation that a tax authority should be free to change its position in the public interest is respected, an award of damages recognises that the public may be best placed to bear the losses flowing from that freedom, rather than adversely affected individual taxpayers.[83]

Additionally, in a broader sense, the operation of compensation as a signalling mechanism for the boundaries of acceptable tax administration behaviour in such cases could be valuable for maintaining tax administration legitimacy.[84] A monetary remedy sends an unambiguous signal of disapproval of unfair tax administration activity.[85] This signal potentially plays an important role in taxpayers having confidence that the system of tax administration will operate within reasonable boundaries. This, in turn, will aid in fostering a climate of voluntary tax compliance.[86] Again, therefore, legislative reform aimed at recognising taxpayer rights to compensation for specific forms of unfair treatment by tax officials is worthy of serious consideration.[87]

Independent oversight and sanctions for unfair treatment

There is no lack of aspirational statements and informal, often self-administered systems, standards and guidelines aimed at ensuring fair treatment of taxpayers in the UK and Australia. As already noted, in both jurisdictions, Charter entitlements to fair treatment are recorded.[88] Further, service standards and other measures exist to measure compliance with these commitments to taxpayers.[89] These

[83] The utilitarian argument is that levying everyone to compensate for losses suffered by particular individuals increases the total good. Cohen discusses this argument at length. See David Cohen, "Suing the State" (1990) 40 *University of Toronto Law Journal* 630, 644-645.
[84] The legitimacy argument has long been recognised in the US – see, for example, Bernard Schwartz, *An Introduction to American Administrative Law* (New York: Oceana Publishing, 1962), 218.
[85] Writers such as McBride, Roots and Fordham make this point in calling for the availability of damages awards in administrative review proceedings – see Jeremy McBride, "Damages as a Remedy for Unlawful Administrative Action" (1979) 38 *Cambridge Law Journal* 323; Lachlan Roots, "A Tort of Maladministration: Government Stuff-Ups" (1993) 18 *Alternative Law Journal* 67, 71; and Michael Fordham (2003), above fn. 78.
[86] As confirmed in numerous studies including those noted above at fn. 8.
[87] It is beyond the scope of this article to formulate a specific statutory damages remedy. However, an example of a general monetary compensation remedy for loss caused by tax official wrongs is formulated and presented in John Bevacqua, *Taxpayer Rights to Compensation for Tax Office Mistakes* (Sydney: CCH, 2011).
[88] See for example, the commitments referred to above at fn. 3 – fn. 5.
[89] For example, the Australian Taxation Office has shown an increasing concern with responsiveness benchmarks which strongly indicate a taxpayer service-oriented attitude. See Australian Taxation Office, "Our Service Standards" available at http://www.ato.gov.au/corporate/distributor.aspx?menuid=0&doc=/content/25940.htm&page=2#P24_2573 [Accessed 1 February 2013]; and Australian Taxation Office, *Annual Report 2010-11* (2011). Further, it has close to 50 consultative forums with taxpayers, professionals and other stakeholders. See Australian Taxation Office, "Stakeholder Consultation Overview" available at http://www.ato.gov.au/corporate/content.asp?doc=/content/00131220.htm&mnu=430198mfp=001 [Accessed 1 February 2013]. This is also a strong indicator of the perceived importance of providing good and fair service to taxpayers. Similarly, in the UK, HMRC are currently producing a performance management system. It has produced a business plan as part of its performance management system which describes its vision as including making taxpayers "feel that the tax system is...even-handed..." HM Revenue & Customs, "Business Plan 2011-2015" available at http://www.number10.gov.uk/wp-content/uploads/2011/01/HMRC-Business-Plan.pdf [Accessed 21 April 2012], 1. Similar commitments are made in HM Revenue & Customs, "HMRC Service Standards for Excise, Customs, Stamp Taxes and

guidelines and standards are an important cog in ensuring fair treatment of taxpayers and should not all be enshrined in legislation enforceable by taxpayers against the Revenue. It is undesirable to allow taxpayers to recover compensation in every conceivable instance of unfair treatment.[90] As Lord Wilberforce observed in *Fleet Street Casuals*, "the income tax legislation contains a large number of anomalies which are naturally not thought to be fair by those disadvantaged."[91] Further, in practical terms it would be impossible to objectively judge every instance of fair treatment encapsulated in value-laden concepts such as "courtesy" and "politeness" which are often referred to in Revenue service charters and guidelines.[92]

However, it is possible to devise legal rules which make revenue authorities accountable and incentivise revenue authorities to treat taxpayers fairly which do not create any commensurate taxpayer avenues of relief for unfair treatment. Such laws are an essential third limb of any attempt to translate taxpayer moral rights to fair treatment into legal rules. Precedents for devising such laws already exist. For example, the US Congress has enacted a number of provisions which might serve as a useful template for Australian and UK lawmakers.

The US Congress has enacted legislative provisions expressly requiring tax official performance of Internal Revenue Service (IRS) employees to be measured by reference to fair and equitable treatment of taxpayers.[93] Further provisions charge the US Treasury Inspector General for Tax Administration with the task of annually evaluating IRS compliance with this obligation, ensuring a high level of accountability.[94] Congress has also enacted a list of "ten deadly sins"[95] which requires the IRS Commissioner to terminate the employment of any employee on misconduct grounds in cases of proven commission of one or more of these "sins". This also provides further specific and real incentives for tax officials to treat taxpayers fairly.[96]

Money Services Customers" available at http://www.hmrc.gov.uk/customs/ecsm-service-standards.pdf> [Accessed 1 February 2013], 3.

[90] The filing of frivolous lawsuits may well ensue. Such a concern led one judge in the US to observe that "filing of frivolous lawsuits merely to protest the assessment of federal income tax has become a new and unpleasant indoor sport" (*McKinney v Regan* 599 F.Supp. 126, 129-30 (M.D. La. 1984)); similarly, the filing of such suits has been judicially described as a vampire requiring a sharpened stake to kill it (*United States v Craig*, 73 A.F.T.R.2d 1099 (D.N.D. 1994)).

[91] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 266.

[92] See, for example many of the commitments contained in the list of commitments under the heading of fairness and reasonableness contained in the Australian Taxpayers' Charter and reproduced above at fn. 3.

[93] Specifically, section 1204(b) of the *Internal Revenue Service Restructuring and Reform Act of 1998*, Pub L No 105-206, 112 Stat 685 (1998) directly requires IRS managers to "use the fair and equitable treatment of taxpayers by employees as one of the standards for evaluating employee performance."

[94] Section 7803(d)(1)(2000) of the US Internal Revenue Code requires the Treasury Inspector General for Tax Administration to annually evaluate whether the IRS has complied with section 1204(b) of the *Revenue Service Restructuring and Reform Act of 1998*, Pub L No 105-206, 112 Stat 685 (1998).

[95] Section 1203 of the *Revenue Service Restructuring and Reform Act of 1998*, Pub L No 105-206, 112 Stat 685 (1998) requires the Commissioner of Internal Revenue to terminate the employment of any employee on misconduct grounds if there is a final administrative or judicial determination that the employee committed one or more of a range of ten infringements of taxpayer rights including infringement of a taxpayer's Constitutional rights and a range of other civil rights, violations of tax laws and IRS policies in order to harass a taxpayer and a range of other wilful or personally motivated activities adversely affecting taxpayers. These have become known as the "ten deadly sins."

[96] The Australian regulation of tax official fair treatment of taxpayer provides a stark contrast to the US approach. In *Commissioner of Taxation v Futuris Corporation Ltd* above fn. 60, (2008) 237 CLR 146, the High Court made reference to the requirement that tax officials, as members of the Australian Public Service act with care and diligence, honesty and integrity in accordance with the *Public Service Act 1999* (Cth). Australian tax officers, as members of the Australian Public Service are, indeed, required to act in accordance with Australian Public Service values and standards of conduct. These are set out in the *Public Service Act 1999* (Cth) and *Public Service Regulations 1999* (Cth). Further, section 13 of the Public *Service Act 1999* (Cth) contains the Australian Public Service Code of Conduct which emphasises the need to deliver "services fairly, effectively, impartially and courteously to the Australian public." (See Australian Public Service Commission, "APS Code of Conduct" available at http://www.apsc.gov.au/aps-employment-policy-and-advice/aps-values-

These enactments provide a particularly pertinent starting point for formulating similar rules in the UK and Australia given the judicial concern in both jurisdictions that entrenching a right to fair treatment through providing taxpayers with avenues of relief against the Revenue might create inconsistencies with the public duties the Revenue. This is because provisions such as these focus on incentivising tax officials to treat taxpayers fairly without directly disturbing any specific Revenue decision concerning any particular taxpayer.

CONCLUSION

This chapter has not sought to pass judgment on the effectiveness of laws for ensuring fair treatment of taxpayers in either Australia or the UK. However, it is clear that in each jurisdiction the current approach is neither perfect nor complete. This is unsurprising because taxpayer rights to fair treatment at the hands of tax officials will always be the subject of a delicate balancing exercise between the private interests of individual taxpayers and the public interest in ensuring that the vital tax administration function is not unduly obstructed or fettered.

Consequently, assessments as to the adequacy of protection of taxpayer rights to fair treatment necessarily involve value-laden judgments of how to resolve the trade-off between these competing interests. These judgments will evolve and shift over time.[97] Further, final determinations must be considered in the context of the constitutional and political framework in which the relevant decision-makers operate.

None of these facts, however, are sufficient reasons for law-makers to shy away from the issue entirely. Legislators and judges are regularly faced with having to make difficult trade-offs between public and private interests.[98] The preceding analysis demonstrates that both in the UK and Australia legislators have not taken up the challenge of weighing up these competing interests. The result in both countries has been that the judiciary has been left with this responsibility.

UK judges, by developing the doctrine of legitimate expectations, have shown a greater willingness to accept this responsibility than Australian judges. Arguably, the increasing influence of the HRA and the recognition of the doctrine of legitimate expectations under European Union law has aided in fostering this judicial receptiveness in the UK. By comparison, Australian judges have been less willing to set precedents which recognise taxpayer fair treatment as more than a mere moral duty on tax officials. The difference in judicial approaches is at least in part explained by the differing constitutional and legislative frameworks of the two countries. However, neither country is far advanced along the path to

and-code-of-conduct/code-of-conduct [Accessed 1 February 2013]. However, the only sanction for breach of the Code is contained in section 15 which provides for a number of possible employee sanctions including possible termination of employment, reprimand, demotion or reduction in salary. In contrast with the US system, there is nothing in this legislation which requires independent oversight of public official compliance with these requirements or which *compels* managers to terminate the employment of officials for particular breaches of the Code.

[97] As Bentley has noted "[e]ssentially taxation can be seen as a barometer of the *developing* balance between State and individual rights." (emphasis added). See Duncan Bentley, *Taxpayers' Rights: Theory, Origin and Implementation* (Alphen aan den Rijn: Kluwer, 2007), 15.

[98] As one author has generally noted: "If all such political 'hot potatoes' were to be deemed unsuitable for judicial scrutiny the administrative law casebooks would be slim volumes indeed." Chris Finn, "The Justiciability of Administrative Decisions: A Redundant Concept?" (2002) 30 *Federal Law Review* 239, 249.

translating the moral duty of tax officials to treat taxpayers fairly into a clear and certain legal right.

This chapter has set out three recommendations for effectively translating the moral duty to treat taxpayers fairly into enforceable legal rules and injecting a degree of clarity and certainty in both jurisdictions. Only one of these recommendations directly centres on providing taxpayers with enhanced formal avenues of relief for unfair treatment – the recognition of a limited right to compensation for unfair treatment. Of the remaining two recommendations, one calls for a statutory pronouncement of taxpayer rights to fair treatment. The second calls for legal rules aimed at providing independent oversight and real incentives for tax officers to treat taxpayers fairly, akin to those in countries such as the US.

The aim of these recommendations is not a *per se* increase in taxpayer ability to successfully sue tax officials in cases of unfair treatment – the desirability or otherwise of such an increase is a matter for the UK and Australian legislatures. Instead, the primary objective is to break the legislative silence in order to assist judges to resolve many of the public policy difficulties which have troubled judges in considering cases concerning claims of unfair treatment by tax officials.
While the challenge of striking the appropriate trade-off between taxpayer rights to fair treatment and the public duties of tax officials will always be a difficult one, these three recommendations provide a useful starting point for proactively and directly addressing the issue. By acting directly and proactively in this way we can at least start the search for an answer to the question posed by Lord Scarman about the obligation to treat taxpayers fairly: “Is it a mere moral duty, a matter for policy but not a rule of law?”[99]

[99] *Fleet Street Casuals*, above fn. 9, [1981] STC 260, 280.

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Conference Commentary: Improving Tax Administration through Research Driven Efficiencies.

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The Internal Revenue Service (IRS) and the Tax Policy Center (TPC) conference on Improving Tax Administration Through Research-Driven Efficiencies was held at the Urban Institute, Washington, D.C., on June 18, 2015[2]. As with the previous conferences organized annually by IRS and TPC, the presenters and the attendees were primarily researchers from academic and independent research institutions, research divisions of tax administrations, as well as tax practitioners and tax law specialists. The participants were greeted by Eric Toder, a Co-Director of the TPC, Alain DuBois, an Acting Director of the IRS Office of Research, Analysis, and Statistics (RAS), and John Koskinen, the IRS Commissioner. Twelve original research papers were presented and discussed in four thematic sessions.

The first session, on the Innovative Methods for Improving Resource Allocation, brought together three conceptually and technically distinct methodologies aimed at measurement and improvement of the effectiveness of tax audits by better targeting.

Alan Plumley (IRS, RAS) presented an empirical estimation of marginal revenue-to-cost functions for a number of categories of correspondence audits of tax returns conducted by the IRS over 2006-2010. For a given amount of audit resources the maximal audit efficiency (in terms of the net direct revenue) is achieved when the marginal revenue-to-cost ratio is equalized across all audit activities (assuming that any possible resource constraints on separate activities are not binding, and that strictly positive amount of resources is allocated to each activity). The authors demonstrated that an efficient allocation of audit resources could deliver an estimated $190 million of additional direct enforcement revenue annually for these tax years. The calculation ignored the indirect, deterrence effect, or the behavioural response of taxpayers to the changes in audit targeting, and any non-monetary effects, but it gives a useful benchmark.

In the study presented by Jeff Wilson (Taxpayer Advocate Service) the researchers investigated how the rate of collection of underpaid tax changes over time subsequent to the issuance of a delinquency notice. A striking result is that money collected typically falls by 50 per cent from year 1 to year 2, and by further 30 per cent from year 2 to year 3; furthermore, the most successful collections are from accounts with relatively small liabilities, $5000 or less, and with self-reported liabilities. Therefore, the research suggests improving efficiency in resource allocation by tagging the most "productive" delinquent accounts and collecting the tax due quickly.

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[2] Presentations and related material can be found at http://www.taxpolicycenter.org/events/tpc-irs-conference-2015.cfm

The third paper, presented by Shannon Chen (PhD student, UT Austin), explored how social network analysis (SNA) techniques can be used to identify legal entities with higher tax compliance risk. The underlying idea is the following: in a given industry, firms are characterized by a certain degree of complexity which can be measured using SNA tools. An unusual value of some measure, or an outlier, could then indicate a structure created to facilitate financial flows leading to deficiencies in tax compliance. The authors estimated a regression with detected deficiency as dependent variable and firm characteristics as explanatory variables, including the network measures (density, diversity, degrees of centrality, etc.), in addition to the standard economic measures (assets, income, etc.). Some network measures were found to be associated with higher compliance deficiency. This suggests a method of flagging up and targeting for audits the “outlier” firms.

In the second session three studies were presented under the headline of Taxpayer Responses to Rules and Enforcement. The common approach was to explore the links from the determinants of the current taxpayer behaviour, or the rules, to audits, from audits to the taxpayer responses, and from responses to the future rules. The first two papers focussed on large businesses, and the third paper on small business and self-employed.

Erin Towery (University of Georgia) presented an investigation of the deterrence effect of audit certainty for the large firms assigned to the Coordinated Industry Case (CIC) programme of the IRS. The IRS uses a point scheme to select the firms for CIC, with the main determinants being the size and complexity, as suggested by the study. The firms assigned to CIC are monitored by the IRS team until the IRS decides this is no longer needed. A typical model of strategic tax compliance assumes that a taxpayer conditions its actions on a belief about the probability of audit. While in a programme such as CIC the audit is certain, a taxpayer may or may not believe that it will uncover its true tax liabilities, and, therefore, may respond with less or more aggressive tax planning. The authors found that the firms assigned to the programme tend to increase tax reserves, indicating a change in expectations regarding future tax payment, but there was no significant deterrence effect of the programme on tax avoidance.

In the second paper, presented by Lisa Rupert (IRS), the authors explored the patterns in the tax return data for the citations on the Uncertain Tax Position Statement (UTP) schedule. The five most commonly cited IRS sections are transfer pricing, research and development credit, trade or business expense, domestic production activities deduction, and capitalized cost. The study provides a comparison of characteristics of the UTP filers and non-filers, and those of UTP-filing firms citing or not citing different sections, for 2011-2012, and concludes that quantitative models can be developed to help IRS with the selection of returns. An interesting question is about the strategic response of the firms: how will the use of the UPT citation patterns for return selection alter the UTP reporting strategies?

The third paper, presented by Saurabh Datta (IRS), investigated how the IRS resources can be used more efficiently in the collection of delinquent taxes, where taxpayers failed to file returns. Specifically, after a series of reminders, the IRS can file a so-called substitute for return, based on the information obtained from other sources and from the previous year, and many such assessments are done within the Automated Substitute for return (ASFR) programme. The authors investigated the effect of the ASFR assignment on collected tax and on the future voluntary filing compliance in the subsequent two to four years. The estimated regression results suggest significant positive and stable effect of ASFR. The estimated model was used to simulate the response of a sample of 1000,000 taxpayers randomly selected from those not assigned to ASFR to a hypothetical assignment in 2009. The additional tax collected per case (direct effect) was estimated to exceed the cost of treatment by the factor of 40 ($3,262 vs $80), and the subsequent increase in voluntarily filed returns (indirect effect) was estimated at 0.19 in 2010, 0.25 in 2011, and 0.29 in 2011 per case. Important issues are the prioritization, or how the taxpayers are selected for ASFR, and the comparison of the cost-effectiveness of ASFR with that of other similar programmes.

In her keynote speech Professor Lillian Mills (UT Austin) talked about the advantages of bringing together research and institutional knowledge in tax compliance. She emphasized the importance of the ease of enforcement for the academic view on tax changes, in addition to the traditional focus on economic efficiency. As another pressing challenge for research in tax administration Professor Mills mentioned a sensible estimation of the tax gap.

The third session, on Improving Tax Administration by Understanding Taxpayer Behaviour, presented studies based on a field experiment (Marco Hernandez, World Bank), on a survey (Mackenzie Wiley, IRS), and on a combination of a lab experiment and a survey (Ariel Wooten, IRS). The common feature of these three studies was an attempt to understand psychological reaction of individuals to various ways of delivering information by tax authorities and to identify the best means of improving compliance as well as the quality of services provided by tax administration to taxpayers.

In the first study the researchers investigated the effect of wording in the letters sent to delinquent taxpayers on behalf of the Guatemalan Tax Authority (GTA). The taxpayers (over 23 thousand individuals or firms) were randomly allocated to receive no letter, the standard GTA letter, or one of four adapted versions of the GTA letter. In the adapted versions non-compliance was framed either as an oversight, or as an intentional and deliberate choice, and an additional message was included either calling to join the compliant majority (social norm) or to be a good citizen and support own country (national pride). The letters citing deliberate choice and social norm appeared to have significant and persistent positive effect on the rate of payment and the amount paid conditional on payment. The authors' estimate of the additional revenue that would have been generated by sending the social norm letter to all taxpayers in the sample was $760,000, or 36 times the cost of sending the letters. In the absolute terms this might be rather a small amount; also, a look at the disaggregated data (who paid and how much) rather than the average could provide an additional insight into the behavioural responses. An interesting question is about the interpretation of the social norm statement: the compliant majority quoted in the letter was 64.5 per cent, suggesting that over a third of taxpayers do not comply. The effect of a similar statement in a country with different cultural background might well be the opposite.

The aim of the second study was to understand taxpayers' preferences over the less expensive digital communication channels for IRS services traditionally provided over the telephone or by regular mail, or in person at a local IRS office. The survey respondents were asked to choose from a list the channel they would prefer for each of the following six services: "submit documentation", "status of a case/transaction", "information about a notice received/case details discussion", "set up a payment plan", "request an extension". The channels included, in addition to a toll-free live or automated phone assistance, regular mail, or a visit to a local office, a number of digital communication products, such as the IRS website – interactive tool, smartphone application, secure message or online chat, automatic e-mail or text message; not all channels were offered for each service. The study also investigated the demographic profiles (age, return preparation method, previous channel use and previous post-filing contact) associated with preferences for a particular channel. The authors found that getting the status of a case has the higher potential for migration to digital channels, and that secure message was preferred to other channels for all services where it was offered as one of the alternatives, whereas there was an almost uniform preference to shift away from the phone. Demographic differences were stronger for some services and channels and weaker for others. The study, however, did not provide any estimates of cost savings for hypothetical migration. One important related issue is whether switching makes compliance cheaper for both sides or shifts the compliance cost onto the taxpayers. Among other concerns mentioned during the discussion were the potential data breach in digital communications and the fact that, according to the study, about two-third of taxpayers needed some help with complying.

The third study investigated a specific and very interesting situation arising from the decision to assign the task of implementing the Affordable Care Act (ACA, also known as "Obamacare") to the IRS. The researchers recruited 119 individual and small business taxpayers to participate in a lab experiment and in a subsequent discussion of their experience and expectations in focus groups. In the lab the participants were presented with hypothetical situations involving compliance with and tax implications of ACA, where they had an option to use an automated phone line newly developed by the IRS for ACA inquiries. The results of this qualitative study are potentially useful for improvement of other IRS services provided by the IRS toll-free telephone lines; however, as noted in the discussion, a survey of taxpayers with actual, rather than lab, experience in ACA inquiries could provide an additional insight in taxpayers' needs. Also, if, according to the previous presentation, for many services telephone assistance is the one most likely to be abandoned given a set of digital communication alternatives, there is, perhaps, a case for considering alternatives for ACA help services as well, before the IRS is locked into an expensive, and potentially far from the most preferred by taxpayers, system.

The final session, with the headline of Helping Taxpayers Get it Right, brought together two studies of the Earned Income Tax Credit (EITC) claims, presented by Patricia Tong (Treasury Office of Tax Analysis) and Elaine Maag (The Urban

Institute), and a study of the effect of recent changes in the IRS regulation of the paid preparer industry, presented by Karen Masken (IRS Return Preparer Office). The common motivation was the complexity of the existing system of tax benefits, where differentiated tax treatments are used to support incomes or incentivize certain behaviours. There is evidence that because of the complexity not all targeted taxpayers understand how correctly to claim benefits, and those using paid tax preparer benefit the most.

In the first study the researchers investigated how military personnel taxpayers use the non-taxable combat pay election (NCPE) in calculation of their EITC. Military service members do not pay tax on any income earned while in combat zone, which results in the reduction of EITC for low incomes. However, since 2004 taxpayers can choose to include some or all of their non-taxable combat pay in EITC (by default it is excluded). An optimizing taxpayer would calculate EITC with and without NCPE to determine the optimal amount of earnings to exclude under NCPE. According to the study, in 2009 about 82 per cent of taxpayers in the sample of 1 million (representing 30 per cent of military service members with non-taxable combat pay) optimized their EITC, with the optimization rate being higher for those using paid tax preparer. Importantly, taxpayers who would benefit from NCPE provision and did not use tax preparer were the least likely to exercise the NCPE option correctly and also had the lowest average income. The authors conclude that NCPE provision increases the complexity of the tax code while benefitting only a small fraction of the military service members.

The second study investigated the links between the errors in the EITC claims and in the Supplemental Nutrition Assistance Programme (SNAP) benefits claims in Florida. This was part of a follow-up of a large project commissioned by the Office of Management and Budget (OMB) on how data can be used across agencies to help reduce over- and under-payments of benefits under various programmes. In this example, because of a certain overlap between EITC and SNAP recipients, SNAP data was used as a potential third-party source for IRS to verify the residency of children of EITC claimants, - an important piece of information, since the largest proportion of EITC over-claims is related to errors with including children who do not meet the residency requirement. The researchers find that SNAP data may help IRS to select post-refund audit cases when "childless" EITC is erroneously claimed by workers with a qualifying child, and to identify eligible non-claimants.

The focus of the final presentation was on the compliance of paid tax professionals who prepare individual income tax returns. The behaviour of tax preparers is largely overlooked in the theoretical literature on tax compliance, although it is recognized that certain regulation and oversight of the preparer industry can improve compliance of their clients. Similarly, in practice the focus of the IRS and other tax authorities was primarily on taxpayer-level treatment, and the effect of preparer-level treatments has not been studied. As part of the new regulations introduced in 2010, aiming to improve industry standards, from 2011 all individual tax returns prepared by paid professionals must show the preparer's tax identification number (PTIN) obtained by registering with IRS. A multi-year study of the effect of various treatments on preparer compliance started in 2012. The results of investigation of two items, Schedule C Net Income returns (a source of about 30 per cent of the individual income tax gap, with large proportion of errors in paid prepared returns) and Additional Child Tax Credits (ACTC, where the majority of claims are prepared by about 1 per cent of paid preparers), were presented. The goal was to identify the cost effectiveness of targeted treatments, such as visits and letters, for different segments of preparer population. The researchers found that for Schedule C preparers all three treatments studied (educational visits, due diligence letters, and continuing education letters) were effective. Letters were, overall, less effective but considerably less costly than visits. For ACTC both treatments studied (letters explaining the use of the relevant schedule, with and without emphasis on a particular provision) were found to be effective. However, the study did not report the size of the effect of these treatments on tax gap, and there was no information on the background characteristics of the selected preparers.

Overall, the range of research questions and methods under the common headline of improving efficiency demonstrated, first, close attention of tax authorities to academic research in taxation and tax administration and, more widely, in economics and other social sciences, and, second, understanding of mutual benefits of communication and collaboration between academics and tax authorities. For understandable reasons, the main, all be it not exclusive, focus of the conference was on the U.S. context.

It seems natural to expect that with growing needs to co-ordinate the efforts of national tax authorities in globalized economy this and other similar conferences will broaden their scope and attract wider international participation.

Review of Recent Literature

Adnan Isin[1]

This section provides a brief review of selected peer-reviewed publications (2015) that investigate aspects of taxpayer and tax authority relations. It does not purport to be comprehensive, but rather gives a flavour of the variety of research studies from around the world. They are presented under broad headings, and in no particular order within those headings. The papers summarised here come from a variety of disciplinary backgrounds including economics, psychology, law and public policy.

Tax Compliance

Alm, Bloomquist and McKee (2015) - On the External Validity of Laboratory Tax Compliance Experiments

In this paper the authors examine the issue of external validity of the studies that use laboratory experiments to derive conclusions about tax compliance. They show that the behavioural patterns of subjects in the laboratory conform to those of individuals making a similar decision in naturally occurring settings. Moreover, they also find that the behavioural responses of students are largely the same as those of nonstudents in identical experiments.

Castro and Scartascini (2015) - Tax Compliance and Enforcement in the Pampas Evidence from a Field Experiment

This paper describes a large field experiment in Argentinian property tax to evaluate how the compliance behaviour of taxpayers varied according to their beliefs regarding the levels of enforcement, reciprocity, and peer-effects. The authors show that introducing messages in the tax bill might be an effective way of influencing taxpayers' behaviour albeit with an observed heterogeneity of taxpayer responses to different messages. The results indicate that the most effective was the deterrence message that listed the actual fines and potential administrative and judicial steps that the municipality might follow in the case of non-compliance. Specifically, the authors estimate that the probability of compliance by a taxpayer that received the deterrence message is 5 percentage points higher than for an individual in the control group.

Kosonen and Ropponen (2015) - The Role of Information in Tax Compliance: Evidence from a Natural Field Experiment

The authors examine unintentional mistakes in VAT tax returns and whether providing information about the tax rules improves reporting. Using a natural field experiment, the authors show that informing taxpayers about tax rules reduces mistakes significantly.

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Kasper, Kogler and Kirchler (2015) - Tax policy and the news: An empirical analysis of taxpayers' perceptions of tax-related media coverage and its impact on tax compliance

In this paper, using a survey-based experiment, the authors examine how actual media representations of tax authorities' trustworthiness and power impact intended tax compliance. The authors find evidence supporting a link between trust, power and intention to comply in a real-world setting, as opposed to hypothetical settings used in previous research.

Thomas (2015) - The Psychic Costs of Tax Evasion

In this paper the author suggests increasing the "psychic cost" of tax evasion as a way of generating more tax revenue. She draws on studies that find people experience some form of psychological discomfort when they are dishonest, which may deter them from cheating and proposes employing subtle behavioural interventions that encourage more honest tax reporting by raising the level of psychological discomfort experienced from underreporting.

Timmesch (2015) - Testing the Models of Tax Compliance: The Use-Tax Experiment

This paper examines non-compliance with US state level use taxes, a type of sales tax payable when purchases are made without payment of sales tax, most usually from online vendors. The author argues that non-compliance costs states up to US$20bn a year. The author makes a case for applying the modern tax compliance theories to promote individual compliance with state use taxes, instead of assuming they are unenforceable.

Devos and Zackrisson (2015) - Tax Compliance and the Public Disclosure of Tax Information: An Australia/Norway Comparison

This paper presents and analyses the strategies adopted by tax authorities globally and specifically in Australia and Norway, regarding the public disclosure of tax information and its likely compliance impact. The authors argue that public disclosure of taxpaying information, in addition to traditional compliance strategies, is potentially useful in improving compliance in Australia. The paper outlines a number of ways additional tax information disclosure could improve overall tax compliance but notes that more empirical studies are needed, preferably with tax authority involvement.

Casagrande, Di Cagno, Pandimiglio and Spallone (2015) - The Effect of Competition on Tax Compliance: The Role of Audit Rules and Shame

The authors conduct a laboratory experiment using students and test two alternative audit rules, random and targeted to those reporting lowest incomes. They show that competition between taxpayers induces more compliance - ceteris paribus tax revenues are higher under the strategic audit rule than under the random one. Authors also test the effects of "name and shame" strategies and show that such strategies reinforces competition but play no significant role on its own.

Tax morale

Andriani (2015) - Tax morale and prosocial behaviour: evidence from a Palestinian survey

This paper use a unique public opinion survey conducted in West Bank and Gaza Strip among Palestinians in 2007 and empirically investigates the relationship between prosocial behaviour and tax morale in the context of state capacity building. The authors use the notions of "public spirit" - a positive attitude adopted by citizens for the benefit of the community and "associational activity" - individuals' engagement in voluntary activities, as two major expressions of prosocial behaviour and estimate their impact on Palestinians' 'tax morale' (intrinsic motivation to pay taxes). They show that tax morale increases with public spirit but it is lower among Palestinians involved in associational activities.

Blaufus, Braune, Hundsdoerfer and Jacob (2015) - Self-serving Bias and Tax Morale

Using a laboratory experiment with student subjects, the authors test the assumption that tax morale arises independently of the individuals' economic situation. The paper shows that self-serving bias plays an important role where individuals with the opportunity to evade taxes consider tax evasion less unethical compared to those without this opportunity. These findings indicate that self-serving bias is observable regardless of the economic conditions.

Lisi (2015) - Tax Morale, Tax Compliance and the Optimal Tax Policy

This paper seeks to incorporate behavioural aspects of compliance into optimal tax policy debates. Using theoretical modelling, it is shown that tax authority monitoring is effective at increasing tax compliance in the case of tax evaders and maintaining the right balance of compliance in the case of honest taxpayers. The paper suggests imposing stricter penalties on dishonest taxpayers and alleviating the tax burden on honest taxpayers.

Thomas (2015) – The Psychic Cost of Tax Evasion

This paper argues that the standard theory under which policymakers should be able to reduce tax evasion by increasing tax penalties, raising the audit rate, or some combination of the two has proven ineffective that the government continues to lose hundreds of billions of dollars in tax revenue due to underreporting by individual taxpayers. Acknowledging the budgetary limitations and political hurdles faced by the IRS the author recommends implementing penalties that would produce psychological discomfort on tax under-reporting by dishonest tax payers. He suggests structuring tax filing process in a way that would emphasize the existence of penalties with such "psyhic" costs.

Shadow Economy and evasion

Viren (2015) - Why So Little Revenues are obtained from a presumed large shadow economy?

This paper examines the gap between very high estimates of the size of the shadow economy and the small amount of government revenue that is obtained by means of tax inspections and regulatory activities. Using tax audit data from Finland the author shows that the actual size of shadow economy is much smaller than is publicized and present it as one of the most important reasons why actions taken by the Finnish government to curtail the shadow economy are disappointing.

Seidel and Thum (2015) - Tax Evasion, Corruption and Market Entry

This paper develops an economic model of the impact of tax policy on firms' market entry and on tax revenue in the presence of corruption when firms can evade taxes. The authors show that if bribers are exogenous, stricter enforcement of taxation lowers market entry which leaves the government with a trade-off between market entry and tax revenues. On the other hand, if bribes are endogenous, stricter enforcement can result in more market entry and more tax revenues.

Schneider, Raczkowski and Mróz (2015) - Shadow Economy and Tax Evasion in the EU

This paper reviews a variety of studies and identifies some 17 shadow economy research areas that could usefully be studied as interdisciplinary projects. The authors conclude that the main driving forces of the shadow economy are indirect taxes followed by self-employment and unemployment.

Benk, Budak, Püren and Erdem (2015) - Perception of Tax Evasion as a Crime in Turkey

Using a survey of 475 self-employed respondents, the paper investigates Turkish taxpayers' perception of the severity of tax evasion relative to other crimes and violations. The authors show that tax evasion is ranked 10th among the 21 offences surveyed. These results indicate that the average person views tax evasion as only somewhat serious, ranking less severe than accounting fraud. It seems that the general public in Turkey do not perceive tax evasion as a serious crime, which together with poor enforcement, has created an environment where some individuals may not be afraid to cheat.

Hard to tax sectors

Huang (2015) - A Study in Compliance: The Taxation of Virtual Economies

This paper looks into the gaming industry and investigates the economic magnitudes of transactions that are facilitated by digital platforms such as mobile apps and games. The taxation of such virtual economies is an important and an emerging issue both from tax policy and administrative perspective. To conceptualize, World of Warcraft, an online multiplayer game created in 2004, have reached US$1.04bn in revenues from over 10 million subscribers. The author argues that the IRS loses a significant amount of potential tax revenue to such transactions and recommends the application of withholding taxation as the most efficient way to capture lost tax revenue from the sale of virtual assets for real dollars.

Tax Complexity

James, Sawyer and Wallschutzky (2015) - Tax simplification: A review of initiatives in Australia, New Zealand and the United Kingdom

This paper considers the role of tax simplification in the operation of a tax system as a whole and then analyses developments in Australia, NZ and the UK. The paper focusses on three aspects: simplifying tax law, taxpayer communications and tax administration. The authors suggest that establishing some form of independent authority may enable effective simplification in the three jurisdictions reviewed, but call for further research into tax simplification.

Borrego, Loo, Lopes and Ferreira (2015) - Tax professionals' perception of tax system complexity: Some preliminary empirical evidence from Portugal

This paper analyses tax professionals' perception of tax complexity in Portugal The authors seek to determine the dimensions of causes of tax complexity and create indices of these causes. They also aim to identify the factors that could influence the level of tax complexity. This paper presents the results collected from 994 questionnaire responses. The survey findings concluded that professionals perceived three dimensions of causes of tax complexity: legal complexity; complexity of information preparation and record keeping; and complexity of tax forms. Exogenous factors include tax knowledge and size of companies.

General Tax Administration

Forman and Mann (2015) - Making the Internal Revenue Service Work

This paper makes suggestions as to how to redesign the federal tax system so that the Internal Revenue Service (IRS) can administer it more effectively given limited available resources, which weaken its enforcement capability. The authors' recommendations include simplifying the tax system, enhancing third-party reporting, and streamlining tax-filing and dispute-resolution procedures.

Browde (2015) - Many Unhappy Returns: The Need for Increased Tax Penalties for Identity Theft-Based Refund Fraud

This paper investigates identity theft-based refund fraud and analyses the inadequacy of existing law to solve the problem. IRS efforts to address the issue include committing resources to assisting victims, updating detection and prevention mechanisms, and increasing criminal investigations and prosecutions.

The IRS's approach and pending proposed legislation are not enough to address the problems created by identity theft-based tax fraud. Accordingly the author recommends enhanced criminal penalties and a new civil penalty for offenders.

Brand, Hodson and Sawyer (2015) - South East Asian tax administration issues in the drive to attract foreign direct investment: Is a regional tax authority the way forward?

This paper examines the relation between foreign direct investment (FDI) and tax administration, an area that is largely neglected by the literature. Authors show that tax administration is a consideration evaluated by foreign investors when making FDI decisions, hence it is in the interests of both parties to resolve tax administration problems such as corruption, inadequate dispute settlement, and difficulty of obtaining binding rulings. They suggest the establishment of ASEAN-based Regional Tax Authority (RTA), possibly even as a first step towards a world tax administration.

Buckers, Hopkins-Burns, Bennet and Namay (2015) - Information Sharing by Government Agencies: The Effect on the Integrity of the Tax System

This paper by New Zealand Inland Revenue researchers, examines increased information sharing activity of the Inland Revenue in New Zealand with other government departments and agencies. The paper reports findings from five studies conducted between 2010 and 2013 and proposes alternative methods that the revenue agency could implement to maintain taxpayer and tax-collector trust. The authors argue that it is vital that the Inland Revenue protects the current high regard that the public holds for its standards of privacy by limiting its information sharing to the most pressing needs, and continuously tightening its information security processes.

Wihantoro, lowe, Cooper and Manochin (2015) - Bureaucratic reform in post-Asian Crisis Indonesia: The Directorate General of Tax

This paper is based on an ethnographic study that examines the movement in the Indonesian Tax Office towards much more bureaucratic organisational form. The authors question the appropriateness of basing public sector reform in the Indonesian public sector on a broadly western model and argue that it is important to carefully modify adopted organisational forms to fit the specific cultural concepts and practices.

Nasyrova (2015) - Estimation of the Quality of Tax Administration in the Russian Federation

This paper explores indicators of the quality of the tax administration in the context of Russia. The author presents growth rates of tax revenues, collection of tax payment, pre-charges as a result of tax inspections, structure dynamics of tax payers, indicators of tax revenues of one tax payer as direct indicators of the quality of the tax administration. The author also argues that an integrated indicator such as the World Bank's notion of "doing business" is an important indirect indicator of the quality of the tax administration.

Björklund (2015) - Common sense at the Swedish tax agency: transactional boundaries that separate taxable and tax free income.

Based on an ethnography of publicly available documentary material, the author analyses how the Swedish tax agency manages the various boundaries present in the income tax system in its enforcement role. The documents are taken by the author as expressions of the collective practices of agency employees that inform taxpayers about the agency's approach to difficult issues such as market exchanges.

Tax Profession

Levy (2015) - Believing in Life after Loving: IRS Regulation and Tax Preparers

In this paper the author critically investigates the recent court decision that overruled the IRS's efforts to regulate tax preparers, an action that is taken in the face of fraudulent and/or incompetent tax reporting by non-qualified tax preparers. The IRS's move to implement standards on the eligibility criteria for tax preparers would be of significant importance as only in 2011, as of the 142 million individual income tax returns filed 79 million were completed by paid preparers. Moreover of those filings, 42 million were filled out by preparers who were neither licensed nor regulated who mostly target low-income families who claim the earned income. The author discusses in detail why the arguments presented against the new regulations were flawed and how congress should increase its support to IRS in this area.

Oyer (2015) - Unregulated Tax Return Preparers: Not Loving the Penalties

This paper, like the above paper, discusses the IRS's recent move on to regulate un-licenced tax preparers. The author argues that specific regulations the IRS wants to implement may over-penalize tax return preparers. The article supports tax preparers' regulation but suggests Congress enact legislation that would limit the penalties and align them with those already in place for tax return preparer misconduct.

Bowde (2015) - Many Unhappy Returns: The Need for Increased Tax Penalties for Identity Theft-Based Refund Fraud

Bowde investigates the growing problem of fraudulent tax returns file using stolen identities which is costing tremendous amount of money on assisting victims, detecting and preventing refund fraud and prosecuting offenders. The author argues that the IRS and the Congress should take on a multi-dimensional approach and implement new civil tax penalties aimed specifically at targeting such tax fraud.

Levy (2015) - Believing in Life After Loving: IRS Regulation of Tax Preparers

In this paper Levy critically examines the IRS endeavour to regulate tax preparers and provide background on the incentives behind the IRS move. The author provides a story of a judicial affirmation that the new rules proposed by IRS were in fact “unlawful” with a critical perspective.

Tax Disputes

Miles (2015) - The price we pay for a specialised society: do tax disputes require greater judicial specialisation?

This paper considers the arguments for greater judicial specialisation in New Zealand tax cases, and concludes based on comparisons with other jurisdictions, that such specialisation is not desirable. In part this is a function of the New Zealand environment where there are insufficient tax cases to warrant specialisation.

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