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### ARTICLES



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# ABOUT THE JOURNAL

The Journal of Tax Administration (JOTA) 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 (CIOT).

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 policymakers 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 INSITUTE 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.

## WEBSITE

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

## SOCIAL MEDIA

We also have an X (formerly Twitter) account (https://x.com/JOTAJournal) and a Blue Sky account (@jotajournal.bsky.social)

# EDITORIAL NOTE

This issue of the Journal of Tax Administration includes six articles, covering a range of perspectives on different aspects of tax administration.

The first paper, "Tax audit quality: The role of experience and technology readiness in a digital world", by Maarten A. Siglé, Stephan Muehlbacher, Lisette E. C. J. M. van der Hel, and Erich Kirchler offers an important and timely contribution to the growing literature on the digital transformation of tax administration. It investigates how tax auditor experience interacts with the adoption of digital tools in shaping the quality of tax audits. Drawing on rich administrative data from a tax authority, the authors construct detailed measures of auditor profiles and audit outcomes, and explore how variations in experience influence audit effectiveness in a technologically evolving environment.

As tax authorities around the world invest in digital infrastructures—from pre-filled returns to algorithmically guided audit selection—the question of how human judgement and institutional knowledge continue to shape enforcement outcomes becomes increasingly relevant. This paper brings fresh empirical evidence to this debate, demonstrating that experience still plays a critical role, but that its value is modulated by the availability and use of digital tools.

The analysis shows that digitalisation and auditor experience are not substitutes, but rather interact in complex ways—pointing to the need for thoughtful integration of technology and training in tax administrations. The results have clear policy relevance. They caution against overly technocratic visions of enforcement where experience is undervalued, and suggest that capacity building remains essential, even in digitally advanced environments. This has practical implications for recruitment, training, and audit strategy.

Arnaldo Purba and Alfred Tran's paper, "How do multinationals shift profits out of Indonesia?", makes a valuable empirical contribution to the literature on international tax avoidance. Using novel administrative data that links tax returns, customs records, and firm-level information, the authors offer policy-relevant insights into the channels and magnitude of profit shifting in a major emerging economy.

The paper's primary contribution lies in its careful use of detailed firm-level microdata to identify transfer pricing practices. The findings carry strong policy implications for developing economies. They highlight the vulnerability of source-based corporate tax systems to base erosion via transfer pricing and underscore the need for better enforcement capacity and data integration. Importantly, the paper offers a practical contribution to how tax administrations can make use of existing administrative data to detect profit shifting without relying exclusively on OECD-style transfer pricing audits.

In "Understanding the BEPS project and other OECD tax initiatives including the Inclusive Forum in the context of treaties and state inequality", Grahame Jackson offers a timely and thoughtful analysis of the Base Erosion and Profit Shifting (BEPS) agenda and related OECD tax initiatives from the perspective of developing countries. By combining institutional insights with country-level illustrations, it provides a nuanced account of the motivations, implementation challenges, and policy trade-offs that these international frameworks present for lower-income jurisdictions.

Rather than treating BEPS as a neutral set of technical standards, the author examines it as a politically and institutionally mediated process, shaped by asymmetries in negotiating power, administrative capacity, and global economic integration. This broader framing enables the paper to move beyond procedural overviews and ask important questions about distributional outcomes, enforcement feasibility, and long-term sustainability.

From a policy and research perspective, the paper raises critical issues for further exploration: the suitability of OECD standards for non-OECD contexts, the scope for greater representation of developing countries in global tax norm-setting, and the institutional prerequisites for effective reform uptake.

Next, Shelley Griffiths and Matthew Handford provide a compelling and critical analysis of tax exceptionalism—the notion that tax law and policy operate in a legal and institutional silo—through the lens of New Zealand's tax system. "Tax exceptionalism: A view from New Zealand" makes an important contribution to the theoretical and normative literature on tax law by grounding abstract debates in the concrete institutional and legal dynamics of a specific jurisdiction.

Rather than uncritically endorsing or rejecting the concept, the authors present it as a contingent institutional arrangement, the implications of which depend on legal culture, administrative design, and the broader political economy. The analysis situates tax exceptionalism in its local context, but also engages with comparative and theoretical debates, making the paper relevant to international audiences.

While focussed on New Zealand, the paper prompts broader reflection on when and why tax exceptionalism may be institutionally functional or problematic. It raises important questions about the relationship between tax administration and general public law, and the conditions under which exceptional governance structures may be warranted.

The fifth paper, "Media discourse around taxation in Ireland and the UK in the wake of financial crisis", by Veronica O'Regan, Philip O'Regan, Sheila Killian, and Ruth Lynch, presents a rich and innovative exploration of how public discourse around taxation has evolved in two comparable yet institutionally distinct settings: Ireland and the United Kingdom. Drawing on a diachronic corpus analysis of mainstream newspaper reporting over a 20-year period (2000–2020), the authors trace shifts in media framing, keyword salience, and discursive strategies associated with tax-related themes. By juxtaposing the two jurisdictions, the paper highlights both shared discursive trends—such as the growing moralisation of tax evasion—and country-specific narratives, including Ireland's post-crisis austerity framing and the UK's emphasis on fairness and corporate responsibility. Importantly, the paper's relevance extends well beyond discourse analysis. For tax scholars, policymakers, and practitioners, it offers valuable insights into how taxation is socially constructed and interpreted—knowledge that is critical for shaping communication strategies, strengthening taxpayer engagement, and anticipating the political reception of tax reforms.

Sreeja K. and Sebastian T. K.'s paper, "Does decentralised local tax administration warrant re-examination?", addresses a relatively underexplored question in tax administration: whether decentralised local tax enforcement enhances or undermines overall compliance and administrative effectiveness. The subject matter is both timely and conceptually rich. As governments around the world increasingly experiment with decentralisation in public service delivery, this paper critically examines whether similar delegation is appropriate—or

efficient—in the domain of tax enforcement. The paper makes a valuable and policy-relevant contribution by questioning the normative case for decentralised tax administration and highlighting the institutional, informational, and coordination frictions that it can introduce. It encourages a rethinking of enforcement models and offers important insights for tax administrators and policymakers navigating the trade-offs between local autonomy and the coherence and efficiency of the broader tax system. It also lays significant groundwork for further research on the institutional design of tax enforcement, particularly in systems with multilevel governance or capacity asymmetries.

**OBITUARY: Stephen Martin Edge (1950–2025)**

The Journal of Tax Administration (JOTA) is deeply saddened to inform its readership of the passing of Steve Edge.

Steve was a long-standing supporter of JOTA and served as Chairman of the Advisory Group of the Tax Administration Research Centre (TARC). A distinguished graduate of the University of Exeter, Steve trained as a lawyer and spent his entire career at the renowned law firm Slaughter and May, where he specialised in corporate tax and became a partner in 1982.

Beyond his professional accomplishments, Steve was known for his generous spirit, sharp intellect, and unwavering commitment to advancing tax research and supporting the academic community. His guidance and encouragement were invaluable to countless colleagues and young researchers, and he played a pivotal role in fostering stronger links between tax practice and academic inquiry.

Steve’s legacy will endure through his many contributions to the field and the people he inspired along the way. He will be greatly missed.

*Christos Kotsogiannis*
*Managing Editor*

# TAX AUDIT QUALITY: THE ROLE OF EXPERIENCE AND TECHNOLOGY READINESS IN A DIGITAL WORLD

*Maarten A. Siglé[1], Stephan Muehlbacher[2], Lisette E. C. J. M. van der Hel[3], Erich Kirchler[4]*



## Abstract

Society is digitising at a rapid pace and tax authorities must keep up with significant changes in how companies administer their tax liabilities. Tax auditors must be able to achieve an efficient and effective audit quality regardless of the degrees to which digitisation and digitalisation have been implemented by the audited companies. Previous research shows a positive correlation between audit experience and audit quality. However, it is unclear whether more experience—which was most likely acquired in traditional audits of accounting systems with low levels of digitalisation—is also beneficial in a changing environment with more highly digitalised companies. We argue that more experienced tax auditors are only superior to less experienced auditors in this changing environment if they are sufficiently willing and equipped to use new technologies and more digitised data. We expect—and find—that experienced tax auditors with adequate technology readiness achieve a higher audit quality in detecting information technology (IT) risks than tax auditors with less experience and/or less technology readiness. Our results, however, also show that more experienced tax auditors do not perform better when detecting traditional risks (i.e. non-IT-related risks) than less experienced auditors. Overall, our results suggest that experience without the propensity to embrace and use new technologies and more digitised data might not be enough to achieve the required audit quality levels in the future. We therefore emphasise the importance of appropriate training (in order to adopt new ways of working and acquire competencies to understand new technologies) and the strategic composition of the tax authorities' audit teams.

**Keywords:** Audit Quality, Tax Audits, Experience, Digitalisation, Technology Readiness.

## 1. INTRODUCTION

Society is digitising at a rapid pace. In combination with new information technology (IT), digitisation implies that significant changes are taking place within companies' business operations, administrative organisation, and internal controls. Consequently, the technological environment also becomes increasingly important in the everyday practices of auditors working for the tax authority (hereafter 'tax auditors') (Bierstaker et al., 2001; Stoel et al., 2012). The guidelines for International Standards on Auditing (ISA), published by the International Auditing and Assurance Standards Board (IAASB), emphasise the importance of the IT

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environment as part of a company's administrative organisation and conclude: "The auditor should obtain an understanding of […] aspects of the entity's IT environment that are subject to risks arising from the use of IT" (IAASB, 2019, p. 14–15). Digitisation affects the auditing process in many ways and brings with it entirely new IT-related risks that require tax auditors to have the appropriate know-how and skills, and the right mindset.

Know-how and skills can be gained from experience. Past research has confirmed that audit performance is positively correlated with audit experience (e.g. Kaplan et al., 2008; Knechel et al., 2013; Lehmann & Norman 2006). However, digitisation is constantly changing the technical environment of audits. With the importance of IT-related risks in tax audits strongly increasing, the question of whether experience gathered in more 'traditional' settings is enough to master the new challenges arises. Prior studies are inconclusive in this regard as they do not distinguish between IT-related audit risks and other, more 'traditional' audit risks. The present paper addresses this gap by analysing the role of tax audit experience in detecting both types of risks (traditional audit risks and IT-related audit risks). Further, we assume that for the detection of IT-related risks, auditors' technology readiness (i.e. how easily they become acquainted with and adopt new technologies) is of similar relevance as their general experience in tax auditing. We argue that the constant change caused by digitisation means that specific IT-related know-how continuously becomes outdated and that new skills must be developed on a regular basis. 'Technology readiness' implies that someone has the right mindset and openness towards technical progress. It forms the basis for tax auditors' motivation to keep abreast of the latest accounting and auditing technologies. Therefore, our second research question is whether tax auditors' technology readiness affects tax audit performance in addition to experience. To the best of our knowledge, neither of our research questions have been studied previously.

In this study, we measure the performance of auditors from four countries' tax authorities in two hypothetical tax audit scenarios. The case described in the scenarios contains either traditional audit risks or both traditional and IT-related audit risks. Unlike previous researchers, we find that more experienced tax auditors are not performing better than less experienced auditors in terms of detecting traditional (i.e. non-IT-related) audit risks. When detecting IT-related risks, however, we find that tax auditors with both experience *and* a high degree of technology readiness perform best in our hypothetical scenario.

The remainder of the paper is structured as follows. In the following section, we provide the institutional and theoretical background on tax auditing and develop our hypotheses. Next, we describe the research method, report the results, discuss our findings and their limitations, and provide suggestions for future research.

## 2. INSTITUTIONAL AND THEORETICAL BACKGROUND

### 2.1. Tax Audits and Audit Quality

The primary goal of tax authorities is to maximise compliance with tax laws. Tax audits are an important instrument used by tax authorities to address non-compliance (OECD, 2017). In the past, tax authorities predominantly pursued deterrence strategies in order to prevent and correct non-compliance by means of tax audits. As suggested in the economic theories of crime (Becker, 1968) and income tax evasion (Allingham & Sandmo, 1972), it is assumed that audits and fines enforce compliance. Meanwhile, however, psychology has shifted attention to fairness and trust-building measures that fuel voluntary compliance (Kirchler, 2007; Kirchler

et al., 2008; Muehlbacher et al, 2011; Prinz et al., 2014). Accordingly, many tax authorities apply a comprehensive compliance (risk) management strategy comprising a whole toolbox of instruments, e.g. providing services and education, implementing cooperative compliance programmes, pursuing fraud investigations, conducting audits, and punishing non-compliers. Ideally, these instruments are applied in response to the behaviour of taxpayers (Braithwaite, 2007). Although tax authority strategies to address non-compliance have become more varied, "[...] audits remain a major tool for tackling non-compliance and in revenue bodies in most OECD countries constitute the largest deployment of resources for administration of the laws" (OECD, 2006, p. 6).

Given the scarcity of academic research on *tax* audit quality,[5] and lacking a theoretical framework, we rely on theories about audit quality in general. The concept of audit quality has received ample academic attention over the course of several decades, but there is still no agreement on how to define and measure audit quality (Knechel et al., 2013). The assessment of audit quality depends on who is referring to it: auditors, users, or regulators (e.g. Aobdia, 2019; Brivot et al., 2018; Knechel et al., 2013).

To circumvent definition problems, most researchers focus on the prerequisites of audit quality, as summarised in audit quality frameworks. Audit quality frameworks generally comprise (a number of) the following elements: *inputs*, *process*, *outcomes*, *context*, *regulation*, and *client demand* (see DeFond & Zhang, 2014; Francis, 2011; Knechel et al., 2013). Depending on the research context, different aspects of quality are discussed in the literature (Knechel et al., 2013). Many of the mentioned facets can be expected to be similarly relevant in the context of tax audits. For example, audits conducted by the tax authorities are characterised by similar inputs and similar processes as audits of financial statements in general (OECD, 2006). The intended outcome—reporting quality—is also mostly equivalent, although specifically aimed at tax returns instead of financial reporting in general. Given these similarities, we rely on the general auditing literature in developing our hypotheses. However, there are also some potential differences. For example, the context regarding compensation and fees is different for tax auditors. Tax auditors are not paid by their 'clients'. In addition, tax auditors do not experience client demand since the choice to perform an audit is made unilaterally by the tax authority. Furthermore, tax authorities do not provide audit services like commercial firms (e.g. preparing accounting records or providing legal services) that are found to lead to economic bonding and a possible decrease of independence (e.g. Knechel et al., 2013).

Given the scarcity of research into tax audit quality in general and into how it is affected by digitalisation in particular, our study makes an important contribution to the field. In the terminology of the above-discussed framework, our study addresses the following elements: *inputs* (the experience of the tax auditor) and *process* (the quality of the planning phase).

## 2.2. Experience in Auditing

More than three decades ago, Abdolmohammadi and Wright (1987) noted that "researchers have long been concerned about the effects of experience on decision making" in auditing (e.g., Bonner, 1990; Earley, 2002; Haynes et al., 1998, Kaplan et al., 2008, and Libby & Frederick,

[5] Related to our research question, Drogalas et al. (2015) focus on the effect of tax authorities utilising IT to enhance their tax audit effectiveness. While they focus on the tax auditor who utilises IT as an audit tool, we focus on the tax auditee who uses IT. In addition, Goldman et al. (2021) focus on the effect of task-specific experience on the audit quality of income tax accounts. While they focus on the audit quality delivered by external auditors who audit tax statements, we focus on the audit quality of tax auditors working for the tax authority.

1990) (p. 1). As a result, experience is considered to be an important factor for audit quality, both in theoretical frameworks (e.g. Francis, 2011; Nelson, 2009) and in regulatory standards (e.g. Public Company Accounting Oversight Board, n.d., p.12).

Empirical studies confirm that the quality of auditors' judgements improve with domain-specific knowledge (e.g. Bonner, 1990). According to Knechel et al. (2013), domain-specific knowledge consists of "knowledge accumulated through client, task, and industry experience" (p. 392). Although most studies only focus on one or two types, be it client-, task-, or industry-specific knowledge, they typically find that auditors' performance improves with experience (e.g. Goldman et al., 2022; Moroney & Carey, 2011). We consider client-based experience to be less important in the context of tax audits, because when compared to general auditors, tax auditors are more likely to deal with an array of clients rather than repeatedly cooperating with the same clients. Therefore, we focus on industry- and task-specific experience.

With regard to industry-specific experience, industry experts are found, for example, to be more likely to disclose errors and uncertainties in their audit reports (Reheul et al., 2017), to be associated with less earnings management (Balsam et al., 2003), and to be better at detecting errors (Owhoso et al., 2002) than non-industry experts. Similarly, task-specific experience is found to be associated with better analytical risk assessment (Bonner, 1990), with greater effectiveness in assessing the risk of fraud in financial statements (Knapp & Knapp, 2001), and with a greater ability to accurately explain audit findings (Libby & Frederick, 1990). Task-specific experience is developed by acquiring base-level knowledge that has common elements across settings and is organised in a manner that is applicable to multiple other settings (Goldman et al., 2022).

Several points are discussed to explain why the availability of task-specific experience improves audit quality. For instance, it is assumed that such experience enables auditors to become more concise in problem solving, using only information that is most relevant for the specific task (Lehmann & Norman, 2006; Shelton, 1999). In general, experienced auditors are more sceptical than less experienced auditors (Kaplan et al., 2008) and more able to identify errors in analytical reviews (Marchant, 1989). More experienced auditors formulate higher quality explanatory hypotheses (Libby & Frederick, 1991). Experience has also been found to mitigate various decision biases affecting the quality of judgements (e.g. Messier & Tubbs, 1994; Smith & Kida, 1991; Trotman & Wright, 1996). However, it seems that audit experience is particularly beneficial when task complexity is high (Alissa et al., 2014; O'Donnell et al., 2005): experience allows auditors to recognise and correctly interpret any potential uncertainties arising in audits.

The relation between experience and audit quality is often described as non-linear (e.g. Anderson & Maletta, 1994; Bedard & Biggs, 1991). The shape of the relationship, however, is still debated. Some authors argue that the relationship is parabolic (e.g. van Nieuw Amerongen, 2007), whereas others propose a flattening function which submits that auditors attain sufficient expertise after a few years (e.g. Anderson & Maletta, 1994). The cut-off point beyond which more experience yields no or minimal advantages is assumed to be around five years of experience (e.g. Bedard & Biggs, 1991; Ríos-Figueroa & Cardona, 2013). In our study, we consider the number of years of experience and distinguish between low and high experience on basis of this cut-off point.

Is more experience always beneficial for the quality of audits? Experience within a specific audit setting might as well lead to systematic biases in judging new information. Knechel et al.

(2013) call this "the curse of knowledge", implying that experience can result in tunnel vision on part of the auditor (p. 393). When auditors rely too heavily on intuition based on experience, they can overweight familiar cues, and underweight or even ignore other relevant information. In other words, more experienced auditors are more likely to succumb to selective information perception and interpretation that fits their pre-existing knowledge (Cahan & Sun, 2015; Moeckel, 1990). This bias could undermine the positive effect of experience on audit quality and amplify the potential negative effect of tunnel vision. Tax audits and, in particular, audits in highly digitalised environments are undoubtedly examples of high complexity tasks. Hence, the arguments discussed above also seem to be generalisable to the specific case of tax audits. We analyse the relationship between audit experience and tax audit quality in a traditional setting involving a low level of digitalisation. Our first hypothesis for this part of our study is:

> *$H_1$: Tax audit experience is positively related to audit quality in regard to traditional risks.*

Subsequently, we test whether the effect of experience also prevails in a more complex and highly digitalised environment when the task for the auditors is to detect IT-related risks. To master the challenges of digitalisation, auditors must be willing to continually familiarise themselves with new technologies—as captured in the concept of technology readiness.

### 2.3. Technology Readiness

In principle, it might be assumed that the relationship between experience and the detection of IT risks is similar to the positive relationship between experience and the detection of more traditional risks, thus H1 could also apply to the detection of IT risks. However, there are reasons to assume that the relationship between experience and the detection of IT risks is less straightforward.

Auditees digitalise and transform their business models using information technology (Wang & Alam, 2007), which requires auditors to acquire the related competencies (Curtis et al., 2009). Technology is becoming increasingly ingrained in internal control systems, the reporting process has changed with tools such as eXtensible Business Reporting Language (XBRL), and audit evidence increasingly stems from data analytics (Pan & Seow, 2016). The pace at which new technologies are developed, introduced, and integrated into businesses is extremely fast. The constantly changing technical environment increases the complexity of an audit (Han et al., 2016). As a result, it is increasingly difficult to gain sufficient experience with these new tools.

On one hand, audit experience might be particularly beneficial when task complexity is high (Alissa et al., 2014). On the other hand, new technologies also bear some new and unconventional risks, which are difficult for even more experienced auditors to recognise and evaluate. Experience in traditional audit settings may even be counterproductive by shaping the auditors' perceptions so that some information is overweighted while other, equally important, information is missed (Moeckel, 1990). Auditors' abilities to cope with the changing IT environment might therefore depend on different characteristics, such as the degree to which they are willing and able to embrace new technologies, i.e. their technology readiness (Parasuraman & Colby, 2015).

We argue that being able to adapt and being willing to learn the necessary skills is of similar importance as experience. Due to the constantly changing audit environment, know-how and

skills become outdated quickly, which requires auditors to make continuous learning efforts in order to become acquainted with new technologies. Therefore, in our second hypothesis, we expect that, in a modern, digitalised audit environment, more experienced tax auditors will only perform better if they have a reasonable degree of technology readiness:

> *$H_2$: Tax auditors' technology readiness moderates the positive relationship between experience and audit quality in regard to IT-related risks.*

## 3. METHOD

### 3.1. Participants

Overall, 390 tax auditors from Austria, Ireland, Lithuania, and The Netherlands participated in our study. Participants were invited by the respective tax authorities collaborating with us. Seven participants left all of the relevant questions blank and, in two cases, a technical malfunction occurred. All data from these participants was excluded from the dataset. In addition, the data obtained from 28 IT auditors within the Dutch sample was excluded because, unlike the other participants, they were supporting audit teams by providing IT knowledge rather than auditing tax returns. The final sample consists of $N$ = 353 tax auditors.

*Table 1: Sample Characteristics by Country*

| | AT | IE | LT | NL | Total |
|---|---|---|---|---|---|
| *Expertise* | | | | | |
| Payroll taxes | 0 | 4 | 0 | 11 | 15 |
| VAT | 0 | 4 | 18 | 59 | 81 |
| CIT | 15 | 14 | 6 | 34 | 69 |
| Certified auditor | 17 | 5 | 55 | 85 | 162 |
| Other | 1 | 7 | 7 | 11 | 26 |
| Total | 33 | 34 | 86 | 200 | 353 |
| *Age* | | | | | |
| 21-29 years | 2 | 0 | 4 | 26 | 32 |
| 30-39 years | 6 | 9 | 17 | 49 | 81 |
| 40-49 years | 11 | 14 | 17 | 36 | 78 |
| 50-59 years | 13 | 11 | 29 | 72 | 125 |
| 60-66 years | 1 | 0 | 19 | 17 | 37 |
| Total | 33 | 34 | 86 | 200 | 353 |
| *Education* | | | | | |
| Middle school | 0 | 2 | 0 | 18 | 20 |
| Bachelor | 8 | 9 | 33 | 82 | 132 |
| Master | 23 | 12 | 51 | 76 | 162 |
| Ph.D | 2 | 1 | 0 | 0 | 3 |
| Other | 0 | 10 | 2 | 24 | 36 |
| Total | 33 | 34 | 86 | 200 | 353 |
| *Gender* | | | | | |
| Female | 11 | 18 | 77 | 53 | 159 |
| Male | 20 | 15 | 5 | 141 | 181 |
| Other | 2 | 1 | 4 | 6 | 13 |
| Total | 33 | 34 | 86 | 200 | 353 |

*AT = Austria, IE = Ireland, LT = Lithuania, NL = The Netherlands*
*CIT= Corporate income tax, VAT = Value added tax*

As shown in Table 1, most of the participants worked for the Dutch Tax Administration ($n$ = 200), with the others working for the tax authorities of Lithuania ($n$ = 86), Ireland ($n$ = 34), and

Austria ($n$ = 33). Almost half of the participants ($n$ = 162) were certified public auditors. Most of the other participants specialised mainly in either auditing value added tax (VAT) ($n$ = 81) or auditing corporate income tax (CIT; $n$ = 69). The remaining participants specialised in auditing payroll taxes or had another specialisation. Most of the participants held a bachelor's degree ($n$ = 132) or master's degree ($n$ = 162). In Ireland and the Netherlands, a large number of participants stated that their minimum level of education was "other". This usually means that they were trained by the tax authority internally. Most participants in Austria and in the Netherlands were male; in Ireland and Lithuania, most were female. The exact frequencies for all sample characteristics, in total and separately for each country, are depicted in Table 1.

### 3.2. Material and Procedure

We developed two versions of a business case for tax auditors containing either only traditional audit risks or traditional and IT-related audit risks. The cases were composed by two of the authors, and experts from the collaborating tax authorities checked that they described realistic audit scenarios for their countries. The descriptions were adjusted in accordance with their feedback. Experts from the collaborating tax authorities translated the original (Dutch) case into English, German, and Lithuanian. Other experts translated this version back to English and a third expert compared the back translation to the original version. All experts confirmed the final translation.

The case described a law firm (labelled with the initialism DH&W) that operated nationwide in the residential country of the participant. The description focussed on the planning stage of a standard audit. In this stage, the materiality was set, key risk areas were identified through understanding the company, and appropriate audit testing was designed as a basis for an efficient and effective audit. Both versions of the case contained six traditional audit risks, such as the risk of overaggressive behaviour. The two versions differed in terms of the inclusion or exclusion of IT-related audit risks (see Appendix I for the wording of both case descriptions). They were developed to test both of our hypotheses and to check whether adding the IT-related risks to the case description also affects the detection of traditional risks.

Participants were invited to become involved in a study on tax audits by our contact people in their respective countries. No further information about the goal of the study was provided. The contact people provided all participants with the link to an online questionnaire. Participants were randomly assigned to one of the two versions of the case. They had 24 hours in which to complete the study and were instructed not to communicate with colleagues about it.

Participants were instructed to imagine that they were part of the team auditing DH&W for CIT and VAT for the year 2018, and were requested to evaluate the company's risk profile and to identify the risks in the described case. They were also asked how realistic they considered the case to be: (a) was the case description similar to that of an actual organisation in their residential country? (1 – totally disagree, 7 – totally agree; $M$ = 4.6, $SD$ = 1.6); and (b) was it likely that they would have to deal with a similar organisation in their daily work? ($M$ = 4.0; $SD$ = 1.9). The responses show that the cases were realistic, especially when considering that the case had to be suitable for all four countries and for tax audit employees, who can audit a wide variety of organisations—both in terms of size and activities.

Each participant was provided with only one of the two versions of the case and instructed to identify as many of the tax risks hidden in the case description as possible. The *traditional*

*audit risks only* version of the case contained six audit risks that are common in standard audit settings and that are mostly independent from the IT environment of the audited company. The *traditional + IT-related audit risks* version of the case included the same six traditional audit risks as the other version (the placing and wording of these risks in the case description were also exactly the same), but it also included four additional risks related to the IT environment of the company to be audited. Thus, the traditional audit risks only version of the case contained six risks and the traditional + IT-related audit risks version contained ten risks (see Table 2 for a complete list of all risks hidden in the two case descriptions). The risks that we placed in the case descriptions were selected by a panel of experts from all four countries. After several rounds of debates, these experts agreed the final wording of both the case and the risks.

### 3.3. Measures

Given the complex nature of the concept (Knechel et al., 2013), we used two different proxies for audit quality as dependent variables, namely the correct identification of the risks in the case, and a composite measure regarding participants' risk assessments of the case (in the tradition of previous research: see, for instance, Anderson & Maletta, 1994; Bonner & Lewis, 1990; Ríos-Figueroa & Cardona, 2013). The first proxy, percentage of *risks detected*, was operationalised as follows. After reading the scenario, participants were asked to name the most significant audit risks that they found in the description of the DH&W case. The questionnaire allowed a maximum of ten risks to be named (in both versions of the case). To make it easier for us to understand the participants' responses, we instructed them to include the text passage from the case description in which they detected the respective risks (it was possible to copy and paste this). The exact wording of the instructions was: "Describe briefly the significant risks related to this audit, with a maximum of ten risks. Link each risk to a part of the text in the case. Please include in your answer the sentence(s) of the case based on which you included this risk".

All risks named by the participants were checked separately for each country by dyads of coders (officials deemed to be experienced experts by the collaborating tax authorities). The named risks were coded in two steps. First, the coders—independently from each other—assessed whether the named risks (and the attached text passages) referred to one of the six (version: *traditional audit risks*) or ten (version: *traditional + IT-related audit risks*) risks that we had pre-defined and hidden in the case description. One of the authors combined the categorisations from all coders and highlighted any differences. In total, the 353 participants named 2,313 risks, of which 1,036 (45%) were also on our pre-defined list of risks that were hidden in the case description.

The remaining named risks that were not on our list were also assessed by the coders independently and were finally considered as not significant or not relevant in the context of the case (i.e. none of the remaining risks were agreed to be significant or relevant by both coders of a specific country). Inter-coder reliability was relatively low for all of the risks combined (Kappa = .68, $p < .001$), although coder agreement was above 59% for all risks. Agreement between the various teams of coders was 69% or higher for all teams. Next, all differences were discussed within the coding teams for each country and, where necessary,

with one of the researchers, until agreements were reached. The final categorisation from each team was pooled.[6]

Panel A in Table 2 shows how often each of the risks hidden in the case description was identified (note that risk numbers seven to ten were only included in the *IT-related audit risks* version of the case). There was high variance in how often each of the risks was identified, with risk number six named only 23 times (6% of $N$ = 353 participants) and risk number five named almost ten times more often (217 times; 62%). In relation to the number of participants that completed the version of the case that included the IT risks ($n$ = 182 participants), risk numbers seven (143 times, 79%), eight (151 times, 83%), and nine (140 times, 77%) were named most often.

Because both versions of the case contained traditional audit risks, but only the second version contained IT-related risk factors, we computed two separate indices for each risk type mirroring the quality of the participant's risk analysis. First, we calculated the percentage of traditional risks (i.e. risks that were not related to the company's IT environment) that were correctly identified (number of risks correctly identified/six) for both versions of the case ($M$ = 26% $SD$ = 0.18). As these risks were the same in both versions of the case, and because these are not related to IT issues, we did not expect to find any difference between the two versions in the detection of the six traditional risks. However, the percentage of correctly identified traditional risks (*traditional risks detected*) was slightly higher in the version of the case that did not contain IT risks (27%) than in the version that included them (24%). This difference was close to significance ($t$ ($df$ = 351) = 1.93, $p$ = .054) and probably arose because the inclusion of IT-related risks detracted the participants from detecting the traditional risks. Next, we calculated a separate index for the four additional IT-related risks in the second version of the case (*IT risks detected;* $M$ = 68%, $SD$ = 0.27). Note that this latter index is only available for the IT-related audit risks version of the case ($n$ = 182).

On the next screen of the online questionnaire, after they had specified all of the risks that they had detected in the case, the participants were provided with a complete list of all of the risks that were hidden in the case description that they had just read (returning to the previous screen and editing the risks that they had mentioned or missed was not possible). Participants were asked to indicate how relevant they considered each of the listed risks, with the following instruction: "The following six [ten] risks were named by another auditor in a different audit team. Please indicate for each risk how relevant this risk would be in your opinion to the audit of DH&W on a scale from very low relevance (1) to very high relevance (7)". The results from this exercise provided us with information on the perceived relevance of our listed risks which we used to validate our risk detection measures. All means for these items are 3.94 or higher and the highest mean is 5.96 (see Panel B in Table 2), indicating that the participants judged the hidden risks to be relevant.

[6] For three of the risks (risks three, six, and ten) the coders agreed on less than 70% of occasions in the first round of coding. From discussions with the expert coders, we learned that these risks were deemed to be a little more ambiguous and harder to identify. Furthermore, in the creation of the list of predefined risks, these three were part of the bottom four in terms of relevance according to the expert panel (with risk number two being the fourth risk in the bottom four). Table 2, Panel B also includes the results of the assessment of the seeded risks by the participants. From the mean assessments, it can be concluded that participants deemed risks number six and ten to be among the least relevant risks. Given all of the above, we performed additional analyses excluding risks number three, six, and ten. These analyses are fully in line with our inferences from the main analyses.

*Table 2: Frequencies of Correctly Identified Risks and Assessments of Their Importance*

| Risk | Panel A: Number of times that risks were identified by participants | | | | | | Panel B: Importance of all risks as assessed by participants | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total ($N$ = 353) | | Traditional ($n$ = 171) | | +IT risks ($n$ = 182) | | $n$ | Min | Max | Mean | *SD* | % coder agreement |
| 1. Incidental transactions | 54 | *15%* | 33 | *19%* | 21 | *12%* | 353 | 1 | 7 | 4.65 | 1.40 | 90% |
| 2. Collusion | 40 | *11%* | 21 | *12%* | 19 | *10%* | 353 | 1 | 7 | 4.34 | 1.51 | 84% |
| 3. Complexity | 72 | *20%* | 45 | *26%* | 27 | *15%* | 353 | 1 | 7 | 3.94 | 1.50 | 59% |
| 4. Aggressiveness | 136 | *39%* | 66 | *39%* | 70 | *39%* | 353 | 1 | 7 | 5.01 | 1.41 | 88% |
| 5. Decentralisation | 217 | *62%* | 103 | *60%* | 114 | *63%* | 353 | 1 | 7 | 5.36 | 1.35 | 81% |
| 6. Services | 23 | *6%* | 14 | *8%* | 9 | *5%* | 353 | 1 | 7 | 3.97 | 1.49 | 60% |
| 7. IT interfaces | 143 | | | | 143 | *79%* | 182 | 2 | 7 | 5.75 | 1.10 | 90% |
| 8. IT segregation | 151 | | | | 151 | *83%* | 182 | 1 | 7 | 5.96 | 1.13 | 88% |
| 9. IT access control | 140 | | | | 140 | *77%* | 182 | 1 | 7 | 5.53 | 1.30 | 84% |
| 10. IT rights | 60 | | | | 60 | *33%* | 182 | 1 | 7 | 4.82 | 1.51 | 68% |
| Total | 1,036 | | 282 | | 754 | | | | | | | |

Note: See Appendix 2 for wording of all risks.

As our second proxy for audit quality, participants were presented with four items relating to how risky they considered the case that was described to them (e.g. the quality of the internal control framework and the quality of the IT control; see Appendix 3 for the wording of all four items). These items were developed on basis of previous studies on audit quality that used a similar method (e.g. Low, 2004). Factor analyses yielded one component (EV = 2.37; % of variance = 59%), scale reliability is satisfactory with Cronbach's alpha = .77 (Hair et al., 1998). Hence, responses to the four items were averaged to form a *perceived riskiness* score.

The section in the questionnaire regarding the operationalisations of the dependent variables (detected risks and perceived riskiness) was followed by items serving as predictor and control variables. With regard to the predictors, we first measured participants' *technology readiness* (TRI) with eight items (see Appendix 3 for the exact wording used) from the TRI 2.0 framework developed by Parasuraman and Colby (2015). We used two items (presented in random order) for each of the four components of this framework (i.e. optimism, innovativeness, discomfort, and insecurity). As for our other items, we used a seven-point scale (1 – low technology readiness, 7 – high technology readiness) instead of the original five-point scale.

We calculated the mean of each of the four components and averaged these to a total TRI score ($M$ = 4.30, $SD$ = 0.69). The analyses of the relation between TRI and audit quality (i.e. the detection of traditional and IT risks) yielded no significant results. This is unsurprising because we expect TRI, like experience, to be non-linearly related to audit quality. While there is no theory on this subject, it seems likely that, once above a certain threshold, having a higher degree of TRI will not help auditors to further improve their audit quality. Therefore, we dichotomised this variable and split it into two groups: low (0) and high (1) TRI. However, there is no clear theoretical cut-off point. Since business IT environments are complex, the performance task that we developed might require higher than average levels of TRI. We therefore split this variable at the 75% percentile (4.75).[7]

[7] In section 4.4 of this paper, we also report results using the median (4.25) as the cut-off point. The results remained unchanged when we used this as a cut-off point.

Secondly, we assessed participants' *experience in tax auditing* by asking for the number of years that their main task while working for the tax authority had been related to auditing.[8] Based on the existing literature on the relationship between experience and audit quality (as discussed in the previous section), we differentiated between participants with low (five years or less) and high (six years or more) levels of experience in tax auditing.[9]

With regard to the control variables, we first measured *professional scepticism*, which is "widely viewed as essential to audit quality" (Quadackers et al., 2014, p. 639). Six items from Brewster et al. (2021), such as "I always try to look at all sides of a problem" (p. 1689), presented in random order (see Appendix 3 for the exact wording) were applied to measure the degree of *professional scepticism*. Due to a low factor loading (< .4) we dropped one item and averaged the five remaining items to a score (1 – low professional scepticism, 7 – high professional scepticism; $M$ = 5.81, $SD$ = .69, $\alpha$ = .75). Next, we assessed participants' *sector experience* through a single item. This control variable concerned participants' experience in the professional service sector, the sector in which our fictional company, DH&W, operates (see Appendix 3 for the exact wording). Responses were collected using a five-point scale (1 – "0%", 2 – "1%–25%", 3 – "26%–50%", 4 – "51%–75%", and 5 – ">75%"; M = 1.79, SD = .92). We also controlled for country and expertise (e.g. VAT auditing or CIT auditing) in the following analyses.

## 4. RESULTS

### 4.1. Descriptive Statistics

Table 3 shows the means, standard variations, and frequencies of all predictor and control variables separately for the two versions of the case. Perceived riskiness is lower in the traditional audit risks version ($M$ = 3.70, $SD$ = 0.97) than the version that also included IT-related audit risks ($M$ = 4.51, $SD$ = 0.99, $t$ ($df$ = 351) = -7.75, $p$ < .01). The other variables did not differ between the two versions.

The intercorrelations are presented in Table 4. More experienced auditors score lower on the TRI scale ($r_s$ = -.11, $p$ < .05) and have spent more of their auditing time in the last three years auditing firms in the professional services industry ($r_s$ = .16, $p$ < .01). Auditors with more professional scepticism seem to be more technology ready, as they have higher TRI scores ($r_s$ = .21, $p$ < .01).

Further, the zero-order correlations in Table 4 show that, in the full sample, regardless of the version of the case, our dependent variable—perceived riskiness—is not correlated with any of the predictor variables. In the traditional audit risks version, however, we found a positive relationship with experience, although this correlation is only statistically significant at the 10% level ($r_s$ = .14, $p$ < .10). The other two dependent variables—the number of traditional

[8] It could be argued that more experienced auditors could also have had more IT training, making it difficult to disentangle the TRI score and audit experience. It might, however, also be that less experienced auditors have had more IT training, as part of a modernised training syllabus. We do not have direct information about the level of IT training received by the participants. We do have information about the level of self-reported IT knowledge and the degree to which each participant would have wanted to consult with an IT auditor in a similar case. Both variables were uncorrelated with experience, suggesting that experience and IT training are not correlated.

[9] In section 4.4 of this paper, we also report results using a cut-off point of seven years. Due to the low number of participants, we could not use a cut-off point of less than five years.

risks detected and the number of IT-related risks detected (only available for the second version of the case description)—were not related to experience. We did not find a significant relationship in either version or across the versions. However, when considering just the traditional audit risks version of the case, we found two unexpected significant correlations. First, the TRI score is positively related to the percentage of detected traditional audit risks ($r_s$ = .15, $p$ < .10). Secondly, auditors who audited more firms in the professional services industry in the past three years detected fewer traditional risks in the version of the case that included the IT-related risks ($r$ = -.27, $p$ < .01).

*Table 3: Descriptive Statistics of All Variables by Case Version*

| | Traditional risks ($n$ = 171) | | | | Traditional + IT-related risks ($n$ = 182) | | | |
|---|---|---|---|---|---|---|---|---|
| | *Min* | *Max* | *M* | *SD* | *Min* | *Max* | *M* | *SD* |
| Traditional risks detected | 0% | 100% | 27% | 19% | 0% | 67% | 24% | 16% |
| IT risks detected | | | | | 0% | 100% | 68% | 27% |
| Perceived riskiness[a] | 1.75 | 6.25 | 3.70 | 0.97 | 2.25 | 7 | 4.51 | 0.99 |
| Experience | 0 | 1 | 0.71 | 0.46 | 0 | 1 | 0.70 | 0.46 |
| TRI | 0 | 1 | 0.25 | 0.43 | 0 | 1 | 0.24 | 0.43 |
| Professional scepticism | 3.80 | 7.00 | 5.77 | 0.68 | 3.40 | 7.00 | 5.85 | 0.70 |
| Sector experience | 1 | 5 | 1.75 | 0.90 | 1 | 5 | 1.83 | 0.95 |

*Note.* [a] perceived riskiness differs significantly ($p$ < .01) between the two versions of the case. All other variables are not significantly different.

Traditional risks detected = percentage of seeded risks correctly identified.

IT risks detected = percentage of seeded IT risks correctly identified.

Perceived riskiness = mean score on four items related to the subjective risk assessment.

Experience = dummy with 0 = low experience (< 5 years) and 1 = high experience (> 6 years).

TRI = technology readiness, dummy with 0 = low TRI and 1 = high TRI.

Professional scepticism = mean score of six items related to the degree of professional scepticism.

Sector experience = sector experience on a scale from 1 (0%) to 5 years (> 75%).

## 4.2. Hypotheses Tests

To test $H_1$ (regarding the effect of experience on audit quality in respect of traditional risks), we conducted a multivariate analysis of covariance (MANCOVA) with audit experience (low vs high) and technology readiness (low vs high), and the version of the hypothetical case (traditional risk version vs traditional + IT-related risk version) as independent variables. In addition, we controlled for each participant's sector experience, professional scepticism, type of expertise, and country. The MANCOVA was performed on the full sample of $N$ = 353, including both versions of the case, as both included the same traditional risks. The analysis (for cell means, see Table 5, Panel A) yielded a marginally significant main effect of experience ($F$ (2, 335) = 2.70, $p$ = .07) and technology readiness ($F$ (2, 335) = 2.42, $p$ = .09), but none of the interaction effects reached statistical significance (Experience x TRI: $F$ = (2, 335) = 1.34, $p$ = 0.26); Experience x TRI x Case version $F$ (6, 670) = 1.04, $p$ = .40).

The MANCOVA was followed up by two separate analyses of covariance (ANCOVAs), one for each of the two dependent variables (traditional risks detected and perceived riskiness). Panel A in Table 5 shows the descriptive statistics for these dependent variables and Panel B summarises the ANCOVA results. In respect of the percentage of traditional risks detected and the perceived riskiness, we did not find a significant main effect for our independent variables

experience and TRI, or for their interaction. Furthermore, we did not find a statistically significant three-way interaction effect for experience, TRI, and the version of the case for both dependent variables. To summarise our results for $H_1$, surprisingly, we found no indication for an effect of experience. It did not play a role in the detection of traditional audit risks or in the perception of risk of the case. We discuss this finding in the last section and provide potential explanations for the null result.

*Table 4: Intercorrelations Between All Variables*

| | Full sample ($n$ = 353) | | | | | Traditional risk version ($n$ = 171) | | Traditional + IT-related risk version ($n$ = 182) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Experience | TRI | Prof. scepticism | Sector experience | Perceived riskiness | Perceived risk | Traditional risks detected | Perceived riskiness | Traditional risks detected | IT-related risks detected |
| Experience | | *-.11*** | *.00* | *.16**** | *.04* | *.14** | *-.03* | *-.01* | *-.09* | *.07* |
| TRI | -.11** | | *.21**** | *-.04* | *.02* | *-.06* | *.15** | *.09* | *.12* | *.06* |
| Professional scepticism | -.01 | .21*** | | *.02* | *.09** | .09 | .13 | .04 | .04 | .01 |
| Sector experience | .13** | -.07 | .03 | | *-.05* | -.08 | -.11 | -.04 | -.27*** | -.03 |
| Perceived riskiness | .05 | .03 | .08 | -.04 | | | .09 | | .16** | .21*** |
| Traditional risks detected | -.04 | .13** | .08 | -.19*** | .07 | .09 | | .16** | | -.02 |

Correlations in italics are Spearman and all others are Pearson * p < .10, ** p < .05, *** p < .01
Traditional risks detected = percentage of seeded traditional risks correctly identified.
IT risks detected = percentage of seeded IT risks correctly identified.
Perceived riskiness = mean score on four items related to the subjective risk assessment.
Experience = dummy with 0 = low experience (< 5 years) and 1 = high experience (> 6 years).
TRI = technology readiness, dummy with 0 = low TRI and 1 = high TRI.
Professional scepticism = mean score of six items related to the degree of professional scepticism.
Sector experience = sector experience on a scale from 1 (0%) to 5 years (> 75%).

Next, we tested our second hypothesis, regarding the impact of experience on detecting IT-related risks and the moderating role of technology readiness. This analysis was based only on the subsample of $n$ = 182 participants who completed the version of the case that included IT-related audit risks. Panel A in Table 6 shows descriptive statistics for the percentage of IT-related risks detected and for perceived riskiness in this version of the case, and Panel B summarises the corresponding ANCOVA results. In respect of the percentage of IT-related risks detected, we observed that more experienced auditors found more risks, although this effect is only close to being significant ($F$ (1, 181) = 3.07, $p$ = .08). In line with our hypothesis, we found that, when an experienced auditor also had a high TRI score, they detected most of the IT-related risks hidden in the case description ($M$ = 79%). This interaction effect reached statistical significance ($F$ (1, 181) = 4.77, $p$ = .03) and is visualised in Figure 1. In respect of perceived riskiness as the second proxy for audit quality, we found a similar pattern, although the interaction effect was not significant in this analysis ($F$ (1, 181) = 2.60, p = .11). In addition, we found no significant main effect of experience on perceived riskiness for this version of the case.

*Table 5: Descriptive Statistics and ANCOVA Results for Traditional Risks Detected and Perceived Riskiness for Both Case Versions (N = 353)*

*Panel A: Descriptive statistics*

| Traditional risks | | Experience < 6y | Experience > 5y | Total | Perceived Riskiness | | Experience < 6y | Experience > 5y | Total |
|---|---|---|---|---|---|---|---|---|---|
| Traditional risks version of the case | Low TRI | 26% (.17) *34* | 26% (.21) *95* | 26% (.20) *129* | Traditional risks version of the case | Low TRI | 3.57 (0.98) *34* | 3.78 (0.90) *95* | 3.72 (0.92) *129* |
| | High TRI | 31% (.13) *16* | 33% (.20) *26* | 32% (.17) *42* | | High TRI | 3.38 (1.18) *16* | 3.81 (1.06) *26* | 3.64 (1.12) *42* |
| | Total | 28% (.16) *50* | 27% (.21) *121* | 27% (.19) *171* | | Total | 3.51 (1.04) *50* | 3.79 (0.93) *121* | 3.70 (0.97) *171* |
| Traditional risks + IT risks version of the case | Low TRI | 23% (.16) *38* | 23% (.16) *100* | 23% (.16) *138* | Traditional risks + IT risks version of the case | Low TRI | 4.59 (0.86) *38* | 4.41 (1.00) *100* | 4.46 (0.96) *138* |
| | High TRI | 31% (.17) *17* | 25% (.14) *27* | 27% (.15) *44* | | High TRI | 4.43 (1.07) *17* | 4.84 (1.04) *27* | 4.68 (1.06) *44* |
| | Total | 26% (.16) *55* | 23% (.16) *127* | 24% (.16) *182* | | Total | 4.54 (0.92) *55* | 4.50 (1.02) *127* | 4.51 (0.99) *182* |
| Total | Low TRI | 25% (.16) *72* | 24% (.19) *195* | 24% (.18) *267* | Total | Low TRI | 4.10 (1.05) *72* | 4.10 (1.00) *195* | 4.10 (1.01) *267* |
| | High TRI | 31% (.15) *33* | 29% (.17) *53* | 30% (.16) *86* | | High TRI | 3.92 (1.23) *33* | 4.33 (1.16) *53* | 4.17 (1.20) *86* |
| | Total | 27% (.16) *105* | 25% (.19) *248* | 26% (.18) *353* | | Total | 4.05 (1.10) *105* | 4.15 (1.04) *248* | 4.12 (1.06) *353* |

*Panel B: ANCOVA*

| Traditional risks | Mean Square | F | p | Perceived Riskiness | Mean Square | F | p |
|---|---|---|---|---|---|---|---|
| Intercept | 0.29 | 9.49 | .00 | Intercept | 55.69 | 69.33 | .00 |
| Experience | 0.00 | 0.00 | .97 | Experience | 2.09 | 2.96 | .11 |
| TRI | 0.08 | 2.58 | .11 | TRI | 0.95 | 1.18 | .28 |
| Case version | 0.08 | 2.52 | .11 | Case version | 50.75 | 63.17 | .00 |
| Experience x TRI | 0.00 | 0.03 | .87 | Experience x TRI | 0.03 | 0.04 | .84 |
| Experience x TRI x case version | 0.01 | 0.27 | .85 | Experience x TRI x case version | 1.39 | 1.73 | .16 |
| Professional scepticism | 0.03 | 0.82 | .37 | Professional scepticism | 0.08 | 0.10 | .76 |
| Sector experience | 0.33 | 11.00 | .00 | Sector experience | 1.54 | 1.91 | .17 |
| *Country and expertise fixed effects* | *yes* | | | *Country and expertise fixed effects* | *yes* | | |
| *Adj r2* | .05 | | | *Adj r2* | .28 | | |

Traditional risks = percentage of seeded traditional risks correctly identified.
Perceived riskiness = mean score on 4 items related to the subjective risk assessment.
Experience = dummy with 0 = low experience (< 5 years) and 1= high experience (> 6 years).
TRI = technology readiness, dummy with 0 = low TRI and 1 = high TRI.
Case version= dummy with 0 = traditional version and 1 = traditional + IT risks version of the case.
Professional scepticism = mean score of six items related to the degree of professional scepticism.
Sector experience = sector experience on a scale from 1 (0%) to 5 years (> 75%).
Country and expertise = Dummies for country (four countries, three dummies) and expertise of the participant (six types of expertise and four dummies included, IT expertise was excluded) were included in the analyses.

*Table 6: ANCOVA Results for IT Risks Detected and Perceived Riskiness for Case Version: Traditional + IT Risks (n = 182)*

*Panel A: Descriptive statistics:* Mean, (Standard Deviation), *Number of observations*

| IT risks detected | Experience <6y | Experience >5y | Total | Perceived riskiness | Experience <6y | Experience >5y | Total |
|---|---|---|---|---|---|---|---|
| | 69% | 66% | 67% | | 4.59 | 4.41 | 4.46 |
| Low TRI | (24%) | (29%) | (28%) | Low TRI | (0.86) | (1.00) | (0.96) |
| | *38* | *100* | *138* | | *38* | *100* | *138* |
| | 59% | 79% | 71% | | 4.43 | 4.84 | 4.68 |
| High TRI | (31%) | (17%) | (25%) | High TRI | (1.07) | (1.04) | (1.06) |
| | *17* | *27* | *44* | | *17* | *27* | *44* |
| | 66% | 69% | 68% | | 4.54 | 4.50 | 4.51 |
| Total | (26%) | (27%) | (27%) | Total | (0.92) | (1.02) | (0.99) |
| | *55* | *127* | *182* | | *55* | *127* | *182* |

*Panel B: ANCOVA*

| IT risks detected | Mean Square | F | p | Perceived riskiness | Mean Square | F | p |
|---|---|---|---|---|---|---|---|
| Intercept | 1.14 | 17.48 | .00 | Intercept | 49.07 | 55.23 | .00 |
| Experience | 0.20 | 3.07 | .08 | Experience | 1.43 | 1.61 | .21 |
| TRI | 0.01 | 0.11 | .74 | TRI | 0.63 | 0.71 | .40 |
| Experience x TRI | 0.31 | 4.77 | .03 | Experience x TRI | 2.31 | 2.60 | .11 |
| Professional scepticism | 0.00 | 0.02 | .90 | Professional scepticism | 0.27 | 0.30 | .58 |
| Sector experience | 0.00 | 0.02 | .90 | Sector experience | 0.04 | 0.04 | .84 |
| *Country/expertise effects* | *Yes* | | | *Country/expertise effects* | *yes* | | |
| *Adj r2* | .10 | | | *Adj r2* | .09 | | |

IT risks detected= percentage of seeded IT risks correctly identified.

Perceived riskiness = mean score on 4 items related to the subjective risk assessment.

Experience = dummy with 0 = low experience (< 5 years) and 1= high experience (> 6 years).

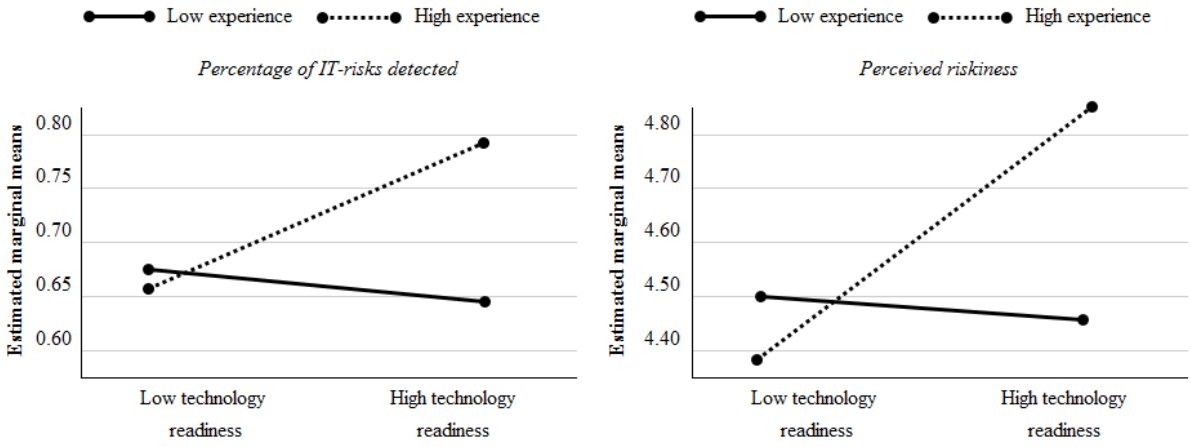
TRI = technology readiness, dummy with 0 = low TRI and 1 = high TRI.

Professional scepticism = mean score of six items related to the degree of professional scepticism.

Sector experience = sector experience on a scale from 1 (0%) to 5 years (> 75%).

Country and expertise = Dummies for country (four countries, three dummies) and expertise of the participant (six types of expertise and four dummies included, IT expertise was excluded) were included in the analyses.

*Figure 1: Estimated Marginal Means of the Two Audit Quality Proxies in the IT-related Audit Risks Version of the Case*




We hypothesised that more experienced auditors perform better only if they are technology ready enough, i.e. if their TRI scores are sufficiently high. To test this, we used contrast weights with 3 for experienced auditors in the high TRI group and -1 for auditors in the three other groups. This contrast was not significant in the traditional risks version of the case. However, in the traditional + IT-related risks version, this contrast was significant at the 5% level ($p$ = .01) for the percentage of IT risks detected (see the first row in Table 7). In line with the non-significant results in Table 5 and Table 6 for perceived riskiness, the contrast for this dependent variable was not significant. As expected, participants with more experience and a higher degree of TRI showed the best performance in the audit task involving IT-related risks.

*Table 7: Planned Contrasts for the Interaction of Experience and Technology Readiness*

| | | Planned contrast, $p$-values (2-tailed) *low exp/low TRI (-1), low exp/ high TRI (-1), high exp/ low TRI (-1) and high exp/ high TRI (+3)* | | | |
|---|---|---|---|---|---|
| | | Traditional risks version | | Traditional + IT risks version | |
| | | *Risks detected* | *Perceived riskiness* | *IT risks detected* | *Perceived riskiness* |
| Cut-off exp 5y | Cut-off TRI 75% | .49 | .48 | .01 | .22 |
| | Cut-off TRI median | .14 | .88 | .02 | .31 |
| Cut-off exp 7y | Cut-off TRI 75% | .49 | .48 | .01 | .22 |
| | Cut-off TRI median | .14 | .88 | .02 | .31 |

## 4.3. Robustness Checks

*Variations in cut-off points for experience and TRI*

We performed the same planned contrast analyses using different cut-off points for the TRI and for experience to check the robustness of our results. For the TRI, we used the median as an alternative cut-off point. For experience, we used a cut-off point of seven instead of five years. Although the previous literature on audit experience suggests that no or only minimal advantages are achieved beyond a cut-off point of five years in experience (e.g. Bedard & Biggs, 1991; Ríos-Figueroa & Cardona, 2013), we also tried the seven-year mark as alternative cut-off to check whether the findings held. The results from these analyses were similar to those from our main analyses. In the traditional risks version, we still found no significant

contrast (untabulated). In the traditional + IT-related risks version, we found a significant contrast in the percentage of IT-related risks detected for all three additional variations of these cut-off points for TRI and experience (see the three bottom rows of Table 7). With regard to perceived riskiness, the patterns for all four variations were similar to the pattern of the IT-related risks detected, but were non-significant.

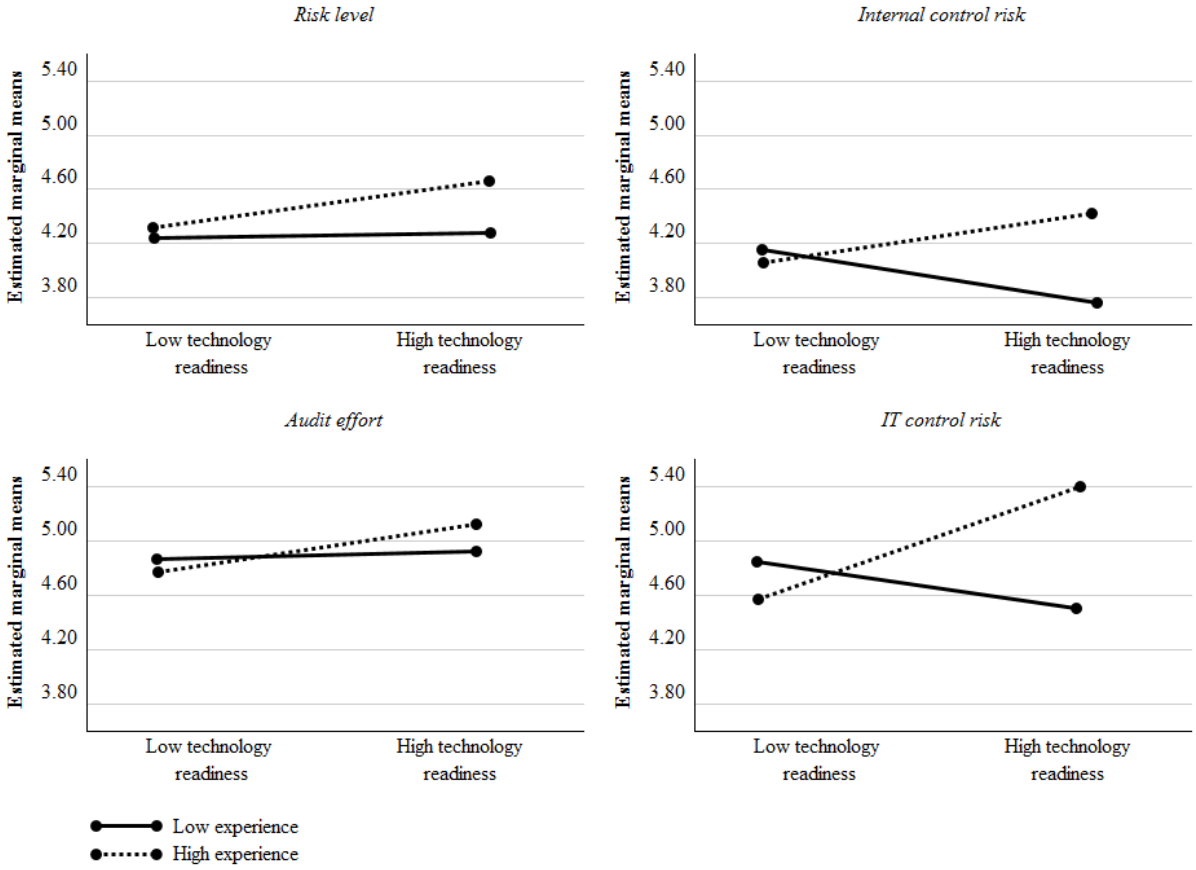
*Equal group sizes*

The proportion of participants in groups differed depending on the chosen cut-off points. For example, in the ANCOVAs presented above, the shares of experienced and inexperienced participants were not equal. This is in line with the skewed distribution of the degree of experience of tax auditors in practice (OECD, 2019), but might have impacted our results. To test this, we performed the same analyses using the median as a cut-off point for both experience and TRI. While group sizes were still not equal (both variables had multiple participants that scored the median), they were much closer to equal size with these cut-off points. The results from these analyses (untabulated) were all qualitatively similar to the analyses presented in Table 7.

*Perceived riskiness separated*

That the *p*-value for the interaction variable was higher for perceived riskiness than for risk detection might be explained by the fact that our composite variable, perceived riskiness, also included all other risks and aspects of the case, while the detection of the IT-related risks focussed solely on the seeded IT-related risks. The inclusion of these other aspects might have diluted the interaction effect of experience and technology readiness. To test this explanation, we analysed the four items of perceived riskiness (risk level, audit effort, internal control risk, and IT control risk) separately. If our suspicion was correct, we would expect the ordinal interaction to be strongest for the item IT control risk. In Figure 2, we visualised the ordinal interactions in the traditional + IT risks version for these four items. In line with our reasoning, the pattern was strongest for the item IT control risk. Furthermore, in the planned contrast, this was the only item for which the ordinal interaction was significant ($p = .02$). This held for all variations of the cut-off points for experience and TRI.

*Figure 2: Estimated Means for the Four Perceived Riskiness Items in the High Risk Setting*




*Experience with auditing in general*

About one in five of the participants had experience of auditing outside of the tax authority (e.g. at a 'big four' auditing firm). Although such auditing experience seems to be less relevant in the context of auditing on behalf of a tax authority, it still contributes to the general experience of auditors and to their skills and knowledge. To account for this, we calculated a measure for total experience by adding up the number of years that each participant indicated they had worked as an auditor at the tax authority and the years they had worked as an auditor outside of the tax authority. The resulting variable was used as a predictor in additional analyses. Conducting the same contrast analyses as in the main analysis yielded similar results. The analyses with the percentage of IT risks detected in the traditional + IT risks version as a dependent variable showed significance for all four cut-off point variations (see the first column in Table 8, Panel A). Furthermore, none of the four contrast analyses with perceived riskiness as a dependent variable yielded significant results (see the second column in Table 8, Panel A).

*Table 8: Planned Contrasts* for Additional Analyses in the Traditional + IT Risks Version*

| Panel A: *p*-values (2-tailed) with total experience | | | |
|---|---|---|---|
| | | IT Risks detected | Perceived riskiness |
| Cut-off exp 5y | Cut-off TRI 75% | .01 | .22 |
| | Cut-off TRI median | .02 | .31 |
| Cut-off exp 7y | Cut-off TRI 75% | .01 | .20 |
| | Cut-off TRI median | .02 | .31 |
| Panel B: *p*-values (2-tailed) excluding risks with low coder agreement | | | |
| | | IT risks detected | |
| Cut-off exp 5y | Cut-off TRI 75% | .01 | |
| | Cut-off TRI median | .01 | |
| Cut-off exp 7y | Cut-off TRI 75% | .00 | |
| | Cut-off TRI median | .01 | |

** = low exp/low TRI (-1), low exp/ high TRI (-1), high exp/ low TRI (-1) and high exp/ high TRI (+3)*
TRI = technology readiness.

*Accounting for low coder agreement*

For three of the risks categorised by the expert coders (risks three, six, and ten), agreement was below 70% in the first coding round. From discussions with our coders, we learned that they considered these risks to be more ambiguous and harder to interpret than the other pre-defined risks. Hence, it is unclear whether the audit quality is really lower when participants do not name these risks. Furthermore, in the creation of the list of predefined risks, these three were in the bottom four in terms of relevance according to the expert panel (with risk number two being the fourth risk in the bottom four). Also, when presented with the full list of seeded risks (see Table 2, Panel B), the participants' evaluations indicated that these specific three risks were not as relevant as we thought when designing the material for our study: in fact, they were among the risks evaluated as least relevant of all seeded risks. To account for this, we performed additional analyses excluding risks number three, six, and ten (note that risks three and six are traditional risks, while risk ten is an IT-related risk). The results were in line with the main analyses (see Table 8, Panel B).

## 5. CONCLUSIONS AND DISCUSSION

The rapid digitalisation of society affects the operations, administrative organisation, and internal control of many organisations. Therefore, the IT environment of organisations plays an increasingly important role when tax authorities are auditing financial statements. Tax auditors must have the appropriate skills to evaluate an entity's IT environment, and to perform effective and efficient tax audits. As the IT environment is constantly changing, however, specialised knowledge and skills can rapidly become obsolete and need to be updated frequently. In this paper, we argue that, in audit environments involving complex IT infrastructures, tax auditors' 'traditional' experience is not enough on its own. In addition, tax auditors need to be motivated and able to continually acquire IT-related knowledge; they must be technology ready. We tested this in a sample of tax auditors of tax authorities from four countries. The auditors dealt with one of two hypothetical cases which either involved only

'traditional' audit risks or 'traditional' audit risks and IT-related risks. We found that audit experience had no effect on audit quality in the 'traditional' setting, but we observed the expected effect of experience and technology readiness on audit quality in respect of IT-related risks. We discuss both findings in the following paragraphs.

In our study, more experienced auditors did not perform better when detecting traditional audit risks. This result was unexpected and contradicted the prior literature (e.g., Goldman et al., 2022). We can only speculate about the reasons for our null finding and will discuss several potential explanations. First, the cut-off point that we used for experience (five years) was probably too high. Some authors argue that two years of experience are enough to master the planning phase of an audit (e.g. Anderson & Maletta, 1994). Since we had too few participants with three or fewer years of experience, we could not test this alternative cut-off point. However, we tested several other cut-off points for experience and found no support for $H_1$.

Secondly, the complexity of the traditional audit risks in our fictional case may have been too low, so that experience could not have had an effect. However, detection rates for the six traditional risks varied between 5% and 63%, which suggests that the task was not too easy for all participants. Interestingly, 55% of the risks identified by the participants were not on our predefined list of risks that were hidden in the case description, and the coders indicated that more experienced auditors highlighted significantly more of these risks as being potentially relevant than less experienced auditors ($m$ =.34 respectively $m$ = .21, $p$ = .01). Because the coders did not agree on these risks, we could not use these in our analyses. It is possible that we did not find an effect of experience because this effect can mainly be found in more original and creative risks, something which is hard to measure with a list of predefined risks.

Thirdly, one of the main arguments as to why more experienced auditors provide higher quality audits is that they are more sceptical than less experienced auditors (Kaplan et al., 2008). By asking the participants to detect risks, we might have primed them to behave in a more sceptical way and thus we might have negated some of the advantages that experience brings to the table. Further research could delve deeper into this effect, for example, by using archival data from actual tax audits.

Fourthly, both experienced and inexperienced tax auditors may have used different judgement and decision processes when evaluating a case. Previous research shows that more experienced auditors select fewer cues and make judgements in less time (Cahan & Sun, 2015). In our study, more experienced participants finished the experiment slightly faster, although this difference was not statistically significant. A more 'heuristical' evaluation such as this might be efficient in one situation, but in another might lead to the auditor having 'tunnel vision'. Although we found no support for the effects of experience, we consider it important to report our null findings (i) to overcome the file drawer problem in published research and (ii) to stimulate more research into the issue—particularly in the context of tax auditing.

For our hypothetical auditing case which also contains IT-related risks, we observed that the combination of experience and technology readiness ensures the best performance in detecting risks hidden in complex IT environments. Therefore, the overall takeaway of our results might be that experience plays a role in achieving higher tax audit quality, just like it does in achieving higher audit quality in general. These results held for various cut-off points for experience and technology readiness. However, for our second audit quality measure—the perceived riskiness of the case—this interaction effect was not significant. The level of perceived riskiness of our fictional case was measured as a composite variable, consisting of the intended audit effort, the

perceived tax risks, the quality of internal control, and the quality of IT control. We did find that more experienced auditors with sufficient technology readiness perceived the IT control risk to be higher than auditors who were less experienced and/or insufficiently technology ready. Accordingly, they also detected more IT-related risks. Interestingly, participants did not infer from the number of IT-related control risks they detected that a higher tax risk could be the result or that more audit effort was required. This might indicate that these participants could identify the IT risks but not the potential impact of such risks on tax returns.

Several limitations should be taken into consideration when interpreting our results. The fact that we failed to replicate the effect of experience on audit quality in the context of tax auditing raises the question of whether our study design was appropriate for testing our hypotheses. The answer to this also, to some degree, affects the validity of our second result, regarding the interaction between experience and technology readiness. However, because the second hypothesis related to a different dependent variable (the number of IT-related risks detected), a cautious interpretation of this result still seems feasible. The subsequent discussion of limitations emphasises some problematic aspects of our method but, overall, we recommend that further research is conducted on both hypotheses before generalising the results to the practice of tax authorities.

The first limitation is that we did not obtain the same proportion of experienced and inexperienced participants for the analyses, mostly due to the skewed distribution of experience amongst the participants—which is in line with statistics provided by the OECD (2019). Although we found similar results when we grouped our data into roughly equal group sizes, the skewed group sizes might have affected our findings. Secondly, the case descriptions used in the scenarios included a number of predefined risks. Determining the relevant tax risks is subjective by nature. We used a large expert group to determine the most relevant risks, but our participants still might have interpreted the predefined risks and the other information in the scenario differently. A third limitation, also related to how the audit scenarios were perceived, is that coder agreement was initially relatively low. We tried to minimise this by using teams of coders and by enabling them to jointly discuss the final coding result. Additionally, we re-ran the analyses after excluding the three risks with lowest coder agreement, which did not change our results.

Despite these limitations, our study contributes to the literature in several ways. First, it addresses *tax audit* quality, a subject that hitherto has received scarce attention despite its importance to the tax system. Secondly, many previous studies have explored the role of experience in auditing (e.g. Cahan & Sun, 2015), whereas we examine empirically whether such experience is generalisable to a highly digitalised setting, and analyse the role that technology readiness plays in this. Thirdly, we add to the literature on technology readiness by applying the framework of Parasuraman and Colby (2015) in the context of (tax) auditing. Fourthly, there is an emergent number of studies focussing on the impact of IT in the audit process (e.g. Bentley, 2021; Cao et al., 2021; Eilifsen et al., 2020; Koreff & Perreault, 2023), but this stream of research focusses on the digitisation of toolkits of auditors rather than on the impact of digitalisation of the audited businesses on the work of the auditor. By addressing how the degree of technology readiness of tax auditors might be related to their performance in settings involving complex, tax-relevant IT risks, we add to a previously largely neglected area of research.

Our study also provides some cautiously drawn insights for tax authorities. In the coming years, many tax authorities will be confronted with the retirement of a large number of employees

(OECD, 2019). Our findings show the types of organisation to which the tax authorities should deploy their decreasing number of experienced auditors and under what conditions these auditors' experience could or could not improve audit quality. This might inform tax authorities' hiring policies and internal tax auditor training programmes.

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## APPENDIX I: CASE

General

With over 80 auditors, lawyers, notaries and tax advisors, Doyle, Holmes & Watson (DH&W) is a nation-wide operating professional services firm in Ireland. The firm has offices in Dublin, Belfast, Cork, Derry and Limerick and has grown historically through a number of mergers and acquisitions. DH&W offers assurance, audit, tax, financial and business advisory services to various economic sectors. The organization is managed from the head office in Dublin.

Organization

DH&W focuses on the challenges of its clients in order to contribute to the success of those organizations. They do this by, among other things, providing top-level advice and also providing excellent service. DH&W works with multidisciplinary teams.

DH&W monitors the markets and sectors in which its customers are active and keeps this knowledge up-to-date. As a result, they quickly identify new developments. DH&W determines the impact thereof and proactively approaches their clients. The multidisciplinary teams combine this sector knowledge with the highest level of expertise. Thanks to the extensive service portfolio, DH&W offers business solutions for every challenge. The firm attaches great importance to its long-term relationships with customers, which sometimes go back 100 years.

*Number of employees at January 1, 2020*

| | |
|---|---|
| Partners | 15 |
| Fee-earners | 75 (including partners) |
| Staff employees | 55 |

*Board*

The board consists of five members. After three years a new board is elected from within the partner group (primus inter pares).

*Organization*

The partners and other fee-earners located in Dublin, are divided into six so-called 'practice groups'. The staff employees are divided into 30 secretaries and 25 staff members, the latter are divided amongst the following departments:

- Financial Administration (FA)
- Tax function
- Research and Development (R&D)
- Human Resources (HR)
- Facility Services
- Information technology (IT)

*Financial figures*

| | |
|---|---|
| Turnover 2018 | € 25.000.000 |
| Profit before profit distribution | € 2.500.000 |

*Number of taxpayers*

| | |
|---|---|
| Number of taxpayers VAT | 4 |
| Number of taxpayers corporate income tax | 3 |
| Number of taxpayers payroll taxes | 3 |

*Compliance history*

DH&W has not been audited for VAT and CIT in the last ten years.

*Business Value Cycle and Internal control in general*

DH&W is a service-oriented organisation, which delivers services to the market with the aim of making profit. The cyclic interrelationship between all primary processes (e.g. services, payment, purchase, sales) of the organisation follows the value cycle of a standard service oriented organisation.

DH&W uses the so-called 'Three Lines of Defense' model:[10]

[10] https://erm.ncsu.edu/library/article/cosos-take-on-the-three-lines-of-defense

1) The first line of defense is the management itself.
2) The second line is the FA department that operates on behalf of management as an adviser but also as a 'reviewer'.
3) The third line of defense is the internal control officer who reports to the DH&W Supervisory Board.

The business control framework – that helps the organisation to establish, assess and enhance its internal control – is maintained by the compliance staff in collaboration with the board and is based on COSO.[11]

Tax function of DH&W

At the head office of DH&W, three full-time tax specialists are responsible for tax matters. The local branches report directly to the head office. The tax function at the head office is also responsible for training the practice groups in all tax matters. These training sessions take place every year. The tax specialists' team has knowledge of (corporate) income tax, VAT as well as payroll taxes. The tax strategy is coordinated within DH&W and can be characterized as business-like ("we pay what we have to, but we do not want to leave opportunities unused"). The tax function can be characterized as professional. Most employees have been in the same place for more than 20 years and have developed highly structured working methods. The Financial Administration, HR and the Tax function have a good working relationship and meet on a monthly basis. DH&W has a small team of internal auditors. They perform various test activities, also regarding tax. It draws up an annual audit plan and communicates the results directly to the board in a formal report.

IT

Situation IT-1: No additional IT risks

All DH&W offices make extensive use of the same solid ERP system.[12] All business cycles and data flows (from order-to-cash, from purchase-to-pay, from hire-to-pay /fire) are based on uniform working methods and as such are fully supported by the ERP application. Special attention is paid to data gathering and the possibilities of Standard Business Reporting (SBR) applications. The processing of VAT-related matters is therefore fully automated, including intercompany transactions. VAT codes are part of the central master data. The IT and Tax departments meet on a regular basis to discuss parameterisation of fiscal aspects of transactions.

User-IDs to all IT-systems are issued centrally from the head office. All passwords have to comply with strict requirements and have to be changed every 45 days. Within the ERP system DH&W uses a limited number of user profiles for assigning user rights. The Financial Administration verifies the mutations in the user IDs on a monthly basis.

The partners within the practice groups are authorized for all purchases. Suppliers can use a web application to log in to the DH&W server for the collection of their orders and order confirmation. All purchase invoices are received centrally in Dublin via a web application,

[11] COSO: https://www.coso.org/_files/ugd/3059fc_1df7d5dd38074006bce8fdf621a942cf.pdf
[12] Enterprise Resource Planning (ERP) is usually referred to as a category of business management software—typically a suite of integrated applications—that an organisation can use to collect, store, manage, and interpret data from many business activities.

automatically coded (including the VAT), digitally scanned, sent to the responsible partner through an automated workflow for approval and subsequently processed in the general ledger. DH&W has a formal back-up and recovery process.

Regarding sales invoices, the Financial Administration receives digital pro forma invoices from the partners. Subsequently, based on client and activity codes in the master data, the correct VAT code is determined and the Financial Administration performs a final check of the invoice.

Situation IT-2: Additional IT risks

All DH&W offices make extensive use of financial accounting software. Five different financial accounting software programs are in use at the various branches. As a result of the various financial accounting software programs, the Financial Administration establishes a monthly manual consolidation process. Special attention is paid to data gathering and the possibilities of Standard Business Reporting (SBR) applications. However, VAT codes are not part of the central master data and can be changed by all users. The IT and Tax departments do not meet on a regular basis; they consult only on when incidents in the parameterisation of fiscal aspects of transactions occur.

User-IDs to all IT-systems are issued centrally from the head office. Due to long waiting times in the issuing of new user-IDs, new employees often use the user-IDs of colleagues until they receive their own IDs. All passwords have to comply with strict requirements and have to be changed every 45 days. Within the financial accounting software programs, DH&W assigns user rights on an individual basis. When employees change function or get additional/ different responsibilities, they automatically get the additional rights needed in the financial accounting software programs. Their supervisor has to report this to the IT-department so that the IT-department will withdraw no longer needed rights within the financial accounting software program.

The partners within the practice groups are authorized for all purchases. Suppliers can use a web application to log in to the DH&W server for the collection of their orders and order confirmation. All purchase invoices are received centrally in Dublin via a web application, automatically coded (including the VAT), digitally scanned, sent to the responsible partner through an automated workflow for approval and subsequently processed in the general ledger. DH&W has a formal back-up and recovery process.

## APPENDIX II: SEEDED RISKS

| Nr. | Risk name | Risk Description | Text in case |
|---|---|---|---|
| 1 | Incidental Transactions | Risk of incorrect tax processing of incidental transactions | A number of mergers and acquisitions |
| 2 | Collusion | Risk of conspiring with clients | The firm attaches great importance to its long-term relationships with customers, which sometimes go back 100 years |
| 3 | Complexity | Complexity due to large number of taxpayers | Number of taxpayers VAT 4, Number of taxpayers corporate income tax 3, Number of taxpayers payroll taxes 3 |
| 4 | Aggressiveness | Risk of overaggressive behaviour | We pay what we have to, but we do not want to leave opportunities unused |
| 5 | Decentralization | Decentralized control | The partners within the practice groups are authorized for all purchases. |
| 6 | Services | Tax risks due to wide range of services, because a wide range of services relate to different types of taxation | With over 80 auditors, lawyers, notaries and tax advisors, Doyle, Holmes & Watson (DH&W) is a nation-wide operating professional services firm |
| 7 | IT Interfaces | Risk of incorrect and/or incomplete of data due to multiple financial accounting software programs with manual interfaces | A monthly manual consolidation process is established |
| 8 | IT Segregation | Tax risks due to faulty segregation of duties | VAT codes are not part of the central master data and can be changed by all users |
| 9 | IT Access Control | Tax risks due to faulty logical access controls | Due to long waiting times in the issuing of new user-IDs, new employees often use the user-IDs of colleagues for a long period of time. |

| | | | |
|---|---|---|---|
| 10 | IT Rights | Tax risks due to faulty rights management | When employees change function or get additional/ different responsibilities, they automatically get the additional rights needed in the financial accounting software programs. Their supervisor also has to report this to the IT-department so that the IT-department withdraws no longer needed rights within the financial accounting software program. |

*N.B. Risks 7 through 10 were only seeded in the version with additional IT risks.*

## APPENDIX III: ITEM WORDING

Perceived riskiness

1. Given the description of the organization, how would you score the audit effort needed for this organization on a scale from relatively few audit hours (1) relatively many audit hours (7)?

2. Given the description of the organization, how would you score the risk profile of this organization on a scale from very low risk (1) to very high risk (7)?

3. How do you estimate the quality of the internal control framework of DH&W on a scale from very low quality (1) to very high quality (7)?

4. How do you estimate the quality of IT control of DH&W on a scale from very low quality (1) to very high quality (7)?

*Items 3 and 4 were reverse coded before calculating the composite variable.*

Technology Readiness

Score the following 8 items on a scale from 1 (strongly disagree) to 7 (strongly agree):

1. New technology contributes to a better quality of life

2. Technology gives me more freedom of mobility

3. Other people come to me for advice on new technologies

4. In general, I am among the first in my circle of friends to acquire new technology when it appears

5. When I get technical support from a provider of a high-tech product or service, I sometimes feel as if I am being taken advantage of by someone who knows more than I do

6. Technical support lines are not helpful because they don't explain things in terms I understand

7. People are too dependent on technology to do things for them

8. Too much technology distracts people to a point that is harmful

*Items 5 through 8 were reverse coded before calculating the composite variable.*

Professional scepticism

Score the following 6 items on a scale from 1 (strongly disagree) to 7 (strongly agree):

1. I always try to look at all sides of a problem

2. One can usually overcome difficulties by thinking about the problem, rather than through waiting for good fortune

3. I try to look at everybody's side of a disagreement before I make a decision.

4. One should disregard evidence that conflicts with one's established beliefs.*

5. A person should always consider new possibilities

6. People should always take into consideration evidence that goes against their beliefs

**Item 4 was removed due to low factor loading.*

Specialism

The *professional service sector* is that part of the economy in which (a group of) trained specialist provide services to clients. Examples of such specialist are lawyers, accountants and architects.

Looking at the last three years, what percentage of your auditing hours have you spent on auditing businesses in the *professional service sector*?

- o 0%
- o >0% ≤25%
- o >25% ≤50%
- o >50% ≤75%
- o >75%

Expertise

What is your main field of expertise at the tax authority? (Choose one)

1. Payroll taxes
2. Value added taxes
3. Corporate income taxes
4. Auditing
5. IT-auditing
6. Other

# HOW DO MULTINATIONALS SHIFT PROFITS OUT OF INDONESIA?

*Arnaldo Purba*[1], *Alfred Tran*[2]



**Abstract**

Prior studies indicate that there are two main channels used by multinational enterprises (MNEs) to shift profits from high-tax countries to low-tax countries: transfer pricing and debt financing. This study investigates profit shifting through these channels in Indonesia using Indonesian tax return data. The performances of foreign-owned Indonesian companies (FOICs), which are Indonesian affiliates of foreign MNEs, and domestic-owned Indonesian companies (DOICs) are compared in terms of earnings before interest and taxes scaled by total sales, and long-term debt to related parties scaled by total assets, in order to capture profit shifting using the transfer pricing and debt financing channels respectively. Propensity score matching and coarsened exact matching are used to match FOICs as the treatment group and DOICs as the control group. The results show that FOICs use both transfer pricing and debt financing to shift profits out of Indonesia.

**JEL Classification Codes**: E62, F23, H26.
**Keywords:** Profit Shifting, Transfer Pricing, Debt Financing, Indonesia.

## 1. INTRODUCTION

The "empirical identification of the existence and magnitude" of cross-border profit shifting is characterised by difficulties (Dharmapala & Riedel, 2013, p. 95). As a result, most empirical studies focus on finding "an indirect identification strategy that measures the impact of variations in corporate tax rates on the profitability of multinational subsidiaries" in different countries (Dharmapala & Riedel, 2013, p. 95). Dharmapala and Riedel (2013) note that only a "small number of studies" attempt to find more direct evidence, such as the channels used by MNEs to shift profits (p. 95).

MNEs can use several channels to shift profits in order to lower their global tax liabilities. The two most common channels used are cross-border transfer pricing and high debt financing arrangements. Most prior studies investigate profit-shifting channels used by MNEs that rely on corporate tax rate variations between the country in which the parent company is located and the country in which the subsidiary operates (see, for example, Buettner & Wamser, 2013; Clausing, 2003; Swenson, 2001; Vicard, 2015). Moreover, most prior studies use data from developed countries and few use data from developing countries.

In the case of Indonesia, two Indonesian Finance Ministers, Agus DW Martowardojo (detikFinance, 2013) and his successor, Bambang PS Brodjonegoro (detikFinance, 2015), issued statements indicating that thousands of FOICs have not paid corporate income tax (CIT) for many years. Brodonegoro (detikFinance, 2015) noted that companies have used transfer pricing and intra-group debt financing to avoid paying Indonesian CIT. While the two

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statements are not empirical evidence of the existence of cross-border profit shifting in Indonesia per se, they indicate that the nation may suffer from such tax avoidance strategies.

Purba and Tran (2020) investigate whether FOICs, i.e. Indonesian affiliates of foreign MNEs, shift profits out of Indonesia by examining how different statutory tax rates (STRs) in Indonesia and the source country of investment impact the taxable income that FOICs report in their Indonesian tax returns. The results show that the lower the parent company's STR, the lower the taxable income reported by the FOICs, indicating that FOICs shift profits to parent companies located in low tax countries. The present study extends Purba and Tran's (2020) study by investigating two channels that FOICs may use to shift profit out of Indonesia.

More precisely, this article investigates whether FOICs use intra-firm transfer pricing and/or debt financing by related parties to shift profits out of Indonesia, a major developing country, by taking a different approach. The analyses include comparisons between FOICs and comparable domestic-owned Indonesian companies (DOICs)[3] in terms of two indicators that are expected to capture the two profit-shifting channels. Specifically, this study compares earnings before interest and taxes scaled by total sales (*EBIT/S*) and long-term liabilities with related parties[4] scaled by total assets (*LTL_RP/TA*) to capture the transfer pricing and debt financing channels of profit shifting respectively.

This study uses confidential corporate tax return data provided by Indonesia's tax authority, the Directorate General of Tax (DGT), including data from financial reports. FOICs (as the treatment group) and DOICs (as the control group) are matched in pairs using the propensity score matching (PSM) and coarsened exact matching (CEM) procedures. Statistical analyses using paired *t*-tests and ordinary least squares (OLS) regressions on the matched samples find that FOICs shift profits out of Indonesia by means of both transfer pricing and debt financing.

The remainder of this article is organised as follows. First, the relevant institutional settings in Indonesia are described. Section three presents a brief literature review and develops the hypotheses for testing. Section four explains the research design and section five presents the empirical results. The contributions made by this study and possible avenues for future research are discussed in the concluding section.

## 2. INDONESIAN INSTITUTIONAL SETTINGS

### 2.1. Corporate Tax System in Indonesia

The Indonesian CIT rate was 30% between 1984 and 2008. It then decreased to 28% in 2009 and to 25% in 2010. Indonesia's Income Tax Law 1983 (ITL 1983) does not allow the CIT paid on company profits to be attached to the dividends and claimed by shareholders as a tax credit. This means that Indonesia adopts the classical system of company taxation rather than the dividend imputation system. In the classical system of company taxation, income tax paid by a company cannot be passed on to its shareholders as tax credit, whereas the dividend imputation system allows this to occur. As Indonesia adopts a classical system that taxes company profit and shareholders' dividend income separately, Indonesian companies have an incentive to avoid CIT in order to maximise their shareholders' wealth.

[3] At least 98% of the sample of DOICs in this study do not involve any foreign ownership.
[4] Income Tax Law No. 7/1983 as lastly amended by Law No. 7/2021 Article 18(4a) of the ITL 1983 refers to related parties as two companies or more that are connected by ownership or control of management or technology.

In Indonesia, consolidation only applies to financial reporting and is not adopted for tax purposes. As a result, all intra-group transactions, including transfer pricing and debt financing, are only eliminated in consolidated financial reports and remain reflected in corporate tax returns. This institutional arrangement allows the present study to investigate intra-group transactions using tax return data by examining whether FOICs use intra-group transfer pricing and/or debt financing to shift profits out of Indonesia.

Article 4(1) of the ITL 1983 states that all income received from within and outside of Indonesia is subject to Indonesian income tax, suggesting that the country has adopted the worldwide income system. To avoid the double taxation of foreign income, Article 24 of the ITL 1983 allows tax that has already been paid offshore by resident taxpayers to be credited against tax payable in Indonesia in the same year as long as it does not exceed a certain level.[5] Scholes et al. (2015) suggest that MNEs in countries that impose worldwide tax systems may have more incentive to shift profits than those in countries that impose territorial tax regimes. This is because, while most countries with worldwide tax systems allow resident taxpayers to offset tax paid in foreign countries against their domestic tax liability, in some cases the full amount of tax paid overseas cannot be claimed because of the tax offset limit imposed by the government.

## 2.2. How Indonesia Fights Profit Shifting by Foreign-Owned Indonesian Companies

Although there is little supporting empirical evidence, the DGT is aware that the incidence of international tax avoidance has increased because of the borderless economy. The following statement depicts the DGT's concern about tax avoidance by FOICs, particularly by means of transfer pricing arrangements:

> Under the current globalisation, the intensity and magnitude of transnational transactions are more dominant in the economy either by related parties or independent parties. This brings different tax implications and should receive serious concerns. Transfer pricing is closely related to transactions between affiliated parties, which must be strictly supervised since it can be used to reduce the tax that must be paid (tax avoidance). (DGT, 2010, p. 80)

The government's concern can also be observed in the amendments to the ITL that have been passed by the legislature since the law came into force on 1 January 1984. Article 18 of the ITL 1983, regarding international tax issues, has been included in these amendments three times. The tax avoidance provisions—especially those related to company tax avoidance—according to Article 18 of the ITL 1983 and its elucidations, as lastly amended in 2021 and taking effect on 1 January 2022, include three specific anti-avoidance rules, as follows:[6]

> 1. Thin capitalisation rules: the Finance Minister is authorised to issue a decree on the debt-to-equity ratio for tax purposes;

[5] Indonesian Finance Minister Decree No. 165/2002 specifies that the limit is calculated as follows: $\frac{\text{income from overseas}}{\text{global TI}}$ X total tax payable.

[6] The ITL 1983 does not contain any general anti-avoidance rule, i.e. anti-tax avoidance rule that is not limited to certain tax subjects or objects.

2. Controlled foreign company (CFC) rules: the Finance Minister is authorised to determine when a resident taxpayer is deemed to receive dividends from a non-listed foreign company provided that the taxpayer (alone or together with other resident taxpayers) controls at least 50% of the shares of the foreign company; and

3. Transfer pricing rules: the Director General of Tax is authorised to redetermine income and deductions, and to reclassify debt as equity for taxable income computation purposes for transactions between related parties.

The amendments to Article 18 of the ITL 1983 detailed above are the main provisions used to combat tax avoidance by MNEs in Indonesia. These new provisions came into force on 1 January 2009 and remained unchanged until 2015. Following the authority given by Article 18(2) of the ITL 1983, the Finance Minister issued Finance Minister Regulation No. 256/2008 in 2008, which contains the CFC provisions. However, there were delays in issuing the operating regulations for thin capitalisation and transfer pricing rules as mandated by Article 18(1) and (3) of the ITL 1983 respectively. The Director General of Tax issued the Director General of Tax Regulation PER-43/PJ/2010 concerning the Implementation of Arm's Length Principle for Transactions with Related Parties in 2010, which came into effect on 6 September 2010. The Finance Minister eventually enacted Regulation of the Minister of Finance of the Republic of Indonesia (PMK) number 169/PMK.03/2015 on Determination of Corporate Taxpayer's Debt to Ratio for Income Tax Calculation Purposes, which contains the thin capitalisation provisions, on 9 September 2015, although this did not come in force until 2016.

Previous studies find that transfer pricing rules effectively increase the use of the arm's length principle on intra-firm trade (e.g. Halperin & Srinidhi, 1987; Schjelderup & Weichenrieder, 1999) and that thin capitalisation rules effectively lessen the incentive to use internal loans for tax avoidance (e.g. Buettner et al., 2012; Buslei & Simmler, 2012). Therefore, the absence of transfer pricing rules before September 2010 and the absence of thin capitalisation rules before 2016 may have provided FOICs with opportunities to shift profits out of Indonesia.

## 3. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### 3.1. The Meanings of Transfer Pricing, the Arm's Length Principle, and Debt Financing

Markusen (1995) defines MNEs as "firms that engage in foreign direct investments" (FDIs), i.e. investments "in which the firm acquires a substantial controlling interest in a foreign firm or sets up a subsidiary in a foreign country" (p. 170). He proposes that the fundamental reason why an MNE may choose to establish an affiliate overseas is that MNEs are different from domestic companies: "If foreign multinational enterprises are exactly identical to domestic firms, they will not find it profitable to enter the domestic market" (Markusen, 1995, p. 173). Further, he discusses several inherent disadvantages and advantages that MNEs commonly encounter. The disadvantages include the higher "costs of doing business in another country, including communications and transport costs, higher costs of stationing personnel abroad, barriers due to language, customs, and being outside the local business and government networks" (Markusen, 1995, p. 173). The inherent advantages that MNEs have are "superior technology or lower costs due to scale economies" (Markusen, 1995, p. 173). In addition, Markusen (1995) referred to the ownership, location and internalisation (OLI) framework proposed by Dunning (1977). The framework posits that the advantages of OLI must be present

for MNEs to undertake FDI. The two paragraphs below describe the three conditions according to Markusen's explanation.

First, ownership is any advantage that represents a "valuable market power" that other firms do not possess, "such as a patent, blueprint, or trade secret", or "something intangible, like a trademark or reputation for quality" (Markusen, 1995, p. 173). Secondly, location refers to the advantage that an MNE can obtain by producing goods in a foreign country. Markusen (1995) notes that these advantages can include lower "tariffs, quotas, transport costs, and cheap factor prices", as well as better "access to customers" (p. 173).

The third, and probably most decisive advantage, is internalisation. For some MNEs, possessing the first two advantages (i.e. ownership and location) may be insufficient to set up a foreign affiliate because they have alternative options, such as providing a domestic firm in the targeted foreign country with a licence to produce the goods or use their production method. By doing this, the parent company does not need to set up a manufacturing facility in that country, something that can be a costly and difficult process. The advantage of internalisation encourages MNEs to set up affiliates in foreign countries. Internalisation is defined as an opportunity to exploit a product or process internally among companies within the same ownership (see Markusen, 1999). That is, internalisation gives MNE affiliates located in different countries opportunities to arrange internal prices and processes for products that are traded within the same group. This explains why internalisation is the most decisive advantage for some MNEs setting up foreign subsidiaries. Citing Rugman (1986), Markusen (1995) wrote that "internalisation is really the only thing that matters to understanding the multinational" (p. 174).

Cross-border profit shifting is a good example of the benefits of internalisation. MNEs can use various channels to shift profits from one subsidiary to others located in different tax jurisdictions. Two profit-shifting channels are extensively studied in the literature. The first channel is intra-group transfer pricing, whereby MNEs set the prices for cross-border transactions between affiliates within the same group to shift profits in order to avoid taxes. Given that MNEs often misuse transfer prices by setting prices that do not satisfy the arm's length principle to lower their tax liability, some studies refer to it as transfer mispricing (Bastin, 2014; Spencer, 2012), abusive transfer pricing (Schindler & Schjelderup, 2013; Wickham, 1991) or transfer price management (Jacob, 1996; Pendse, 2012).

The widely accepted definition of transfer pricing is presented below:

> "Transfer pricing" is the general term for the pricing of cross-border, intra-firm transactions between related parties. Transfer pricing therefore refers to the setting of prices [footnote removed] for transactions between associated enterprises involving the transfer of property or services. These transactions are also referred to as "'controlled" transactions, as distinct from "uncontrolled" transactions between companies that are not associated and can be assumed to operate independently ("on an arm's length basis") in setting terms for such transactions. (United Nations, 2013, p. 2)

Based on the above definition, transfer pricing appears to have a negative connotation: MNEs are likely to use it as a strategy to avoid income taxes by arranging the prices used for cross-border, intra-firm transactions.

The arm's length principle refers to prices used for transactions between independent or non-related parties. Tax convention models such as the Organisation for Economic Co-operation and Development (OECD)'s Model Tax Convention on Income and on Capital (OECD, 2017)—the OECD Model—and the United Nations Model Double Taxation Convention between Developed and Developing Countries (UN, 2017)—the UN Model—require MNEs to use the arm's length principle for pricing intra-firm transactions.

The arm's length principle treats the members of an MNE group "as separate entities rather than as inseparable parts of a single unified business" (OECD, 2009, p. 27) and it is "essentially an approximation of market-based pricing" (United Nations, 2013, p. iii). That is, the arm's length principle requires MNEs to use market prices for intra-firm transactions rather than arranging or managing the transfer prices to avoid income taxes in high-tax jurisdictions. However, in the real world, there are difficulties in applying the arm's length principle, especially in situations where the goods or services involved are unique and where market-based prices in transactions between independent parties are absent.

The second channel that MNEs use to shift profits is high debt financing, especially financing by loans from related parties. A company may deliberately finance its business activities by debt rather than by equity. For instance, companies may deliberately restructure their financing arrangements so that the finance is recognised as a debt or loan rather than as equity capital under the tax rules. This is often referred to as "thin capitalisation" in the tax literature. From a taxation point of view, the reason why MNEs tend to use loans to finance subsidiaries in high-tax countries is that debt financing (also known as leveraging or gearing) is more beneficial than equity financing because the payment of interest on debt is deductible for tax purposes, whereas the payment of dividends on equity is not.

Both FOICs and DOICs can use transfer pricing and debt financing as channels to shift profits between related parties. However, when DOICs shift profits between related parties, the group as a whole will likely end up with the same tax liability because the members of the group are taxed under Indonesian tax law. In contrast, an FOIC has incentives to shift profits out of Indonesia because the parent company and its affiliates are in different tax jurisdictions. For example, an FOIC that requires substantial capital to finance its operations, such as a mining FOIC, has incentives to be financed by intra-group debts from its parent company or an affiliate located in a low-tax jurisdiction. Accordingly, the interest expense paid on the intra-group debt by the FOIC will lead to higher tax benefits in Indonesia than the tax cost associated with the interest income in the low-tax country where the lender is located. Cross-border profit shifting out of Indonesia by foreign MNEs—either by transfer pricing or debt financing—can lower the total tax payable by the group as a whole.[7]

### 3.2. Review of Some Prior Studies and Development of Hypotheses

Some previous studies focus on transfer pricing arrangements, some focus on debt financing, and some examine both. This section presents three examples of studies that focus on transfer pricing. Bartelsman and Beetsma (2003) examine whether MNEs shifted profits among OECD countries during the period 1979–1997. Unlike earlier studies that examine income shifting from developed countries to low-tax jurisdictions, they focus on profit shifting by MNEs

[7] From a theoretical point of view, Indonesian affiliates of MNEs may also receive profit shifted from other affiliates in higher tax jurisdictions. However, as the corporate tax rate in Indonesia (28% in 2009 and 25% from 2010) is relatively high compared to many other countries, especially tax havens, it is doubtful that Indonesia may be chosen as a profit-shifting destination by MNEs.

among OECD countries and base their empirical analysis "solely on the manufacturing sector" (Bartelsman & Beetsma, 2003, p. 2246). They control "for the effects of taxes and unobserved productivity on the scale of real economic activity" by "regressing the ratio of total value added to wage payments on tax rate differences", and claim that this "novel method" can isolate "the pure effects of income shifting" (Bartelsman & Beetsma, 2003, p. 2226). They find significant tax-motivated transfer price arrangements by MNEs. Specifically, they find that a unilateral tax increase reduces the reported income tax base and estimate that "more than 65% of the additional revenue" expected from such a tax increase "is lost because of income shifting" (Bartelsman & Beetsma, 2003, p. 2246).

Bernard et al. (2006) study how MNEs based in the United States (U.S.) set prices that differ across related and unrelated party buyers. Using U.S. international trade transaction data provided by the U.S. Census Bureau and the U.S. Customs Bureau between 1992 and 2000, the authors find that U.S. exporters set substantially higher prices for their arm's length customers than for related parties. These differences exist even for transactions with the same characteristics (i.e., the same product, the same exporter, the same time of shipping, and the same shipment mode). Their findings suggest that U.S.-based MNEs have used transfer pricing arrangements as a channel for shifting profits out of the United States.

Using firm-level trade data for France in 2008, Vicard (2015) examines whether MNEs in France avoid French income tax by means of transfer pricing in trade with related parties, as well as the documents that the MNEs use "to manipulate their transfer prices to shift profits to affiliates located in low tax countries in order to reduce their tax expenses" (p. 3). He finds that if France has a corporate tax rate that is one percentage point higher than that of its trade partner, intra-firm export prices reduce by 0.22% and intra-firm import prices increase by 0.24%. Therefore, like the authors of the previous studies, he finds that French-based MNEs also use the transfer pricing strategy to shift profits.

The next three studies discussed investigate whether MNEs shift profits by means of debt financing. Mills and Newberry (2004) investigate how tax rate differences affect income reporting by MNEs and examine whether tax incentives affect the debt policies of foreign MNEs. They use two different measures of foreign tax incentives. First, they define tax incentives as the difference between the U.S. statutory corporate tax rate and the foreign MNE parent's effective tax rate. Secondly, they refer to tax incentives as the difference between the U.S. statutory corporate tax rate and the statutory corporate tax rate of the foreign MNE parent's home country. They find that the use of debts in U.S. affiliates is higher for foreign MNEs with lower foreign tax rates than for foreign MNEs with higher foreign tax rates for both measures of tax incentives, suggesting that MNEs finance their U.S. affiliates with higher debt only when the parent country of the U.S. affiliate has a lower income tax rate than that of the United States.

Huizinga et al. (2008) used firm-level data for European MNEs and their affiliates over the period 1994–2003 to examine whether an MNE's indebtedness in a country depends on tax rate differences. When considering an MNE "with two equal-sized establishments in two separate countries", an overall tax increase of 10% in one country increases "the leverage ratio in that country by 2.4%, while the leverage increase in the other country decreases by 10%" (Huizinga et al., 2008, p. 81). This finding suggests that European MNEs use high debt financing to shift profits out of high-tax host countries.

Buettner and Wamser (2013) also confirm that MNEs use debt financing to shift profits. Using panel data on German MNEs, they examine whether tax rate differences in 145 countries were used to facilitate internal debt financing by MNEs to shift profits to low-tax jurisdictions during 1996–2005. They observed that a foreign affiliate tends to use more internal debt financing if (1) the parent controls another affiliate that operates in a low-tax jurisdiction and (2) the tax rate difference between the foreign affiliate and the affiliate with the lowest tax rate within the group is significant. While the effect is small (partly, they find, because of the German-controlled foreign company rules), this result suggests that German MNEs shift profits out of high-tax countries by means of intra-group debt financing.

The studies mentioned above investigate the channels (either transfer pricing or debt financing) used by MNEs to shift profits by relying on the effect of tax rate differences. In a different study, Egger et al. (2010) examine both channels by comparing foreign-owned companies and domestic-owned companies. Specifically, they use data from 1999 to 2004 about more than 500,000 plants in 31 European countries to identify the causal effects of foreign ownership on profit tax savings. They argue that "by focusing on foreign-owned and comparable domestically-owned firms", they will "not only be able to estimate tax savings through foreign ownership as such but also identify" the important channels used by foreign-owned corporations to avoid income taxes (Egger et al., 2010, p. 100). They continue:

> Two such channels whose relative importance we will be able to explore are the (direct) shifting of profits from high-tax to low-tax countries (e.g., by transfer pricing, royalty and license fee payments, and other measures) and the (indirect) shifting of the tax base by shifting debt to countries where corporate tax rates are relatively high. (Egger et al., 2010, p.100)

They discover that "profit shifting through transfer pricing or royalty and license payments" is "relatively more important" than debt shifting in European economies (Egger et al., 2010, p. 106).

While all prior studies discussed in this section focus on channels used by MNEs to shift profits from the perspective of a developed country, cross-border profit shifting by means of transfer pricing and debt financing is also likely to occur in Indonesia—a developing country—for two reasons. First, FOICs have a competitive advantage over DOICs because, as explained in section 2.1, FOICs are affiliates of foreign MNEs and can, therefore, use the international network of affiliates (the internalisation factor) to avoid Indonesian CIT. Secondly, prior studies (e.g. Crivelli et al., 2015; Fuest & Riedel, 2010) find that developing countries also suffer as a result of profit shifting by MNEs. While these studies do not specifically investigate how MNEs shift profits out of developing countries, the findings appear to be plausible.

This study attempts to provide empirical evidence of the channels used by FOICs to shift profits out of Indonesia by comparing FOICs and DOICs. Specifically, it utilises two measures to detect the channels used by FOICs to shift profits out of Indonesia. First, earnings before interest and taxes (EBIT) to sales ratio (*EBIT/S*) is expected to capture profit shifting through transfer pricing arrangements. If foreign MNEs establish FOICs to artificially suppress selling prices, or to inflate purchase costs, management fees, rent or lease payments, or royalties or licence fees paid to affiliates overseas, their *EBIT/S* will be lower than those of comparable DOICs (comparable in terms of industry sector, firm size, and maturity). Thus, the lower *EBIT/S* of FOICs relative to comparable DOICs indicates the incidence of profit shifting by means of transfer mispricing of goods and services.

Secondly, long-term liability to related parties to total assets ratio (*LTL_RP/TA*) is expected to capture profit shifting through intra-group debt financing. The higher *LTL_RP/TA* of FOICs relative to comparable DOICs indicates the incidence of profit shifting by means of intra-group debt financing. Transfer pricing and debt financing can be complementary to, or a substitute for, each other as the channels to shift profits (Saunders-Scott, 2015).

Therefore, this study predicts a negative relation between *FOIC* (an indicator variable that takes the value of "1" if the Indonesian company is an FOIC and "0" for a DOIC) and *EBIT/S*, and a positive relation between *FOIC* and *LTL_RP/TA*. This leads to the two hypotheses stated in the alternative form as follows:

H1: FOICs report lower *EBIT/S* than comparable DOICs.
H2: FOICs report higher *LTL_RP/TA* than comparable DOICs.

## 4. RESEARCH DESIGN

### 4.1. Sample Selection and Period of Study

This study uses confidential corporate tax return data obtained from the DGT under a data nondisclosure agreement. However, the DGT only supplies tax return data for DOICs registered in the Jakarta tax offices. Given the variation in the quality of tax return data processed by the Jakarta tax offices and regional tax offices, this study only includes companies (FOICs and DOICs) registered with the Jakarta tax offices in order to ensure consistent data quality. This study uses data reported in company tax returns because, according to the OECD (2015), tax return data can capture the existence of profit shifting by MNEs more effectively than financial data. All firms in the current study have been anonymised by the DGT for privacy protection.

The time period for the study is 2009 to 2015. A key reason for starting the study from 2009 is related to the Indonesian tax administrative reform, better known as *modernisasi* (modernisation), which began in July 2002. Completed at the end of 2008, the reform claimed to have equipped Indonesian tax office units nationwide with "more efficient organizational structure, more simplified and transparent business process, adoption of the more advanced system and information technology, better human resources and improved good governance" (DGT, Ministry of Finance of the Republic of Indonesia, 2010, p. 38). As a result, tax return data from 2009 onwards is expected to be more reliable for research purposes. The reason for ending the period of study in 2015 is simply because this was the latest year for which the confidential tax return data was available from the DGT.

Table 1 presents the derivation of the final samples used in this study for the two dependent variables.

*Table 1: Final Sample Size*[8]

| | ***EBIT/S*** | ***LTL_RP/TA*** |
|---|---|---|
| Number of firm-years between 2009 and 2015 with data available for PSM procedure | 31,596 | 33,099 |
| Number of firm-years between 2009 and 2015 in the matched sample available for paired *t*-tests and OLS regressions | 5,272 | 7,458 |
| Consisting of: | | |
| FOICs | 2,636 | 3,729 |
| DOICs | 2,636 | 3,729 |

Notes: PSM: Propensity score matching. OLS: Ordinary least squares. FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

## 4.2. Measurement of Variables and Statistical Procedures

This study examines whether FOICs use transfer pricing and debt financing to shift profits out of Indonesia by comparing their profitability and the extent of intra-group debt financing with those of comparable DOICs. Following Egger et al. (2010), it examines foreign-owned companies (the treatment group) and comparable domestic-owned companies (the control group) in order to identify the channels used to shift profits. This is done in three stages, as outlined below.

*Stage 1 – Regression models without matching*

In the first stage, OLS regressions are used to investigate whether FOICs reported significantly lower *EBIT/S* and significantly higher *LTL_RP* than DOICs. More precisely, the two profit-shifting channel indicators used in this study are:

1. *EBIT/S* (earnings before interest and taxes scaled by total sales) to detect profit shifting by transfer pricing. The difference between the *EBIT/S* of FOICs and DOICs captures suppressed selling prices, inflated purchase prices, and inflated rent, royalties and management fees paid to associates overseas.

2. *LTR_RP/TA* (long-term liabilities to related parties scaled by total assets) to detect profit shifting by intra-group debt financing.

Equations (1) and (2) are the two OLS regression models used to analyse the differences between FOICs and comparable DOICs in terms of the two intra-group profit-shifting indicators:

[8] For EBIT/S model, the authors consider observations with EBIT/S < -1 and EBIT/S > 1 outliers. As for LTL_RP/TA model, the authors consider observations with LTL_RP/TA < 0 and LTL_RP/TA > 1 outliers.

$$EBIT/S_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 Age_{it} + \beta_{4-76} Industry_{it} + \beta_{77-82} Year_t + \varepsilon_{it} \quad (1)$$

$$LTL\_RP/TA_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 CapInt_{it} + \beta_4 Age_{it} + \beta_{5-77} Industry_{it} + \beta_{78-83} Year_t + \varepsilon_{it} \quad (2)$$

where:

$EBIT/S_{it}$ is earnings before interest and taxes divided by sales for firm *i* and year *t*;

$LTL\_RP/TA_{it}$ is long-term liability to related parties divided by total assets for firm *i* and year *t*;

$FOIC$ is a dummy variable that equals 1 if the company in the sample is an FOIC, or 0 if the company in the sample is a DOIC;

$\ln Sales_{it}$ is the natural logarithm of total sales for firm *i* in year *t*;

$CapInt_{it}$ is capital intensity, measured by net property, plant, and equipment scaled by total assets for firm *i* and year *t*;

$Age_{it}$ is the number of years the company has been registered in an Indonesian tax office for firm *i* and year *t*;

$Industry_{it}$ is a set of dummy variables indicating the DGT industry classification of firm *i* and year *t*;

$Year_t$ is a set of six dummy variables that is expected to account for yearly fluctuations in *EBIT/S* or *LTL_RP/TA* (the dependent variable) that were not explained by *FOIC* (the independent variable) and any of the above control variables;

$\varepsilon_i$ is the error term.

Equations (1) and (2) control for firm size by using total sales as a proxy. Total sales are in a natural logarithmic form (ln*Sales*) to transform total sales that are likely skewed into a more approximately normal variable. An advantage of using sales rather than assets as a proxy for firm size is that sales might capture firm size better than assets for companies that have large sales but only a small amount of assets. Firm size effects reported in the literature are inconsistent.[9] Therefore, following prior studies (e.g. Mills & Newberry, 2004), no sign is predicted for ln*Sales*.

Another control variable, *Age*, represents the number of years between a taxpayer's registration with a tax office in Indonesia and the lodging of their first tax return for the respective year in the study period. Previous studies (e.g. Grubert, 1998) provide evidence of the so-called maturation effect, which theorises that mature companies report higher levels of income. Accordingly, this study predicts a positive relationship between *EBIT/S* and *Age*, but does not predict any relationship between *LTL_RP/TA* and *Age*.

Equations (1) and (2) also control for *Industry* and *Year*. *Industry* is a series of indicator variables to control for industry effects. This study uses the two-digit industry classifications for Indonesian taxpayers set by the DGT. The *Year* dummy variables are included to provide a control for yearly variations in the magnitude of *EBIT* and *LTL_RP* reported by company taxpayers due to factors other than *FOIC* and the other control variables, such as macroeconomic conditions, that may differ from year to year.

This study follows prior studies (e.g. Myers, 1977) and includes capital intensity (*CapInt*) as a control variable when examining whether FOICs shift profits by means of intra-group debt financing in Equation (2). As explained by Mills and Newberry (2004), "capital structure theory suggests that debt usage is higher when firms have more assets–in–place (capital intensity)" (p. 98). Like prior studies, this study predicts a positive sign of the coefficient of *CapInt*.

A company is defined as an FOIC if more than 50% of its equity is held by non-residents for tax purposes. Conversely, a company in which the majority shares are owned by Indonesian residents for tax purposes is defined as a DOIC. Consistent with hypotheses H1 and H2, the coefficients of *FOIC* for the *EBIT/S* and *LTL_RP/TA* models are predicted to be negative and positive respectively.

*Stage 2 – Propensity score matching*

In the second stage, the PSM technique is used to ensure that FOICs and DOICs are comparable in terms of firm size (proxied by ln*Sales*), maturity (proxied by *Age*), industry (using the DGT two-digit industry classification) and year. For the debt financing model, in addition to the four variables mentioned above, this study also includes capital intensity (*CapInt*, proxied by net property, plant, and equipment (PPE) scaled by total assets) as one of the matching criteria. Using the above matching criteria as the independent variables to compute the propensity scores, an FOIC is matched to a DOIC with the nearest propensity score for comparison. This study follows the PSM procedure presented below (using the Stata statistical package with the add-on procedures of *pstest* and *psmatch2*) to match an FOIC to a DOIC before running paired *t*-tests and OLS regressions again:

[9] Using the inverse sales as the size variable, Grubert et al. (1993) find that size is sometimes significant in their taxable income to asset regressions. On the other hand, Mills and Newberry (2004) find insignificant results for their size variable, which is proxied by total sales divided by worldwide sales.

1. Run a regression with *EBIT/S* (*LTL_RP/TA*) as the dependent variable, and *FOIC*, ln*Sales*, *Age*, and *Industry* indicators, as well as *Year* indicators (and *CapInt* when *LTL_RP/TA* is the dependent variable) as independent variables to set the e(sample).

2. Use *pstest* to test the differences in means between the independent variables across the treatment group (FOICs) and the control group (DOICs) before matching.

3. Use *psmatch2* and logit regression to compute propensity scores using *FOIC* as the dependent variable, ln*Sales*, *Age*, *Industry* indicators, *Year* indicators (and *CapInt* for the *LTL_RP/TA* model) as the independent variables, and match each FOIC to the DOIC with the nearest propensity score, without replacement.

4. Use *pstest* to test the differences in terms of firm size, age (and capital intensity) between FOICs and the matched DOICs. If there is any significant difference between the two groups, specify a caliper (see Step 5).

5. Set a caliper initially as 0.25 of the standard deviation of the generated propensity scores.

6. Run *psmatch2* to match treatment firms to their nearest neighbour control firms subject to the requirement that the propensity scores of the matched pairs are within the specified caliper, without replacement.

7. Use *pstest* again to examine whether any significant differences remain in terms of firm size, age (and capital intensity) between the two groups. If so, reduce the caliper and repeat step 6 until no significant differences in terms of firm size, age (and capital intensity) are found between the two groups.

8. Run paired *t*-tests and the OLS regressions on the propensity score-matched sample.

The matched samples obtained from the PSM techniques ensure that the FOICs and the DOICs are comparable in firm size, maturity, capital intensity, industry affiliation, and year. Paired *t*-tests are run to examine whether the two groups (FOICs and the matched DOICs) are significantly different from each other in terms of the two outcome variables, *EBIT/S* and *LTL_RP/TA*. OLS regression models, as represented by equations (1) and (2), are run again on the matched sample to further investigate the channels used by FOICs to avoid Indonesian CIT. The current study runs all regressions by clustering the errors by firms to allow for heteroscedasticity and autocorrelation within a firm. A set of *Year* dummy variables is also included to capture some of the yearly variations that have not been captured by *FOIC* and the control variables. Panel data analyses (e.g. a fixed effects model) are not appropriate for the current study. The main reason is simply because *FOIC*—the test variable—is an indicator variable (i.e. equals 1 if the firm is a FOIC and 0 otherwise) and therefore does not vary across years for a firm.

*Stage 3 – Coarsened exact matching*

PSM has been extensively used since it was introduced in a seminal paper written by Rosenbaum and Rubin (1983), mainly due to its superiority when creating a simple and direct comparison of baseline covariates between treated and controlled observations. However, there has been debate about the validity of the PSM method. The debate has intensified in recent years, largely due to King and Nielsen (2019) who observe that PSM "often accomplishes the opposite of its intended goal—thus increasing imbalance, inefficiency, model dependence, and bias" (p. 435).

Therefore, the current study uses coarsened exact matching (CEM) as an alternative matching method to check whether the PSM produces consistent results. CEM improves the estimation of causal effects by reducing imbalance in treated and control group covariates (Blackwell et al., 2009). CEM generates strata and uses weights to offset different strata sizes between treated and control units. An option for not using weights—known as the k-to-k option—is available for users with enough data. It prunes observations within each stratum "until the solution contains the same number of treated and control units within all strata" (Blackwell et al., 2009, p. 536). The current study runs regressions using both the CEM weighted sample and the CEM k-to-k sample, but only reports the results of the CEM weighted sample because the results of the k-to-k sample are similar.

## 5. EMPIRICAL RESULTS

### 5.1. Summary Statistics

Table 2 shows the descriptive statistics of the key variables for the *EBIT/S* and *LTL_RP/TA* models in Panels A and B respectively after the propensity score matching PSM procedure.

Panel A shows that *EBIT/S* has a mean of 0.068, suggesting that, on average, companies in the sample report an EBIT of 6.8% of their total sales. After PSM, the matched sample of FOICs has a mean *EBIT/S* of 5.4%, which is lower than the mean *EBIT/S* of 8.1% of the matched sample of DOICS, consistent with profit shifting using transfer pricing. The mean of ln*Sales* is 24.9, indicating that, on average, the companies in the final sample have annual sales of around Rp65 billion, which is equivalent to approximately USD4.8 million using the 31 December 2015 exchange rate for tax purposes (i.e. $1 = Rp13,640). After PSM, the matched FOICs and DOICs have very similar firm sizes as measured by ln*Sales*. The average *Age* is 12 years, indicating that, on average, companies in the sample are relatively mature. After PSM, the matched FOICs and DOICs are very similar in terms of maturity, as measured by *Age*.

From Panel B, *LTL_RP/TA* has a mean of 0.027, suggesting that, on average, companies in the sample recorded long-term liability to related parties of 2.7% of their total assets. After PSM, the matched sample of FOICs has a mean *LTL_RP/TA* of 3.2%, which is higher than the mean *LTL_RP/TA* of 2.2% of the matched sample of DOICs, consistent with profit shifting using related-party debt financing. The mean of ln*Sales* is 25.1, similar to that of the *EBIT/S* model. In terms of the age of companies, the final sample in the *LTL_RP/TA* model shows a similar level of maturity as that of the *EBIT/S* model. The mean of *CapInt* is 0.25, indicating that, on average, companies in the sample have 25% of their assets in the form of net PPE. After PSM, ln*Sales*, *CapInt*, and *Age* are very similar for the matched FOICs and DOICs.

*Table 2: Descriptive Statistics After Propensity Score Matching Procedure*

**A. *EBIT/S* Model**

| Variable | All Obs No. | All Obs Mean (Std Dev) | FOICs No. | FOICs Mean (Std Dev) | DOICs No. | DOICs Mean (Std Dev) |
|---|---|---|---|---|---|---|
| *EBIT/S* | 5,272 | | 2,636 | | 2,636 | |
| | | 0.068 | | 0.054 | | 0.081 |
| | | (0.208) | | (0.216) | | (0.199) |
| ln*Sales* | 5,272 | | 2,636 | | 2,636 | |
| | | 24.902 | | 24.886 | | 24.919 |
| | | (2.130) | | (2.271) | | (1.978) |
| *Age* | 5,272 | | 2,636 | | 2,636 | |
| | | 12.231 | | 12.158 | | 12.304 |
| | | (8.436) | | (8.866) | | (7.983) |

**B. *LTL_RP/TA Model***

| Variable | All Obs No. | All Obs Mean (Std Dev) | FOICs No. | FOICs Mean (Std Dev) | DOICs No. | DOICs Mean (Std Dev) |
|---|---|---|---|---|---|---|
| *LTL_RP/TA* | 7,458 | | | | | |
| | | 0.027 | 3,729 | 0.032 | 3,729 | 0.022 |
| | | (0.115) | | (0.126) | | (0.102) |
| ln*Sales* | 7,458 | | | | | |
| | | 25.074 | 3,729 | 25.083 | 3,729 | 25.066 |
| | | (2.258) | | (2.472) | | (2.021) |
| *CapInt* | 7,458 | | | | | |
| | | 0.254 | 3,729 | 0.251 | 3,729 | 0.257 |
| | | (0.230) | | (0.225) | | (0.235) |
| *Age* | 7,458 | | | | | |
| | | 13.353 | 3,729 | 13.234 | 3,729 | 13.472 |
| | | (8.572) | | (8.999) | | (8.121) |

Notes: FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

Table 3 shows the Pearson correlation between the main variables in this study after PSM.

*Table 3: Pearson Correlation Matrix After Propensity Score Matching Procedure*

**A. EBIT/S**

| | ***FOIC*** | ***EBIT/S*** | **ln*Sales*** | ***Age*** |
|---|---|---|---|---|
| *FOIC* | 1 | | | |
| *EBIT/S* | −0.065 *** | 1 | | |
| ln*Sales* | −0.008 | 0.132 *** | 1 | |
| *Age* | −0.009 | 0.088 *** | 0.331 *** | 1 |

**B. LTL_RP/TA**

| | *FOIC* | *LTL_RP/TA* | ln*Sales* | *CapInt* | *Age* |
|---|---|---|---|---|---|
| *FOIC* | 1 | | | | |
| *LTL_RP/TA* | 0.043 *** | 1 | | | |
| ln*Sales* | 0.004 | 0.008 | 1 | | |
| *CapInt* | −0.013 | 0.122 *** | 0.133 *** | 1 | |
| *Age* | −0.014 | −0.035 *** | 0.321 *** | 0.044 *** | 1 |

Note: ***, **, and * indicate significance at 1%, 5%, and 10% levels respectively in a two-tailed test. FOIC: Foreign-owned Indonesian company.

FOICs are negatively (positively) correlated with *EBIT/S* (*LTL_RP/TA*) and are significant at the 1% level, which is consistent with the prediction. Firm size is positively correlated with *EBIT/S* but is not significantly correlated with *LTL_RP/TA*. *Age* has a significantly positive (negative) correlation with *EBIT/S* (*LTL_RP/TA*). As predicted, capital intensity is positively correlated with long-term liabilities to related parties.

A test of collinearity is run to calculate the variance inflation factor (VIF) for each variable to examine whether any one of the regressors is a perfect linear function of another regressor. The VIFs are in the range of 1.01 to 3.59 and 1.01 to 4.14 for the *EBIT/S* and *LTL_RP/TA* models respectively. The VIFs are lower than the general tolerance value of 10, indicating the absence of collinearity issue in both models.

### 5.2. Results of Statistical Analyses

Using equations,

$$EBIT/S_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 Age_{it} + \beta_{4-76} Industry_{it} + \beta_{77-82} Year_t + \varepsilon_{it}$$

and

$$LTL\_RP/TA_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 CapInt_{it} + \beta_4 Age_{it} + \beta_{5-77} Industry_{it} + \beta_{78-83} Year_t + \varepsilon_{it},$$

Table 4 shows the key regression results for the two stage 1 profit-shifting indicators (i.e. using the available dataset before matching an FOIC with a DOIC).

*Table 4: Results of Regression Estimations Without Any Matching Procedure*

| | **Expected sign** | | **Dependent variable: *EBIT/S*** | **Dependent variable: *LTL_RP/TA*** |
|---|---|---|---|---|
| *FOIC* | − \| + | | −0.044 *** | 0.016 *** |
| | | | (−7.60) | (4.63) |
| ln*Sales* | \| | | 0.010 *** | −0.001 |
| | | | (7.87) | (−1.36) |
| *CapInt* | \| + | | | 0.040 *** |
| | | | | (7.24) |
| *Age* | + \| | | 0.000 | −0.000 * |
| | | | (1.43) | (−1.65) |
| *Industry#* | ? \| ? | | Yes | Yes |
| *Year* | ? \| ? | | | |
| 2010 | | | 0.001 | 0.000 |
| | | | (0.37) | (0.24) |
| 2011 | | | −0.011 *** | −0.003 |
| | | | (−3.30) | (−1.58) |
| 2012 | | | −0.013 *** | −0.002 |
| | | | (−3.86) | (−1.17) |
| 2013 | | | −0.021 *** | −0.003 * |
| | | | (−4.86) | (−1.80) |
| 2014 | | | −0.015 *** | −0.003 * |
| | | | (−3.70) | (−1.93) |
| 2015 | | | −0.047 *** | −0.003 * |
| | | | (−10.67) | (−1.81) |
| Constant | | | −0.127 | 0.050 |
| | | | (−3.43) | (4.15) |
| $R^2$ | | | 0.243 | 0.042 |
| *n* | | | 31,596 | 33,099 |

Notes: *t*-statistics appear in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. The regression results for the industry dummy variables are not reported for conciseness. FOIC: Foreign-owned Indonesian company.

The results show that FOICs report *EBIT/S* of around 4.4 percentage points lower and *LTL_RP/TA* of 1.6 percentage points higher than those of DOICs. The directions of both coefficients are consistent with the prediction and are significant at the 1% level, supporting both hypotheses H1 and H2.

The coefficient for ln*Sales* is positively significant at the 1% level in the *EBIT/S* regression model but is insignificant in the *LTL_RP/TA* regression model, suggesting that firm size is significantly associated with profitability, but not long-term liability to related parties.

The coefficient for *CapInt* is positive and significant at the 1% level, suggesting that the more capital intensive the company, the higher the level of long-term borrowings from related parties.

The coefficient for *Age* is insignificant in the *EBIT/S* regression model and only significant at the 10% level in the *LTL_RP/TA* regression model, indicating that the maturity level of the companies is not associated with the magnitude of the profitability that they report and the level of long-term borrowings from related parties.

The coefficients of *Year* for the *EBIT/S* model suggest that Indonesian companies reported significantly less earnings before interest and tax for 2011 to 2015 than in 2009. The magnitude of the gaps between 2009 and later years show an increasing trend except in 2014. The coefficients of *Year* for the *LTL_RP/TA* model do not show a similar pattern.

Before the matching procedure, FOICs may concentrate in some industries, while DOICs may concentrate in other industries. Different industries may have different *EBIT/S* and different levels of capital intensity, hence different degrees of reliance on debt. Also, FOICs and DOICs may differ in terms of firm size and age. Although the regression models before the matching procedure control for the effects of industry, firm size, age, and year, the coefficients for *FOIC* in the two regression models may still be unreliable. Therefore, in stage 2, the PSM procedure described earlier is carried out to match an FOIC with a DOIC in order to derive a final sample of FOICs and DOICs that are comparable in terms of industry, firm size, age, year (for both models), and capital intensity (for the *LTL_RP/TA* model only) before paired *t*-tests and further regression analyses are conducted.

Table 5 presents the key results of stage 2 (i.e. after PSM) using the paired *t*-tests for both the *EBIT/S* and *LTL_RP/TA* models.

*Table 5: Results of Paired t-tests After Propensity Score Matching Procedure*

| | **Expected Sign** | **Dependent variable:** ***EBIT/S*** | | **Dependent variable:** ***LTL_RP/TA*** | |
|---|---|---|---|---|---|
| ATE—*FOIC* (1 vs 0) | − \| + | −0.022 | *** | 0.009 | *** |
| *n:* FOICs (treatment) | | 2,636 | | 3,729 | |
| *n:* DOICs (control) | | 2,636 | | 3,729 | |

Notes: ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. ATE is the average treatment effect. FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

The paired *t*-tests compare 2,636 FOICs with 2,636 matched DOICs and show that, on average, FOICs report lower *EBIT/S* by 2.2 percentage points, which is consistent with hypothesis H1. The result of the paired *t*-test for *LTL_RP/TA* also confirms that FOICs report nearly one percentage point higher long-term liabilities to related parties after comparing 3,729 FOICs with 3,729 matched DOICs, which is consistent with hypothesis H2. Both results are significant at the 1% level.

Table 6 presents the key results of the OLS regressions for both the *EBIT/S* and *LTL_RP/TA* models after PSM using the following equations:

$$EBIT/S_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 Age_{it} + \beta_{4-53} Industry_{it} + \beta_{54-59} Year_t + \varepsilon_{it}$$

and

$$LTL\_RP/TA_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_2 CapInt_{it} + \beta_4 Age_{it} + \beta_{5-61} Industry_{it} + \beta_{62-67} Year_t + \varepsilon_{it}$$

The coefficients for *FOIC* before and after the PSM procedure are consistent. After the matching procedure, the coefficients indicate that, on average, FOICs report *EBIT/S* of around 2.7 percentage points lower, and *LTL_RP/TA* of nearly one percentage point higher, than those of their matched DOICs. The negative relationship between *FOIC* and *EBIT/S*, and the positive relationship between *FOIC* and *LTL_RP/TA*, indicate that FOICs use both transfer pricing and debt financing strategies to shift profits out of Indonesia, which is consistent with the hypotheses and the results of the stage 1 regressions.

The coefficient of *FOIC* in the *EBIT/S* model shows that, on average, FOICs report lower *EBIT/S* by 2.7 percentage points after controlling for ln*Sales*, *Age*, *Industry* and *Year*, supporting hypothesis H1. The coefficient of *FOIC* in the *LTL_RP/TA* model also confirms that FOICs report nearly one percentage point higher long-term liabilities to related parties, supporting hypothesis H2. The coefficients of *FOIC* are significant at the 1% and 5% levels respectively for the EBIT/S and LTL_RP/TA models.

The coefficient for ln*Sales* is positively significant at the 1% level in the *EBIT/S* regression model but is insignificant in the *LTL_RP/TA* regression model, suggesting that firm size is significantly associated with profitability, but not long-term liability to related parties.

The coefficient for *CapInt* is positive and significant at the 1% level, which is consistent with the prediction that the more capital intensive the company, the higher the level of long-term borrowings from related parties.

As predicted, the coefficient for *Age* is positive and significant at the 1% level in the *EBIT/S* regression model, indicating that more mature companies tend to report higher profitability. The coefficient for *Age* is insignificant in the *LTL_RP/TA* regression model, suggesting that the level of maturity is not associated with the level of long-term borrowing from related parties.

Finally, the coefficients of *Year* for the *EBIT/S* model suggest that Indonesian companies reported less earnings before interest and taxes in later years than in 2009, and the gaps between 2009 and the later years show an increasing trend except in 2013. The coefficients of *Year* for the *LTL_RP/TA* model do not show a similar pattern.

*Table 6: Results of Regression Estimations Without Any Matching Procedure*

| | **Expected Sign** | | | **Dependent variable:** ***EBIT/S*** | | **Dependent variable:** ***LTL_RP/TA*** | |
|---|---|---|---|---|---|---|---|
| *FOIC* | − | \| | + | −0.027 | *** | 0.009 | ** |
| | | | | (−3.85) | | (2.27) | |
| ln*Sales* | | \| | | 0.012 | *** | 0.000 | |
| | | | | (4.97) | | (0.41) | |
| *CapInt* | | \| | + | | | 0.054 | *** |
| | | | | | | (4.99) | |
| *Age* | + | \| | | 0.002 | *** | −0.000 | |
| | | | | (3.16) | | (−1.48) | |
| *Industry#* | ? | \| | ? | Yes | | Yes | |
| *Year* | ? | \| | ? | −0.020 | | −0.002 | |
| 2010 | | | | (−2.23) | ** | (−0.52) | |
| 2011 | | | | −0.024 | *** | −0.003 | |
| | | | | (−2.91) | | (−0.69) | |
| 2012 | | | | −0.027 | *** | −0.004 | |
| | | | | (−2.91) | | (−0.93) | |
| 2013 | | | | −0.023 | ** | −0.005 | |
| | | | | (−2.29) | | (−0.94) | |
| 2014 | | | | −0.031 | *** | −0.005 | |
| | | | | (−3.23) | | (−1.06) | |
| 2015 | | | | −0.062 | *** | −0.004 | |
| | | | | (−5.92) | | (−0.86) | |
| Constant | | | | −0.184 | | 0.047 | |
| | | | | (−2.76) | | (1.72) | |
| $R^2$ | | | | 0.085 | | 0.050 | |
| *n* | | | | 5,272 | | 7,458 | |

Notes: *t*-statistics appear in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. The regression results for the industry dummy variables are not reported for conciseness. FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

Table 7 presents the key results of the OLS regressions for both the *EBIT/S* and *LTL_RP/TA* models after the coarsened exact matching procedure.[10] We used the following equations:

$$\frac{EBIT}{S}_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_3 Age_{it} + \beta_{4-53} Industry_{it} + \beta_{54-59} Year_t + \varepsilon_{it}$$

and

$$LTL\_RP/TA_{it} = \beta_0 + \beta_1 FOIC_{it} + \beta_2 \ln Sales_{it} + \beta_2 CapInt_{it} + \beta_4 Age_{it} + \beta_{5-61} Industry_{it} + \beta_{62-67} Year_t + \varepsilon_{it}.$$

The coefficients of *FOIC* after the CEM procedure are consistent with those before and after the PSM procedures. After the CEM, the coefficients of *FOIC* indicate that, on average, FOICs

[10] The results reported in Table 7 are those of regression using the CEM weighted sample. The results of regression using the CEM sample with the k-to-k option are similar, so are omitted here to save space.

report *EBIT/S* of 2.3 percentage points lower, and *LTL_RP/TA* of 1.6 percentage point higher, than those of the matched DOICs. The coefficients of *FOIC* are statistically significant at the 0.01 level in both models. As the key results in stages 2 and 3 are consistent and support both hypotheses H1 and H2, FOICs appear to use both transfer pricing and debt financing strategies to shift profits out of Indonesia. The consistent results of PSM and CEM enhance the credibility of these matching methods and the empirical findings.

*Table 7: Results of Regression Estimations After Coarsened Exact Matching Procedure*

| | **Expected Sign** | | | **Dependent variable:** ***EBIT/S*** | | **Dependent variable:** ***LTL_RP/TA*** | |
|---|---|---|---|---|---|---|---|
| *FOIC* | − | \| | + | -0.023<br>(-5.21) | *** | 0.016<br>(5.32) | *** |
| ln*Sales* | | \| | | 0.014<br>(12.27) | *** | 0.001<br>(0.98) | |
| *CapInt* | | \| | + | | | 0.010<br>(1.03) | |
| *Age* | + | \| | | 0.001<br>(2.10) | ** | -0.001<br>(-3.53) | *** |
| *Industry#* | ? | \| | ? | Yes | | Yes | |
| *Year*<br>2010 | ? | \| | ? | -0.010<br>(-1.47) | | -0.013<br>(-2.38) | ** |
| 2011 | | | | -0.022<br>(-3.19) | *** | -0.007<br>(-1.36) | |
| 2012 | | | | 0.004<br>(0.64) | | -0.011<br>(-1.97) | ** |
| 2013 | | | | 0.001<br>(0.20) | | -0.018<br>(-3.39) | *** |
| 2014 | | | | -0.005<br>(-0.66) | | -0.007<br>(-1.37) | |
| 2015 | | | | -0.080<br>(-11.93) | *** | -0.000<br>(-0.03) | |
| Constant | | | | -0.216<br>(-7.02) | | 0.042<br>(1.89) | |
| $R^2$ | | | | 0.117 | | 0.048 | |
| *n* | | | | 14,136 | | 5,119 | |

Notes: *t*-statistics appear in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. The regression results for the industry dummy variables are not reported for conciseness. FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

## 5.3. Additional Analyses

An FOIC can shift profit to its immediate parent, ultimate parent, or any overseas affiliate in the MNE group that has a tax rate lower than that of the FOIC in Indonesia. Therefore, even if the immediate parent has a tax rate higher than the FOIC's Indonesian tax rate, the FOIC can

still shift profit to another overseas affiliate with a lower tax rate. Nonetheless, dividing the FOIC's sample into a subsample where its parent's tax rate is *lower* than the FOIC's Indonesian tax rate, and another subsample where its parent's tax rate is *higher* than the FOIC's Indonesian tax rate may provide additional insights.

*Table 8: EBIT/S Ratio: FOICs Versus DOICs*

| | Regression *without* PSM | | Regression *after* PSM | | Paired *t*-test *after* PSM | |
|---|---|---|---|---|---|---|
| | Coef. of *FOIC* | Std. Dev. | Coef. of *FOIC* | Std. Dev. | Mean Diff. | Std. Dev. |
| All FOICs with valid EBIT/S | -0.044*** | 0.0057 | -0.027*** | 0.0071 | -0.022*** | 0.0067 |
| FOICs with parent's tax rate *lower* than FOIC's | -0.058*** | 0.0079 | -0.054*** | 0.0095 | -0.056*** | 0.0094 |
| FOICs with parent's tax rate *higher* than FOIC's | -0.022*** | 0.0076 | -0.020** | 0.0084 | -0.024*** | 0.0081 |

Note: ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. FOICs: Foreign-owned Indonesian companies. DOICs: Domestic-owned Indonesian companies.

Transfer pricing involves the trading of goods and services, so this channel is more likely to be used when a FOIC's immediate parent has a *lower* tax rate than the FOIC. Therefore, in Table 8 (above), the difference between the EBIT to sales ratios of FOICs and DOICs are much larger in cases of parents with lower tax rates than in those of parents with higher tax rates. However, even in cases where parents are subject to higher tax rates, profit shifting out of Indonesia still occurs because FOICs can shift profits to other lower tax affiliates using transfer pricing, as evidenced by the statistically significant difference between the EBIT-to-sales ratios of FOICs and DOICs.

*Table 9: LTD_RP/TA Ratio: FOICs Versus DOICs*

| | Regression *without* PSM | | Regression *after* PSM | | Paired *t*-test *after* PSM | |
|---|---|---|---|---|---|---|
| | Coef. of *FOIC* | Std. Dev. | Coef. of *FOIC* | Std. Dev. | Mean Diff. | Std. Dev. |
| All FOICs with valid LTD_RP/TA | 0.016*** | 0.0035 | 0.009** | 0.0041 | 0.009*** | 0.0029 |
| FOICs with parent's tax rate *lower* than FOIC's | 0.015*** | 0.0050 | 0.011 | 0.0068 | 0.008 | 0.0052 |
| FOICs with parent's tax rate *higher* than FOIC's | 0.015*** | 0.0044 | 0.013*** | 0.0047 | 0.011** | 0.0044 |

Note: ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels respectively in a two-tailed test. FOICs: Foreign-owned Indonesian companies.

Related party debt finance can be provided by any affiliate in a low tax country, whether or not the affiliate is carrying on an active business that involves the trading of goods and services. Therefore, in Table 9, when the immediate parent has a *higher* tax rate than the FOIC, related party debt financing is more likely to be used than transfer pricing to shift profit to a low-tax affiliate. On the other hand, when the immediate parent has a *lower* tax rate than the FOIC, transfer pricing is more likely to be used to shift profit to the parent company, so the difference in *LTD_RP/TA* between FOICs and DOICs becomes insignificant after PSM.

For both ratios, the results of the full sample and subsamples are consistent with profit shifting out of Indonesia.

## 6. CONCLUSION

This article examines the incidence of profit shifting in a developing country by analysing corporate tax return data obtained from the Indonesian tax authority. The empirical findings corroborate prior studies' findings that developing countries may suffer from profit-shifting strategies adopted by MNEs. Therefore, this article is expected to contribute to knowledge about international tax avoidance.

This study fills a gap in the base erosion and profit shifting (BEPS) literature in the following ways. First, it is one of the earliest studies to use firm-level data to examine the profit-shifting channels used by foreign MNEs in a developing economy. Secondly, it uses confidential Indonesian tax return data supplied by the DGT. The OECD (2015) states that tax return data can provide more reliable information about the incidence of BEPS. By using tax return data, the findings of this study are expected to provide more reliable results and facilitate a deeper understanding of the BEPS issue, especially from the perspective of a developing country. Thirdly, this study is arguably the first study to use domestic-owned companies as a counterfactual to identify profit shifting by foreign-owned companies in a developing country. Finally, this study uses two alternative matching methods, PSM and CEM, to match the two groups of companies to identify profit shifting through two channels: transfer pricing and related party debt financing. The fact that the two matching methods produce consistent key results enhances the credibility of these methods and the empirical findings.

In recent years, the Indonesian government has been trying to keep pace with tax avoidance activities in the rapidly developing business environment by making some progressive changes. For example, it recently introduced the Minister of Finance regulation number 22/PMK.03/2020, which details the procedures for advance pricing agreements. This states that the DGT has the authority to determine the transfer price used by taxpayers if they do not meet the arm's length principle as stipulated in the regulation. The regulation came into effect on 18 March 2020 and is, therefore, an important development that occurred subsequent to the period of study covered in this article. Future research is needed to further examine whether profit-shifting activities in Indonesia have declined following the implementation of the new regulation.

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# UNDERSTANDING THE BEPS PROJECT AND OTHER OECD TAX INITIATIVES INCLUDING THE INCLUSIVE FRAMEWORK IN THE CONTEXT OF TREATIES AND STATE INEQUALITY

*Grahame Jackson*[1]



**Abstract**

In this article, the author seeks to establish a functioning, non-context-specific definition of an "unequal treaty" that takes into account underlying principles of state equality, the concept of treaties, and non-coercion, whilst sitting outside of any single historical moment, by reference to international customary law, the United Nations (UNs)' resolutions of the General Assembly, and normative or moral concepts of coercion. Having established a definition, the author goes on to apply that definition to a number of developments and provisions that were put in place in the last decade, such as the Foreign Account Tax Compliance Act (FATCA), the Common Reporting Standard (CRS) and the outflows of the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) project, setting these provisions within their political and procedural contexts so as to place them within the historical tradition of treaties between large and small powers. By applying this definition, the author concludes that some, but not all, of the recent tax-related provisions amount to "unequal treaties".

In establishing a methodology with which to assess the inequality of treaties and applying that to the current tax relevant provisions, the author hopes to allow an informed discussion based not only on the objectives of large powers but also on an assessment of the characteristics of the methods by which the community of developed nations, as represented by the OECD, achieves its goals in the tax context.

**Keywords:** Unequal Treaty, CRS, FATCA, GLoBE Rules, Sovereignty, Equality.

## 1. INTRODUCTION

The concept of "unequal treaties" is a political, moral, and legal one. When considering the literature, the author encountered papers considering the Chinese "Unequal Treaties" and the position of the Ottoman Empire in relation to the European powers and the United States (US) in the nineteenth century.

However, to understand unequal treaties only in the context of the past would be an error—forms of interaction between states develop and do not simply disappear. Having said that, much of the groundwork for this paper comes from papers drafted in the early to mid-twentieth century by necessity, as that was the period in which many unequal treaties were unwound and there was much discussion of such things.

It is axiomatic that unequalness is not all that is required for a treaty to be either void or voidable. Many writers have given examples of enforceable treaties made from a position of

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inequality, such as the Treaty of Versailles (see, for example, Buell in Putney and Buell, 1927), which can plausibly be described as a treaty made under a threat of force, but which remained enforceable despite this (see, for example, Detter, 1966). Any discussion of whether a treaty is voidable or not betrays the contractual theory basis of international treaties, as Fleming (2020) points out: "International law relies on the private contract theory of treaties, or the idea that a treaty is 'essentially a contract between governments'—or, more precisely, a contract between states" (p. 6).

The aim of this paper is to argue that the international agreements that have followed the Group of 20 (G20)'s request to the Organisation for Economic Co-operation and Development (OECD, 2015) to deal with aggressive tax avoidance and evasion by way of the Base Erosion and Profit Shifting (BEPS) project should be understood not only from the perspective of whether or not they eliminate BEPS but also from the perspective of whether or not the implementation of such a project fits within the moral international framework established in the twentieth century. The literature has considered the "fairness" of the BEPS project. de la Feria (2022) provides a comprehensive judgement when she states that "the prevailing narrative of an inclusive process is open to challenge as constructed more upon the self-interest of the more powerful global tax players than altruism and also characterised by paternalistic coercion" (p. 61).

de la Feria goes on to delineate two methods for measuring the "fairness" of the relevant treaties (she focusses on the global minimum tax rate proposal or Pillar 2 [OECD, 2025(a)], but the author sees no reason to discard her method when assessing any other international tax proposal), that is by the fairness of their outcomes and by their procedural fairness. Much has been written about the legitimacy of international bodies, such as the OECD, and the requirement that they are legitimate in their own right. Ring (2008) states that "essentially, if real power is being transferred to another level of decision making beyond the state, that body must itself earn democratic legitimacy and cannot rely on the pre-existing legitimacy of the nation-states" (p. 171).

The processes of the organisation must be legitimate in order to legitimise its outputs. Relying on the fact that the governments of the United Kingdom (UK) or the US etc. are legitimate in the hope that such legitimacy will "rub off" onto the OECD or the United Nations (UN) is not sufficient for Ring and should not be sufficient for others. This paper seeks to go beyond Ring's (2008) definition of legitimacy. Ring (2008) emphasises the legitimacy question of the international organisations in question because, if those organisations are legitimate, it should follow that the jurisdictions that participate are correctly bound by the communal decisions of those organisations.

However, in many cases, the treaty-making process is two-sided and Ring's (2008) discussion of legitimacy is limited to the legitimacy of one of those sides, that is the international organisation. Nations in the core group of OECD members perform dual roles as both members and signatories of the treaties in question, while the input levels of those who are simply members of the Inclusive Framework (see below at 3.6) are minimal; they simply enter into agreements presented to them. This paper seeks to measure the output of the arrangements that have been, or are being, implemented by applying a measure of equality, rather than discussing whether or not the OECD, or other international body, is legitimate. It is obvious to all those who have a historical understanding that even legitimate bodies can act in a way that is morally reprehensible. Legitimacy is no cover for wrongdoing, though it may legitimate the act in

question as, flowing properly from the relevant *demos*, it does not mean that the act itself or the outcome of that act is morally sustainable.

One of the criticisms that could be levied at this paper is that it ignores or rejects the concept of sovereignty as responsibility, as described by Dietsch (2015), and instead applies a form of Westphalian sovereignty, i.e. that the sovereign entity lives free of interference from others. Dietsch (2015) states:

> International tax theory should follow the lead of other domains of international law in replacing the antiquated notion of Westphalian sovereignty with a concept of sovereignty that acknowledges both obligations and rights of states in their conduct towards other countries. One candidate is the notion defended above, labelled *sovereignty as responsibility*. (p. 186)

The author would reject this criticism; the description of sovereignty as responsibility does not eliminate the requirement for equality. In fact, the requirement to abide by the principle of equality demands that the nations seeking to alter the international tax system should do so within a framework that properly respects the concept of equality. Simply deploying their international position to ensure that a new international tax order is established would be a breach of their responsibility to abide by the sovereignty as responsibility model.

Dietsch may well respond to that by arguing that his concept of sovereignty as responsibility generates more demanding requirements of justice than simply respect for sovereignty and a need for equality in treaties. The author would agree that a responsible member of the community of nations is subject to a number of rules which go beyond that. However, the existence of a wide-ranging responsibility for all members of the international community does not eliminate the requirement for equality in dealings. Dietsch (2015) poses the following question "*What are the duties that states have towards other states in their fiscal policies*?" and answers it as follows: "Any country's autonomy prerogative comes with the obligation of respecting the same prerogative in others" (p. 181).

The author would argue that this cuts both ways and that the autonomy prerogative of smaller states should be respected as much as that of larger states (which Dietsch, 2015, argues is undermined by the loss of tax base of the larger state). If the above comment is an adequate summary of sovereignty as responsibility, it would appear to the author that this is not as greatly divergent from the Westphalian conceptualisation of sovereignty as freedom from intervention as it may at first seem. If a country may live free of intervention, the other members of the system must respect its autonomy.

In this paper, the author does not seek to discuss the minutiae of the procedural fairness of a given process. Instead, the aim is to identify the characteristics that are rejected in the colonial era's unequal treaties and to frame them as an objective test that can be applied to treaties from all periods.

The literature relating to unequal treaties is mostly concerned with the colonial era treaties between colonial or neocolonial powers and those powers that were in decline or were disadvantaged at that time (such as China and the Ottoman Empire). The discussions of such treaties, therefore, were written in the early to mid-twentieth century and much of the UN's work in the mid-twentieth century was designed to eliminate such treaties, which arose from power imbalances. This paper seeks to examine whether those treaties exhibit similar

characteristics to the modern tax-based provisions being introduced by the OECD and similar bodies. It will necessarily require a review of the landmark papers discussing such treaties, such as Detter (1966) and Putney and Buell (1927), although it will avoid a discussion as to the validity of such treaties. These texts argue that such treaties are valid and that the international order could not withstand their voiding on grounds of inequality. However, in this paper, it is argued that although new unequal treaties agreed amidst the framework of declarations and rules promulgated since World War II are not invalid, entering into them breaks a moral rule, if not a legal one.

The author seeks to set those provisions in a moral context that reflects the reality of their conclusion in a more accurate way than is normally presented in the media of the larger nations.[2] This will allow the reader to understand these provisions within a moral context informed by historical events considering the two sides of the process of their establishment. The author believes that this historical context has been neglected by the literature, which seeks to either legitimatise or delegitimise the process in isolation from it.

To be clear, the author does not seek the overturning of the treaties and arrangements that he concludes amount to unequal treaties; that would be a matter of law and, whilst morality often informs law, law is not morality. However, a consideration of the morality of the methods by which treaties are included should be part of how states regulate their own behaviour, and future behaviour can be informed by a conversation about morality. Citizens of a state should have an understanding of the moral nature of that state's behaviour. Once they have that information, they can call their state to account for the morality of its behaviour.

As the author shows below, it is the method of conclusion and the process of negotiation that make a treaty unequal. A treaty with identical provisions could be entered into by a state without the features of the conclusion process detailed below and it would not be unequal.

The paper proceeds as follows. In section two, the author discusses the concept of equality, what a treaty is (and, by necessity, what is a state is), and what makes treaties unequal. The author argues that equality between parties is a fundamental principle of the post-World War II era and that it is reinforced by a number of declarations and inclusion in the UN Charter (1945). As to what a treaty is, the author takes an expansive approach to the definition of what a state is and seeks to include a number of non-governing jurisdictions that negotiate independently in the OECD framework and that are represented as separate to their "mother" countries. Section three applies the definition arrived at in section two to a number of treaties and arrangements entered into in the last 25 years, measuring them against such definition. He argues that a number of those provisions amount to unequal treaties for the definition contained in section two. In section three, the author draws conclusions as to the effect of whether or not a treaty is unequal and calls for a truly inclusive approach to be taken in future.

[2] Media coverage of such developments is almost universally positive in the G20 nations. The following examples are reasonably representative: "G20: World leaders agree to historic corporate tax deal" (2021), and Milliken and Holton (2021).

## 2. WHAT IS AN UNEQUAL TREATY?

In this section, the author examines the ideas that come together to make up the concept of an unequal treaty. First, he discusses the concept of equality and the obligation on states to treat each other as equals, how that concept has been developed over the last 100 years, and what foundational articulations of the concept of equality can tell us about how it should be applied. The author then lays the groundwork for his definition of unequal treaties by discussing what a treaty is and, as a consequence of that, what a state is. In the final part of this section, he proposes a functioning definition of an unequal treaty.

### 2.1. The Concept of Equality

The concept of equality among states is vital to the functioning of the international community. It has long been a bedrock of international relations, as is stated by Ansong (2016): "prior to the establishment of the United Nations, sovereign equality of states already formed the philosophical and normative foundation of the international law that was to be constructed in the post-World War II era" (p. 14).

It sits at the heart of the UN Charter (1945), which states at Article 2(1) that "[t]he Organization is based on the principle of the sovereign equality of all its Members".

To understand what that means, we need to take a closer look at what sovereignty is and what equality is. The UN's Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in accordance with the Charter of the United Nations (UN General Assembly, 1970) (the "Declaration") states:

> All States enjoy sovereign equality. They have equal rights and duties and are equal members of the international community, notwithstanding differences of an economic, social, political or other nature.
>
> In particular, sovereign equality includes the following elements:
>
> (a) States are judicially equal;
> (b) Each State enjoys the rights inherent in full sovereignty;
> (c) Each State has the duty to respect the personality of other States;
> (d) The territorial integrity and political independence of the State are inviolable;
> (e) Each State has the right freely to choose and develop its political, social, economic and cultural systems;
> (f) Each State has the duty to comply fully and in good faith with its international obligations and to live in peace with other States.

The Declaration is a resolution of the General Assembly. There was some debate as to whether or not a UN General Assembly Resolution was binding in international law but, at the date of writing, the UN states that the General Assembly resolutions are not binding. Aside from those lengthy debates on international law, the author thinks it useful to consider that the Declaration occupies a position of guidance. Using that analogy, Article 2(1) of the UN Charter (1945) is the base legislation, which is binding on the Member States, and the Declaration amounts to guidance issued by the authority as to what the scant words of the legislation mean. It is an internationally recognised guide to the law.

Together, Article 2(1) of the UN Charter (1945) and the Declaration set the boundaries of what a state can do when it interacts with another state. According to the Declaration, a state should not impose itself on the "personality" of another state, nor undermine the "territorial integrity" nor the "political independence" of another state, as to do so would be a violation of the principle of equality. However, these documents do not mandate that a state may not use a strong negotiating position to the detriment of another state. The freedom to contract in a way which favours your own state is not eliminated by them, but they do limit the power of states to do anything which violates the Declaration's exhortation to "live in peace with other States".

This is a paper in a tax journal discussing tax-related international developments and, as such, we should focus on those elements of an economic nature. Section (e) of the section of the Declaration cited above states that a state "has the right to freely choose and develop its political, social, economic and cultural systems". This is a limited statement which is developed under the UN General Assembly (1975), Chapter 2, Article 1 of which states:

> Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever.

The aim of this paper is not to conduct an examination of the proceedings of the UN in this field, nor to provide commentary on all the resolutions cited. It is important to establish that the concept of equality does not simply stop at the threat of violence or the forcing of treaties that allow for foreign forces in a state's territory. Instead, the equality of states is understood to apply to all spheres of interaction; this rests on an understanding, expressed in the quotation above, that one state cannot coerce another state into taking an action.

### 2.2. What is a Treaty?

Much of the literature that deals with unequal treaties comes from, or concerns, states entering into such treaties in the nineteenth century, such as China and the Ottoman Empire. As such, it focusses on a historical analysis of the concept that may well provide a solid ground from which we can build, but which cannot deal with the concept of unequal treaties in the modern context. International norms have changed to such an extent that, for example, the imposition of an extraterritorial system such as that imposed by the capitulation treaties in China (Detter, 1966) would be unthinkable (and unworkable)[3] in today's world. If the phrase "unequal treaty" is to have continuing moral and political significance, a non-context-specific definition, which can be applied to treaties throughout history, is required. The author does not believe that unequal treaties must be grounded in the naked imperial aggression of the nineteenth century; it is conceptually possible for a state to impose such a treaty today and, without a functioning definition that is free of historical assumptions, one would be unable to identify it as unequal. To fail to do so would be to fail to see the similarities of treaties throughout history and, therefore, be unable to identify new forms of "unequal treaty"; in other words, we must be able to name new treaties as part of a historical tradition.

[3] The author believes that the changes in information availability and the lack of public support for the open humiliation of foreign powers based on a better understanding of the equality of all humans driven by various conventions and organisations in the post-war world means that such openly aggressive and imperialist agreements would not be publicly sustainable in the modern era. However, it is also noted that such agreements were almost universally predicated on some loss or slight against the more powerful state, which may be mirrored in the campaigns around 'tax havens' 'eroding' tax bases.

Therefore, we must arrive at a settled definition of "treaty" before we can conclude what makes such an agreement "unequal".

Article 1(A) of the Vienna Convention on the Law of Treaties (1969; "the Vienna Convention") defines a treaty as "an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation".

This is simple enough in its language. To qualify as a treaty, the document in question must be:

a) "international"
b) concluded by States
c) written
d) "governed by international law".

The author believes there is little profit in considering the word "international", which, in this context, is synonymous with "between states"; the ordinary language meaning of nation and international (as in "between nations", such as between England and Wales) is lost in this usage.[4]

The second requirement is that, in order for something to be a treaty, it must be concluded between "States". As Castellino (1997) states, "[i]nherent contradictions are unavoidably part of international law since no two situations are exactly similar and each case must be treated on its own merit" (p. 90).

However, the Montevideo Convention on the Rights and Duties of States (1933; the "Montevideo Convention") lays out a generally accepted basic description of statehood. Despite being a Pan-American document, the Montevideo Convention is generally accepted as representing a codification of the customary law position in international law as it was when the convention was entered into. The Montevideo Convention is a starting point from which factual deviations may occur and a convenient codification of international customary law in 1933. While the Montevideo Convention is not binding outside of the Americas, it summarises the provisions that are.

Article 1 of the Montevideo Convention (1933) states that "[t]he state as a person of international law should possess the following qualifications: *(a)* a permanent population; *(b)* a defined territory; *(c)* government; and *(d)* capacity to enter into relations with other States". For the purposes of this article, the author will deem 1(a)–(c) to be uncontroversial.[5]

However, the final limb does throw some practical issues into the light. A number of territories in the world are what is described as "non-self-governing";[6] they do not possess functioning

[4] Perhaps this sentence informs the reader that the author originates from a state that is made up of nations that cannot act independently.
[5] This does not mean that none of these territories have disputed territorial extent. For example, Gibraltar, is subject to a territorial claim from Spain and an element of its territory (the Isthmus) is contested under separate grounds than the remainder of the territory. However, that is not to say that the territory of Gibraltar practically extends to the border with Spain and that border can be defined. The existence of a dispute does not undermine the ability to define a territory's boundaries.
[6] As defined by Chapter XI, Article 73 of the UN Charter (UN, 1945).

foreign services and are not eligible for membership of the UN. However, it would be too quick to conclude that a "State" must have a fully functioning diplomatic apparatus to qualify as having the "capacity to enter into relations with other states". Frederick Tse-shyang Chen (2001) states that:

> [a]n entity may appear to fall short of statehood in one or another important respect yet be held a state eligible for membership. Conversely, an entity may appear to be well-qualified as a state yet be refused the status of statehood remaining ineligible for membership. Under this practice, states can mean a full-fledged independent sovereign entity, a political subdivision, an overseas possession of a state, a mandated territory, an entity with a dubious degree of independence, an entity with a government controlled in varying degrees by another government, an entity without a government, an entity with a disputed territory, and so on. (p. 26).

We can take from this that the UN deviates from the apparent plain English meaning of the Vienna Convention (1969) whenever it feels it necessary, and that the term "state" can mean any political organisation with a defined territory even if it does not have a developed method of interacting with other states.

From this, it must be concluded that, at least in some circumstances, for the purposes of executing agreements between jurisdictional powers, a state is a state when other states require it to be a state. It would seem odd that the Vienna Convention (1969), if applied retrospectively, would have the effect of negating the accession of the Philippines to the UN or the effect of denying the right of non-self-governing territories to be acceded in exactly the same manner if approved by the General Assembly. The boundary of statehood becomes blurred in arenas such as the OECD/G20's Inclusive Framework on BEPS ("the Inclusive Framework"), where there is a requirement for jurisdictions that are not "states" in the restrictive sense to participate as if they were states.

It is, for example, important to include the 14 British Overseas Territories[7] in OECD initiatives given the preponderance of low tax jurisdictions. They may well not have a formal "capacity to enter into relations with other States" (Montevideo Convention, 1933, Article 1[d]) but they do informally negotiate through their governments and competent authorities.[8] Tax information exchange agreements (TIEAs) are negotiated by British Overseas Territories and signed under Letters of Entrustment, issued by the UK, which empower the competent authority to enter into such arrangements.

If substance over form is paramount, then whilst the British Overseas Territories do not have full capacity to enter into relationships with other states, they do, on occasion, do so in a limited way. It would seem unfair that they should not be considered states in those circumstances.[9] Given that this is as much a moral assessment as a legal one, it would be wrong to state that treaties/agreements do not fall into the category of "unequal" because one territory entering

[7] That is, the Falkland Islands; Gibraltar; the Pitcairn Islands; the Cayman Islands; Montserrat; the British Indian Ocean Territory; South Georgia and the South Sandwich Islands; the Sovereign Base Areas of Akrotiri and Dhekelia; the Turks and Caicos Islands; Anguilla; British Antarctic Territory; Saint Helena, Ascension and Tristan da Cunha; Bermuda; and the British Virgin Islands.

[8] It is now common for the UK to provide its Overseas Territories with letters of authority granting them the power to negotiate their own tax treaties.

[9] See below for a further discussion of the position of overseas territories in a British context.

into them did not have full capacity under international law.[10] Thus, for the purposes of this paper, and following on from the practical reality of interjurisdictional relationships that a state is a state when it is treated as such and the fact that the OECD does treat non-self-governing territories as if they were states, a wider interpretation of "state" should be taken and a formalistic approach resisted.

Therefore, any agreement entered into by, and binding on, a government whether by a formal set of relations or through relations of some other, but equivalent and effective form, is considered a "treaty" for our purposes.

### 2.3. When are Treaties "Unequal"?

The term "unequal treaty" has historical and moral weight that cannot simply be ignored when adopting a definition. It is a powerful designation and should be acknowledged as that. One seeks to define "unequal treaty" so that a rational tool can be applied to agreements and treaties, both modern and historic, that will ascribe a moral judgement to them. Unequal treaties are understood to be morally wrong because they arise from the assertion of power and coercion by one party on another. It is the process of conclusion that contains the morally reprehensible act, not the treaty itself.

This is explicit in the UN Conference on the Law of Treaties' "Declaration on the Prohibition of Military, Political or Economic Coercion in the Conclusion of Treaties" (UN, 1971), which;

> [s]olemnly condemns the threat or the use of pressure in any form, whether military, political or economic, by any State in order to coerce another State to perform any act relating to the conclusion of a treaty in violation of the principles of equality of States and freedom of consent. (p. 285).

This declaration is not binding law, but it does seek to condemn coercion whether by economic means or otherwise. This condemnation has a moral weight if not a legal one.

To arrive at a measure of what is unequal, one must identify the similar characteristic exhibited by treaties that have generally been considered unequal. There is a risk of circularity arising from drawing conclusions about unequalness simply from those things that are called unequal, but the author believes this not to be the case here. The literature clearly identifies a class of treaties from the nineteenth century and dating back beyond that period, which were commonly known as "Unequal Treaties" (Nozari, 1971), which includes treaties across all major continents. In China, the phrase "Unequal Treaties" has such common currency that it has become somewhat of a slogan (Wang, 2005, pp. 1–2). The literature often names treaties with China or the Ottoman Empire as examples of "unequal treaties" (Detter, 1966), and it is clear that a class of historical documents exists that can be considered to be the product of unjust imposition by a stronger party. The author's aim is to arrive at a functioning understanding of the characteristics that make those treaties unequal and to apply that as a yardstick to measure current arrangements. If unequal treaties are considered to be "bad", identifying their characteristics so that the actors on the international stage can avoid the pitfalls which led to the moral wrong that these treaties represent is surely a worthy effort.

[10] In fact, a lack of independence may always indicate an inequality, at least of expertise.

As a follow-on from this position, the relationship between the legal position detailed in section 2.1 and the moral position detailed here in section 2.3 should be considered. If we are discussing morals, what is the relevance of the legal position?

The UN Charter (1945) is a unique document. Its preamble speaks, in moral terms, of "dignity and worth", "justice and respect", and "tolerance" (UN, 1945). The mission of the UN is, therefore, framed as a moral one. As a result, the inclusion, at Article 2(1), of the following language—"[t]he Organization is based on the principle of the sovereign equality of all its Members" (UN Charter, 1945)—makes sovereign equality not just a legal provision but also a moral one. It is the basis of the UN and the UN is a moral project, and that project cannot achieve its objectives without a respect for sovereign equality (and, therefore, sovereign equality is itself a moral good). The fact that the UN issues declarations, such as UN (1971), which issue moral condemnations but which are non-binding, would seem to cement the moral nature of the organisation. Therefore, respect for sovereign equality is itself a moral imperative.

One objection to an appeal to the UN as a guide to the "wrongness" of the practice of imposing unequal treaties is that the UN deals with matters of law, not morality. The author hopes that he has gone some way to describing a hybrid role for the UN, such that it is not only a lawgiver but also frames the scope of morally acceptable behaviour within the law with its gamut of moral statements, such as the above declaration.

However, if this position is rejected by the reader, one could consider the moral rule "unequal treaties are wrong" to be emergent from the practice of social interaction between states and, in fact, "practice dependent". Practice dependence theory, put simply, states that "the content, scope, and justification of a conception of justice depends on the structure and form of the practices that the conception is intended to govern" (Sangiovanni, 2008, p. 138). The injustice of unequal treaties emerges from the social practice of entering into treaties and, therefore, the position of the UN and the international practice of entering into treaties are relevant to the conception of what a "just" treaty is that emerges from this.

The author believes that the two arguments above—(i) that the UN is itself a moral body which not only makes "law" but also sets the boundaries of moral discussion, and its pronouncements are therefore relevant to the moral discussions; and (ii) that a practice dependence position that the conception of justice applicable to treaties places unequal treaties beyond the pale—have, as part of their source, the practice of treaty conclusion. If so, a discussion of the legal position of state equality informs the moral conversation, which is not only interesting but necessary. There is no simple answer to what is considered "unequal" in terms of a moral assessment of a treaty and the circumstances that give rise to it. One should consider the unequal treaties of the past, identify their common characteristics, and refine these into a test which can be applied moving forwards. The only method that the author views as being well constructed is to take a two-tiered approach to the definition of "unequal".

### *2.3.1. Inequality of outcomes*

By inequality of outcomes, we mean that a treaty results in outcomes that are unequal between the two parties, such as in the case of the capitulation treaties entered into by China. This requires a consideration of the text and the practical effects of the treaty itself. Historically, this can be seen in the outcomes of the treaties of the Ottoman Empire discussed by Detter (1996). She details how these treaties were initially based on a footing of equality but, as the power imbalances changed over time, they became onerous and invasive to the sovereignty of the

Ottoman Empire, and what began as gracious permissions became burdensome (Detter, 1996, pp.1069–1089). Thus, we must consider practical outcomes rather than legalistic forms if we are to understand the legal and moral position of a treaty.

### *2.3.2. Exercised inequality of power*

It is, of course, conceptually possible for a state to enter into a treaty that is detrimental to its interests by accident, through a lack of understanding, or from altruism. Imagine, for instance, a scenario in which a leading Western power wrote off debts in return for the reopening of diplomatic relations, or surrendered a military base in return for a promise of non-aggression on the part of the (much smaller) country in which the military base was located. These treaties are not rendered unequal by the fact that the larger state gives something freely, yet, despite their equality, they have unequal outcomes. There must be a second quality that a treaty exhibits that makes it "unequal". The author would contend that this second quality would be that it is entered into by two parties who have unequal power, whether that be economic, military, or diplomatic power. However, simple inequality of power is insufficient (or any treaty entered into by the US would be an unequal treaty if it resulted in an inequality of outcomes, no matter how restrained the US was in its negotiating technique). In addition to that objective inequality, the power inherent in that or some other inequality must be exercised or threatened to be exercised to the potential detriment of the weaker party in relation to the matter at hand. It is possible to interpret this requirement for the use of power inequality to boil down to nothing more than saying that a state should not violate the sovereign equality of other states. However, this would be inadequately narrow; any state, whether more or less powerful than another, can attempt to violate the sovereign equality of another but, in this case, sovereign equality must be violated by the use of a power inequality and it must be in relation to the treaty in question.

It is tempting to simply say that one state must coerce another to enter into a treaty for that treaty to be unequal. This is very similar to the position that the author has taken above, and he is tempted to adopt Nozick's (1969) description of coercion, which can be summarised as P coerces Q if:

1. *P* aims to keep *Q* from choosing to perform action *A*;
2. *P* communicates a claim to *Q*;
3. *P*'s claim indicates that if *Q* performs *A*, then *P* will bring about some consequence that would make *Q*'s *A*-ing less desirable to *Q* than *Q*'s not *A*-ing;
4. *P*'s claim is credible to *Q*;
5. *Q* does not do *A*;
6. Part of *Q*'s reason for not doing *A* is to lessen the likelihood that *P* will bring about the consequence announced in (3).

The author believes that this adequately describes the mechanism by which the inequality of power is exercised to the potential detriment of the smaller state, but it does not adequately describe a power imbalance of the type that the author seeks to capture. A small state willing to fight to the death may well be able to coerce a larger state which is unwilling to fight (such as in the case of the contest between North Vietnam and the US), but one would not describe a treaty in such a situation as an "unequal treaty". As a result, the two-stage approach that the author has taken, i.e. that a state must have a power inequality in its favour and that inequality must be deployed to the potential detriment of another less powerful state, is his preferred route to this second limb.

It is also tempting to include a requirement for the detriment to the smaller state to be material in the test for inequality of outcomes. To do so would be to look for some form of legalistic invalidity. This is not the aim of this paper; instead, the author is seeking to characterise treaties as unequal or not, and the second limb requirement for a form of coercion to be involved seems sufficient to eliminate the danger of treaties with unequal outcomes being classed as "unequal" simply because the benefits of the promises in the treaty were more in favour of one jurisdiction than another.

Detter (1996) seems to describe the international community (or at least the communist states of the time) reaching for some sort of analogous articulation of this two-tier approach:

> Apart from the objective condition "unequal" the communist States sometimes appear to introduce another prerequisite for the invalidity of such treaties: the treaties should have been "forced" upon one of the parties. Other delegates from the communist States have stressed that the coercion is the cause of invalidity even if they, also, pointed out that the unequal treaties ought to lose validity for "international sociological reasons". (p. 1083)

Detter (1996) then makes the point that "perhaps the real cause of invalidity is coercion rather than the inequality itself" (p. 1083).

This is a perfectly valid point, but this paper is not about the invalidity or otherwise of unequal treaties, but simply about arriving at a practical definition and then applying such definition to the agreements in the BEPS project.

In response to Detter (1996)'s point, one could conceptually construct a treaty that would not meet this paper's definition of an unequal treaty, but that would be invalid by virtue of Article 52 ("Coercion of a State by the use or threat of force") or Article 51 ("Coercion of a representative of a State") of the Vienna Convention (1969). Imagine a treaty in which State A is suffering an epidemic and State B has the means, by use of its military, to distribute a vaccine to save lives. In the negotiating process for a treaty for State B's military to access to State A, the representative of State A refuses access on some socio-cultural grounds. In desperation, the representatives of State B threaten to simply push their military into State A if State A refuses to sign the treaty. In this case, the treaty is clearly invalid under Article 52 of the Vienna Convention (1969), but it would not be considered an unequal treaty under this paper's definition, as it would fail the "inequality of outcomes" limb. It may well be that, practically, there is little to no difference but, conceptually, the difference remains.

The fact of the necessity of a power imbalance is made clear by Albert H. Putney, in Putney and Buell (1927), when he states:

> It is also apparent that no unequal treaty can permanently continue to exist against a large country. A small country may continually have to keep to a treaty in force which imposes not only inequality but injustice upon it, but in the case of a large country it is quite certain, whatever basis you may place it upon, that a large country will only consent to any unequal treaty…so long as she is unable and does not have the strength to abrogate it. (p. 90)

Thus, the author comes to the conclusion that, to be unequal, a treaty must be made between two or more governments, be binding on all (whether directly through formal diplomatic

procedures or through some other effective arrangement), and must first have unequal outcomes, and secondly have been entered into as a result of a more powerful party or parties potentially exercising that power to the detriment of one or more of the other parties in connection with the process that the weaker party negotiates or accedes[11] to the treaty.

#### *2.3.3. When is coercion coercion?*

One potential weakness in the author's approach is that he has not delineated what amounts to coercion. He is comfortable with Nozsick (1969)'s definition above, although it does not provide details of the boundaries of what is and what is not acceptable behaviour. As with so many of these matters, an attempt at coercion must be effective for it to be coercion in a real sense. Therefore, the author cannot lay out a boundary that, for example, a withholding tax of 10% is acceptable but one of 35% is not. Whether a threat amounts to coercion or not is dictated not by the contents of the threat but by the effect of the threat. For example, the imposition of a ban in Australia on the import of bananas would have little to no effect on Russia, but it would, conversely, have a large effect on the government of Norfolk Island, which exports substantial numbers of bananas to Australia (The Parliament of the Commonwealth of Australia, Joint Standing Committee on the National Capital and External Territories, 2005). It is for this reason that the author shies away from drawing sharp lines. Instead, the conclusion should be drawn that a measure is coercive when it has the effect of coercing in terms of Nozick (1969)'s definition above.

## 3. PRACTICAL APPLICATION OF THE DEFINITION

In this section, the author will draw upon the conclusions of section two and apply the definition of "unequal treaty" to the current international agreements that have arisen since 1999 to tackle international tax avoidance. The author will apply the definition firstly to TIEAs drawing on the factual background which led to the conclusion of the "Taxation: Information exchange: Agreement between the United States of America and Gibraltar" (2009) ("US–Gibraltar TIEA"), as an example. Following on from that, he will apply the same methodology to the Foreign Account Tax Compliance Act (FATCA) intergovernmental agreements (IGAs) entered into by the US with many jurisdictions around the world, and then to the Common Reporting Standard (CRS) and the Global Anti-Base Erosion Model (GloBE) Rules (or global minimum tax rate). At the same time, he will review the mechanisms by which non-compliant jurisdictions are listed or suffer other "defensive measures". His conclusion will be that some of the provisions under consideration will amount to unequal treaties.

### 3.1. Current International Agreements and Actions

In order for the definition of "unequal treaties" to be meaningful, one must apply it to real-world cases in which large and powerful states with agendas interact with small and less powerful states. Much of the world's activity on a multilateral level in recent years has been concerned with climate change, and in relation to taxation and the limitation of possibilities for internationally mobile individuals and multinational enterprises to arrange their affairs in such a way as to limit the taxation due to be paid. Much of the compliance-related behaviour[12]

[11] This particular wording is included here to ensure that it is clear that the author includes those agreements whereby a party may accede at a later date to a pre-made agreement and that accession to that agreement is made under pain of some exercise of a power inequality.

[12] The author has chosen the phrase "compliance-related behaviour" as it lacks the linguistic baggage of "avoidance" or "evasion" but covers both of the types of behaviour that reduce tax liabilities.

targeted is legal and works within the rules of international taxation. The reform of the international tax framework has been one of the G20's objectives since 1998. The ministers of the G20 instructed the OECD to have as its goal to:

> secure the integrity of tax systems by addressing the issues raised by practices with respect to mobile activities that unfairly erode the tax bases of other countries and distort the location of capital and services. Such practices can also cause undesired shifts of part of the tax burden to less mobile tax bases, such as labour, property, and consumption, and increase administrative costs and compliance burdens on tax authorities and taxpayers. (OECD, 2001, p. 5)

### 3.2. TIEAs

The first attempts to take steps to reshape the tax landscape occurred in 1999 and 2002. In its report to the 2000 Ministerial Council Meeting (OECD, 2001; "the June 2000 report"), the OECD instructed the Committee on Fiscal Affairs to publish "an OECD List of Uncooperative Tax Havens, by 31 July 2001" (p. 30). The OECD published this list ("the OECD list") on 18 April 2002 and the jurisdictions in question were told that if they did not make the relevant commitment to tax transparency and, by extension, implement such commitment, they would be subject to "defensive measures" (OECD, 2002, p. 1)—an, as yet, undefined threat.

The message to these uncooperative tax havens from the Chair of the OECD's Committee on Fiscal Affairs, Gabriel Makhlouf, was loud and clear. Makhlouf stated that "OECD member countries will use the list as a basis for the framework of co-ordinated defensive measures now being developed" (OECD, 2002, p. 1) and that the OECD's "aim is that the framework of co-ordinated defensive measures applying to uncooperative financial centres prevents them from gaining an economic advantage" (OECD, 2002, p. 2).

In understanding whether the outcomes of this threat mean that the instruments and agreements that implement those outcomes amount to unequal treaties, we must understand what was expected of the jurisdictions in question if they wished to be removed from this list. First, they were required to commit to a taking number of actions, such as those detailed in the letter from the Chief Minister of Gibraltar, Sir Peter Caruana, of 27th February 2002 to the Secretariat of the OECD, which included commitments:

> i) to allow information to be exchanged with OECD Members on specific request, by 31 December 2003 for criminal tax matters and by 31 December 2005 for civil tax matters;
> ii) not to introduce bank secrecy laws;
> iii) to negotiate TIEAs;
> iv) to introduce laws that enable government access to the beneficial ownership of companies or other entities;
> v) to introduce laws that enable government access to information about the settlors and beneficiaries of trusts established in Gibraltar;
> vi) to introduce laws that enable government access to bank information;
> vii) to abolish "designer" rates for tax; and
> viii) to abolish bearer shares. (Caruana, 2002)

In this paper, we are only concerned with treaties and this letter is not a treaty in any meaningful sense: it is a simple response to a threat. Instead, we should concern ourselves only with point

(iii) of Sir Peter Caruana's letter, that is, that Gibraltar (and all those other jurisdictions that gave similar commitments) would negotiate TIEAs with a number of other states and jurisdictions. It was this commitment that led to the meeting between Sir Peter Caruana and the US Treasury Secretary, Tim Geithner, in London on 31st March 2009, and the signing of the US–Gibraltar TIEA (Government of Gibraltar, 2009).

First, we should consider limb one of the author's two-limbed definition of "unequal treaties", i.e. that there is an inequality of outcomes between the two parties to the agreement. The US Treasury Secretary of the time, Tim Geithner, stated:

> The President's budget makes a commitment to reduce international tax avoidance. As part of this commitment, the Treasury Department is embarking on an ambitious effort to deal with offshore compliance as evidenced by today's agreement with Gibraltar…I will continue to demand transparency from countries on behalf of American taxpayers. I look forward to Gibraltar's cooperation with the United States and to this agreement serving as an example for other financial centers around the world. (Government of Gibraltar, 2009, p. 1)

In contrast to this assurance that the US–Gibraltar TIEA would produce a variety of beneficial outcomes for the US stands the likelihood of there being a practical effect to the benefit of Gibraltar. The Gibraltarian tax base is much more limited than the US tax base. The now repealed Income Tax Act 1952 (Gibraltar)—which was in force in 2002 when Sir Peter Caruana sent his letter and agreed to enter into a number of agreements, and was still in force in 2009 when he entered into the US–Gibraltar TIEA—exempted a large number of the kinds of income which are the focus for international tax avoidance:

> (a) dividends paid or payable by a company ordinarily resident in Gibraltar to a company;
> (b) dividends paid or payable to a person who for the purposes of this Act is neither ordinarily resident in Gibraltar nor a permitted individual;
> (c) dividends paid or payable by a company the shares of which are quoted on a Recognised Stock Exchange;
> (d) interest paid or payable by a bank, building society or other financial services institution licensed to take deposits under the Financial Services (Banking) Act or equivalent legislation in any other jurisdiction;
> (e) interest paid or payable by the Gibraltar Government Savings Bank;
> (f) income from debentures issued by a company the shares of which are quoted on a Recognised Stock Exchange, including debenture stock, loan stock, bonds, certificates of deposit and any other instruments creating or acknowledging indebtedness including bills of exchange accepted by a banker other than instruments included in (g) below;
> (g) income from loan stock, bonds, and other instruments creating or acknowledging indebtedness issued by or on behalf of a government, a local or public authority;
> (h) income from units in a collective investment scheme which is marketed and available to the general public, including shares in or securities of an open-ended investment company;
> (i) income from rights to and interests in anything falling within (a) to (h) above; and

> (j) a dividend paid or payable out of the profits or gains of a company which has profits or gains on which the company is not liable to pay tax by virtue of (a) to (i) above to the extent of the amount of the dividend represented by the proportion which the amount of the income not liable to tax by virtue of (a) to (i) above bears to the entire income of the company for the year of assessment. (Income Tax Act 1952 (Gibraltar), Part II, s. 6[1][8])

A Gibraltarian would not pay tax on income from shares quoted in the US, interest received from a bank in the US, income from US treasury bonds etc., or dividend income from companies that earned their income in the US but not in Gibraltar.

Once one understands the domestic effect of the legislation in place when the US–Gibraltar TIEA was signed,[13] it is difficult to imagine a scenario in which Gibraltar would have any cause to seek information under the US–Gibraltar TIEA; the US–Gibraltar TIEA would, at least, be of much less use to Gibraltar than to the US. It is clear to this author that, due to the nature of the Gibraltar tax base, the US–Gibraltar TIEA has an unequal outcome.

However, an unequal outcome is not sufficient for a treaty to be considered, by our definition, an "unequal treaty". For that, the second limb must apply: there must be an inequality of power that is deployed to the potential detriment of the weaker party in relation to the matter at hand.

The US is an OECD Member State and, as such, had been party to all of the decisions and processes that had culminated in the June 2000 report (OECD, 2001) and the threat that "defensive measures" would be taken against uncooperative tax havens (OECD, 2002, p. 1). For a small jurisdiction such as Gibraltar, the unspecified threat of "defensive measures" (OECD, 2002, p. 1) that would impact its financial sector was intolerable, as Sir Peter Caruana said in his New Year's message of 1 January 2001: "No one in Gibraltar…should underestimate how important the finance centre is to the economic, and therefore to the social and political prosperity of Gibraltar" (Government of Gibraltar, 2001). He stated that: "Government will be obliged to take certain measures, especially changes to our tax system, to enable the finance centre to continue to flourish" (Government of Gibraltar, 2001).

The message was as clear as the threat from Gabriel Makhlouf (OECD, 2002); Sir Peter Caruana felt that the survival of his jurisdiction was at stake.[14] The power of the US and its partners in the OECD, which then accounted for more than 90% of the global economy, had been levied at Gibraltar and its fellow "tax havens". Sir Peter Caruana understood that and, as a result, was willing to enter into TIEAs which provided little to no benefit to the Gibraltarian state.

As a result, one is obliged to acknowledge that the US–Gibraltar TIEA amounts to an "unequal treaty".

[13] Current legislation, to a large degree, mirrors the Income Tax 1952 Act (Gibraltar) in this regard.

[14] The historical and geopolitical context in which Gibraltar sits means that this statement by Sir Peter Caruana was more than political hyperbole. It had long been the policy of the Government of Gibraltar to ensure that Gibraltar was not a drag on the British Exchequer, because a Britain that was suffering loss in its relationship with Gibraltar would be less likely to robustly defend Gibraltar against the territorial claim from Spain.

### 3.3. FATCA IGAs

The history of FATCA and the beginnings of true international automatic information sharing by previously secret jurisdictions is a complex one and is beyond the scope of this paper. Suffice to say that, in its initial form, FATCA was aimed not at international agreements but instead directly at financial institutions that refused to share data with the US authorities. Originally, those financial institutions that refused to cooperate with FATCA would be subject to a withholding tax of 30% on any payment made to them. This was, and was designed to be, of course, intolerable to the financial institutions. By 2010, the global financial system had become so interconnected that no bank could withstand the threat of being effectively locked out of the US dollar banking system. However, a number of jurisdictions had either data protection laws or specific banking secrecy laws that disallowed the passing of information envisaged by FATCA.

The solution to this was that the US government would enter into IGAs to ensure that local governments would remove barriers, introduce regulations, and either make reports to the US Treasury themselves or instruct relevant financial institutions to do so. Both the Model 1A IGA and the Model 2 IGA contain an element of reciprocity, while the Model 1B is wholly one-sided with no room for reciprocity.[15] For example, Article 2(1) of the Agreement between the Government of the United States of America and the Government of Ireland to Improve International Tax Compliance and to Implement FATCA (2012; "US–Ireland IGA"), a Model 1A IGA, states:

> Subject to the provisions of Article 3, each Party shall obtain the information specified in paragraph 2 of this Article with respect to all Reportable Accounts and shall annually exchange this information with the other Party on an automatic basis pursuant to the provisions of Article 27 of the Convention.

This can be contrasted with Article 2(1) of the Agreement between the Government of the United States of America and the Government of Ireland to Improve International Tax Compliance and to Implement FATCA (2014), a Model 1B IGA, which states:

> Subject to the provisions of Article 3 of this Agreement, the British Virgin Islands shall obtain the information specified in paragraph 2 of this Article with respect to all U.S. Reportable Accounts and shall annually exchange this information with the United States on an automatic basis.

Even in the case of Model 1A and Model 2 agreements, it is commonly accepted that the US has not played fair in this area and that FATCA is not a properly reciprocal arrangement. In his evidence to the Senate Finance Committee in 2022, Charles Rettig, the then US Commissioner of the IRS, stated that:

[15] The Model 1A and 1B IGAs are designed to permit the financial institutions of the non-US Party to report to the central authorities in their home countries, which will then pass that information on the US. The Model 2 IGA permits financial institutions to report directly to the US (thus lightening the burden for small administrations). The Model 1A permits reciprocity and the Model 1B does not; therefore, the Model 1B is more often used by those jurisdictions that have no use for income-related information, as they do not have the relevant tax base. For more information, see IRS (2025).

> Over time, the U.S. has established a broad network of information exchange relationships with other jurisdictions based on established international standards. The information obtained through those relationships has been central to the recent successful IRS enforcement efforts against offshore tax evasion…Currently, however, the U.S. provides less information to foreign governments than we receive from them. (IRS, 2002)

Prior to this, and in relation to the implementation of the Common Reporting Standard (CRS), which mirrors FATCA in almost all respects save that it is truly reciprocal in the data exchanged (see below for a discussion of the position around CRS), the US Government Accountability Office (2019) stated that:

> While having the United States adopt the CRS reporting system in lieu of FATCA could benefit FFIs [foreign financial institutions] that may otherwise have to operate two overlapping reporting systems, it would result in no additional benefit to IRS in terms of obtaining information on U.S. accounts. Additionally, it could generate additional costs and reporting burdens to U.S. financial institutions that would need to implement systems to meet CRS requirements. (pp. 33–34)

As the CRS requirements are almost identical to those of the FATCA from the perspective of a financial institution,[16] it is clear from this that the lack of reciprocity is more than simply a mismatch in terms of volumes.

The author would contend that this lack of functioning reciprocity is sufficient to meet the first limb of the test for unequal treaties, i.e. unequal outcomes, especially in cases of IGAs, which envisage reciprocal exchanges, such as the US–Ireland IGA.

The second limb (that there must be an inequality of power that is deployed to the potential detriment of the weaker party in relation to the matter at hand) is equally met. The threat of the economic damage that would be done to a jurisdiction by its financial institutions having to either detach themselves from the US dollar banking system or suffer the pain caused by a 30% withholding tax if they abided by their local banking privacy laws would be very real for a highly integrated, open economy, such as Jersey. In effect, the major "offshore" jurisdictions were given no choice.

FATCA is a good example of coercion being a matter for case-by-case analysis; the same threat may have different outcomes when made to different parties. For example, Afghanistan does not participate in FATCA. However, FATCA is highly unlikely to be relevant to Afghanistan and the effect of implementation of a 30% withholding tax on payments from the US system to Afghanistan's very limited financial institutions is of a different order of magnitude than the effect of the implementation of a similar levy on all US dollar payments made to financial institutions in finance centres.

In conclusion, the author is of the opinion that, in the cases of those jurisdictions with highly open economies that interact regularly with the US banking system and have well-developed financial services industries, FATCA IGAs amount to unequal treaties. This is particularly true of Model 1B IGAs but also (given the lack of practical reciprocity) true of Model 1A and Model 2 IGAs.

[16] For a broader discussion of FATCA and CRS, see Brown and Jackson (2021).

## 3.4. The Mechanisms of Coercion

At this stage, it has become convenient and necessary to understand the mechanisms and frameworks that have been built by the international community to institutionalise the threat that was made by Makhlouf of "defensive measures" being taken against those jurisdictions that refuse to cooperate (OECD, 2002, p. 1).

The provisions that the author will consider will be the OECD list (see OECD, 2002) and the European Union list of non-cooperative jurisdictions for tax purposes (European Council, 2024; "the EU list").

### *3.4.1. The OECD list*

The OECD list was developed in response to the June 2000 Report, which identified a number of uncooperative tax havens. The method by which an uncooperative tax haven could remove itself from the OECD list was to make a commitment to the principles of transparency (including TIEAs) and, consequently, to implement a number of TIEAs.

By 2009, the OECD list was empty and it has remained so. This means that, in its own limited terms, the OECD list must have been successful. No identified tax haven remains uncooperative.

However, the list remains, as does the unspecified threat that "defensive measures" will be taken against any jurisdiction which becomes uncooperative (OECD, 2002, p. 1).

### *3.4.2. The EU list*

The OECD list sits alongside a list prepared by another multi-jurisdictional organisation: the EU. The EU introduced its list in 2016 and published a number of criteria for inclusion. These criteria are listed in General Secretariat of the Council of the European Union (2016, pp. 4–7).

The full text of the requirements is long and involved, though it may be summarised as saying that the jurisdiction in question must engage with the OECD project to eliminate BEPS (including entering into any agreements that are necessary), and must correctly implement and receive high ratings from the review process.

It is noteworthy that, on 8th November 2022, the EU widened the criteria for inclusion on the list to include "'tax features of general application'" (European Council, 2022). These, however, are not relevant to our discussion here, as none of those matters relate to international agreements. It is however, mentioned for completeness.

### *3.4.3. What happens to jurisdictions on the EU list?*

Unlike the OECD list, the EU list has a number of practical effects. For example, Hallmark C of the provisions set out in Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (Directive 2018/822; "the DAC 6 provisions") states that an intermediary must report:

**Specific hallmarks related to cross-border transactions**

1. An arrangement that involves deductible cross-border payments made between two or more associated enterprises where at least one of the following conditions occurs…

(b) although the recipient is resident for tax purposes in a jurisdiction, that jurisdiction either:

(i) does not impose any corporate tax or imposes corporate tax at the rate of zero or almost zero; or

(ii) is included in a list of third-country jurisdictions which have been assessed by Member States collectively or within the framework of the OECD as being non-cooperative…

At this point, it is worth pausing. The format of Hallmark C(1)(b) of the DAC provisions is that it specifically states that the residence of a jurisdiction is relevant. For Hallmark C(1)(b) to be engaged, the entity must be properly resident in a jurisdiction. This is the building block of international taxation and would permit exclusive taxing rights under Article 2 of the OECD's Model Tax Convention on Income and on Capital 2017 (OECD, 2017). However, in the case of those jurisdictions that meet the criteria (that either the recipient jurisdiction has 0% tax, or is on the OECD list or the EU list), their tax residence, rather than simply being a marker of belonging to another territory, means that they become objects of suspicion and causes those dealing with them to be subject to reporting. One would assume that the scrutiny that such reporting attracts will result in challenges to residence that would not be forthcoming if there was no such reporting. It would seem that the perfectly permissible exercise of the sovereign right to either tax or not tax affects whether the EU respects the test of belonging, which is corporate residence.

In addition to this, the individual Member States have, within their domestic law, anti-avoidance rules which are triggered if a country is on the EU list. These rules were introduced as a result of the recommendations of the Code of Conduct Group and include:

a) Non-deductibility of costs;
b) Controlled foreign company rules;
c) Withholding tax measures;
d) Limitation of participation exemption (General Secretariat of the Council of the European Union, 2017, Annex III Part B)

In other words, if a jurisdiction will not comply with the OECD and the EU requirements, its residents will be "punished". Of course, this is not the language used by the large jurisdictions. Instead, they speak of "cooperation" instead of "compliance", and "defensive measures" instead of "punishment". However, it is unclear what comfort these kindly words give to a company properly resident in a listed jurisdiction following the transfer pricing guidelines in accordance with best practice and compliant with EU economic substance rules (i.e. it is a real business generating the income in its jurisdiction of residence) when a penal 35% withholding tax applied to dividends, interest or bank deposit income earned in Portugal (PwC, 2025).

It would be remiss of a disinterested observer to state that the threat of being included on the EU list does not amount to a form of "coercion", and that the power imbalance between the EU as a trading bloc and a single small island jurisdiction is not real.

It is clear that the mandating of automatic exchange of information and of implementation of the anti-BEPS proposals must throw into question the status of any agreement arising out of those frameworks that an EU Member State or the EU itself enters into for our definition of "unequal treaties".

### 3.5. The CRS

With this in mind, we should consider the CRS. The CRS is a regime that is related to but distinct from FATCA. It builds upon FATCA conceptually but implements those concepts in a truly global way. At the time of writing, the OECD lists 178 countries as having implemented CRS legislation. That is not to say that all countries exchange information with each other; instead, exchanges are not carried out until an activated exchange relationship exists between jurisdictions in a bilateral manner. This leads to a patchwork of exchanges and to each jurisdiction producing a list of other jurisdictions with which they will exchange information.[17] As an example, Gibraltar does not exchange information with the British Virgin Islands.

The CRS is thus a framework that is backed by bilateral agreements to exchange information. It is these bilateral agreements that we should consider when applying our test for an unequal treaty.

One would not claim that an activated exchange relationship between, for example, Jersey and Greenland, would be an unequal treaty. There is no imbalance of power between these jurisdictions and there is unlikely to be a materially unequal outcome.

In the case of an EU jurisdiction that enters into an activated exchange relationship with a small, low tax jurisdiction, such as Jersey, the Isle of Man, Vanuatu or any number of similar jurisdictions, there is a distinct imbalance of power between a Member State of the EU (whose international tax relations must be understood in the context of the EU's frameworks) and a small nation or Crown Dependency.

In addition, those smaller jurisdictions are faced with the issue that non-automatic exchange of information (effectively through CRS) is one of the criteria considered when assessing a jurisdiction for inclusion in the EU list. Refusal to exchange information leaves a jurisdiction open to economic "punishment"—or, alternatively, "defensive measures" (OECD, 2002, p. 1). That is a form of coercion, and an imposition of the sovereignty of less powerful nations because it means that the EU will only accept a legitimate exercise of the sovereignty of a jurisdiction if it is exercised in a manner of which the EU approves.

As to outcomes regarding an EU–Non-EU activated exchange relationship, the author takes much the same position as he does with TIEAs; it is unlikely, and in some cases impossible, that a jurisdiction such as those targeted by the EU list would benefit from an exchange agreement with a large EU jurisdiction, despite the obvious gains for the EU jurisdiction. Therefore, the author opines that there is an unequal outcome in such a case.

In respect of developed economies outside of the EU, there is a requirement for a case-by-case analysis, which is not suitable in a paper of this length. However, I would suggest that a number of criteria should be considered when assessing whether or not an activated exchange

[17] For an example of such a list, see HM Government of Gibraltar, Income Tax Office (2023).

relationship should be entered into between a non-EU developed economy and a low tax jurisdiction:

i) Does the developed economy have domestic "defensive measures" (OECD, 2002, p. 1), the use of which are framed by reference to information exchange or some related criteria (such as inclusion on the OECD list)?

ii) Would the exercise of those "defensive measures" (OECD, 2002, p. 1) plausibly damage the economy of the low tax jurisdiction?

iii) Does the taxation system of low tax jurisdiction feature characteristics such as taxation of interest and other passive income that would mean that the information exchanged under the CRS would be of use to the low tax jurisdiction?

By answering these three questions, the criteria of unequal power, the deployment of that inequality, and the inequality of outcomes are fulfilled, and thus by the definition detailed above, the CRS agreements, when entered into between a small jurisdiction for which the threat of "defensive measures" (OECD, 2002, p. 1) is material and the EU is an "unequal treaty".

### 3.6. The GLoBE Rules

On 8th October 2021, the 138 members of the Inclusive Framework agreed to a permit the implementation of what are known as the GLoBE Rules (OECD, 2021). This article is not the place to discuss the inequities of the Inclusive Framework, save to say that it has been accused of being a legitimising forum designed to assist in the implementation of its agenda rather than one that includes its non-core members in the decision-making process. This is highlighted by Fung (2017), who states that "only at the implementation stage of the BEPS Package are all countries treated as 'horizontal equals' in order to ensure its proper execution" (p. 54).

This lack of inclusivity seems to continue until the present day, as de la Feria (2024) notes, covering not only the earlier projects but also the process of development of the GLoBE Rules.

> Indeed whilst the stated aim of the Inclusive Framework was to engage all participating States – at present 135 – in "an inclusive dialogue on an equal footing to shape standards", in the context of the power asymmetry between developed and developing countries one does not necessarily follow the other, i.e., inclusion does not necessarily mean equal footing (p. 72).

In other words, the Inclusive Framework is only inclusive to the extent that it is necessary to include jurisdictions in order to get them to do what is required in respect of implementing the proposals drafted by the OECD Secretariat, who answer not to the members of the Inclusive Framework, but instead to the OECD Members themselves who, in turn, are mandated by the G20. The issues relating to the lack of creditability in the mechanisms of the Inclusive Framework that were highlighted by Fung (2015) still exist.

Rather like the dictated terms of the capitulation treaties highlighted by Detter (1966), the treaties or agreements around BEPs and GLoBE are presented fully formed for "approval". There is no fundamental negotiation of the objectives; details are set out by one side and the others simply assent. The OECD's mechanism may not be as crude as that of a nineteenth century colonial representative seeking a treaty with an indigenous ruler, but they are difficult

for the weaker party all the same, no matter how many grand ceremonies declaring that the agreements represent "inclusion" the representatives of smaller states are invited to. As with all projects, the Inclusive Framework can be expected to grow over time, and one must expect different levels of encouragement to participate to be applied to different jurisdictions. It is worthy of note that all major international "finance centres" of any repute are members of the Inclusive Framework. This may well account for the fact that some jurisdictions are not members. Many of these jurisdictions may not be relevant but, as they become relevant, we should expect international pressure to join the International Framework to be applied to them.

Finally, one must apply the definition of "unequal treaties" developed above. The GLoBE Rules qualify as a treaty in the eyes of the author because they contain an element of agreement, not only on form, but also on how to proceed. The 8th October statement (OECD, 2021) contained an agreement that, whilst no party to the statement was obliged to implement the rules either in full or in part, they were obliged not to impede the implementation of the rules by others in any way. There are several mechanisms by which it may be possible to block the GLoBE Rules from being implemented, depending on the particular elements of the rules being implemented by a party or the defensive steps that a jurisdiction could take to object to the implementation of the rules by another jurisdiction.[18]

As to whether the GLoBE Rules are unequal, we should consider the definition of "unequal treaties" developed above:

i) At this stage, it is unclear whether outcomes will be unequal. The implementation of the Qualified Domestic Minimum Top Up Tax (QDMTT)[19] could provide a significant boost to the exchequers of small, currently low tax jurisdictions, but it could also see a flight of capital that leaves these jurisdictions impoverished. The overriding nature of the QMDTT means that a low tax jurisdiction can tax a multinational enterprise (MNE) based in its jurisdiction and keep the tax that would otherwise be taken by other jurisdictions under other limbs of the GLoBE Rules. Alternatively, and in the case of MNEs that are headquartered in developed countries and have subsidiaries in low tax jurisdictions, the Income Inclusion Rule (IIR)[20] or UTPR may well mean that those subsidiaries cease to be viable and will need to be closed, impacting the economies of the low tax jurisdictions. Which of these effects has the greatest impact is yet to be seen, but the author believes it to be most likely that the economies of the low tax jurisdictions will suffer as a result of the GLoBE Rules. If this is the case, the outcome of the GLoBE Rules will be unequal.

ii) There is an inequality of power between the OECD and the jurisdictions in question. The OECD represents over 90% of the world economy. The Member States sponsoring the GLoBE Rules wield huge economic power when compared to the low tax jurisdictions and can act in concert. The past 20 years in international taxation have told the story of an ever-increasing pressure being placed on the low tax jurisdictions to end their model of low tax, low presence, corporate residence. One of the manifestations of that pressure has been the construction of an

[18] For example, a jurisdiction could suspend double taxation treaties in protest or could refuse to renegotiate treaties which have clauses that do not permit the application of the Under Taxed Payment Rule (UTPR; OECD, 2021), although the compatibility of the UTPR with existing treaties is a matter of ongoing debate.

[19] A QDMTT is a domestic minimum tax rule that applies to those MNE constituent entities that are in scope of Pillar 2 imposing a minimum tax of 15% in a manner that is consistent with the GloBE Rules; see OECD (2025b).

[20] The Income Inclusion Rule (IIR) is one of the three interlocking rules which make up the GLoBE Pillar 2 regime. In essence, it is similar to a traditional controlled foreign company rule and ensures that, where a MNE has subsidiaries that pay less than the 15% minimum rate, the parent in a relevant Pillar 2 jurisdiction will pay a tax equal to the amount below the 15% effective tax rate of the subsidiary (OECD 2021).

infrastructure for international tax compliance; and the creation of lists and detailing of consequences for nations that do not cooperate. There is now an implicit threat built into the system that any low tax jurisdiction that refuses to cooperate with the OECD will suffer economic consequences. However, implicit is not explicit (such as with the earlier threats that "defensive measures" would be taken [OECD, 2002, p. 1] detailed above in the earlier arrangements). The only extant method by which the OECD can explicitly take action against a state is to include it on the OECD list. Numerous jurisdictions have failed to sign up to the GLoBE Rules and none have been included in the OECD list as a result of this. For now, at least, there seems to be no direct consequences for non-cooperation, despite the fact that there is a general atmosphere of demands for participation. However, one must question what a more active organisation, such as the EU, may do in future to "encourage" participation.

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With regard to the GloBE Rules, the situation is, as yet, unclear. No threats have been made and the question of equality of outcomes remains unresolved.

Given the consensus that several elements of the GLoBE Rules can be implemented unilaterally (the IIR and the UTPR), it seems that the Inclusive Framework may be no more than a forum of unnecessary consensus. This may well undermine any conclusion as to the inequality of the GLoBE Rules if low tax jurisdictions' only obligation is mere acquiescence to actions within the sovereign discretion of other parties.

The author is forced to conclude that either the GLoBE Rules do not amount to an unequal treaty, as the obligations contained therein do not amount to matters of sufficient substance, or there is insufficient data as to the process of conclusion or the equality of the outcomes to make a judgment.

## 4. CONCLUSION

At the beginning of this paper, the author set out to develop a modern test for an unequal treaty. He has not taken a position on whether such a treaty should be void or voidable. Instead, he aimed to identify the undercurrents of power in the relationships between the Western countries pushing for tax reform and those low tax jurisdictions being pressured to comply.

Nothing in this paper is meant to diminish the pain and humiliation experienced by those nations that suffered under unequal treaties in the nineteenth century, and there is a material difference in the effects of those cruder, more violating treaties, and the effects of today's modern equivalents. After all, the OECD would not go to such lengths and create such a fanfare when states join the Inclusive Framework if they did not feel that such outward shows of respect were useful. That is not to say that we cannot find some underlying characteristics that run through both the unequal treaties of the nineteenth century and those of the present international tax reform; we can, as the author hopes that he has shown. Without undertaking a search for such underlying principles and relying on a narrower definition of "unequal treaties", the larger powers will simply ensure that they stand one inch to the side of legality when they exercise their power over smaller nations. In other words, they will indulge in avoidance of the rules and the dressing up of the Inclusive Framework. The use of language of inclusion when no meaningful inclusion is present does, to those who work in international tax, look strikingly similar to the lack of substance that so exercises the OECD when put in place by taxpayers. If the lack of substance present in the Inclusive Framework was present in the affairs of a company, one wonders whether it would amount to avoidance.

Once the relevant agreements have been identified as unequal treaties, the reader should ask themselves whether there is a moral argument that is strong enough to defend the deviation from the doctrine of sovereign equality that is implied in the imposition of an unequal treaty. Some will argue that the low tax jurisdictions were abusing the international taxation system in a way that, whilst not against the rules of international taxation, was certainly not in the spirit of those rules, and that their manipulation of the rules had long since bent the international system so out of shape that it had become dysfunctional. There is a strong case to be made that this position is correct, although the inhabitants and citizens of low tax jurisdictions are unlikely to agree. It is beyond the boundaries of this research to answer the question "in which position would the imposition of unequal treaties be morally permissible?" Dietsch (2015) makes a strong case that the use of abusive tax competition undermines the tax bases of the larger nation by limiting the resources of wealth that they have available for taxation and that, in the case of a system strategically designed to exploit the weaknesses of the international taxation system and the mobility of capital, those choices are illegitimate. It is perfectly understandable that, in those cases, a state would wish to "defend" its tax base (Dietsch, 2015, p.186).[21] It is not for this article to discuss whether this moral justification is sufficient to excuse the moral issues intrinsic in the imposition of an unequal treaty, nor to establish a complete theory of international justice. The aim of this article is, instead, to highlight the methods by which what many may perceive to be a moral good is being implemented, and to explain that the imposition of these arrangements on smaller states is not a "morality free zone" whereby entirely justified "good guys" simply right the wrongs perpetrated by "evil" tax evaders. Too often the public debate is framed in these terms and, if a complete theory of international justice is to be developed over time, it must acknowledge that, on occasion, large states impose unequal treaties on small states. It cannot do that without identifying characteristics that make those treaties "unequal". Once that has been achieved, a secondary process of developing a series of rules as to when (if ever) such treaties can justifiably be imposed should be carried out and that is a matter for further research. The author hopes that this research will be undertaken and that, as a result, the larger states will have moral boundaries set for them with regard to their behaviour.

Regardless of the moral justification for the actions of the OECD and other large and wealthy states in the establishment of these agreements, we should name them for what they are: agreements imposed by those jurisdictions with power and economic strength upon jurisdictions with less power and economic strength under a threat, explicit or implicit, of economic consequences. In other words, unequal treaties.

The OECD may not know this, but it certainly intuits it. It is for that reason that it expends so much energy on the Inclusive Framework. It seems to seek to establish the Inclusive Framework as an international tax organisation (ITO), such as the one described by Dietsch (2015): "An ITO with inclusive membership would provide the ideal forum" (p. 106).

[21] This is a space in which much work can be done. A substantial attempt is made by Dietsch (2015) in Chapter 2, in which he describes a difference in legitimacy between a state that strategically positions itself to carry out tax competition and has a detrimental effect on others, and a state that, for legitimate reasons, takes a different approach to balancing budget and redistribution, and, as a consequence, has an attractive taxation system. His proposal is a mixed constraint on the fiscal sovereignty of a state, i.e. a mix of both intention and outcome. This is a wholly reasonable approach, but it is one from which the EU seems to be deviating the EU's Economic and Financial Affairs Council (ECOFIN)'s amendment to the gateway criteria for consideration by the Code of Conduct (Business Taxation) Group to add a specific criterion for tax features of general application (October 2022) (European Council, 2022), which focusses entirely on outcomes. Further research could assess whether or not this is justified, but one must question whether or not the EU is attempting to impose a uniform tax system on the world.

The aim of an ITO with inclusive membership is to legitimise the decision-making process and ensure that the members accept implementation as a responsibility flowing from sovereignty as responsibility. For those with understanding of the Inclusive Framework, it seems that the OECD has read the words but not really understood them.

In conclusion, without being a truly legitimate body in which all members have equal voices and their views are given equal weight, the OECD and its organs are window dressing, and the treaties and provisions that they impose upon the members of the Inclusive Framework or the international community remain unequal and exhibit similar characteristics at their core as the unequal treaties of the nineteenth century.

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# TAX EXCEPTIONALISM: A VIEW FROM NEW ZEALAND

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## Abstract

This paper provides a perspective on the phenomenon of tax exceptionalism in New Zealand administrative law. Tax exceptionalism is broadly defined as the perception that tax law is so different or special when compared to other areas of law that relevant developments in other areas of the law are not applied or applied inconsistently. However, there has not yet, to our knowledge, been any investigation into tax exceptionalism in New Zealand. This article aims to fill this gap. First, it argues that tax exceptionalism is evident in the New Zealand Supreme Court's judicial review judgment in *Tannadyce v Commissioner of Inland Revenue* (*Tannadyce*)[4] and, in particular, the Supreme Court's approach to privative clauses. It then argues that New Zealand's particular brand of tax exceptionalism represents a concerning departure from its constitutional norms and this cannot be justified by public policy. In doing so, the article not only sheds light on something that has not received attention in New Zealand, but further contributes to the broader international understanding of the phenomenon while recognising that the precise manifestation of the phenomenon is a reflection of the particular environment in which it occurs.

## 1. INTRODUCTION

In a pair of articles published in this journal in 2017, Kristin Hickman and Stephen Daly offered perspectives on the phenomenon of tax exceptionalism in US and UK administrative law. This paper provides a similar perspective on the phenomenon in New Zealand administrative law. Tax exceptionalism is broadly defined as the perception that tax law is so different or special when compared to other areas of law that relevant developments in other areas of the law are not applied or applied inconsistently. However, there has not yet, to our knowledge, been any investigation into tax exceptionalism in New Zealand. This article aims to fill this gap. First, it argues that tax exceptionalism is evident in the New Zealand Supreme Court's judicial review judgment in *Tannadyce Investments Ltd v Commissioner of Inland Revenue* (*Tannadyce*)[5] and, in particular, is evidence of tax exceptionalism in the Supreme Court's approach to privative clauses. It then argues that New Zealand's particular brand of tax exceptionalism represents a concerning departure from its constitutional norms and this cannot be justified by public policy. In doing so, the article not only sheds light on something that has not received attention in New Zealand but further contributes to the broader international understanding of the phenomenon.

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[3] The authors thank the anonymous reviewers for their helpful comments: the usual caveats apply.
[4] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[5] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.

The general concept of tax exceptionalism—that tax is somehow different from other bodies of law—comes in many guises depending on the legal and constitutional norms of a particular jurisdiction. Hickman (2017) and Daly (2017) demonstrate that. The claim can be general: somehow tax will be treated somewhat differently from other areas of law. In New Zealand, there are many examples. For instance, uniquely, the Inland Revenue Department ("Inland Revenue") drafts tax legislation: this is usually the role of the specialist Parliamentary Counsel Office, a statutory office reporting to the Attorney General.[6] We concentrate here on a particular and specific manifestation of the phenomenon in New Zealand: the courts' treatment of privative clauses in legislation.

In section two, we outline the general characteristics of tax exceptionalism and its close relative, tax myopia, as they appear in a New Zealand context. In section three, we map the development of tax exceptionalism in the New Zealand Supreme Court's attitude to privative clauses in tax matters in comparison with the well-established orthodoxy on the courts' scepticism about such ouster clauses. In section three, we discuss the consequences of tax exceptionalism for New Zealand taxpayers and how it undermines the rule of law.

## 2. TAX MYOPIA AND TAX EXCEPTIONALISM: THE GENERAL AND THE SPECIFIC NEW ZEALAND ENVIRONMENTS

In his 1994 article "Tax myopia, or mamas don't let your babies grow up to be tax lawyers", Paul Caron decried the tendency of judges, academics, and practitioners to treat tax as a "self-contained body of law" (Caron, 1994, p. 518). He argued this "misperception" had "impaired the development of tax law by shielding it from other areas of law that should inform the tax debate" and that other areas of law had "been impoverished by the failure to consider how tax law can enrich their development" (Caron, 1994, p. 518). At first glance, this may appear to be more a matter of academic curiosity than of real practical significance. However, the short-sighted belief that tax is special has led courts to approach tax in a way that is inconsistent with the general body of administrative law.

With all phenomena, there are some commonalities across time and space, but many of the characteristics are reflections of the jurisdiction in which they exist. Tax exceptionalism is no exception. Here, we map the general and specific nature of it in New Zealand. In 1995, Sir Ivor Richardson, a New Zealand tax jurist and thinker, remarked that that despite being "crucial to the functioning of government and the economy" and "*raising major questions as to the application of public law values* [emphasis added], tax administration has not been a major field of study for tax professionals" (p. 197). He also emphasised that "public inquiries into tax matters and Court reviews of tax processes could benefit from reasoned policy discussion of the central role of voluntary compliance and taxpayer privacy and confidentiality" (Richardson, 1995, p. 197). What he noted, although this is not how he characterised it, was that tax was somehow seen as disconnected from law, from public law specifically, and from the "reasoned policy discussion" that public administration was generally subjected to (Richardson, 1995, p. 197). He did not use the term "tax myopia" but, in essence, that was what he was alluding to. It is important to recognise that tax myopia, while unfortunate, is at least *understandable*. Tax law has several characteristics, relating to its history, complexity, and form of administration, that give the appearance of operating outside of established legal norms.

[6] Legislation Act 2019 (New Zealand), Part 6; on the role of Inland Revenue in drafting tax legislation, see Legislation Act 2019, s. 68 and Inland Revenue Department (Drafting Order) 1995 (SR1995/286) (New Zealand); see also Griffiths (2017).

The need for common consent means that taxes may only be levied by an Act of Parliament.[7] At first glance, this constitutional element suggests that tax is "quintessentially law". However, tax's reliance on statute may, in fact, have segregated it from the common law-based private law practised and taught in the eighteenth and nineteenth centuries (Griffiths, 2017). Indeed, the need for clear parliamentary language contributed to a persistent form of tax exceptionalism: literal interpretation. The upshot, at this stage, is that while the literal approach has since been abandoned and New Zealand's legal system has become increasingly statute-based, the perception of tax as operating outside of established legal norms persists.

Furthermore, tax "must, by its very nature, be abstract and technical, and can never be easy reading."[8] Statutory language should only ever be simplified "as far as is practicable" (Law Commission Act 1985, s. 5(1)(d); see also Richardson, 2012) and sometimes that might not be very far at all. As former New Zealand Chief Justice Dame Sian Elias (2014) has said, income tax legislation deals "with a wholly artificial universe constructed by law" (p. 48).

A second source of complexity is what John Prebble KC (1995) refers to as the "ectopic nature of income tax law" (p. 111). Income tax depends on the existence of a concept of income that "ultimately can[not] be defined by law" because, unlike most things that are defined by law, income is not something that exists as a physical fact or as an abstract thought (Prebble KC, 1995, p. 114). As Prebble KC observed, income tax can only ever be applied to a legalistic "simulacrum" of transactions rather than the transactions themselves (Prebble KC, 2002, p. 307). The law must impose artificial constraints of space (such as source and residence rules) and time (such as tax years). Artificiality creates opportunities for tax avoidance, which must be countered by a further set of artificial rules which, in turn, gives rise to new issues that need to be addressed. Prebble KC (1995) argues this has made income tax more formalistic and less comprehensible than other areas of law.

Finally, in contrast to most areas of law, tax legislation is primarily interpreted and administered by the executive branch (Griffiths, 2017). In New Zealand, it is the Commissioner of Inland Revenue ("the Commissioner") who is charged with the "care and management" of taxes (Tax Administration Act 1994 [New Zealand] ["TAA 1994"], s. 6A; Griffiths, 2017) and protecting the "integrity of the tax system" (TAA 1994, s. 6; Griffiths, 2017). It is the Commissioner who has the power to review and amend taxpayers' self-assessments and, therefore, it is the Commissioner who is primarily responsible for interpreting the Inland Revenue Acts. For this reason, tax practitioners must concern themselves with a significant body of "soft law" promulgated by Inland Revenue in the form of Interpretation Statements (Griffiths, 2021). This, combined with the fact that Inland Revenue's primary practitioners are accountants rather than lawyers, understandably causes many people to perceive tax as being removed somehow from the traditional legal system (Griffiths, 2017).

This amalgam of factors does make tax law "different", special and, to some degree, disconnected from the rest of the law. It is inevitable that it will become self-referring and that a separate epistemic community will form (de Cogan, 2015). It is also understandable. We might describe this phenomenon as tax myopia: tax law and practice can and must provide the answers to problems in tax law. The tendency to ignore the rest of the law is unsurprising and

[7] Bill of Rights 1688 1 Will & Mar, Sess 2, c 2, article 4, incorporated into New Zealand law by the Imperial Laws Application Act 1988, s 3. See also Constitution Act 1986. The Bill of Rights 1688 and the importance of common consent are discussed in greater depth in section four of this article.
[8] HM Stationery Office (1936), pp. 18–19.

often necessary. But it potentially leaves tax law somewhat disconnected from the norms and values of the web of law in which it is located.

Tax exceptionalism, then, is best understood as the crystallisation of tax myopia into common law. It arises when a judge forms a myopic view of tax and allows this to cloud their judgement in the application of public law principles. This can happen because of independent error on the judge's part or (more commonly) through the exploitation of the judge's misperceptions by an opportunistic revenue authority or, on occasion, taxpayers (Walker, 2017). Consequently, there is real potential for tax exceptionalism in any country in which tax myopia can be found. This includes New Zealand.

Taken together, the history, complexity, and bureaucracy of tax law go some way to explaining its perceived difference from the rest of the law (Griffiths, 2017). However, this perceived difference is just that: perceived. To adopt a genetic analogy, tax law displays some different physical characteristics to other areas of law, but it is still of the same species. Its underlying genetics are not so different from other areas of law that they cannot interbreed. Indeed, they *should*. Tax myopia is already present in New Zealand. The question is whether it has crystallised into tax exceptionalism.

## 3. TAX EXCEPTIONALISM: NEW ZEALAND'S ADMINISTRATIVE LAW AS A CASE STUDY

Section 109 of the TAA 1994 is a privative clause which purports to restrict access to judicial review. We argue that the Supreme Court's interpretation of s. 109 in *Tannadyce*[9] is inconsistent with New Zealand courts' approach to privative clauses generally. This inconsistency cannot be explained by the TAA 1994's legislative scheme and, therefore, appears to be evidence of the solidification of tax myopia into tax exceptionalism in New Zealand.

This article focusses solely on evidence of tax exceptionalism in New Zealand's judiciary and does not assess the prevalence of tax exceptionalism in the attitudes of New Zealand's legislators or revenue officials. In the authors' view, it is present but that is a project for another day.

### 3.1. Disputes under the TAA 1994

The TAA 1994 deems certain decisions, including assessments, to be "disputable decisions" (s. 3). Its disputes process is designed to keep challenges to disputable decisions out of court. Section 109 of the TAA 1994 is intended to ensure that taxpayers cannot initiate challenge proceedings via the Taxation Review Authority ("TRA") or in the High Court until this process is complete (unless the Commissioner agrees to cut the process short; see TAA 1994, s. 89N[1][c][viii]). Section 109 operates by deeming disputable decisions to be correct except in statutory challenge proceedings:

[9] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.

> Except in objection proceedings under Part 8 or a challenge under Part 8A,—
>
> (a) no disputable decision may be disputed in a court or in any proceedings on any ground whatsoever; and
>
> (b) every disputable decision and, where relevant, all of its particulars are deemed to be, and are to be taken as being, correct in all respects. (TAA 1994, s. 109)

Section 109 of the TAA 1994 is supported by s.114(a), which provides that assessments made by the Commissioner will not be invalidated "through a failure to comply with a provision of" the TAA "or another Inland Revenue Act".

### 3.2. How New Zealand courts usually approach privative clauses

New Zealand courts (like UK courts) regard themselves as the ultimate interpreters of the law and protectors of the rule of law (Joseph, 2021; *Tannadyce*)[10]—there is no concept of interpretive or *Chevron* deference like that found in the US.[11] Consequently, New Zealand courts are generally suspicious of privative clauses and will often disregard them entirely. In *Bulk Gas Users v Attorney-General* (*Bulk Gas Users*), Cooke J held that privative clauses "will not apply if the decision results from an error on a question of law which the authority is not empowered to decide conclusively".[12] Courts will be slow to conclude that Parliament intended an authority to be so empowered (*Regina [Privacy International] v Investigatory Powers Tribunal* (*Privacy International*) at [111] per Lord Carnwath).[13]

Judicial review is fundamental to the rule of law, as reflected in Lord Bingham (2007)'s second and sixth principles of the Rule of Law: "questions of legal right and liability should ordinarily be resolved by application of the law and not the exercise of discretion" (p. 72) and "ministers and public officers at all levels must exercise the powers conferred on them reasonably, in good faith, for the purpose for which the powers were conferred and without exceeding the limits of such powers" (p. 78). If Parliament wishes to restrict such a fundamental constitutional principle then it must "squarely confront what it is doing and accept the political cost" (*Regina v Secretary of State for the Home Dept, Ex parte Simms* at p. 131 per Lord Hoffmann).[14] This common law position is reinforced by the New Zealand Bill of Rights Act 1990 ("NZBORA 1990"), which provides that courts must interpret privative clauses in a manner consistent with the right to judicial review as far as possible (*Zaoui v Attorney-General (No 2)* at [99], citing NZBORA 1990, ss. 6 and 27[2]).[15]

This does not mean that courts must always read down privative clauses. They may still exercise their discretion to decline review in the interests of justice and the rule of law. As Lord Carnwath put it, the status of adjudicative bodies "is to be respected and taken into account,

[10] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[11] *Chevron USA, Inc v Natural Resources Defense Council, Inc* 468 US 837 (1984).
[12] *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA) at 133.
[13] *Regina (Privacy International) v Investigatory Powers Tribunal* [2019] UKSC 22, [2020] AC 491.
[14] *Regina v Secretary of State for the Home Dept, Ex parte Simms* [2000] 2 AC 115 (HL).
[15] *Zaoui v Attorney-General (No 2)* [2005] 1 NZLR 690 (CA).

not by exclusion of review, but by careful regulation of the court's power to grant or refuse permission for judicial review (*Privacy International* at [99]).[16]

Courts will generally use their discretion to decline review (and uphold the privative clause) if they are satisfied that the grounds of review can be appropriately dealt with under a statutory dispute resolution mechanism. This prevents bespoke statutory mechanisms from being undermined by costly and time-consuming review proceedings. For example, in *Ramsay v Wellington District Court* (*Ramsay*),[17] the Court of Appeal held that the applicability of s.133(4) of the Accident Insurance Act 1998 (a privative clause)[18] was ultimately a question of fact: if the alleged ground of review could be addressed through the statutory appellate process, then s. 133(4) *would* apply. However, if it could not, s. 133(4) would not preclude judicial review (*Ramsay* at [35]–[37]). In practice, then, courts will generally give effect to privative clauses, but they do so by their own choice, not by order of Parliament. The ultimate question "is not what the clauses enact but what the rule of law requires" (Joseph, 2021).

### 3.3. The Evolution of s. 109 of the TAA 1994: From "Exceptional Circumstances" to Exceptionalism

Section 109 of the TAA 1994 replaced s. 27 of the Income Tax Act 1976 (New Zealand) ("ITA 1976"). The Court of Appeal considered s. 27 of the ITA 1976 on several occasions throughout the 1980s and 1990s.[19] There is no material difference between the two sections (*Tannadyce* per McGrath J at [22]).[20]

In *Commissioner of Inland Revenue v Canterbury Frozen Meat Co Ltd*, at 688, the Court of Appeal held that s. 27 of the ITA 1976 only barred judicial review of the correctness of an assessment, not procedural challenges "on traditional administrative law grounds."[21] In *Golden Bay Cement Ltd v Commissioner of Inland Revenue* (*Golden Bay Cement*), the Court of Appeal clarified that challenges on administrative law grounds could and *should* be brought under the statutory appeal process.[22] The Court endorsed the following passage from Lord Scarman:

> Where Parliament has provided by statute appeal procedures, as in the taxing statutes, it will only be very rarely that the courts will allow the collateral process of judicial review to be used to attack an appealable decision. (*Regina v. Inland Revenue Commissioners, Ex parte Preston* at 852)[23]

[16] *Regina (Privacy International) v Investigatory Powers Tribunal* [2019] UKSC 22, [2020] AC 491.
[17] *Ramsay v Wellington District Court* [2006] NZAR 136 (CA).
[18] Accident Insurance Act 1998, s. 134(4). Section 134(4) was succeeded by s. 133(5) of the Accident Compensation Act 2001. The Court of Appeal saw "no substantive differences" between the two provisions: *Ramsay v Wellington District Court* [2006] NZAR 136 (CA) at [27].
[19] *Commissioner of Inland Revenue v Lemmington Holdings Ltd* [1982] 1 NZLR 517 (CA); *Commissioner of Inland Revenue v Canterbury Frozen Meat Co Ltd* [1994] 2 NZLR 681 (CA); *Golden Bay Cement Ltd v Commissioner of Inland Revenue* [1996] 2 NZLR 665 (CA); and *New Zealand Wool Board v Commissioner of Inland Revenue* [1997] 2 NZLR 6 (CA).
[20] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[21] *Commissioner of Inland Revenue v Canterbury Frozen Meat Co Ltd* [1994] 2 NZLR 681 (CA).
[22] *Golden Bay Cement Ltd v Commissioner of Inland Revenue* [1996] 2 NZLR 665 (CA).
[23] *Regina v. Inland Revenue Commissioners, Ex parte Preston* [1985] AC 835 (HL).

The Court of Appeal would, therefore, only entertain review in "exceptional circumstances, typically an abuse of power" (*Golden Bay Cement Ltd* at 672).[24] However, the court did not exhaustively define "exceptional circumstances", leaving the question to judicial discretion. For example, exceptional circumstances arose on the facts of *Golden Bay Cement* because the Court of Appeal had already heard full argument on the relevant issues, and recourse to the objection procedure would be wasteful (at 673–674).[25] The Privy Council endorsed this approach in *Miller v Commissioner of Inland Revenue* (*Miller*), at [18] per Lord Hoffmann, summarising the position as follows:

> It will only be in exceptional cases that judicial review should be granted where the challenges can be addressed in the statutory objection procedure. Such exceptional circumstances may arise most typically where there is abuse of power…But they have also been held to arise where the error of law claimed is fatal to the exercise of statutory power and where it would be wasteful to require recourse to the objection procedure.[26]

Therefore, until the early 2000s, tax privative clauses cases were still being approached in accordance with the general position outlined in *Bulk Gas Users*.[27] However, the Court of Appeal began to treat tax somewhat differently in the case of *Westpac Banking Corp v Commissioner of Inland Revenue* (*Westpac*).[28]

Westpac Banking Corp ("Westpac") was one of several banks involved in litigation with the Commissioner over the tax consequences of a series of structured financial transactions called "repo deals". The Commissioner issued a binding ruling (see TAA 1994, s. 91E) that the general anti-avoidance rule (Income Tax Act 2007, s. BG 1) would not apply to one of Westpac's transactions. The Commissioner subsequently sought to reassess Westpac in relation to other repo deals, alleging avoidance. Westpac sought judicial review on the basis that it would be substantively unfair (or contrary to a substantive legitimate expectation) to depart from the earlier ruling.

Westpac first had to establish the existence of "exceptional circumstances" which placed its challenge outside of the scope of s. 109 of the TAA 1994 (*Westpac* at [59]).[29] The Court observed that the TAA 1994's statutory dispute provisions were akin to a dispute resolution "code" which provided "a particularly inauspicious context for judicial review" (*Westpac* at [47]).[30] Exceptional circumstances would only arise where "what purports to be an assessment is not an assessment" or where there had been "conscious maladministration" (*Westpac* at [59]).[31] This was based on the language of the High Court of Australia in *Commissioner of Taxation v Futuris Corporation Ltd* (*Futuris*)[32] in applying s. 175 of the Income Tax

[24] *Golden Bay Cement Ltd v Commissioner of Inland Revenue* [1996] 2 NZLR 665 (CA).
[25] *Golden Bay Cement Ltd v Commissioner of Inland Revenue* [1996] 2 NZLR 665 (CA).
[26] *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC).
[27] *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA).
[28] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[29] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[30] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[31] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[32] *Commissioner of Taxation v Futuris Corporation Ltd* [2008] HCA 32, (2008) 237 CLR 146.

Assessment Act 1936 (Cth)[33] which formed part of a similar disputes regime to that found in New Zealand. The High Court of Australia held that:

> Where s 175 applies, errors in the process of assessment do not go to jurisdiction and so do not attract the remedy of a constitutional writ under s 75(v) of the Constitution or under s 39B of the Judiciary Act. (*Futuris* at [24])[34]

Judicial review was therefore only available where "what purports to be an assessment is not in fact an assessment" (*Westpac* at [59]).[35] This included "tentative or provisional assessments which for that reason do not answer the statutory description in s 175" as well as "conscious maladministration of the assessment process [which] may be said also not to produce an 'assessment' to which s 175 applies" (*Westpac* at [25]).[36]

In applying *Futuris*, the New Zealand Court of Appeal overlooked the conceptual gulf between Australian and New Zealand administrative law.[37] The organising principle of Australian judicial review is "jurisdictional error". Courts can generally only review those decisions that give rise to "jurisdictional error" as opposed to errors "within jurisdiction".[38] New Zealand judicial review is organised around the concept of "error of law" and makes no distinction between jurisdictional and non-jurisdictional errors.[39] The Court of Appeal therefore adopted an approach which, while entirely correct in Australia, was directly contrary to the organising principle of New Zealand administrative law.

The Court of Appeal appears to have reasoned that taxpayers' individual rights are secondary to those of the "hidden third party" of compliant taxpayers (*Westpac* at [61][40]; see also Griffiths, 2011). First, the Court minimised the importance of procedural propriety in tax cases by pointing out that a taxpayer's liability to tax exists independently of the Commissioner's assessment and that procedural impropriety could not erase this liability.[41] Secondly, the Court warned of the risk of taxpayers using judicial review to "game" and "delay" the statutory processes (*Westpac* at [62]–[63]).[42] Thirdly, the Court viewed these "collateral challenges" as of particular concern because of their potential to waste limited Inland Revenue resources (*Westpac* at [64])[43]: a concern that appears to evoke the Commissioner's "highest net revenue" objective under s. 6A(2) of the TAA 1994.

The Court of Appeal, therefore, appears to have reached its conclusion based on a belief that tax was "somewhat different" from other areas of administrative law. This was observed with concern by some (Griffiths, 2011).

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[33] "The validity of any assessment shall not be affected by reason that any of the provisions of this Act have not been complied with" (Income Tax Assessment Act 1936, s. 175).
[34] *Commissioner of Taxation v Futuris Corporation Ltd* [2008] HCA 32, (2008) 237 CLR 146.
[35] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[36] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99 at [25].
[37] *Commissioner of Taxation v Futuris Corporation Ltd* [2008] HCA 32, (2008) 237 CLR 146.
[38] *Wei v Minister for Immigration and Border Protection* [2015] HCA 51, (2015) 257 CLR 22 at [28]; Lord Woolf et al. (2018), pp. 237–239; and Taggart (2008), pp. 8–9.
[39] *Peters v Davison* [1999] 2 NZLR 164 (CA) at 188.
[40] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[41] See *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99 at [61]. This appears to ignore the Privy Council's observation that "the making of an assessment, whether correct or not, may be an abuse of power" (*Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC) at [14]).
[42] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.
[43] *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 99.

### 3.4. *Tannadyce*

Despite this concern, the Supreme Court fully embraced tax exceptionalism in *Tannadyce*.[44] Tannadyce Investments Ltd claimed that Inland Revenue withheld financial records necessary for it to complete its returns for the 1993–1998 income years which, in turn, caused the Commissioner to enter a prejudicial default assessment.[45] The company applied for judicial review of this assessment, arguing that the Commissioner had, by withholding the records, engaged in "conscious maladministration" involving abuse of power and breach of natural justice (*Tannadyce* at [40]).[46]

The Supreme Court majority of Tipping, Blanchard, and Gault JJ applied what could be described as an orthodox process of statutory interpretation. Parliament's intention, they held, was plainly that "disputes and challenges capable of being brought under the statutory procedures [be] brought in that way and were *not to be made subject of any other form or proceeding in court or otherwise* [emphasis added]." (*Tannadyce* at [53]). This comprehensive prohibition was indicated by the words "on any ground whatsoever" (*Tannadyce* at [54]). The majority recognised that judges "should be slow to conclude that a statutory provision ousting or limiting access to the courts was intended to preclude applications to the High Court for judicial review" (*Tannadyce* at [56], citing *Bulk Gas Users* at 133).[47] However, they concluded that there was "no need to strain to reconcile the terms of s 109 with the general availability of judicial review" (*Tannadyce* at [57])[48] because the TAA 1994's challenge procedure contains a built-in right to challenge disputable decisions in the High Court (TAA 1994, Part 8A). In their view, this outcome did "not in any way diminish the general importance and availability of judicial review" but was merely a "product of the text and purpose of s 109 in its particular statutory context" (*Tannadyce* at [60]).[49] Judicial review would, therefore, only be available in relation to disputable decisions where:

> (a) It was "not practically possible for a taxpayer to challenge the decision under Part 8A" (*Tannadyce* at [58]);[50] or
>
> (b) There was a "flaw in the statutory process" that could not be addressed within the regime itself (*Tannadyce* at [59]).[51]

In their view, an unwritten "exceptional circumstances" exception would "not be consistent with the purpose which Parliament was trying to achieve" (*Tannadyce* at [72]) [52]when it enacted s. 109 of the TAA 1994 and provided an opportunity for "gaming the system" (*Tannadyce* at [71]).[53]

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[44] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[45] The Commissioner may issue a default assessment under s. 106 of the TAA 1994 if the taxpayer's returns are unsatisfactory.
[46] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2010] NZCA 233, (2010) 24 NZTC 24 at [40].
[47] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153; *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA).
[48] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[49] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[50] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[51] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[52] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[53] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.

In summary, the majority concluded that s. 109 of the TAA 1994 precludes judicial review of disputable decisions "unless the taxpayer cannot practically invoke the relevant statutory procedure" and that such circumstances were "likely to be extremely rare" (*Tannadyce* at [61]).[54] TIL had not established the existence of such a situation (*Tannadyce*).[55]

Elias CJ and McGrath J authored what Glazebrook J (a current judge of the Supreme Court with particular expertise in taxation) later described extrajudicially as a "very strong minority opinion" (Glazebrook, 2015, p. 9).[56] The minority argued that privative clauses should not be approached from an orthodox statutory interpretation standpoint because courts of higher jurisdiction "have constitutional responsibility for upholding the values which constitute the rule of law" and ensure that "when public officials exercise the powers conferred on them by Parliament, they act within them" (*Tannadyce* at [3]).[57] They do this through the mechanism of judicial review (*Tannadyce*).[58] Statutes that purport to limit this mechanism are, therefore, viewed with suspicion and this is reflected in the interpretive presumption that "it was not Parliament's intention to allow decision makers power conclusively to determine any question of law" (*Tannadyce* at [3]).[59] In this context, judicial review should be available whenever it best serves the ends of justice, regardless of the statutory scheme. It should not be confined to cases where the taxpayer is unable to bring the grievance within the statutory process (*Tannadyce*).[60] The correct approach to s. 109 was therefore a flexible one (as outlined by the Privy Council in *Miller*.[61] The range of circumstances that might call for judicial review are too diverse to permit the framing of a definitive rule. While, generally, the statutory disputes process will be able to provide superior remedies to judicial review, it is impossible to foresee all possible circumstances in which this will not be the case (*Tannadyce*).[62]

This approach protects "the integrity of the tax system" (TAA 1994, s. 6) and ensures that taxpayers are assessed "fairly, impartially, and according to law" (TAA 1994, s. 6[2][b]). In contrast, there was a risk that the majority approach might lead to taxpayers facing "substantial prejudice" if required to proceed under the statutory procedure (*Tannadyce* at [38]).[63] It was only in circumstances where the statutory process "will in substance remedy the prejudice" that the court should "exercise its *discretion* [emphasis added] against granting relief" (*Tannadyce* at [38]).[64] Moreover, the minority argued that their approach was "consistent with the approach taken to challenges to administrative decisions *in areas other than taxation* [emphasis added]".[65] They cited, in particular, Cooke J's general approach in *Bulk Gas Users*, and the Court of Appeal's observation in *Ramsay* that this restrictive interpretation would apply *unless a challenge is amenable to the statutory process* (*Tannadyce*).[66]

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[54] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[55] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[56] Justice Glazebrook was appointed to the Supreme Court in 2012, a year after *Tannadyce Investments Ltd v Commissioner of Inland Revenue* was decided.
[57] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[58] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[59] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[60] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[61] *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC).
[62] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[63] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[64] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[65] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[66] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153; *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA); *Ramsay v Wellington District Court* [2006] NZAR 136 (CA).

While the minority's criticism was primarily aimed at the majority approach, they also disapproved of the outcome in *Westpac*. They argued that the Court of Appeal had not addressed the *Miller* line of authority despite the lack of significant legislative change. They went on to criticise the Court's reliance on *Futuris* on the basis that an approach based on Australian judicial review principles was no substitute for New Zealand principles developed by the Court of Appeal and the Privy Council over 25 years (*Tannadyce*).[67]

The majority responded at paragraphs [69] to [73] of their judgment (*Tannadyce*). In their view, it was "not necessary" to address the *Miller* line of authority because "the essence of the earlier cases was captured in Westpac" because it perpetuated the "exceptional circumstances" exception (*Tannadyce* at [70]).[68] In any event, the majority considered that the earlier cases had overlooked the existence of an ultimate right of appeal to the High Court, which they considered would always provide an adequate remedy which, under the reasoning in *Ramsay*, meant the interpretive presumption did not apply (*Tannadyce*).[69]

This is not a convincing rebuttal. The approach in *Westpac* was plainly more restrictive than that in *Miller*, especially given the reliance on *Futuris*. It is difficult to believe that the majority overlooked this. It also seems unrealistic to suggest that Sir Ivor Richardson repeatedly overlooked the implications of an eventual right of appeal to the High Court given his role in designing the TAA 1994 and his extrajudicial wariness of judicial review in a tax context (Richardson et al., 1993). This does not mean that the majority's approach was necessarily *wrong*, but it does suggest that it involved a departure from established principles of public law.

### 3.5. Restricting *Tannadyce*

The question, then, is did *Tannadyce* mark a general change in New Zealand's approach to privative clauses, or the carving out of a new approach for tax law only? Subsequent cases involving privative clauses suggest the latter. The Supreme Court has consistently followed the *Bulk Gas Users* approach in all subsequent non-tax cases and has overtly restricted *Tannadyce* to its statutory context in two judgments.[70]

The first case is *H (SC 52/2018) v Refugee and Protection Officer* (*H*).[71] The appellant was an applicant for refugee status. A Refugee and Protection Officer (RPO) erroneously rejected his application after he failed to attend an interview for medical reasons, and rejected his

[67] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[68] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[69] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[70] The Supreme Court has mentioned *Tannadyce* on six additional occasions: *Orlov v New Zealand Law Society* [2013] NZSC 94 cites *Tannadyce* for the unremarkable proposition that "the Court would not normally permit judicial review proceedings to be heard ahead of the statutory proceedings, other than in exceptional cases" (at [6]); *Skinner v R* [2016] NZSC 101, [2017] 1 NZLR 289 cites *Tannadyce* for the proposition that Parliament never intended s. 109 of the TAA 1994 to apply to criminal proceedings (at [14]–[19]); *Austin v Roche Products (New Zealand) Ltd* [2021] NZSC 62 cites *Tannadyce* as showing the continued approval of *Ramsay* (at [20]); *FMV v TZB* [2021] NZSC 102, [2021] 1 NZLR 466 did not raise an ouster clause issue of the kind considered in *Tannadyce* (at [129]); *M (SC 82/2020) v Attorney-General* [2021] NZSC 118, [2021] 1 NZLR 770 cites *Tannadyce* for a proposition unrelated to privative clauses; *Chesterfields Preschools (in liq) v Commissioner of Inland Revenue* [2021] NZSC 133 is a recall application in which the applicant unsuccessfully argues that the Court ought to have considered *Tannadyce*.
[71] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.

explanation because his supporting documents did not meet a series of non-statutory requirements. H sought judicial review of the RPO's decisions to reject his medical certificate and to reject his status application (*H*).[72]

The RPO argued that s. 249 of the Immigration Act 2009 precluded review. Section 249 of the Immigration Act 2009 is "in effect, a privative provision" (*H* at [62])[73] but the Supreme Court held (unanimously) that judicial review nonetheless provided a more appropriate remedy than the statutory dispute process (*H*).[74] In these circumstances, the Court concluded that s. 249 should be read down, expressly endorsing the approach in *Bulk Gas Users*:

> Since the decision of the Court of Appeal in *Bulk Gas Users Group v Attorney-General*, it has been settled law that a privative provision does not necessarily prevent scrutiny of a decision based on an error of law on the part of the decision-maker that is otherwise reviewable. The Court may strike out review proceedings where the Court is satisfied that the available appeal rights provide a more appropriate pathway to a remedy than might otherwise have been sought in the review proceedings. But for the reasons given, the deprivation of first instance determination as required by the statute could not be remedied by the alternative pathway of appeal in the present case. (*H* at [78])[75]

This echoed the language of the Privy Council in *Miller* and the minority in *Tannadyce*. The Court then distinguished *Tannadyce* on the basis that the TAA 1994 created a statutory disputes regime "sufficiently comprehensive to render judicial review unnecessary, except where the challenge process could not be invoked" (*H* at [87]).[76] This was because s. 109 of the TAA 1994 "did not prevent access by the taxpayer to the Court on matters of unlawfulness, but rather provided a statutory process for such access" (*H* at [87]).[77]

The second case is *Ortmann v United States of America* (*Ortmann*).[78] *Ortmann* formed part of the ongoing extradition battle between the United States and Kim Dotcom. One issue on appeal was whether Dotcom's application for judicial review was an abuse of process. The Court of Appeal treated *Tannadyce* as authority for the proposition that "if a ground of judicial review can be raised and adequately determined through the case-stated appeal process under s 68 [of the Extradition Act 1999] — as, in our assessment, it has been in this case — judicial review is not available" (*Ortmann* [2018] at [311]).[79] However, the Supreme Court held that "*Tannadyce* principles" were not "engaged on the facts of this case" (*Ortmann* [2020] at [573].[80] They pointed out that "*Tannadyce* was a very different case from the present. It was a tax case" (*Ortmann* [2020] at [573]).[81] Unlike the TAA 1994, the Extradition Act 1999 does not have a privative clause and provides only "carefully circumscribed" appeal rights (*Ortmann*

[72] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[73] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[74] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[75] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[76] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[77] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[78] *Ortmann v United States of America* [2020] NZSC 120, [2020] 1 NZLR 475.
[79] *Ortmann v United States of America* [2018] NZCA 233, [2018] 3 NZLR 475.
[80] *Ortmann v United States of America* [2020] NZSC 120, [2020] 1 NZLR 475.
[81] *Ortmann v United States of America* [2020] NZSC 120, [2020] 1 NZLR 475.

(2020) at [572], citing *Ortmann* [2018] at [311]).[82] The essence of *Tannadyce* was that Parliament had left "virtually no role for judicial review" (*Ortmann* [2020] at [572]).[83]

Read together, *H* and *Ortmann* suggest an effort to confine *Tannadyce* to its own statutory setting and protect the general principles established in *Bulk Gas Users* (Joseph, 2021). In both cases, the Supreme Court appears to suggest that *Tannadyce* will only apply in tax cases. Ostensibly, this is because the TAA 1994 is the only statutory regime comprehensive enough to render judicial review unnecessary, but it is difficult to escape the general trend of reinforcing *Bulk Gas Users* while limiting *Tannadyce* to tax. This trend is reinforced by Glazebrook J's concurrence in both *H* and Ortmann, and Elias CJ's concurrence in *H* (her Honour having retired prior to *Ortmann*), despite their criticism of *Tannadyce*.

### 3.6. *Tannadyce* as Tax Exceptionalism

While it appears that the Supreme Court *does* treat s. 109 of the TAA 1994 as somewhat different from other privative clauses, this does not necessarily reflect tax exceptionalism. It is possible that *Tannadyce* simply established a general principle that privative clauses will not, as a matter of law, be read down where an accompanying statutory regime renders judicial review practically redundant and the TAA 1994 just happens to be *exceptionally comprehensive* when compared to other statutes. It would, therefore, be Parliament, not the courts, who treated tax as being different (as Parliament, being sovereign, is permitted to do). This explanation is flawed because the TAA 1994's disputes regime is not so comprehensive as to render judicial review redundant. The cost and inefficiency of the statutory regime means that it will often be inadequate to address procedural improprieties that can (and should) be resolved by way of judicial review. *Tannadyce* is, therefore, better explained as a conscious limitation of judicial review in tax cases.

At face value, cost and inefficiency might seem incapable of giving rise to "exceptional circumstances" justifying review. This is not the case. Both *Miller* and *Golden Bay Cement* indicate that "exceptional circumstances" justifying review may arise "where it would be wasteful to require recourse to the objection procedure"(*Miller* at [17]; *Golden Bay Cement* at 673–674).[84] In any event, a theoretical right of appeal to the High Court means little if the disputes regime renders it practically inaccessible.

The inefficiency and cost of the disputes process is something of a running joke among tax commentators.[85] The disputes process alone frequently takes more than two years to complete and subsequent challenge to the High Court more than doubles this timescale (Keating, 2012). Meanwhile the cost has led the Tax Committee of the New Zealand Law Society and the New Zealand Institute of Chartered Accountants (2008) to conclude that the statutory process "simply pric[es] some taxpayers out" (p.12).

[82] *Ortmann v United States of America* [2020] NZSC 120, [2020] 1 NZLR 475; *Ortmann v United States of America* [2018] NZCA 233, [2018] 3 NZLR 475.
[83] *Ortmann v United States of America* [2020] NZSC 120, [2020] 1 NZLR 475.
[84] *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC); *Golden Bay Cement Ltd v Commissioner of Inland Revenue* [1996] 2 NZLR 665 (CA).
[85] See, for example, Shewan (2002); Blanchard (2005); Keating (2012), pp. 15–22; Glazebrook (2015), pp. 4–10; Young (2011), p. v ; Griffiths (2011), pp. 221–225.

In order to maintain "the integrity of the tax system" (TAA 1994, s. 6), taxpayers have their liability determined "fairly impartially and according to law" (TAA 1994, s. 6[2][b]). As the *Tannadyce* minority notes, the Commissioner exercises "highly intrusive statutory powers", the improper exercise of which "can give rise to departures from the statutory purposes of such significance that resulting assessments, or other decisions affecting taxpayers, should be invalidated" (*Tannadyce* at [35]).[86] A recent example of such a departure can be found in the recent *Parore* cases, in which Inland Revenue officials compelled the defendant in a tax evasion prosecution to disclose facts and legal arguments relevant to his case through the TAA 1994's civil disputes resolution process prior to commencing the criminal prosecution. The prosecution was stayed on the basis that this breached the defendant's "right to silence" under NZBORA 1990, and the Court of Appeal subsequently made a formal declaration that Inland Revenue had breached Mr Parore's right to a fair trial under s. 25(a) of NZBORA 1990.[87] The High Court had also ordered Inland Revenue to pay damages to the defendant but this was reversed on appeal.[88] Such improprieties are of significant public and constitutional importance, and should be resolved promptly, efficiently, and without undue cost. The statutory disputes process does not always allow for this. Indeed, it may not remedy some pre-assessment improprieties at all if they do not affect the ultimate assessment (Richardson et al., 1993). Therefore, the process may provide a superior remedy to judicial review in many instances, but to suggest that judicial review no longer has a role to play is to ignore reality.

The disputes regime's limitations were well known at the time of *Tannadyce*. The suggestion that the majority's reasoning "rested on the premise that Parliament had created…an appeal process that was sufficiently comprehensive to render judicial review unnecessary, except where the challenge process could not be invoked" does not, therefore, hold water (*H* at [87]).[89] It is more intellectually honest to recognise *Tannadyce* for what it was: a conscious decision to *restrict* judicial review rights, and the ability of courts to uphold the rule of law, to ensure the efficient operation of the tax system. This is reflected in the majority's repeated emphasis on the importance of the speed and efficiency purportedly provided by the statutory regime, as well as the need to avoid "gaming" (*Tannadyce* at [49], [51], [55], [67], [71], [72]).[90] In making this trade-off, they created a rule exclusive to tax. This is textbook tax exceptionalism.

## 4. THE GENERAL CASE AGAINST TAX EXCEPTIONALISM AND THE SPECIFIC NEW ZEALAND CONTEXT

The case against tax exceptionalism rests on two propositions. The first is the basic tenet of the rule of law that "laws should apply equally to all, save to the extent that objective differences justify differentiation" (Lord Bingham, 2007, p. 73). Therefore, in the absence of objective differences between revenue authorities and other administrative actors, the same principles of public law should apply. This was the sentiment expressed by both the US Supreme Court in *Mayo Foundation for Medical Education and Research v United States* (*Mayo Foundation*)[91]

[86] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[87] *Commissioner of Inland Revenue v Parore* [2021] NZHC 3405 (stay); and *Attorney-General v Parore* [2025] NZCA 328 (declaration).
[88] *Parore v Attorney-General* [2023] NZHC 1010; and *Attorney-General v Parore* [2025] NZCA 328. For a summary of the High Court decision and Inland Revenue's response, see Handford (2023).
[89] *H (SC 52/2018) v Refugee and Protection Officer* [2019] NZSC 13, [2019] 1 NZLR 433.
[90] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[91] *Mayo Foundation for Medical Education and Research v United States* 562 US 44 (2011). See Hickman (2019).

and Lord Woolf in *R (Coughlan) v North and East Devon Health Authority*.[92] The second proposition is that, as Elias CJ observed during the *Tannadyce* hearing, "there's nothing special about tax except that it is a very extensive statutory regime" (*Tannadyce* (Trans) at 21).[93]

The first proposition can be taken as given. Therefore, tax exceptionalism is prima facie contrary to the rule of law unless it can be shown that there is some characteristic of tax *that merits different treatment*. Such justifications are hard to find. As Hickman (2006) has observed, normative arguments in favour of tax exceptionalism in the United States tend to criticise general administrative law principles (such as *Chevron* deference) rather than describing particular characteristics of tax which render it somehow "special" when compared to other areas of administrative law (Murphy, 2014).

*Tannadyce* appears to rest on the assumption that there is a particular need for efficiency in tax that justifies an exceptional limitation of judicial review. There are two flaws in this justification, which we discuss below. First, it is constitutionally inappropriate for courts to restrict their own ability to determine questions of law in the name of administrative efficiency. Secondly, even if such an outcome were constitutionally appropriate, Inland Revenue's need for judicial oversight is too great, and *Tannadyce*'s efficiency gains too minor, to justify striking the balance as the majority did.

### 4.1. Only Parliament Can Limit Judicial Review

The *Tannadyce* majority argued that a strict interpretation of s.109 of the TAA 1994 "leads to a much more efficient and satisfactory process overall" (*Tannadyce* at [55])[94] because "the use of the statutory procedures removes the opportunity which the availability of judicial review would present, and has presented, for gaming the system" (*Tannadyce* at [71]).[95] This is undoubtedly a meritorious aim. In this respect, taxation is "different from and more important than any other single [government] activity," or, put differently, "the *sine qua non* for all other governmental activities" (Johnson, 2012, p. 279). Indeed, it is this "revenue imperative" that justifies imbuing revenue authorities with expansive information-gathering and enforcement powers (Johnson, 2012, p. 279). However, taxation also carries inherent oppressive potential because it allows for the restriction of individual property rights without the individual having committed any "mischief" (Griffiths, 2017, p. 60). For this reason, it is a well-accepted principle in liberal democracies that "tax can be levied only if a statute lawfully enacted so provides" and that this principle will be enforced by independent courts (Vanistendael, 1996, p. 15). This is the "principle of legality". In common law countries, the principle of legality is derived from the "principle of consent". The principle of consent can be traced back to Magna Carta (1297, 25 Edw I, cl 12), which prohibited the levelling of "scutage or aid" without the "general consent" of the realm.[96] This position was restated in the Petition of Right 1627, which received Royal Assent in 1628, which demanded that "no man hereafter be compelled to make or yield any gift, loan, benevolence, tax, or such charge without common consent of Parliament thereof" (3 Cha I, c 1, cl X) and, again, in the Bill of Rights of 1688, which provides that

[92] *Regina v North and East Devon Health Authority, Ex parte Coughlan* [2001] QB 213 (CA) at [61]. See Daly (2019).
[93] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC Trans 22 at [21].
[94] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[95] *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR 153.
[96] "General consent" was defined in Magna Carta (1297 25 Edw I, cl 14) to include the greater barons and senior clergy. While the reality fell far short of genuine representative democracy, these provisions nevertheless seeded the idea of "no taxation without representation" and, with it, the establishment of the common council, as a means of obtaining popular consent.

"levying money for or to the use of the Crown, by pretence of prerogative, without grant of Parliament, for longer time or in other manner then the same is or shall be granted, is illegal" (1 Will & Mar, Sess 2, c 2, article 4). This core principle is preserved in s. 22a of the New Zealand Constitution Act 1986. This language makes clear that Parliamentary consent is required not only for the collection of taxes, but for the manner of their collection. If the Commissioner or Inland Revenue exceed the limits of the revenue-collecting powers conferred upon them by Parliament, they act not only ultra vires the TAA 1994 but ultra vires the Bill of Rights. As a result, according to Andrew Park QC in Richardson et al. (1993), it is not "acceptable in a democracy governed by the rule of law for the Revenue's use of quite drastic…powers to be immune from challenge in the Courts" (p. 204).

Park QC notes, however, that at the same time, judicial review proceedings can "gum up the works for years" and be "intensely frustrating to Revenue authorities" (Richardson et al., 1993, p. 204). Tax administration must, therefore, strike a balance between efficiency and the judicial oversight necessary to maintain the rule of law and uphold parliamentary supremacy.

In New Zealand, the appropriate balance between efficient tax collection and judicial oversight is a question for Parliament. The role of the courts "is to determine what is lawful and what is not" (*Lab Tests Auckland Ltd v Auckland District Health Board* (*Lab Tests Auckland*) at [379]).[97] They "do not defer to anything or anybody" (*Lab Tests Auckland* at [379]).[98] What this means in practice is that they will not allow an executive body to determine the legality of their own actions without exceptionally clear parliamentary language to the contrary (*Regina (ProLife Alliance) v British Broadcasting Corp* cited with approval in New Zealand in *Mangawhai Ratepayers and Residents Association Inc v Kaipara District Council*).[99] This does not mean that the courts will not recognise the "relative institutional competence" of regulatory authorities—but they will do so at their own discretion. No amount of "institutional competence" will prevent courts from assessing the legality of executive behaviour.[100]

This is not an arbitrary position. It flows from the needs of New Zealand's particular constitutional arrangement (Elias, 2018). Westminster parliamentary systems embrace the "efficient secret" of cabinet government.[101] The legislature and the executive are, in effect, controlled by a single body and cannot be relied upon to act as meaningful checks upon each other's powers (Bagehot, 1963). Judicial review acts as a "principal constitutional check" that courts "cannot avoid without affecting the constitutional balance" (Elias, 2018, p. 25). If a court constrains its own ability to engage in judicial review, it inhibits its constitutional role. Therefore, while it may be constitutional for a court to decide not to exercise its judicial review jurisdiction on the facts of a particular case, it is not constitutional to decide that no jurisdiction exists at all (provided the matter involves questions of law appropriate for judicial resolution). Only Parliament can do that, because only Parliament's authority derives from the common consent, and only the common consent can waive the right to protection from state overreach. Any other arrangement invites tyranny.

[97] *Lab Tests Auckland Ltd v Auckland District Health Board* [2008] NZCA 385, [2009] 1 NZLR 776 at [379].
[98] *Lab Tests Auckland Ltd v Auckland District Health Board* [2008] NZCA 385, [2009] 1 NZLR 776 at [379].
[99] *Regina (ProLife Alliance) v British Broadcasting Corp* [2003] UKHL 23, [2004] 1 AC 185; *Mangawhai Ratepayers and Residents Association Inc v Kaipara District Council* [2015] NZCA 612, [2016] 2 NZLR 437.
[100] For the origins of the phrase "relative institutional competence" see *A v Secretary of State for the Home Department* [2004] UKHL 56, [2005] 2 AC 68 at [29] per Lord Bingham, as cited in *Child Poverty Action Group Incorporated v Attorney-General* [2013] 3 NZLR 729, [2013] NZCA 402 at [92].
[101] See Bagehot (1963), p.65.

As Steve Johnson observed, "the movement against tax exceptionalism does not" require perfect uniformity between tax and the rest of the law; "it requires only that differences between tax and other areas be created for good reason by [the legislature], rather than stemming from judicial decree or parochial insularity" (Johnson, 2012, p. 280).

### 4.2. *Tannadyce* Strikes the Wrong Balance

Judicial oversight is particularly important in a tax context because of the lack of executive or legislative checks upon Inland Revenue. Inland Revenue is responsible for assessing taxpayers, conducting investigations and audits, disputing assessments, running the disputes process itself, entering settlements with taxpayers, and releasing "soft law" guidance (which non-legally trained advisers who engage with Inland Revenue can be expected to treat as law). Outside of those rare cases that make it to the TRA or the High Court, Inland Revenue fills the role of police, prosecutor, and judge. Even members of the Adjudication Unit, which is ostensibly independent, are officers of the department and "independent in a limited sense only" (Griffiths, 2012, pp. 5–6).

Parliamentary oversight on tax matters is also limited. The Tax Working Group (2018) expressed concern at "the level of tax expertise" within the Office of the Ombudsman (p. 5). Moreover, it is Inland Revenue (rather than the Parliamentary Counsel Office) that is responsible for drafting substantive tax legislation and elected members of Parliament often lack the technical knowledge to effectively critique Inland Revenue's proposed drafting (Legislation Act 2019, s. 68).[102] Inland Revenue has also generally resisted statutory attempts to enhance taxpayers' administrative rights (Clews, 2013).

With the deepest respect to the Court of Appeal in *Parore*, non-binding Inland Revenue guidance can never "ensur[e] that there is unlikely to be" a breach of a taxpayers' rights.[103] Taxpayers need to be assured that appropriate remedies will be available *if* something does go wrong. It is not clear, for example, that there are adequate checks and balances to prevent Inland Revenue from engaging in (to use an American example) the "fiscal equivalent of racial profiling" (Clews, 2013, p. 205). Inland Revenue has considerable powers of search and seizure, including the power to enter business premises without a warrant (TAA 1994, s. 17). There is also a (still unresolved) question of the extent to which Inland Revenue can legitimately *detain* a person in the course of exercising their search function (Clews. 2013, p. 209). NZBORA 1990 rights (ss. 21 and 23) are particularly important in this context and it is not clear that Inland Revenue is doing enough to protect them (Clews, 2013; *Parore*).[104] Inland Revenue's combination of invasive powers and minimal oversight therefore create, if anything, a particularly *auspicious* context for judicial review.[105]

The United States Supreme Court expressly rejected tax exceptionalism in *Mayo Foundation*, holding that they were "not inclined to carve out an approach good for tax law only" (at [55]).[106]

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[102] Legislation Act 2019, s. 68.
[103] See *Attorney-General v Parore* [2025] NZCA 328 at [100].
[104] *Commissioner of Inland Revenue v Parore* [2021] NZHC 3405 (stay); and *Parore v Attorney-General* [2023] NZHC 1010 (damages) The Court of Appeal confirmed there was a breach of Parore's rights, but this was not substantial enough to warrant an award of damages, *Attorney-General v Parore* [2025] NZCA 328 at [99]–[100]. For a summary of the *Parore* decisions and the Inland Revenue's response see Handford (2023).
[105] Compare *Westpac Banking Corp v Commissioner of Inland Revenue* [2009] NZCA 24, [2009] 2 NZLR 9at [47].
[106] *Mayo Foundation for Medical Education and Research v United States* 562 US 44 (2011).

Tax exceptionalism persists, however, through the opportunistic arguments of tax authorities (and, on occasion, private litigants). In the United Kingdom, tax exceptionalism arises primarily from misunderstanding the scope of HM Revenue and Customs' managerial discretion rather than from treating tax as inherently special (Daly, 2017). While this is not tax exceptionalism in the American sense, it is still an abnormality of which courts should be wary.

The New Zealand Supreme Court in *Tannadyce* (and the Court of Appeal in *Westpac*) created an approach to privative clauses that is "good for tax law only" (*Mayo Foundation* at [55]).[107] Tax exceptionalism of this kind is inherently problematic because it involves courts abdicating their oversight function without Parliamentary authority. Only Parliament, empowered by the common consent, can exempt revenue authorities from judicial oversight.

Even if *Tannadyce* were justified as a matter of principle, it would still be unjustified as a matter of policy. The Commissioner's expansive powers require oversight. The statutory regime is too inefficient and Inland Revenue-dominated to provide an adequate remedy in many situations. Nor does the Ombudsman, or indeed Parliament, have the expertise to provide an adequate check. Tax exceptionalism, therefore, threatens the integrity of the New Zealand tax system.

While Tax Administration Act reform may improve oversight and accountability, it cannot fix the root of the problem. Tax exceptionalism arises because the legal community treats tax as different from the rest of the law. It can only be avoided if the legal community—judges, practitioners, and academics—recognise tax as part of the general law. The best strategy for defeating tax exceptionalism may simply be to drag it out into the open. Academic scrutiny of myopic judicial attitudes should encourage the broader reconsideration of myopic attitudes in all parts of the legal community.

## 5. CONCLUSION

Daly (2017) points out that Hickman (2017) wrote that "[c]ourts and commentators have read the Court's Mayo Foundation decision broadly as repudiating tax exceptionalism from general administrative law requirements, doctrines, and norms" (Hickman, 2017, p. 82, cited in Daly, 2017, p.106), while "[l]egal scholars have identified numerous ways in which tax administrative practices arguably have deviated from general administrative law requirements, doctrines, and norms" (Hickman, 2017, p. 83, cited in Daly, 2017, p.106). This article has continued the identification of deviant tax administration in the New Zealand context.

In contrast to the US Supreme Court's express repudiation of tax exceptionalism in *Mayo Foundation*, the New Zealand Supreme Court has carved out an approach to privative clauses "good for tax law only" (*Mayo Foundation* at [55]).[108] This difference is supposedly justifiable because of a bespoke, comprehensive dispute resolution regime that, ultimately, might end in access to the courts to resolve the dispute between a taxpayer and the Commissioner. However, this justification is flawed in a practical sense, as the bespoke process is complex and inefficient, and has a chilling effect on tax cases going to court. Furthermore, there remain some situations that fall outside of that process for determination.[109]

[107] *Mayo Foundation for Medical Education and Research v United States* 562 US 44 (2011).
[108] *Mayo Foundation for Medical Education and Research v United States* 562 US 44 (2011).
[109] See, for example, *Charter Holdings Ltd v Commissioner of Inland Revenue* [2016] NZCA 449.

The modern state depends on tax and, as the somewhat hackneyed phrase says, everyone "paying their fair share". But a tax system depends on trust (Freedman, 2016) and its "integrity" depends on tax liabilities determined "fairly, impartially and according to law" (TAA 1994, s 6[2][a]). As the minority in *Tannadyce* recognised, there must be a role for judicial oversight. The space for judicial review might not be large, and the use of the court's inherent jurisdiction might not be routinely invoked, but it must exist. New Zealand's courts have been understandably reluctant to see their role minimised. The decision in *Tannadyce* is an unfortunate departure from that norm. New Zealand's unwritten constitution works with a system in fine and careful balance. Sections 6 and 6A of the TAA 1994 seek to establish a balance to protect the "integrity of the tax system" (TAA 1994, s. 6). Anything that impedes that balance must be closely watched.

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# MEDIA DISCOURSE AROUND TAXATION IN IRELAND AND THE UK IN THE WAKE OF FINANCIAL CRISIS

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**Abstract**

Media representation of tax practices is important because of the impact of public opinion on tax policy. Traditionally viewed as a technical subject and the preserve of professionals, taxation has recently become the focus of widespread and more informed public attention, as a result of, inter alia, tax scandals and the financial crisis. These events, together with wider international tax reform initiatives, provide researchers with an opportunity to explore the impact of tax reform on discourse by the public, as well as by tax experts and professionals. To this end, we analyse the changing treatment of tax-related issues in the mainstream and professional media in Ireland and the United Kingdom (UK) in order to capture expert voices, as well as public discourse. We do so in the immediate and medium-term aftermath of the financial crisis.

Our analysis of tax discourse in general, and of the public framing of the term "tax avoidance" in particular, in both Ireland and the UK, reveals that a marked change has occurred in the public discourse in Ireland, a country struggling in the aftermath of a severe financial crisis. In contrast, our research finds that there is greater consistency in the UK's mainstream and professional media. Our findings also indicate that expert voices may lag behind public opinion.

**Keywords:** Media, Taxation, Ireland, UK, Diachronic, Semantic Prosody.

## 1. INTRODUCTION

Taxation can be framed as a complex technical area and the formation of tax policy has, until recently, been dominated by expert voices. However, while it is technical, taxation is sanctioned by politicians who, ultimately, take their lead from the public that elects them, as well as from expert advisers and lobbyists. A sequence of high-profile international tax scandals and, in Ireland, a multinational taxation policy that linked tax liability to Foreign Direct Investment (FDI) and, thereby, to employment policy, had the effect of catapulting discussion of tax-related issues from the realm of experts to a wider domain and audience (C. Graham & O'Rourke, 2023). The fact that these events occurred as the country struggled with the terms of a painful bailout in the wake of a severe financial crisis focussed attention on national revenues and, by extension, on the national tax culture. Such a "sense of crisis" is, Birks notes (2017) a "critical factor" in moving the discussion beyond the sphere of the "elites" in a manner that allows "communication to flow in from [the] periphery" (pp. 297–298). Discussion of tax policy in Ireland moved suddenly, therefore, from the quiet restrictions of

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the professional office to the daily headlines of national news media, and embraced language that referenced emotion as much as expertise (Birks, 2017; Canning & O'Dwyer, 2013; Clemente & Gabbioneta, 2017; De Widt & Oats, 2024; C. Graham & O'Rourke, 2023; Storbeck et al., 2020).

In the United Kingdom (UK), a more confident management of constrained national finances, as well as government priorities that were less inclined to champion tax policy as an aspect of FDI, provided a more settled environment. Nevertheless, as in Ireland, austerity and the state of the national finances were the backdrop against which tax was discussed (Birks, 2017; Birks & Downey, 2015). However, while tax issues did inform debates and media coverage, and a policy of austerity raised the prospect of "'hardworking taxpayers" being left to "'pick up the bill'" (Birks, 2017, p. 305), the national consciousness was less impacted by issues specifically linked to crisis (Ashour, 2021; Birks, 2017; Birks & Downey, 2015).

Ultimately, tax policy is formed by elected governments and, as such, is impacted by the way in which public concerns about aspects of tax policy are promoted—or otherwise—in mainstream media. However, national media outlets also serve to shape public opinion, and are directly and indirectly influenced by government. In situations where the preferred economic policy is dependent on a particular set of tax strategies, for example, media outlets may adopt a position that favours the status quo. The way in which tax is reported in the popular media may, therefore, depend on a range of national imperatives, as well as the moral concern of the public.

The UK and Ireland have much in common in the area of corporate tax, with broadly similar structures and tax heads. Ireland, however, has made corporate tax rates and rules a key element of its economic policy, attracting multinational investment, particularly from the United States (US), at a rate that has triggered significant international concern (Kelpie, 2018; Killian, 2006, 2021; Ní Chasaide, 2021; Tørsløv et al., 2018). This occurred at a time when the OECD's Base erosion and profit shifting (BEPS) project had served to raise the consciousness of influential political and media voices in tax policy. While the OECD process did not, in itself, trigger a changed discourse, the high-profile debates that it prompted meant that the Irish context was infused with a sense of additional urgency and normative expectations. As Radcliffe et al. (2018) note, "while BEPS is clearly having regulatory consequences, it also relies upon the moral cajoling of both countries and corporations" (p. 49). This was particularly the case in Ireland: at a time when the budgetary and broader social costs of the bailout that followed the financial crisis were beginning to impact the lives of taxpayers, BEPS informed the political consciousness. This was in contrast to the situation in the UK, where there was less disruption, and a greater sense of continuity and independence (Birks, 2017; C. Graham & O'Rourke, 2019, 2023; Schmidtke, 2016).

In Ireland, therefore, the context was defined by a bailout crisis in which the country's national finances were severely constrained, at a time when tax policy was being more keenly and publicly scrutinised; in the UK, while austerity loomed, the government was pursuing a broadly consistent policy, which was characterised by largely stable finances and tax streams (Birks, 2017; Birks & Downey, 2015). With both countries nevertheless facing periods of economic turmoil, they offer different settings in which to explore how local context affects both public and professional discourse—discourses which ultimately impact on tax policy. The way in which tax is discussed in the mainstream media is, at least in part, a reflection of public concern, moderating and framing what can and cannot be questioned or addressed. It is also a reflection of the "construction of national independence in the media" of both countries (C. Graham &

O'Rourke, 2023, p. 1886). Meanwhile, in the parallel professional media, experts are having a more closed discussion, talking largely to their peers. An analysis of both forms of media, therefore, in these two jurisdictions, sheds light on the extent to which each keeps pace with international norms, and so legitimises or sanctions tax practices.

This paper adopts a corpus linguistics approach to the analysis of eight large, specialised tax corpora drawn from both popular and professional media in both countries. The years 2012 and 2018 were chosen because they offered a longitudinal spectrum that captured a moment immediately after the financial crisis and one that allowed us to take a more medium-term view. Using diachronic analysis, we explore the nature of the coverage and the discourse in both Ireland and the UK, by both experts and non-experts, and examine how the representation of tax practices developed in each case during this period. A more detailed linguistic analysis of a key term of interest follows this in order to provide deeper insights into the discursive construction of specific tax practices and related changes in attitudes over time. We employ the concept of semantic prosody to examine the key term "tax avoidance" across mainstream media corpora in order to capture how the pragmatic and connotational meaning around this term has evolved in response to a changing international socio-political landscape.

Recent research has identified concerns amongst managers and tax professionals with regard to the nature and tone of the mainstream media's coverage of tax-related issues, and the consequential impact on corporate reputations and tax policies (Chen et al., 2019; J. R. Graham et al., 2014). Chen et al. (2019), for instance, "examine which factors are associated with the likelihood and negative tone of media coverage of corporate taxes", identifying issues such as corporate visibility and cash tax avoidance as specific features (p. 84). In the process, they not only bring to light the impact of media coverage of corporate taxes on companies, but also show that the manner of this coverage "influences the public's perception" of tax-related issues (Chen et al., 2019, p. 86). Recent studies of expert and popular voices, focussing on the media framing of "tax avoidance", conclude that this term is poorly defined and often poorly understood by the public (Christians, 2017; Oats and Tuck, 2019).

This attention to the mainstream media reflects its growing role in framing our understanding of tax practices (C. Graham & O'Rourke, 2023) and is essential for a variety of reasons, not least those centring on issues of power and the common good (Sikka, 2015). In this context, the question of the media's role in society's understanding of the impact of tax practices is particularly relevant because it focusses attention on an area with significant and immediate consequences for society at large. Given the growing "politicisation" of tax-related issues in the mass media (Schmidtke, 2016, p. 64; Neu et al., 2019) as well as the broader considerations induced by BEPS, it is important to both track and understand the role of the media in framing the discussion of such key socio-political topics. This requires a keener identification and understanding of any changes in attitude and consequential policy implications, with a simultaneous recognition of the manner in which the broader discussion is informed by media interventions and commentary (Chen et al., 2019; Schmidtke, 2016).

With a view to better understanding this changing environment, this study specifically centres on the manner in which language use evolved over a six-year period, with a focus on terms with particular connotations within the discipline and the broader media world (Chen et al., 2019). In analysing whether and how the discourse evolved over this period, it draws on large corpora compiled from both wide-circulation newspapers and from professional journals at two points in time. Our research progresses in two stages: initially, we use the eight resulting specialised corpora to undertake a diachronic analysis of keywords and terms to explore the

extent to which a change in focus emerged in these jurisdictions in relation to tax practice during this period (Sinclair, 2004; Vaughan & O'Keeffe, 2015). This analysis is conducted in both the popular and professional press, in order to capture any change in the nature and tone of the coverage of tax issues during this period. Secondly, we focus on public or popular representations of "tax avoidance", a term that emerges as salient from the corpora. This more fine-grained analysis of the popular press coverage of "tax avoidance" allows us to examine how the pragmatic and connotational meaning attributed to the term has changed, in a manner that supplements the broader macro analysis.

We find that there was a sudden and significant evolution in the discourse about tax within the Irish mainstream press during this period. The implications of such a change mark a turning point in societal engagement with an issue of major social import and a challenge to professional claims of exclusive authority. While there were similar changing patterns of coverage in the UK press, continuity and consistency were more evident. We also find that significant differences emerged between Ireland and the UK in terms of the nature and tone of the popular discourse taking place. In Ireland, a country subject to external criticism for its adoption of a tax-based economic policy designed to attract multinational investment, there was a notable change in attitude in the mainstream media around the term "tax avoidance". To some extent, the change in Irish media coverage brought it into line with the coverage within the UK media. However, there was little evidence of an immediate and/or substantive response by the professional press to these changing dynamics in Ireland. This is an interesting trend, indicating that the popular press was catching up with broader, international narratives, while expert voices remained less inclined to engage.

This paper uses a corpus-based methodology to identify and analyse patterns in the discourse of these various media. Using Sketch Engine, the corpus linguistics software, keyword analysis is carried out to observe broad trends in coverage relating to tax practices and the use of language in that context. This allows us to establish whether, and to what degree, there is evidence of change in the way in which tax in general was being represented and discussed in the media in Ireland and the UK.

The key focus of this paper is, therefore, the assessment of attitudinal change evident in the nature of the discourse and coverage by mainstream and professional press in relation to tax-specific policies and issues. Corpus-based discourse analysis, focussing initially on keyword analysis of all eight corpora in order to identify key topics of interest to the press, is followed by close examination of lexical fields and collocate analysis of the key term "tax avoidance". This provides both a broad overview of trends in press coverage as well as a more detailed view of a salient term, and provides interesting insights into how the discourse around tax practices may have changed.

The paper proceeds as follows: section two looks at data and methodology, section three presents our findings, section four presents a discussion of our findings, and section five concludes.

## 2. DATA AND METHODOLOGY

Corpora were compiled for the mainstream Irish and UK media for 2012 and 2018, with an equivalent focus on expert discourse through corpora compiled from Irish and UK professional journals, specifically accounting/legal journals, for the same time periods. As a result, the database underpinning this study draws on a set of large corpora compiled from both wide-

circulation newspapers and more targeted professional journals. The eight resulting specialised tax corpora (four for each country) allowed us to identify broad trends in the discourse over time, drawing on large-scale datasets using a corpus-based methodology. It also facilitated a more detailed analysis of changes in pragmatic meaning and semantic prosody around the specific term "tax avoidance" through the diachronic analysis of lexical fields and collocational patterns in order to explore the extent to which a change in attitude may have emerged in relation to this tax practice.

The data for the Irish and UK mainstream media was extracted from the *Nexis* database, which provides news and information from a range of sources (in this case, newspapers). This data covers two separate four-month periods—January to April 2012 and January to April 2018—which were chosen as a large sample of text was available from each period. For each period, we searched *Nexis* for articles containing the token "'tax" in two of Ireland's leading daily national newspapers ("The Irish Independent" and "The Irish Times"), and in two of the UK's leading daily national newspapers ("The Guardian"[2] and the "Financial Times"). This resulted in the compilation of four separate specialised corpora: Irish Media 2012, Irish Media 2018, UK Media 2012, and UK Media 2018. The Irish Mainstream Media Corpus 2012 contained 1,691,953 words (circa 1.7 million), while the Irish Mainstream Media Corpus 2018 contained 1,402,513 words (circa 1.4 million). The UK Mainstream Media Corpus 2012 contained 1,897,859 words (circa 1.9 million) and the UK Mainstream Media Corpus 2018 contained 3,993,432 words (circa four million). For analytical purposes, the results are normalised to words per million throughout the paper. These are summarised in Table 1.

*Table 1: Media Corpora, Ireland and UK*

| | **Ireland** | | | | **UK** | | | |
|---|---|---|---|---|---|---|---|---|
| **Year** | 2012 | | 2018 | | 2012 | | 2018 | |
| **Corpus** | Mainstream 1.7m | Professional 0.2m | Mainstream 1.4m | Professional 0.2m | Mainstream 1.9m | Professional 0.2m | Mainstream 4.0m | Professional 0.2m |
| **Source** | "The Irish Independent" "The Irish Times" | "Accountancy Ireland" "Law Society Gazette Ireland" | "The Irish Independent" "The Irish Times" | "Accountancy Ireland" "Law Society Gazette Ireland" | "The Guardian" "Financial Times" | "EconomiA" "The Law Society Gazette" | "The Guardian" "Financial Times" | "EconomiA" "The Law Society Gazette" |

The data for the professional media was sourced from the database *Nexis* and from the archives of the publications of the professional journals. For comparative purposes, we used publications from parallel periods to those used for the mainstream media. We searched articles in two of Ireland's and the UK's leading professional journals in the accountancy/law areas, again using the token "tax": in the case of Ireland, we used "Accountancy Ireland" (the journal of Chartered Accountants Ireland) and the "Law Society Gazette Ireland". These corpora are called Irish Professional Journals Corpus 2012 (221,647 words) and Irish Professional Journals Corpus 2018 (196,265 words). Using the same approach, we compiled similar corpora from UK professional publications—"EconomiA" (the journal of the Institute of Chartered Accountants in England and Wales between 2012 and 2019) and "The Law Society Gazette"—for the same time periods. These are called UK Professional Journals Corpus 2012 (206,705

[2] Birks and Downey(2015) note that: "Over the course of almost a decade, then, *The Guardian* together with a number of pressure groups (Tax Justice Network) and NGOs [non-governmental organisations] (e.g. Oxfam, Action Aid) had campaigned against tax avoidance by both wealthy individuals and corporations" (p. 172).

words) and UK Professional Journals Corpus 2018 (219,151 words) respectively. For analytical purposes, the results are also normalised to words per million.

As a first step, we conducted a keyword analysis of multi-term expressions using Sketch Engine, the language analysis software. Extracted keywords and terms "can be used to define and understand the main topic of the corpus" (Sketch Engine, 2023b) and provide "a sense of what items characterize the data set—or the 'aboutness' of a given text or set of texts" (Vaughan & O'Keeffe 2015, p. 262). This allowed us to establish major trends in the discourse and to identify key topics in the coverage relating to tax practices in each corpus. A keyword is a word that occurs in a text more often than we would expect it to occur by chance alone. Keyword analysis differs from frequency analysis as "[k]eywords are not the most frequent words in any corpus or text, but rather the most unusually frequent (or infrequent) relative to some comparative baseline. In other words, while word lists present frequency information, the calculation of which words are key measures the *saliency* of words in a text" (Vaughan & O'Keeffe, 2015, p. 262). By default, general language corpora are used as reference corpora to represent non-specialised language. In the Sketch Engine software, a reference corpus is used in keyword extraction and term extraction; this is a general corpus with which the focus corpus is compared, so that keywords and terms can be identified correctly. In this study, the default reference corpus used by Sketch Engine is *English Web 2020 (enTenTen20)* (38,149,437,411 words). Keyword analysis measures the "keyness" of lexis in a corpus by identifying "individual words (tokens) which appear more frequently in the focus corpus than in the reference corpus" (Sketch Engine, 2023a). This is captured in a "score", which compares the normalised frequencies of linguistic items between corpora. It is also possible to identify terms, i.e. "multiword units which are typical of a corpus/document/text or which define its content or topic" (Sketch Engine, 2023a).

While keyword analysis can assist in identifying some key issues relating to broad patterns of media discourse, the additional focus of this paper is on the pragmatic meaning of particular terms and, specifically, how this may change over time. This idea of dynamic linguistic change and the role of lexical fields can usefully be viewed through the concept of semantic prosody. As Partington (1998) notes, semantic prosody refers to "the spreading of connotational colouring beyond single word boundaries" (p. 68) It is closely related, as Louw (1993) observes, "to the consistent aura of meaning with which a form is imbued by its collocates" (p. 157). In this understanding of prosody, the words surrounding a particular term, especially where they "co-occur typically with other words that belong to a particular semantic set" (Hunston, 1995, p.137), endow that term with a particular meaning—one that may morph over time as not only the term itself, but also its customary collocates, evolve. Any examination of attitudinal change relating to the usage of a term requires, therefore, that attention be paid to not only the term itself, but also to the collocates associated with it, particularly if these words habitually attach themselves to the key term (Stubbs, 1995).

As a second stage of the study, therefore, we focus on the specific term "tax avoidance" in the mainstream media. This means that a corpus-based analysis of broad trends highlighting salient topics relating to tax practice is complemented with an approach that is more detailed and nuanced (looking at a particular term). By undertaking an analysis of lexical fields and collocational patterns, it is possible to trace patterns in the semantic prosody and pragmatic meaning around a salient term in discourse, and examine how this may have changed over time (Partington, 1998). For this, we also draw on the work of Chen et al. (2019), who produced a "custom dictionary of negative tax words [that] will be useful to researchers in examining the determinants and consequences of negativity about taxes in other settings" (p. 85). We chose

the term "tax avoidance" because it exhibited a number of key qualities. First, tax avoidance is a legal practice, in contrast, for example, to tax evasion, which is an illegal practice involving fraud or misrepresentation. Tax avoidance was the focus of attention under the BEPS process, a feature that immediately prompted a consideration of not only international dynamics, but the "moral boundaries" within which such terminology needed to be considered (Radcliffe et al., 2018, p. 45). The term "tax avoidance" also accurately captures the issue of rising public concern—aggressive but legal actions, particularly by large corporates, which result in significantly reduced tax liabilities. Moreover, the word "avoid" is specifically identified by Chen et al. (2019) as a word "with negative connotations" in terms of tone (p. 112). Secondly, "tax avoidance" relates to an actual tax practice and would be widely appreciated as a term that carried meaning for each person/entity interacting with it. Thirdly, the term has the potential to be imbued with additional meaning by association. Finally, in this study, "tax avoidance" emerges as a salient term across mainstream media corpora, as evidenced by our initial keyword analysis. Deeper examination of this phrase offers, therefore, the possibility of a keener understanding of the dynamic manner in which discursive patterns resulting in shifts in the pragmatic meaning of tax-related terms could challenge the dominance of the expert.[3]

## 3. FINDINGS

First, this section reports our findings on diachronic variation in the salience of key terms of interest in both the Irish and UK mainstream and professional journals corpora. Secondly, we identify and report on shifts in pragmatic meaning and semantic prosody around the phrase "tax avoidance" during the same period in the mainstream press only. The significance of these findings is discussed in section four.

### 3.1. Diachronic Variation of Salient Terms

Our initial tests focussed on establishing the presence or otherwise of diachronic variation in relation to key terms relating to tax practices in both 2012 and 2018. This analysis of salient terms aimed to identify empirically whether variation in media coverage of key topics occurred during this period. These tests focussed on each national corpora and, in particular, on the corpus linguistics ideas of "keyness" and "'frequency" as means of establishing which topics are characteristic of the corpora in order to track variation in salience over time.

#### *3.1.1. Diachronic variation in Irish mainstream media corpora, 2012 and 2018*

To explore diachronic variation across the Irish mainstream media corpora, we ran the keyword analysis tool in Sketch Engine for each corpus and extracted the top 30 key multiword expressions relating to tax in the Irish Mainstream Media Corpus 2012 and Irish Mainstream Media Corpus 2018. The results can be seen in Tables 2 and 3.

[3] Given the limited nature of the professional media corpus, we decided not to do a similar test for "tax avoidance" with regard to it.

*Table 2: "Irish Media 2012" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web2013 (enTenTen13)
(items: **78,903**) filter containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | property tax | 317 | 0 | 161.24 | 0.00 | 162.2 |
| 2 | income tax | 275 | 0 | 139.88 | 0.00 | 140.9 |
| 3 | tax relief | 186 | 0 | 94.61 | 0.00 | 95.6 |
| 4 | tax rate | 157 | 0 | 79.86 | 0.00 | 80.9 |
| 5 | corporation tax | 155 | 0 | 78.84 | 0.00 | 79.8 |
| 6 | motor tax | 126 | 0 | 64.09 | 0.00 | 65.1 |
| 7 | household tax | 98 | 0 | 49.85 | 0.00 | 50.8 |
| 8 | tax evasion | 96 | 0 | 48.83 | 0.00 | 49.8 |
| 9 | transaction tax | 71 | 0 | 36.11 | 0.00 | 37.1 |
| 10 | corporate tax | 70 | 0 | 35.61 | 0.00 | 36.6 |
| 11 | pre-tax profit | 65 | 0 | 33.06 | 0.00 | 34.1 |
| 12 | new tax | 63 | 0 | 32.04 | 0.00 | 33.0 |
| 13 | tax system | 62 | 0 | 31.54 | 0.00 | 32.5 |
| 14 | tax bill | 59 | 0 | 30.01 | 0.00 | 31.0 |
| 15 | financial transaction tax | 59 | 0 | 30.01 | 0.00 | 31.0 |
| 16 | pre-tax loss | 53 | 0 | 26.96 | 0.00 | 28.0 |
| 17 | tax revenue | 49 | 0 | 24.92 | 0.00 | 25.9 |
| 18 | tax regime | 47 | 0 | 23.91 | 0.00 | 24.9 |
| 19 | tax base | 44 | 0 | 22.38 | 0.00 | 23.4 |
| 20 | road tax | 40 | 0 | 20.35 | 0.00 | 21.3 |
| 21 | carbon tax | 39 | 0 | 19.84 | 0.00 | 20.8 |
| 22 | tax liability | 39 | 0 | 19.84 | 0.00 | 20.8 |
| 23 | corporation tax rate | 34 | 0 | 17.29 | 0.00 | 18.3 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 24 | cent tax | 33 | 0 | 16.79 | 0.00 | 17.8 |
| 25 | paying tax | 31 | 0 | 15.77 | 0.00 | 16.8 |
| 26 | tax break | 31 | 0 | 15.77 | 0.00 | 16.8 |
| 27 | mortgage tax | 29 | 0 | 14.75 | 0.00 | 15.8 |
| 28 | tax avoidance | 29 | 0 | 14.75 | 0.00 | 15.8 |
| 29 | extra tax | 28 | 0 | 14.24 | 0.00 | 15.2 |
| 30 | mortgage tax relief | 27 | 0 | 13.73 | 0.00 | 14.7 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Table 3: "Irish Media 2018" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2020 (enTenTen20)
(items: **148,356**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | corporation tax | 167 | 17,818 | 99.50 | 0.40 | 72.0 |
| 2 | pre-tax profit | 119 | 8,418 | 70.90 | 0.19 | 60.6 |
| 3 | corporate tax | 193 | 56,401 | 114.99 | 1.25 | 51.5 |
| 4 | digital tax | 70 | 1,990 | 41.71 | 0.04 | 40.9 |
| 5 | tax change | 68 | 10,809 | 40.51 | 0.24 | 33.5 |
| 6 | tax reform | 118 | 51,616 | 70.30 | 1.15 | 33.2 |
| 7 | tax regime | 71 | 14,104 | 42.30 | 0.31 | 33.0 |
| 8 | irish tax | 55 | 1,506 | 32.77 | 0.03 | 32.7 |
| 9 | sugar tax | 48 | 2,426 | 28.60 | 0.05 | 28.1 |
| 10 | tax bill | 99 | 55,941 | 58.98 | 1.24 | 26.7 |
| 11 | tax relief | 77 | 44,475 | 45.88 | 0.99 | 23.6 |
| 12 | tax cut | 157 | 136,169 | 93.54 | 3.03 | 23.5 |
| 13 | tax rate | 205 | 191,685 | 122.14 | 4.26 | 23.4 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 14 | motor tax | 38 | 511 | 22.64 | 0.01 | 23.4 |
| 15 | corporate tax rate | 50 | 14,770 | 29.79 | 0.33 | 23.2 |
| 16 | tax receipt | 48 | 16,221 | 28.60 | 0.36 | 21.8 |
| 17 | tax avoidance | 53 | 22,441 | 31.58 | 0.50 | 21.7 |
| 18 | tax plan | 41 | 15,657 | 24.43 | 0.35 | 18.9 |
| 19 | tax base | 51 | 31,433 | 30.39 | 0.70 | 18.5 |
| 20 | tax system | 67 | 55,456 | 39.92 | 1.23 | 18.3 |
| 21 | tax rule | 36 | 12,929 | 21.45 | 0.29 | 17.4 |
| 22 | tax revenue | 98 | 110,436 | 58.39 | 2.46 | 17.2 |
| 23 | local property tax | 30 | 5,808 | 17.87 | 0.13 | 16.7 |
| 24 | gains tax | 43 | 28,700 | 25.62 | 0.64 | 16.2 |
| 25 | capital gains tax | 41 | 27,706 | 24.43 | 0.62 | 15.7 |
| 26 | aggressive tax | 25 | 2,010 | 14.90 | 0.04 | 15.2 |
| 27 | property tax | 130 | 193,328 | 77.45 | 4.30 | 14.8 |
| 28 | corporation tax rate | 23 | 1,416 | 13.70 | 0.03 | 14.3 |
| 29 | tax policy | 40 | 33,892 | 23.83 | 0.75 | 14.2 |
| 30 | road tax | 27 | 14,178 | 16.09 | 0.23 | 13.9 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

In the Irish Mainstream Media Corpus 2012, we see that the two top key terms were “property tax” (#1) and “income tax” (#2). This indicates that personal tax issues were the most salient subjects in the Irish media’s coverage of tax in early 2012, reflecting topics of paramount concern in the aftermath of the Irish bailout by the European Union (EU), the European Central Bank and the International Monetary Fund in 2011. The terms “tax relief” [#3] and “tax rate” [#4] were also high on the list, as were “motor tax” (#6) and “household tax” (#8). “Corporation tax” and “corporate tax” were also focusses of media attention but were ranked lower, at #5 and #11 respectively, in terms of keyness. “Tax evasion” was also a salient term (ranked at #9), whereas “tax avoidance” was less salient (ranked at #29 and, furthermore, with a significantly lower score than “tax evasion” in terms of frequency of occurrences per million [Table 2]).

A diachronic comparison of the two corpora shows that significant changes in the media coverage of tax occurred between 2012 and 2018. Keyword analysis of the 2018 corpus (Table 3) shows that personal tax issues, which were the major focus of interest in 2012, were

superseded by the topic of corporation/corporate tax in 2018, as can be seen by a comparison of the top three key terms in 2012 and 2018 (see Tables 2 and 3). The term "corporation tax" moved up from #5 in 2012 to #1 in 2018, and "corporate tax" moved up from #11 in 2012 to #3 in 2018. In terms of word frequency analysis, "corporate tax" dramatically increased in terms of numbers of occurrences between 2012 and 2018 (from 35.61 to 114.99 hits per million). While "tax evasion" disappeared from the top 30 keywords in 2018, the term "tax avoidance" was more salient, moving from #29 to #18 in terms of keyness. This is also reflected in frequency analysis, where "tax avoidance" moved from 14.75 hits per million in 2012 to 31.58 hits per million in 2018. Interestingly, the term "aggressive tax", not present in 2012, ranked at #27 in 2018. Overall, this suggests that discussions about "corporation tax" and "corporate tax" (combined) in the Irish media increased significantly after 2012 and had become the key topic by 2018, overtaking personal taxation issues as the topics receiving most attention. Furthermore, the data shows that there was an increased focus on the topic of "tax avoidance" in 2018, while "tax evasion'" was no longer a key topic. In addition, the term "aggressive tax" was also on the radar in 2018 as a new key term (Table 3).

Concordance analysis of a random sample of the term "corporation tax" shows that much of the discussion in 2018 around this topic focussed on multinational corporation tax and the sustainability of tax revenues. This is evident in the following extracts:

> (1) "The big question is the sustainability of our tax receipts, particularly the *corporation tax* [emphasis added] tax numbers. Will the US tax reform package eat into our slice of foreign investment and resultant tax revenues?…Our view continues to be that the strong corporation tax growth witnessed in recent years will hold up, despite changes in the US and elsewhere" (O'Dwyer, 2018)

> (2) "A separate study published on *corporation tax* [emphasis added] showed that 80 per cent comes from multinationals and that 39 per cent of tax comes from just 10 companies, up from 37 per cent in 2016. Revenue estimates that more than €158 billion of trading profits was reported by companies in 2016, up by more than 10 per cent on the previous year" (Taylor, 2018)

A diachronic analysis of the data based on keyword, frequency, and concordance analyses suggests that the mainstream media coverage of tax in Ireland changed significantly between 2012 and 2018, as the topics of "corporation/corporate tax" and "tax avoidance" were more salient in 2018, reflecting a shift away from the preoccupation with personal taxation issues that was prevalent in 2012.

### *3.1.2 Diachronic variation in UK mainstream media corpora, 2012 and 2018*

To explore diachronic variation across the UK mainstream media corpora, we ran the keyword analysis tool in Sketch Engine for each corpus and extracted the top 30 key multiword expressions in the UK Mainstream Media Corpus 2012 and UK Mainstream Media Corpus 2018. The results can be seen in Tables 4 and 5.

*Table 4: "UK Media 2012"' – Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2020 (enTenTen20)
(items: **194,903**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | pre-tax profit | 451 | 8,418 | 198.22 | 0.19 | 167.8 |
| 2 | tax relief | 350 | 44,475 | 153.83 | 0.99 | 77.8 |
| 3 | pre-tax loss | 116 | 1,805 | 50.98 | 0.04 | 50.0 |
| 4 | corporation tax | 135 | 17,818 | 59.34 | 0.40 | 43.2 |
| 5 | tax rise | 92 | 3,947 | 40.44 | 0.09 | 38.1 |
| 6 | tax avoidance | 121 | 22,441 | 53.18 | 0.50 | 36.1 |
| 7 | cent tax | 85 | 3,406 | 37.36 | 0.08 | 35.7 |
| 8 | tax rate | 420 | 191,685 | 184.60 | 4.26 | 35.3 |
| 9 | tax system | 172 | 55,456 | 75.60 | 1.23 | 34.3 |
| 10 | tax break | 176 | 65,177 | 77.36 | 1.45 | 32.0 |
| 11 | tax allowance | 75 | 3,756 | 32.96 | 0.08 | 31.3 |
| 12 | rate of income tax | 72 | 2,539 | 31.65 | 0.06 | 30.9 |
| 13 | transaction tax | 73 | 5,261 | 32.09 | 0.12 | 29.6 |
| 14 | rate of tax | 73 | 6,826 | 32.09 | 0.15 | 28.7 |
| 15 | capital gains tax | 102 | 27,706 | 44.83 | 0.62 | 28.4 |
| 16 | gains tax | 103 | 28,700 | 45.27 | 0.64 | 28.2 |
| 17 | value added tax | 70 | 6,283 | 30.77 | 0.14 | 27.9 |
| 18 | mansion tax | 61 | 1,041 | 26.81 | 0.02 | 27.2 |
| 19 | granny tax | 57 | 83 | 25.05 | < 0.01 | 26.0 |
| 20 | corporate tax | 127 | 56,401 | 55.82 | 1.25 | 25.2 |
| 21 | tax cut | 224 | 136,169 | 98.45 | 3.03 | 24.7 |
| 22 | tax bill | 113 | 55,941 | 49.67 | 1.24 | 22.6 |
| 23 | income tax | 437 | 341,669 | 192.07 | 7.60 | 22.5 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | Term | Focus | Reference | Focus | Reference | Score |
| 24 | tax-free cash | 48 | 812 | 21.10 | 0.02 | 21.7 |
| 25 | personal tax | 61 | 12,657 | 26.81 | 0.28 | 21.7 |
| 26 | tax evasion | 88 | 39,246 | 38.68 | 0.87 | 21.2 |
| 27 | top rate of income tax | 46 | 508 | 20.22 | 0.01 | 21.0 |
| 28 | council tax | 78 | 30,853 | 34.28 | 0.69 | 20.9 |
| 29 | tax authority | 71 | 24,439 | 31.21 | 0.54 | 20.9 |
| 30 | tax regime | 57 | 14,104 | 25.05 | 0.31 | 19.8 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Table 5: "UK Media 2018" – Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2020 (enTenTen20)
(items: **312,197**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | Term | Focus | Reference | Focus | Reference | Score |
| 1 | company tax | 374 | 5,427 | 78.27 | 0.12 | 70.7 |
| 2 | tax cut | 1,036 | 136,169 | 216.82 | 3.03 | 54.1 |
| 3 | company tax cut | 191 | 544 | 39.97 | 0.01 | 40.5 |
| 4 | tax reform | 368 | 51,616 | 77.02 | 1.15 | 36.3 |
| 5 | council tax | 272 | 30,853 | 56.93 | 0.69 | 34.4 |
| 6 | pre-tax profit | 185 | 8,418 | 38.72 | 0.19 | 33.5 |
| 7 | corporate tax | 310 | 56,401 | 64.88 | 1.25 | 29.2 |
| 8 | corporate tax cut | 103 | 3,194 | 21.56 | 0.07 | 21.1 |
| 9 | tax bill | 182 | 55,941 | 38.09 | 1.24 | 17.4 |
| 10 | tax avoidance | 114 | 22,441 | 23.86 | 0.50 | 16.6 |
| 11 | tax rate | 388 | 191,685 | 81.20 | 4.26 | 15.6 |
| 12 | sugar tax | 70 | 2,426 | 14.65 | 0.05 | 14.8 |
| 13 | corporate tax rate | 89 | 14,770 | 18.63 | 0.33 | 14.8 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 14 | tax change | 81 | 10,809 | 16.95 | 0.24 | 14.5 |
| 15 | capital gains tax | 104 | 27,706 | 21.77 | 0.62 | 14.1 |
| 16 | tax rise | 68 | 3,947 | 14.23 | 0.09 | 14.0 |
| 17 | gains tax | 104 | 28,700 | 21.77 | 0.64 | 13.9 |
| 18 | corporation tax | 79 | 17,818 | 16.53 | 0.40 | 12.6 |
| 19 | tax policy | 99 | 33,892 | 20.72 | 0.75 | 12.4 |
| 20 | wealth tax | 67 | 9,643 | 14.02 | 0.21 | 12.4 |
| 21 | tax relief | 109 | 44,475 | 22.81 | 0.99 | 12.0 |
| 22 | tax haven | 85 | 27,937 | 17.79 | 0.62 | 11.6 |
| 23 | tax system | 118 | 55,456 | 24.70 | 1.23 | 11.5 |
| 24 | company tax rate | 47 | 1,328 | 9.84 | 0.03 | 10.5 |
| 25 | tax plan | 63 | 15,657 | 13.19 | 0.35 | 10.5 |
| 26 | business tax | 65 | 20,594 | 13.60 | 0.46 | 10.0 |
| 27 | new tax | 88 | 49,396 | 18.42 | 1.10 | 9.3 |
| 28 | tax authority | 61 | 24,439 | 12.77 | 0.54 | 8.9 |
| 29 | tax fraud | 46 | 11,213 | 9.63 | 0.25 | 8.5 |
| 30 | taxable income | 73 | 57,756 | 15.28 | 0.94 | 8.4 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

In the UK Mainstream Media Corpus 2012, we see a wide range of key terms relating to both company and personal taxation, including terms of interest for this study, such as “corporation tax” (#4), “corporate tax” (#20), “tax avoidance” (#6), and “tax evasion” (#26). Comparison of frequencies per million shows that there was less discussion about “corporation tax” in the UK corpus (59.34 hits per million) than in the Irish corpus (78.84 hits per million). However, the term “corporate tax” was discussed more frequently in the UK corpus (55.82 hits per million) than in the equivalent Irish corpus (35.61 hits per million). So, if the terms are viewed in aggregate, this topic received almost the same amount of attention in the media of both countries in 2012 (UK =115.16 hits per million / Irish = 114.45 hits per million).

A diachronic comparison of the two UK mainstream media corpora shows that there were some changes in terms of key multiword expressions between 2012 and 2018. A new term, “company tax”, appeared as the #1 key term. The term “corporation tax”, which ranked at #4 in 2012, fell to #18 in 2018. However, the use of “corporate tax” rose sharply from #20 in 2012 to #7 in

2018. If the three terms are viewed in aggregate, the frequency per million was 159.68 in 2018, whereas the aggregate frequency for "corporation tax" and "corporate tax" was 115.16 in 2012. Overall, therefore, there was more discussion of this topic in the UK media in 2018, reflecting a similar trend to diachronic shifts in the Irish mainstream media's coverage of this topic. Also, as with the trend in the Irish Mainstream Media Corpus 2018, the term "tax evasion" no longer appears in the top 30 key terms in the UK Mainstream Media Corpus 2018. However, in contrast to its use within the Irish corpus, the term "tax avoidance" decreases in salience and frequency per million in the UK mainstream media corpora, moving from #6 in 2012 to #10 in 2018 (see Table 5). Overall, there is greater consistency in the UK mainstream media coverage of relevant tax terms than there is within the Irish mainstream media coverage.

### *3.1.3. Diachronic variation in Irish professional journals, 2012 and 2018*

To explore diachronic variation across the Irish professional journals corpora, we ran the keyword analysis tool in Sketch Engine for each corpus, and extracted the top 30 key multiword expressions in the Irish Professional Journals Corpus 2012 and Irish Professional Journals Corpus 2018. The results can be seen in Tables 6 and 7.

*Table 6: "Irish Professional Journals 2012" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2020 (enTenTen20)
(items: **22,645**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | irish taxation | 6 | 105 | 16.02 | < 0.01 | 17.0 |
| 2 | tax accountancy | 5 | 62 | 13.35 | < 0.01 | 14.3 |
| 3 | preliminary tax for companies | 4 | 3 | 10.68 | < 0.01 | 11.7 |
| 4 | discretionary trust tax | 4 | 10 | 10.68 | < 0.01 | 11.7 |
| 5 | tax for companies | 4 | 254 | 10.68 | < 0.01 | 11.6 |
| 6 | preliminary tax | 4 | 309 | 10.68 | < 0.01 | 11.6 |
| 7 | trust tax | 4 | 507 | 10.68 | 0.01 | 11.6 |
| 8 | tax work | 4 | 1,420 | 10.68 | 0.03 | 11.3 |
| 9 | system of taxation | 4 | 2,259 | 10.68 | 0.05 | 11.1 |
| 10 | significant tax | 4 | 5,722 | 10.68 | 0.13 | 10.4 |
| 11 | tax advantage | 4 | 12,942 | 10.68 | 0.29 | 9.1 |
| 12 | reporting of income tax | 3 | 12 | 8.01 | < 0.01 | 9.0 |
| 13 | tax pitfall | 3 | 96 | 8.01 | < 0.01 | 9.0 |

*Table 7: "Irish Professional Journals 2018" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2020 (enTenTen20)
(items: **28,660**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | preliminary tax for companies | 8 | 3 | 34.29 | < 0.01 | 35.3 |
| 2 | tax for companies | 8 | 254 | 34.29 | < 0.01 | 35.1 |
| 3 | preliminary tax | 8 | 309 | 34.29 | < 0.01 | 35.1 |
| 4 | corporation tax | 11 | 17,818 | 47.15 | 0.40 | 34.5 |
| 5 | tax haven | 11 | 27,937 | 47.15 | 0.62 | 29.7 |
| 6 | tax matter | 6 | 7,271 | 25.72 | 0.16 | 23.0 |
| 7 | corporation tax return | 5 | 516 | 21.43 | 0.01 | 22.2 |
| 8 | inheritance tax | 7 | 23,937 | 30.01 | 0.53 | 20.2 |
| 9 | tax relief | 9 | 44,475 | 38.58 | 0.99 | 19.9 |
| 10 | initial instalment of preliminary tax | 4 | 0 | 17.15 | 0.00 | 18.1 |
| 11 | dividend withholding tax return filing | 4 | 1 | 17.15 | < 0.01 | 18.1 |
| 12 | instalment of preliminary tax | 4 | 1 | 17.15 | < 0.01 | 18.1 |
| 13 | date for filing corporation tax | 4 | 2 | 17.15 | < 0.01 | 18.1 |
| 14 | withholding tax return filing | 4 | 2 | 17.15 | < 0.01 | 18.1 |
| 15 | dividend withholding tax return | 4 | 3 | 17.15 | < 0.01 | 18.1 |
| 16 | filing corporation tax return | 4 | 6 | 17.15 | < 0.01 | 18.1 |
| 17 | filing corporation tax | 4 | 7 | 17.15 | < 0.01 | 18.1 |
| 18 | payment of preliminary tax | 4 | 8 | 17.15 | < 0.01 | 18.1 |
| 19 | withholding tax return | 4 | 138 | 17.15 | < 0.01 | 18.1 |
| 20 | taxing master | 4 | 300 | 17.15 | < 0.01 | 18.0 |
| 21 | tax return filing | 4 | 634 | 17.15 | 0.01 | 17.9 |
| 22 | dividend withholding tax | 4 | 687 | 17.15 | 0.02 | 17.9 |
| 23 | tax authority | 6 | 24,439 | 25.72 | 0.54 | 17.3 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | Term | Focus | Reference | Focus | Reference | Score |
| 24 | capital gains tax | 6 | 27,706 | 25.72 | 0.62 | 16.5 |
| 25 | gains tax | 6 | 28,700 | 25.72 | 0.64 | 16.3 |
| 26 | withholding tax | 5 | 18,150 | 21.43 | 0.40 | 16.0 |
| 27 | tax regime | 4 | 14,104 | 17.15 | 0.31 | 13.8 |
| 28 | tax devolution | 3 | 212 | 12.86 | < 0.01 | 13.8 |
| 29 | tax landscape | 3 | 584 | 12.86 | 0.01 | 13.7 |
| 30 | irish tax | 3 | 1,506 | 12.86 | 0.03 | 13.4 |

A diachronic comparison of the two corpora shows that in Irish professional journals in 2012, tax was discussed primarily in generic and technical terms, with "Irish taxation" (#1), "tax accountancy" (#2), and "preliminary tax for companies" (#3) appearing as the most salient terms. The terms "corporation tax" and "corporate tax" did not appear as keywords in 2012, although the term "tax for companies" appeared at #5. In Irish professional journals in 2018, we observed only minimal changes, as "preliminary tax for companies" remained a key topic (#1,#2, and #3) but the term "corporation tax" appeared at #5 and "tax haven" appeared at #6. However, only two documents from "Accountancy Ireland" in the Irish Professional Journals Corpus 2018 addressed the topic of corporation tax, which indicates that this was not a major focus of interest for these outlets.[4] In terms of tone and point of view in the discourse around corporation tax in Irish professional journals in 2018, a closer analysis of a random sample of concordance lines for "corporation tax" revealed that a defensive standpoint was taken regarding EU tax policy proposals on tax harmonisation and their impact on Irish corporation tax policy, as we can see from this quote:

> Second, the powers that be in the EU would like to quietly strangle the low *corporation tax* [emphasis added] golden goose that has laid so many economic eggs for Ireland. Speaking to the *Oireachtas* [Parliamentary] Committee on Budgetary Oversight last September, the chairperson of the Fiscal Advisory Council, Seamus Coffey, warned that corporation tax harmonisation plans across the eurozone pose a bigger threat to Ireland than Brexit. (Lucey, 2018, p. 16)

It is also noteworthy that the terms "tax avoidance" and "tax evasion" did not appear in either the Irish Professional Journals Corpus 2012 or the Irish Professional Journals Corpus 2018. This lacuna is surprising and suggests that there was a dissonance between increasing attention to the topic in mainstream media discourse as well as more negative public attitudes on this

[4] In order to check whether this was due to the fact that, at most, only two volumes of the relevant professional journals were published during this four-month period, we extended our search of "Accountancy Ireland" to April 2020. Since our analysis of the Irish Mainstream Media indicated that there had been a change in the content and tone between the 2012 and 2018 datasets, this also allowed us to check whether a response might have been delayed for both pragmatic and legacy reasons. Our search did not suggest such a response over this slightly longer timeframe.

topic, and the response of the professional journals to these developments in Ireland. Unlike in the mainstream Irish media, there was little or no change in relation to the approach to key topics, which remained largely technical. Where the topic of corporation tax was addressed in 2018, a critical stance towards proposals on tax harmonisation is evident and issues around tax avoidance were not addressed at all.

### *3.1.4. Diachronic variation in UK professional journals, 2012 and 2018*

To explore diachronic variation across the UK professional journals corpora, we ran the keyword analysis tool in Sketch Engine for each corpus, and extracted the top 30 key multiword expressions in the UK Professional Journals Corpus 2012 and UK Professional Journals Corpus 2018. The results can be seen in Tables 8 and 9.

*Table 8: "UK Professional Journals 2012" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2015 (enTenTen15)
(items: **30,916**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | tax system | 24 | 29,651 | 98.11 | 1.92 | 33.9 |
| 2 | personal tax | 9 | 3,268 | 36.79 | 0.21 | 31.2 |
| 3 | tax avoidance | 10 | 9,660 | 40.88 | 0.63 | 25.7 |
| 4 | corporation tax | 9 | 7,476 | 36.79 | 0.49 | 25.4 |
| 5 | tax relief | 12 | 16,368 | 49.06 | 1.06 | 24.3 |
| 6 | tax agent | 6 | 1,935 | 24.53 | 0.13 | 22.7 |
| 7 | tax advice | 6 | 1,947 | 24.53 | 0.13 | 22.7 |
| 8 | tax planning | 7 | 5,461 | 28.62 | 0.35 | 21.9 |
| 9 | inheritance tax | 6 | 4,723 | 24.53 | 0.31 | 19.5 |
| 10 | tax expert | 5 | 1,742 | 20.44 | 0.11 | 19.3 |
| 11 | guidance leading tax | 4 | 0 | 16.35 | 0.00 | 17.4 |
| 12 | guidance leading tax expert | 4 | 0 | 16.35 | 0.00 | 17.4 |
| 13 | leading tax expert on hand | 4 | 0 | 16.35 | 0.00 | 17.4 |
| 14 | tax expert on hand | 4 | 1 | 16.35 | < 0.01 | 17.4 |
| 15 | leading tax expert | 4 | 30 | 16.35 | < 0.01 | 17.3 |
| 16 | leading tax | 4 | 347 | 16.35 | 0.02 | 17.0 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 17 | car tax | 4 | 1,223 | 16.35 | 0.08 | 16.1 |
| 18 | tax law | 8 | 19,256 | 32.70 | 1.25 | 15.0 |
| 19 | amount of tax | 4 | 3,808 | 16.35 | 0.25 | 13.9 |
| 20 | tax code | 7 | 17,817 | 28.62 | 1.16 | 13.7 |
| 21 | personal tax system | 3 | 33 | 12.26 | < 0.01 | 13.2 |
| 22 | stamp duty tax | 3 | 54 | 12.26 | < 0.01 | 13.2 |
| 23 | duty tax | 3 | 246 | 12.26 | 0.02 | 13.1 |
| 24 | tax director | 3 | 329 | 12.26 | 0.02 | 13.0 |
| 25 | turnover tax | 3 | 535 | 12.26 | 0.03 | 12.8 |
| 26 | area of tax | 3 | 603 | 12.26 | 0.04 | 12.8 |
| 27 | complex tax | 3 | 860 | 12.26 | 0.06 | 12.6 |
| 28 | tax case | 3 | 1,465 | 12.26 | 0.10 | 12.1 |
| 29 | tax evasion | 6 | 17,412 | 24.53 | 1.13 | 12.0 |
| 30 | carbon tax | 6 | 19,292 | 24.53 | 1.25 | 11.3 |

*Table 9: "UK Professional Journals 2018" Keyword Analysis – Multiword Terms (Filter "Tax")*

Reference corpus: English Web 2015 (enTenTen15)
(items: **33,864**) filter, containing tax

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | **Term** | **Focus** | **Reference** | **Focus** | **Reference** | **Score** |
| 1 | tax avoidance | 16 | 9,660 | 62.33 | 0.63 | 38.9 |
| 2 | inheritance tax | 10 | 4,723 | 38.96 | 0.31 | 30.6 |
| 3 | tax authority | 12 | 10,020 | 46.75 | 0.65 | 28.9 |
| 4 | transaction tax | 9 | 4,000 | 35.06 | 0.26 | 28.6 |
| 5 | land transaction tax | 6 | 58 | 23.38 | < 0.01 | 24.3 |
| 6 | tax planning | 8 | 5,461 | 31.17 | 0.35 | 23.8 |
| 7 | tax regime | 8 | 6,128 | 31.17 | 0.40 | 23.0 |
| 8 | welsh tax | 5 | 69 | 19.48 | < 0.01 | 20.4 |
| 9 | shrinking tax base | 5 | 119 | 19.48 | < 0.01 | 20.3 |
| 10 | shrinking tax | 5 | 171 | 19.48 | 0.01 | 20.3 |
| 11 | corporation tax | 7 | 7,476 | 27.27 | 0.49 | 19.0 |
| 12 | tax practice | 5 | 1,655 | 19.48 | 0.11 | 18.5 |
| 13 | tax base | 9 | 15,792 | 35.06 | 1.02 | 17.8 |
| 14 | tax saving | 5 | 3,528 | 19.48 | 0.23 | 16.7 |
| 15 | valuation for inheritance tax | 4 | 1 | 15.58 | < 0.01 | 16.6 |
| 16 | stamp duty land tax | 4 | 196 | 15.58 | 0.01 | 16.4 |
| 17 | duty land tax | 4 | 216 | 15.58 | 0.01 | 16.4 |
| 18 | making tax | 4 | 484 | 15.58 | 0.03 | 16.1 |
| 19 | corporate tax | 10 | 24,338 | 38.96 | 1.58 | 15.5 |
| 20 | tax evasion | 8 | 17,412 | 31.17 | 1.13 | 15.1 |
| 21 | tax system | 11 | 29,651 | 42.85 | 1.92 | 15.0 |
| 22 | capital gains tax | 5 | 8,798 | 19.48 | 0.57 | 13.0 |
| 23 | gains tax | 5 | 9,223 | 19.48 | 0.60 | 12.8 |

| | | Frequency | | Frequency per million | | |
|---|---|---|---|---|---|---|
| | Term | Focus | Reference | Focus | Reference | Score |
| 24 | land tax | 4 | 4,659 | 15.58 | 0.30 | 12.7 |
| 25 | peruvian tax | 3 | 7 | 11.69 | < 0.01 | 12.7 |
| 26 | devolved tax | 3 | 187 | 11.69 | 0.01 | 12.5 |
| 27 | tax appeal | 3 | 651 | 11.69 | 0.04 | 12.2 |
| 28 | tax arrangement | 3 | 868 | 11.69 | 0.06 | 12.0 |
| 29 | tax practitioner | 3 | 955 | 11.69 | 0.06 | 11.9 |
| 30 | tax scheme | 3 | 1,337 | 11.69 | 0.09 | 11.7 |

A diachronic comparison of the two corpora shows that, in 2012, “tax system” was the #1 key term, and “tax avoidance” and “corporation tax” were salient and ranking highly as key terms (#3 and #4 respectively). The term “tax evasion” also appeared in the top 30 key terms, ranked #29. By 2018, “tax avoidance” had risen to #1 as a key term and “tax evasion” had risen to #20. “Corporation tax” had dropped slightly as a key term to #11. However, the aggregate frequencies per million for “corporation tax” and “corporate tax” in 2018 (66.23 hits per million) show that overall coverage of this topic had actually increased.

In contrast to the coverage in the Irish professional journals then, we see a consistent focus in the UK’s professional journals on corporation/corporate tax, and an increased focus on the topics of “tax avoidance” and “tax evasion”. This demonstrates that significant differences existed between the Irish and UK professional press coverage, with UK professional journals focussing much more on tax avoidance, tax evasion, and corporate tax during the timeframe studied, and that there had been a greater convergence between the UK’s mainstream media and its professional press overall.

### 3.2. Semantic Prosody and “Tax Avoidance”

For the second part of our study, we examine the key term “tax avoidance” across the mainstream media corpora in more detail, using the concept of semantic prosody, to capture how the pragmatic and connotational meaning of this term may have shifted in the discourse over time. As outlined in the methodology section, we chose the term “tax avoidance” for a number of reasons, not least that it emerged as a salient term across the mainstream media corpora, as evidenced by our initial keyword analysis. It is also a term, as noted by Oats and Tuck (2019), that is poorly defined and poorly understood by the public.

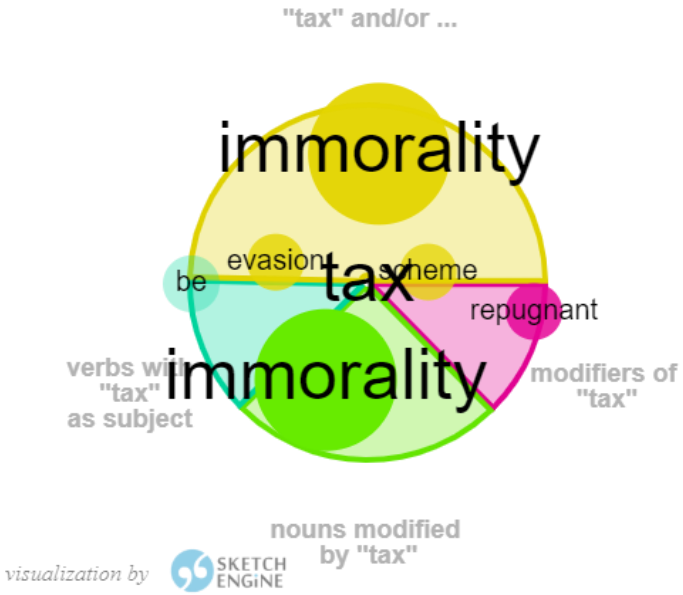
A fundamental principle in corpus linguistics posits that meaning is created by the co-selection of words—i.e. an extended unit of meaning called a “lexical item” (Cheng, 2013, p.1)—which has particular semantic prosodies that convey the speaker’s/writer’s attitudinal, pragmatic (context-specific) meaning (Sinclair, 2004). Semantic prosody has been defined by Louw as a “consistent aura of meaning with which a form is imbued by its collocates” (1993, p. 157) while Baker et al. (2006) describe discourse prosody as “the way that words in a corpus can collocate with a related set of words or phrases, often revealing (hidden) attitudes” (p. 58). The next section examines the semantic prosody around the term “tax avoidance” by looking

at its lexical fields and most frequent collocates in order to shed light on media attitudes towards the term, its aura of meaning, and whether these have changed over time in both the Irish mainstream media and the UK mainstream media.

### *3.2.1. Irish mainstream media corpora 2012 to 2018: "Tax avoidance" - Word sketch and collocate analysis*

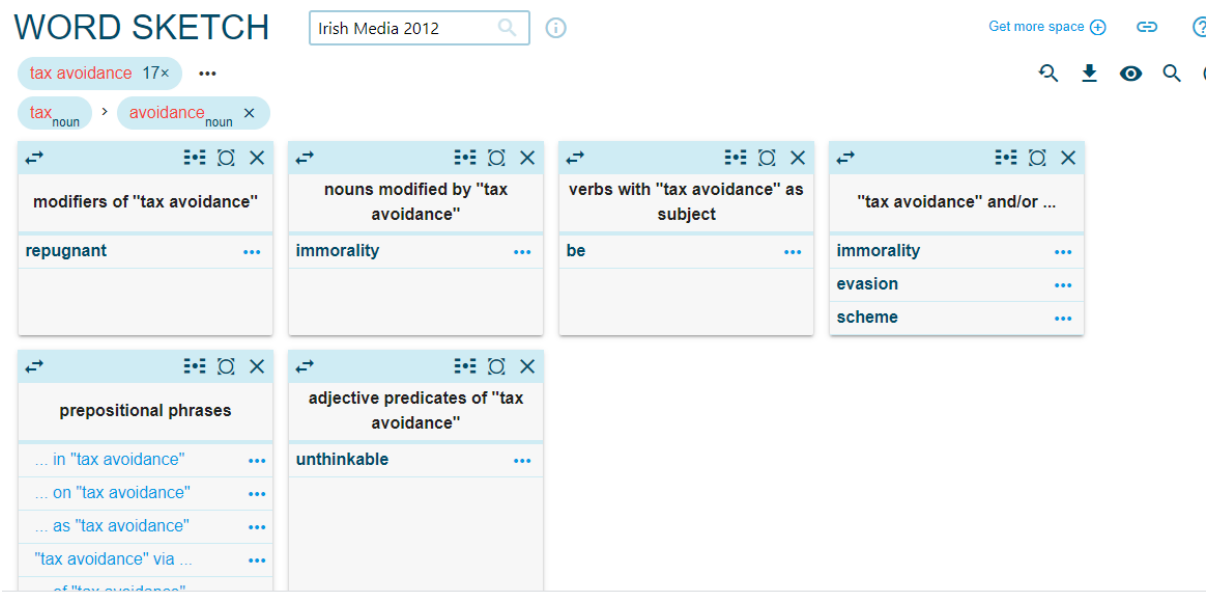
To explore variation in semantic prosody of the term "tax avoidance" in the Irish mainstream media corpora between 2012 and 2018, we carried out a word sketch and collocate analysis for the term on each corpus (Figures 1a, 1b, 2a, 2b, 3, and 4). The results from the word sketch analysis show striking differences in terms of the number of occurrences of the search term itself and the nature of the lexical field surrounding it (Figures 1a, 1b, 2a, and 2b).

*Figure 1a: Word Sketch: "Tax Avoidance", Irish Media 2012*




Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 1b: Word Sketch: "Tax Avoidance", Irish Media 2012*



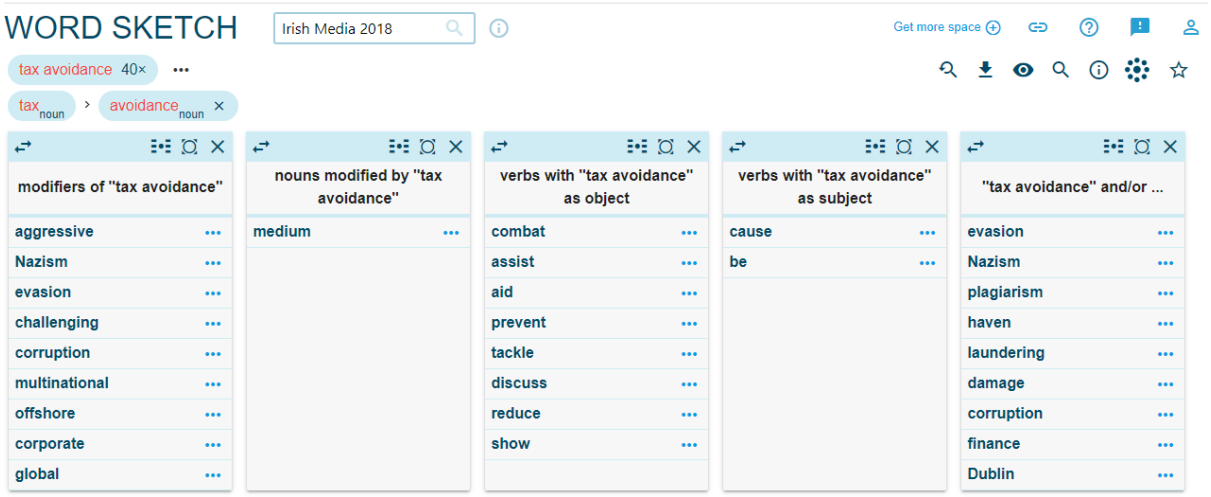

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

The term "tax avoidance" occurs 17 times in the 2012 corpus and there is a limited range of collocates co-occurring, with a major emphasis on the term "immorality" (Figure 1a). This suggests that the topic is not a focus of significant attention in Irish media coverage in 2012, is primarily framed in terms of morality (a term associated generally with behaviour in the personal sphere) and, furthermore, is not directly connected to specific actors.

*Figure 2a: Word Sketch: "Tax Avoidance", Irish Media 2018*


Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 2b: Word Sketch: "Tax Avoidance", Irish Media 2018*




Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

In 2018, there was an increase in the number of occurrences of the term (40 occurrences), and a major shift in the range and tone of collocates used in connection with it (Figure 2a). The wider range of pejorative modifiers in the discourse around "tax avoidance" in 2018 shows that was then perceived in a much more negative light, being described as aggressive, associated with corruption and evasion, and directly linked to multinational, corporate entities (Figure 2b). Furthermore, there was an increase in the number of transitive verbs with tax avoidance as a direct object, signifying a change in perspective. This indicates that there was a significant change in the semantic prosody of the term "tax avoidance" in 2018, as it was surrounded by a more pejorative lexical field and associated with illegality. Collocate analysis also shows that it was a clear focus of critical attention linked to specific actors, amplifying its unacceptability in terms of social norms and values. A further collocate analysis of "tax avoidance" using the Concordance tool in Sketch Engine confirms this pattern (Figures 3 and 4).

*Figure 3: "Tax Avoidance" Collocates, Irish Media 2012*

| | Word | Cooccurrences | Candidates | T-score | MI | LogDice |
|---|---|---|---|---|---|---|
| 1 | engaged | 3 | 79 | 1.73 | 11.23 | 9.80 |
| 2 | scheme | 4 | 405 | 2.00 | 9.29 | 8.23 |
| 3 | were | 3 | 3,999 | 1.70 | 5.57 | 4.61 |
| 4 | their | 3 | 4,412 | 1.69 | 5.43 | 4.47 |
| 5 | Irish | 4 | 10,383 | 1.92 | 4.61 | 3.65 |
| 6 | on | 5 | 13,377 | 2.14 | 4.57 | 3.61 |
| 7 | as | 3 | 9,658 | 1.64 | 4.30 | 3.34 |
| 8 | The | 4 | 15,965 | 1.87 | 3.99 | 3.03 |
| 9 | for | 3 | 17,629 | 1.57 | 3.43 | 2.48 |
| 10 | in | 5 | 33,368 | 2.00 | 3.25 | 2.29 |
| 11 | the | 11 | 90,078 | 2.89 | 2.95 | 2.00 |
| 12 | . | 9 | 75,830 | 2.60 | 2.91 | 1.96 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 4: "Tax Avoidance" Collocates, Irish Media 2018*

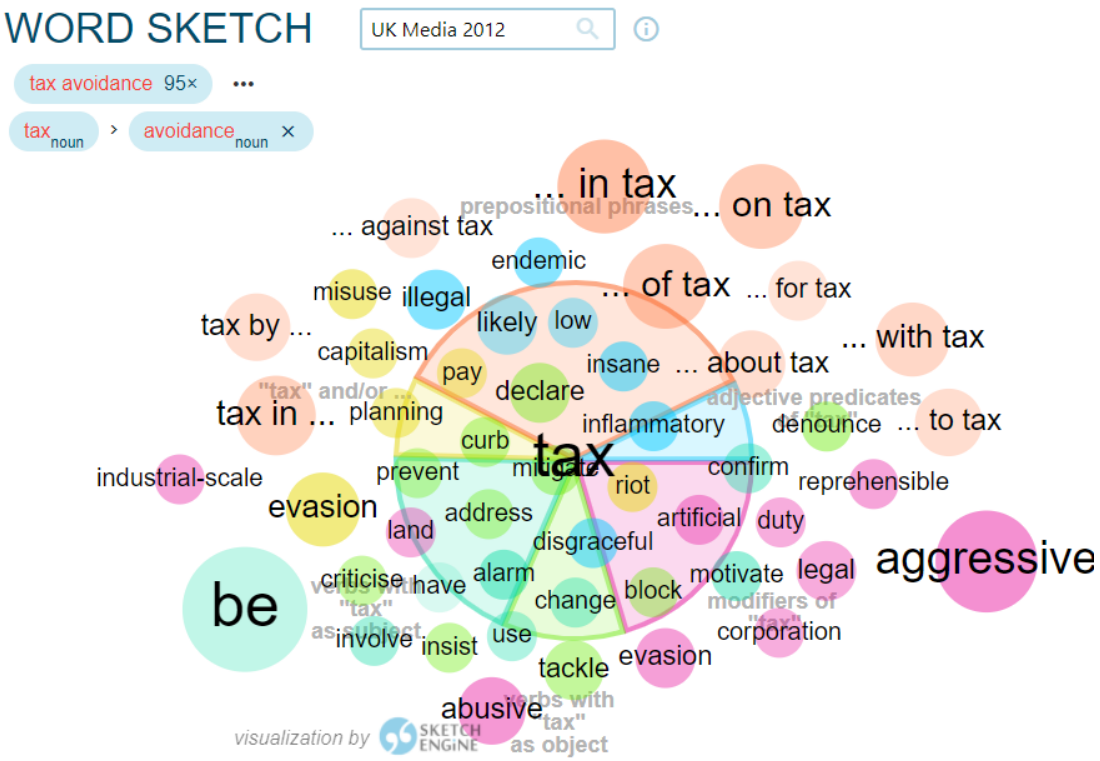
| | Word | Cooccurrences | Candidates | T-score | MI | LogDice |
|---|---|---|---|---|---|---|
| 1 | aggressive | 5 | 71 | 2.24 | 11.12 | 10.37 |
| 2 | evasion | 3 | 32 | 1.73 | 11.54 | 10.18 |
| 3 | moves | 3 | 70 | 1.73 | 10.41 | 9.64 |
| 4 | multinational | 3 | 114 | 1.73 | 9.70 | 9.20 |
| 5 | corporate | 5 | 403 | 2.23 | 8.62 | 8.49 |
| 6 | approach | 3 | 234 | 1.73 | 8.67 | 8.42 |
| 7 | global | 5 | 543 | 2.23 | 8.19 | 8.10 |
| 8 | against | 6 | 748 | 2.44 | 7.99 | 7.94 |
| 9 | scheme | 3 | 389 | 1.72 | 7.93 | 7.80 |
| 10 | down | 3 | 1,071 | 1.71 | 6.47 | 6.45 |
| 11 | by | 8 | 6,772 | 2.75 | 5.23 | 5.26 |
| 12 | on | 8 | 11,598 | 2.70 | 4.45 | 4.49 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

### *3.2.2. UK mainstream media 2012 to 2018: "Tax avoidance" - Word sketch and collocate analysis*

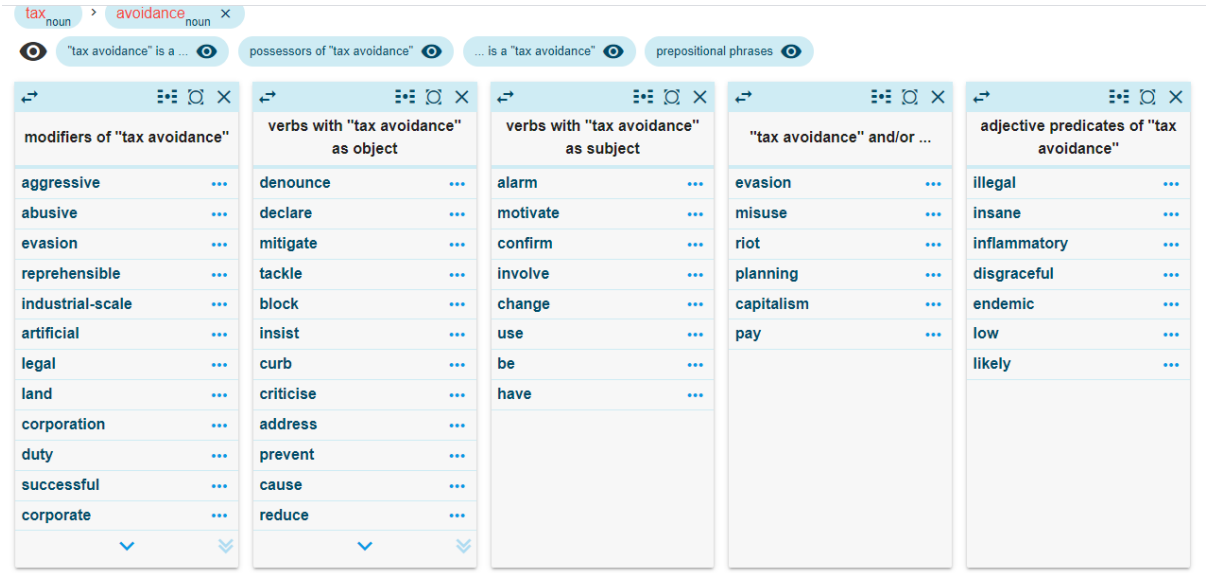
To conduct a comparative analysis of the UK mainstream media corpora in 2012 and 2018, we carried out a word sketch and collocate analysis for the term "tax avoidance" on each corpus. In contrast to the Irish sample, the results showed striking continuity in terms of the number of occurrences of the search term in both time periods (95 and 98 hits respectively) and the lexical field surrounding it (Figures 5a, 5b, 6a, and 6b). The term occurred 95 times in the 2012 corpus and co-occurred with a large range of collocates, showing that it was a significant focus of attention at this point in time. Many of these collocates were either implicitly or explicitly evaluative, and took a clear moral stance on the practice. Pejorative modifiers, such as "aggressive", "abusive", and "reprehensible", signify an unequivocal attitude in the discourse and the large number of transitive verbs with "tax avoidance" as an object (e.g. "denounce", "tackle", and "block") indicate a strong sense of agency in dealing with it in a pro-active manner. Interestingly, the term was juxtaposed with a legal lexical field, with terms such as "evasion" and "illegal" appearing in the discourse, emphasising its absolute unacceptability in terms of societal norms. In relation to actors, we see reference to "corporation", "corporate" and "capitalism", indicating that the discourse clearly identified this arena/field as a major focus of concern (Figure 5a).

*Figure 5a: Word Sketch: "Tax Avoidance" UK Media 2012*



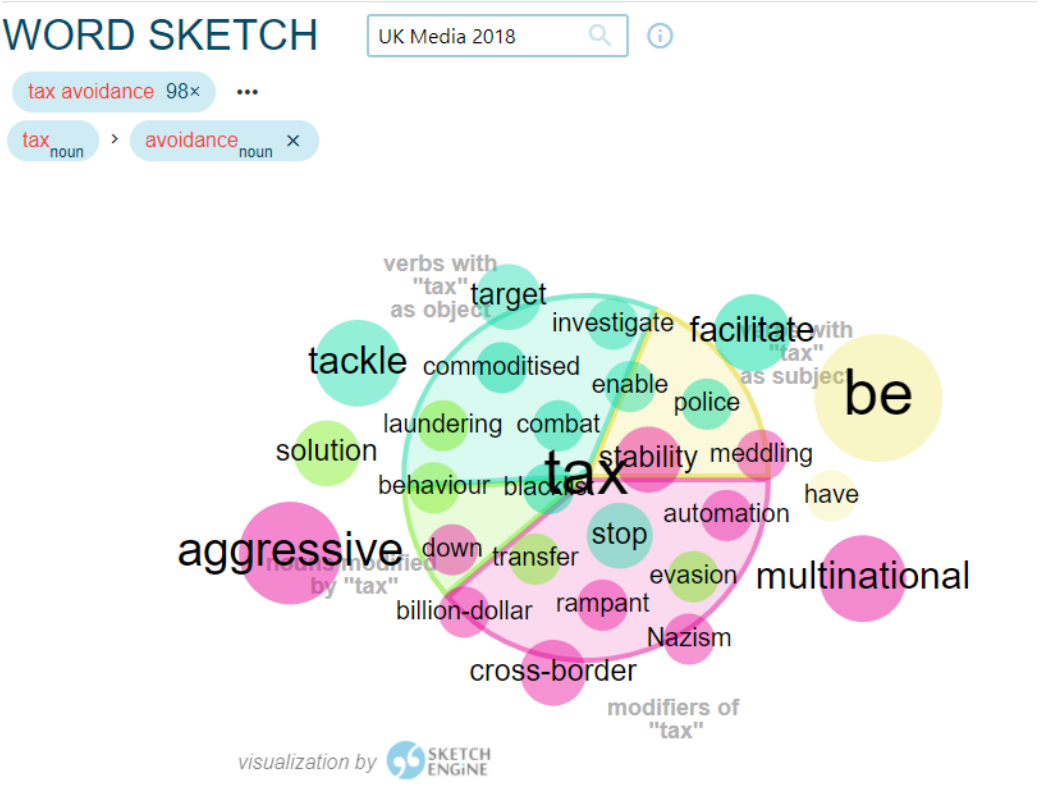

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 5b: Word Sketch: "Tax Avoidance", UK Media 2012*



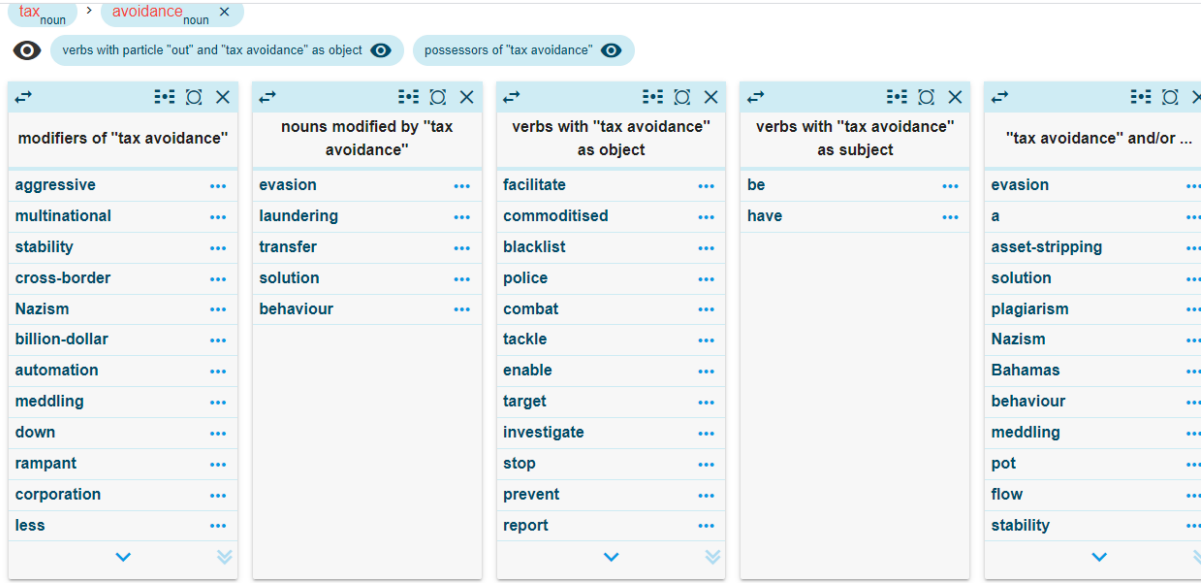

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 6a: Word Sketch: "Tax avoidance", UK Media 2018*




Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 6b: Word Sketch: "Tax Avoidance", UK Media 2018*




Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

There was substantial continuity in the 2018 corpus in terms of the number of occurrences of the term "tax avoidance" (98), and the range and tone of collocates used in connection with it (Figure 6a). The term continued to be associated with pejorative modifiers and a legal/criminal lexical field (e.g. "evasion", "laundering", and "investigate"). "Aggressive" continued to be the top modifier, but there was a significant change in terms of more specific identification of associated actors: the term "multinational", which was not present in 2012, was a salient collocate in 2018, while "corporation" was still present (Figures 7 and 8). This suggests that, while there was continuity between 2012 and 2018 in terms of its negative semantic prosody, there was a greater focus on the multinational sector in 2018.

*Figure 7: "Tax Avoidance" Collocates, UK Media 2012*

| | Word | Cooccurrences | Candidates | T-score | MI | LogDice |
|---|---|---|---|---|---|---|
| 1 | aggressive | 10 | 125 | 3.16 | 10.52 | 10.36 |
| 2 | abusive | 6 | 27 | 2.45 | 11.99 | 10.35 |
| 3 | engage | 6 | 45 | 2.45 | 11.26 | 10.18 |
| 4 | morally | 4 | 19 | 2.00 | 11.92 | 9.84 |
| 5 | artificial | 4 | 32 | 2.00 | 11.16 | 9.71 |
| 6 | clamp | 3 | 25 | 1.73 | 11.10 | 9.37 |
| 7 | crack | 3 | 37 | 1.73 | 10.54 | 9.25 |
| 8 | evasion | 4 | 106 | 2.00 | 9.44 | 9.15 |
| 9 | reaction | 3 | 55 | 1.73 | 9.97 | 9.10 |
| 10 | schemes | 7 | 305 | 2.64 | 8.72 | 9.06 |
| 11 | illegal | 3 | 73 | 1.73 | 9.56 | 8.96 |
| 12 | wrong | 3 | 178 | 1.73 | 8.27 | 8.35 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

*Figure 6: "Tax Avoidance" Collocates, UK Media 2018*

| | Word | Cooccurrences | Candidates | T-score | MI | LogDice |
|---|---|---|---|---|---|---|
| 1 | multinational | 11 | 85 | 3.32 | 12.26 | 10.63 |
| 2 | evasion | 10 | 107 | 3.16 | 11.79 | 10.36 |
| 3 | aggressive | 13 | 189 | 3.60 | 11.34 | 10.33 |
| 4 | schemes | 9 | 195 | 3.00 | 10.77 | 9.77 |
| 5 | vehicle | 6 | 225 | 2.45 | 9.98 | 9.06 |
| 6 | Charles | 5 | 182 | 2.23 | 10.02 | 8.98 |
| 7 | judgment | 3 | 108 | 1.73 | 10.04 | 8.61 |
| 8 | climate | 6 | 479 | 2.44 | 8.89 | 8.30 |
| 9 | arrangements | 4 | 282 | 2.00 | 9.07 | 8.27 |
| 10 | slow | 3 | 301 | 1.73 | 8.56 | 7.79 |
| 11 | scheme | 3 | 617 | 1.72 | 7.52 | 7.02 |
| 12 | role | 3 | 901 | 1.72 | 6.98 | 6.56 |
| 13 | key | 3 | 1,125 | 1.71 | 6.66 | 6.28 |

Source: Produced by the authors using Sketch Engine (https://www.sketchengine.eu/)

Comparisons of the use of the term "tax avoidance'" in the Irish and UK media, and of how its semantic prosody may have changed during this period, show a significant shift in the pattern and context of the use of the term in the Irish media, indicating that there was a change in its pragmatic meaning between 2012 and 2018. A collocational pattern of under-lexicalisation and vagueness in 2012 was replaced by a heightened critical tone, increased coverage, and association with particular entities. This contrasts with the collocational pattern in the UK media, which reflected a more consistently critical attitude and negative representation of the practice of tax avoidance during the same period. However, analysis of the term "tax avoidance" shows that, by 2018, both the Irish and UK media discourse was far more focussed on the link between this tax practice and the multinational sector (Birks, 2017).

## 4. DISCUSSION

Tax has, until recently, been presented as an area requiring technical expertise and one best left to the experts (Carter et al., 2015; Neu et al., 2019). For this reason, discussion of tax practices such as "tax avoidance", "tax fraud" and "effective tax rates" has been largely limited to the professional press, i.e. journals of the accountancy and legal professions. However, more recent developments have led to a marked change in public perception (Clemente & Gabbioneta, 2017; Neu et al., 2019; Oats & Tuck, 2019; Roulet, 2019). What had previously been viewed as an essentially turgid and complex system of rules, which was understood only by professionals, has now come to be seen as a key domain in which public priorities may be contested and wealth distribution directly affected (Neu et al., 2019; Roulet, 2019). In the Irish context, the increasingly international contextualisation of tax has also been important. For instance, the BEPS project impacted both the discourse and the reference points against which it was set. Whereas a predominantly isolationist perspective had heretofore dominated, commentators now referred to an international dynamic charged with moral and normative overtones. Coupled with a sense of crisis in which the national finances and moral imperatives overlapped, public priorities were now being contested, at least in the mainstream media. This contrasted somewhat with the discourse in the UK, where greater evidence of continuity reflects an engagement less influenced by the immediate challenges of austerity and national finances, and more consistent in its analysis.

While in Ireland, the result has been a more informed engagement by the mainstream media on issues relating to tax practice, tax avoidance, and multinational fiscal behaviour, the professional media has sought to retain its position as mediator between experts and the broader populace (Kneafsey & Regan, 2022; O'Regan & Killian, 2014). Meanwhile, overwhelmed by the depth of mass media resources and a broader public discourse that has challenged the role and primacy of expertise in public interest debates, the capacity of the professional media to command public attention has diminished (Clemente & Gabbioneta, 2017; Neu et al., 2019; Schmidtke, 2016).

Since, traditionally, the tax field has been dominated by those infused with an essentially technocratic paradigm, the public expression of tax practice has typically mirrored this perspective. Reflecting this disciplinary control, public discourse has usually been limited to essentially powerless reactions to budgetary pronouncements or to occasional eruptions of disgust at scandals that can be traced to dubious tax practices (Carter et al., 2015; Clemente & Gabbioneta, 2017). With the increased attention brought by mainstream media in the wake of the Panama (International Consortium of Investigative Journalists [ICIJ], 2025a) and Pandora (ICIJ, 2025b) scandals, however, discussion of previously "complex" topics has found a wider audience. In this context, the language of public discourse has assumed a new significance.

This is especially the case where there has been a change from a previously dominant paradigm in which the general public and mainstream media typically deferred to the overly technocratic language of those who commanded the field.

The result of this change in provenance and focus has been a discourse dramatically different from that controlled by "experts", a discourse that not only threatens the traditional modes of understanding, but one that exposes professionals to public attention and criticism (Canning & O'Dwyer, 2013; O'Regan & Killian, 2014). Civic voices are now given attention and these are characterised by calls to ensure that tax policy should more effectively and immediately reflect broader social imperatives. A language that embraces emotion and societal aspirations has overtaken a technical language that better served the interests of elites and their representatives (Chen et al., 2019; Evans, 2018; Schmidtke, 2016).

In seeking to better understand the extent to which the emergence of the mainstream press as mediators of a new discourse has materially impacted the manner and tone of tax-related issues, we examined outputs of the mainstream and professional press at two time points. This allowed for a longitudinal assessment of the short-term and medium-term impacts of financial crisis, and a better understanding of the linguistic consequences of these events in both mainstream and professional media. We find that there was a significant evolution in the language used in the mainstream press in the discussion of tax in Ireland over this period, probably due to the immediate social and political consequences of financial crisis and bailout. This is likely to have been exacerbated in the Irish context by the extent to which it became apparent that tax policy was linked to industrial policy and FDI. Significantly, there was far more focus in the Irish mainstream media on corporate tax and on the issue of tax avoidance in 2018, in contrast to the primacy of personal tax issues in the earlier time period. This reflects the manner in which national finances and various tax scandals informed public engagement.

The topic of corporation tax receives almost the same amount of attention in the media of both countries in 2012 (UK = 115.16 / Irish = 114.45 hits per million). By 2018, there is more discussion of this topic in the UK media, reflecting a similar trend to diachronic shifts in the Irish mainstream media coverage of this topic. In the UK mainstream media corpora, the term "tax evasion" no longer appeared in the top 30 key terms by 2018, in a similar manner to the trend in Ireland. Unlike in the Irish corpus, the term "tax avoidance" decreased in salience and frequency per million, moving from #6 in 2012 to #10 in 2018. However, there is more evidence overall of continuity in the UK discourse, which continued to be characterised by an ongoing concern with a wide range of tax issues pertaining to society, including corporate tax, tax avoidance, and tax evasion. In general, the UK media has been more consistent over the period, suggesting a more informed and established engagement with tax-related topics, as well as a more settled overall tax policy.

Analysis of lexical fields and collocates shows that the semantic prosody around "tax avoidance" changed significantly in Ireland over this period and, by 2018, was viewed by the mainstream media in a more negative and critical light. This indicates that, over the period in question, there was a significant recalibration in the Irish attitude to tax avoidance, consistent with the idea in Onu and Oats (2015) that media coverage leads the public to view tax avoidance as widespread and negative. In the UK, however, a critical attitude towards tax avoidance was already evident in the 2012 corpus, with more consistency in the semantic prosody and range of pejorative modifiers associated with the term over the course of this period. The only notable new collocate in 2018 was "multinational", suggesting a more refined identification of specific actors.

In the Irish professional journals, there was little evidence of any significant change in the coverage of tax issues and the discourse deployed during this period, which remained largely technical. The terms "tax avoidance" and "tax evasion" did not appear in either the Irish Professional Journals Corpus 2012 or the Irish Professional Journals Corpus 2018. This is interesting and suggests that there was a discrepancy between mainstream media coverage and professional discourse. In terms of tone and point of view, the discourse around corporation tax in Irish professional journals in 2018 revealed a cautious stance regarding EU tax policy proposals on tax harmonisation and their potential impact on Irish corporation tax policy. In combination, these findings suggest that expert and public voices may have been out of sync, with the profession lagging behind the public on this issue.

In the UK's professional journals, we see a sustained focus on corporate tax issues, and increasing discussion of both tax avoidance and tax evasion. In 2012, "tax avoidance" and "corporation tax" ranked very highly as key terms (#3 and #4 respectively) while the term "tax evasion" also appeared in the top 30 key terms. By 2018, "tax avoidance" had risen to #1 as a key term and "tax evasion" had risen to #20. This was in significant contrast to the Irish professional press coverage, with earlier and more sustained attention being given to these topics in the UK's professional journals. Moreover, this signifies greater convergence between the UK's mainstream media and professional journals overall.

## 5. CONCLUSION

This study compares tax discourse in Ireland and the UK at a time when austerity and the evolving international fiscal landscape was affecting the two countries differently. Traditionally viewed as a technical subject and the sphere of experts, tax and tax policy discussions were catapulted into the public domain in the period immediately following the financial crisis. Analysis of the mainstream and professional press in the UK in 2012 and 2018 shows continuity in the discourse, with considerable convergence in coverage in the UK's mainstream media and its professional journals. In Ireland, by contrast, the discourse in the mainstream media (but not in professional journals) shifted significantly between 2012 and 2018. This may relate to the fact that Ireland was responding to extreme disruptive challenges that involved a financial collapse and a humiliating bailout where the social contract was ruptured. It may also have been influenced by the changing international discourse, and Ireland's support for the OECD's BEPS process. Regardless of causality, it demonstrates how international crises and reform processes create a context for public discourse on taxation.

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# DOES DECENTRALISED LOCAL TAX ADMINISTRATION WARRANT RE-EXAMINATION?

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## Abstract

The higher-level government's degree of control over the subnational government administration is frequently a topic for discussion among academics and policymakers. Generally, local taxes are designed poorly and in a presumptive way, and "administered with low coverage rates, arbitrary assessments, and large delinquent lists" (Bird, 2015, p. 18). Increases in incidences of tax evasion and compliance costs are important arguments against the local administration of taxes. Recent theoretical and empirical studies argue for the existence of self-governing local governments, which requires an efficient local tax system to be in place. Using panchayat-level and municipal-level data, this paper investigates the efficiency of the local tax administration in Kerala, a state in India, and tries to estimate the amount of revenue that would be generated if the system were to be rationalised. It also addresses the question of whether local tax administration needs to be re-examined.

**Keywords:** Local Taxes, Profession Tax, Decentralisation of Tax Administration
**JEL Codes:** H71, H24, H77

## 1. INTRODUCTION

As a policy approach and an academic subject, the concept of fiscal federalism has gained a new dimension, with the widespread practice of decentralisation by both developed and developing countries taking place towards the end of the twentieth century. Consequently, the degree of control that the higher-level government has over the administration at subnational or lower government levels became a topic for discussion in the field. In many countries, decentralisation has been practiced as assigning public expenditure activities and providing centrally collected tax revenue to lower levels of government. In developing countries, the main challenge is to ensure accountability. Empirical studies have confirmed that the expenditure funded by revenue, especially tax revenue, sourced at lower government levels is more effective than expenditure based on transfers from higher levels of government (Bird, 2001; Boex & Yilmaz, 2010; de Mello, 2000; Meloche et al., 2004; Rodden, 2003; Rodríguez-Pose & Krøijer, 2009), and have recommended using taxes and user charges in order to increase accountability (Rodden, 2003; Singh & Srinivasan, 2006; Weingast, 2009). This emphasises the need for lower levels of government to boost their own revenue (especially, in the case of local governments, tax revenue) so that they can function as self-governing institutions.

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In India, the 73rd and 74th Constitutional Amendment Acts[4] have increased local governments' expenditure responsibilities without assigning additional tax revenue to them. The power to assign revenue and expenditure responsibilities is vested with the state governments. No state has taken the initiative to transfer more power to levy and collect taxes to the local governments. Therefore, the discrepancy between revenue and expenditure—often referred to as vertical imbalance—increased after the amendments. The amount of revenue generated by ("own revenue") the grama panchayats (India's village councils) is less than ten percent of their total revenue receipts (Comptroller and Auditor General of India, 2024).

Property tax is the major source of revenue for the panchayats in all states. However, in some states, octroi (a tax imposed on goods that a person takes with them when crossing state borders, which is imposed by the states of Gujarat, Maharashtra, and Rajasthan), profession tax (imposed by the states of Assam, Gujarat, Kerala, Madhya Pradesh, and Punjab), and entertainment tax (imposed by the states of Assam, Gujarat, Kerala, Punjab, Uttar Pradesh, and Tamil Nadu) provide significant sources of revenue. It has been reported that the main issue with own revenue mobilisation is "not the lack of the tax bases" devolved, but "the lack of will or incentives" to collect taxes that correspond to already provided tax bases" (Jha et al., 2019, p. 74). The capacity of the local governments to administrate and enforce taxes is limited. In addition, as pointed out by Jena and Gupta (2008), the excess "state control" over the "tax rates, base, and exemptions" also limits states "revenue raising capacity" (p. 130). Country-level experiences also give the impression that local taxes are poorly designed and that administrative efficiency is insufficient to draw all potential taxpayers into the tax net, to assess all income, and to value all property. Therefore, the attention given to the decentralisation of tax administration needs further examination (Bird, 2015). The focus of the present paper is to identify the constraints faced by the local governments in Kerala when attempting to increase their revenue mobilisation capacity through profession tax.

The rest of this paper is organised as follows: the second section explains the theoretical arguments for local taxes and country-level practices. The extent of revenue decentralisation in India, particularly in Kerala, and the issues related to the mobilisation of profession tax in Kerala is also examined in this section. In section three, we present the research method used in this paper. The data analysis and results are presented in section four. Section five concludes the paper.

## 2. THE THEORETICAL ARGUMENTS FOR LOCAL TAXES AND COUNTRY-LEVEL PRACTICES

The spirit of fiscal federalism is decentralisation by giving the local governments the authority to frame policies, regulate local markets, design the provision of local public goods and services according to the local circumstances, and fix tax rates (ideally to reflect local demand for public services). Therefore, Pareto efficiency can be attained by equating the cost and benefit of providing collective goods. The spatial incidence of benefit and of tax burden are the two key factors determining the types of expenditure and taxation at various levels of government (Musgrave, 1971; Oates, 1972). In a decentralised government, economic efficiency can be attained through benefit taxation, where tax is equal to the marginal cost of providing public goods at the jurisdictional level and can also be applied at the individual level (Musgrave, 1971). The best system, as noted by Olson (1969), is one that can balance benefit

[4] 73rd Constitutional Amendment Act, 1992 (India); 74th Constitutional Amendment Act, 1992 (India).

and cost. However, this does not occur in the real world, as governments cannot provide public goods by equating benefit with the tax burden.

Oates (1996) and McLure (1999) remark that if the function of local government is limited to garbage collection and sweeping, user fees are optimal and sufficient. In contrast, more responsible social services should go hand in hand with taxation. According to Musgrave (1983, 1959, 1969), the taxes imposed by the local government should be in the form of benefit taxes with stable revenue and immobile tax bases, like property tax and user fees. Brennan and Buchanan (1980), however, argue that local taxes should be on mobile tax bases to facilitate competition, which would reduce the size of the public sector and thereby increase the efficiency of public service provision. In the Tiebout model (Tiebout, 1956), taxes are considered to be the price paid for the use of local public goods. Benefit taxation will induce firms and households to choose the jurisdiction that effectively and efficiently supplies public goods.

According to Weingast (2009), "an ideal type" of fiscal federalism or "market-preserving federalism" must satisfy "five conditions" (p. 281). There must be: (a) a "hierarchy of governments", (b) institutionalised political authority, (c) autonomy for the subnational governments, (d) "a common market that allows factor and product mobility" across subnational governments, and (e) "hard budget constraints" for subnational governments (Weingast, 2009, p. 281). Weingast (2009) emphasises the need for fiscal and political incentives for subnational governments and the importance of relying on complementary institutions that support one another in order to provide efficient public services. Vo (2008), citing Garzarelli (2004), states that subnational and local governments need "incentives" in order "to do a better job to avoid outward migration of people and firms" and "knowledge of local preferences and tastes" if "economic efficiency" is to be achieved when providing "local public goods and services" (p. 49).

Tax is an important fiscal incentive when trying to achieve fiscal autonomy and accountability. According to Weingast (2006), "on the government accountability dimension, citizens have strong incentives to monitor their taxes, to demand responsiveness, and to ensure that they get their money's worth" (p. 28; see also Bahl, 1999; McLure, 1999; Oates, 2005; Pöschl & Weingast, 2013; Weingast, 2009). Musgrave (1971) is of the view that tax assignment should be in such a manner that its burden falls on the local residents, so that a functional relationship between the community through contribution and the benefit received can be established (see also Musgrave & Musgrave, 1989). As Bahl and Bird (2008) have rightly pointed out:

> local residents are likely to hold officials more accountable if local public services are financed to a significant extent from locally imposed taxes and charges as opposed to central government transfers. Ideally, to have this beneficial effect, local taxes must be both visible to local voters and large enough to impose a noticeable burden. (pp. 4–5)

According to Watt (2006), an ideal local authority is one where "people pay for and vote" for what they need (p. 9). Such a system will ensure accountability. The "principle of benefit" is the philosophical support for local taxes, as it ensures the efficient utilisation of public expenditure and guarantees fiscal discipline among local governments. Empirical studies also substantiate this argument (Bird, 2001; Boex & Yilmaz, 2010; de Mello, 2000; Meloche et al., 2004; Rodden, 2003; Rodríguez-Pose & Krøijer, 2009).

Weingast (2009) cites McKinnon (1997), who states that there is a disincentive problem in relation to the transfer system. According to Weingast (2009), McKinnon (1997) points out that Canada and Italy, which have been subject to soft budget constraints, provide huge subsidies to their poorer regions, leading their public sector enterprises to make losses. The southern US states, meanwhile, face hard budget constraints and receive no subsidies (McKinnon, 1997, as cited in Weingast, 2009). According to Weingast (2009), these states were the poorest in the US "after the Civil War through mid-20$^{th}$ century" but "were able to grow rich by redesigning their economies with low regulatory burdens relative to the industrialized North and to take advantage of lower labor costs" (p. 284). The results of Dillinger and Webb's (1999) study, based on the experiences of Argentina and Brazil, and Kornai et al. (2003)'s findings with regard to the collapse of the banking sector in East Asian countries, also substantiate this argument. Expenditure based on intergovernmental transfers forces electorally motivated politicians to take advantage of fiscal illusion.[5] The implementation of the transfer system leads to inefficiency in the allocation of funds due to uncertainty about the amount that will be received and when it will be received if the design of the system is not transparent (Bird, 2001; Boex & Yilmaz, 2010). Oates (2005) suggests that "the solution to the problem" is "the reform of political and fiscal institutions to alter the whole structure of incentives for budgetary decision-making" (p. 361). Grants should be given to meet the allocative and distribution functions, and not to provide fiscal bailouts. The greater the proportion of revenue generated by local governments, the greater effort the local government will make to improve the efficiency of its operations and introduce innovative methods of delivering public goods. If there is no link between tax and expenditure activities, people think that taxes collected from them are used in other localities and this prevents public officials from being able to provide public goods efficiently.

When developing a revenue base, local governments are usually advised to implement local income tax and business tax. According to McLure (1999), residence-based income tax, which is collected through the filing of tax declarations, is "probably superior to employment-based payroll taxes" (p. 14). However, due to the challenges involved in implementing this in developing countries, Bahl (1999) suggests using separate tax systems for urban and rural sectors, if needed. Important arguments for introducing business taxes are revenue flexibility and the benefit principle. Since it is difficult to impose user charges on every business activity and input, it is better to levy a generalised tax on business. The optimal option for this is value added income tax (BVT) i.e. value added tax (VAT) which is levied on an income basis (Bahl & Bird, 2008). Bird (1999) opines that this "would minimize both" the "horizontal and vertical" spillover effects of taxation (p. 32). Business taxation is also advocated from the point of view of efficiency, equity, and political cost. Another argument favouring the implementation of business tax is that "a significant portion of the local government expenditure directly benefits businesses" (Bird, 2014, p. 2). Waste disposal, for example, is a major problem faced by most of the local bodies, especially in cities. Therefore, such a tax would be more suitable for large cities and metropolitan regions. McLure (1980) has opposed this tax on efficiency grounds, claiming that the distortion effect is greater. To limit the burden of taxes on non-residents, one suggestion is to introduce "a uniform set of tax bases for local governments…with a limited amount of rate flexibility being permitted" (Bird & Slack, 2014, p. 366). BVT requires a well-designed accounting system, political will, and a developed administrative set-up with a clear legal framework; therefore, it is important for developing and transitional countries to design

[5] If the citizens are subject to fiscal illusion, instead of actual benefits received from the government, they do not fully understand the true cost of fiscal deficits and future tax liability.

and implement BVT to suit their particular circumstances (Bird & Gendron, 2007; Bird & Vaillancourt, 1998).

Recently, little attention has been given to the decentralisation of tax administration. Even if tax decentralisation and the decentralisation of tax administration are related issues, separate decisions need to be made with regard to them. While decentralising the administration of local taxes is theoretically advisable, owing to the comparative advantage of identifying the tax base, country-level experiences show that these taxes are designed poorly and in a presumptive way, and are "administered with low coverage rates, arbitrary assessment, and large delinquent lists" (Bird, 2015, p. 18). A common and economically feasible approach is to allow the local governments to administer those taxes that are easy for them to assess and collect. The key arguments against the local administration of taxes are increased tax evasion and increased compliance costs. In practice, as Bird (2015) points out, property valuation, assessing income, and other tasks "can be complex and require coordinated action between a number of different local, state, and national agencies and departments" (Bird, p. 17).

Tax revenue is less than 50 per cent of the total revenue of the local governments in most countries (Steffensen, 2010). Financial autonomy is only given to local governments in some North American countries to some extent. In most developing countries, central government intervenes in fixing tax rates and tax bases, and the share of subnational tax revenue in total taxes accounts for 10 per cent on average (Bahl & Bird, 2008). According to Bahl and Bird (2008), "sub-national governments in countries like Cambodia, China, and Vietnam…raise less than 5 percent of their total revenue from own sources" (pp. 5–6). In Africa, local governments' own revenue is, on average, 30 per cent of their total budget, except in Zambia (77 per cent) and South Africa (90 per cent) (Letaief et al., 2009). Their main source of funding is shared taxes, with VAT being the most important of these (Letaief et al., 2009). Countries like South Africa, Tanzania, Zambia, and Zimbabwe enjoy some freedom in fixing service fees and tariffs (Letaief et al., 2009).

Surcharges on income tax and VAT are now widely accepted in the US and Canada. Surcharges are the easiest tool with which to achieve fiscal autonomy without "unacceptable inequities, economic distortions, or complexities of compliance and administration" (McLure, 1999), but this comes at the expense of the fiscal freedom of the local government and brings with it the problem of transferring revenue (Bird, 1999; Sjoquist, 2015). In Organisation for Economic Co-operation and Development (OECD) countries, local governments rely on direct taxes on businesses and surcharges on national income taxes. In Denmark, Norway, and Sweden, surtaxes on national income tax are the main source of revenue for local governments, and these are "levied at a flat, locally-established rate…and collected by the central government" (Bird, 2010, p. 35). The Canadian VAT experience[6] reveals that "a single administration and common base" would be an efficient system (Bahl & Bird, 2008, p. 22). It is argued that, in large countries with federal features, such as India and Brazil, surcharges can be used to expand the revenue bases of the subnational governments (Bird, 2000).

[6] Bahl and Bird (2008) explain that two forms of VAT system are in place in Canada. The first is a "'dual VAT system'" comprising "the Québec Sales Tax (QST) and the federal VAT (GST)" (p. 22). The second is a system of "VATs (the Harmonized Sales Tax [HST])", which are applied by "three small provinces…" on the same base as the federal GST" (Bahl and Bird, 2008). In the second system, revenue is collected by the federal government and "distributed to the provinces based on estimated taxable consumption in each province" (Bahl and Bird, 2008, p.22).

## 2.1. Revenue Decentralisation in India and Kerala

In India, decentralisation has only been introduced seriously in some states. The 73rd and 74th Constitutional Amendment Acts have the provision to transfer 29 functions and 24 taxes to the local governments. Some states have transferred all 29 functions, some states have transferred some of them, and others have not taken the initiative yet. The number of taxes assigned to panchayats ranges from 19 in Gujarat to one in Uttarakhand. Although taxes are assigned to the panchayats, half of the states do not collect all the taxes that have been assigned. Notably, the states of Bihar, Jharkhand, Odisha, Punjab, and Assam do not collect any of the assigned taxes (Alok, 2024).

Maharashtra collects the most tax per capita (₹209.36), with Kerala in second place (₹178.09) (Government of India [GoI], Ministry of Panchayati Raj, & Tata Institute of Social Sciences, Mumbai, 2016; Rao & Rao, 2008). Relatively inelastic taxes, like taxes on property, profession, entertainment, and advertising are assigned to the local governments. The discretion enjoyed by the central government in transferring funds led it to transfer more funds to some states (Gupta & Mukhopadhyay, 2014; Singh, 2015; Singh & Srinivasan, 2006). The states of Karnataka, Kerala, Tamil Nadu, and Maharashtra occupy the top positions in the devolution index (Alok, 2024). Although Kerala is in a better position than other states, the extent of fiscal decentralisation in India is meagre when compared to developed countries.

In Kerala, own revenue resources of the local governments constitute less than 10 per cent of the total revenue receipts during the eight years between 2014–15 and 2021–22 (Comptroller and Auditor General of India, 2018, 2024). The ratio of local government own revenue to the gross domestic product of the state, which stood at 0.34 in 2009–10, declined to 0.204 percent in 2019–20 (GoK, 2021). A similar trend of decline can be observed in the ratio of local government own revenue to states' own revenue (GoK, 2021). The GoK (2021) notes that "these declining ratios reflect the absence of buoyancy of Local Government revenues relative to the growth of the economy, indicating the urgent need for interventions to improve revenue mobilisation" (p. 12). Total tax revenue as a percentage of total receipts is less than seven percent between 2013–14 and 2021–2024 (Comptroller and Auditor General of India, 2018, 2024). Property tax and profession tax together contribute 95 per cent of the tax revenue of local governments in Kerala (GoK, 2021). When the Goods and Service Tax (GST) was introduced in 2017, entertainment tax was abolished in Kerala but additional tax revenue was not provided to the local governments (GoK, 2021).

## 2.2. Profession Tax in India and Kerala

Article 276 of the Constitution of India refers to taxes on "professions, trades, callings or employments" and provides that power is given to the state government to make laws on such taxes, subject to a maximum ceiling, which is fixed in the constitution. The maximum ceiling was fixed as ₹250 in 1949 and revised to ₹2500 in 1988. Among the 25 states, 16 have assigned the profession tax to panchayats and 12 of these are collecting it (Alok, 2024). In India, and particularly in Kerala, profession tax is a payroll tax imposed on earned income.

In Kerala, profession tax is the second largest source of tax revenue for the local governments, (with property tax being the largest) (GoK, 2021). Profession tax is levied based on half-yearly income. Kerala's profession tax slabs, showing the half-yearly income limits and tax rates, are detailed in Table 1. The author's calculate that the share of profession tax within the total tax revenue, on average, fell from 39.3 per cent during the period 2009–10 to 2013–14 to 29.9 per

cent during the period 2014–15 to 2019–20. According to the authors' calculations, the ratio of profession tax to net state domestic product also shows a declining trend during the last decade. However, the annual growth rate of profession tax revenue was 5.96 per cent during 2014–15 to 2019–20, which was higher than the annual average growth rate of total tax revenue (4.04 per cent) during the same period (GoK, 2021).

*Table 1: Profession Tax Rates in Kerala prior to and as of October 2024*

| Slab | Half-Yearly Income | Previous Rate | Current Rate (from 01-10-2024) |
|---|---|---|---|
| 1 | Up to ₹11999 | Nil | Nil |
| 2 | ₹12,000 – ₹17,999 | ₹ 120 | ₹ 320 |
| 3 | ₹18,000 – ₹29,999 | ₹ 180 | ₹ 450 |
| 4 | ₹30,000 – ₹44,999 | ₹ 300 | ₹ 600 |
| 5 | ₹45,000 – ₹99,999 | ₹450/₹600/₹750 | ₹ 750 |
| 6 | ₹100,000 – ₹124,999 | ₹ 1,000 | ₹ 1,000 |
| 7 | ₹125,000 and over | ₹ 1,250 | ₹ 1,250 |

Source: Govt. Order LSGD-RC2/13/2024-LSGD Or.No.1149/2024/LSGD dated 27/06/2024; Mundra (2025).

The key constraints faced by the local government when trying to boost the collection of profession tax are the ceiling on the amount of tax that can be collected and the requirement for a constitutional amendment to be made in order to raise this ceiling. India's Finance Commissions have repeatedly recommended both an upward revision of the ceiling for profession tax and that this provision should be removed from the constitution so that Parliament can revise the ceiling when appropriate (GoK, 2021). Although these proposals have been accepted in principle (GOK, 2021), they have not yet been put into practice.

The state government has been lax in implementing and revising the tax rules of local government. The existing maximum ceiling of ₹2,500 per annum was set in 1988 but was only introduced in Kerala with effect from 1996 (GoK, 2021). As per the recommendation of the First State Finance Commission (GoK, State Finance Commission, 1996), the Government of Kerala introduced The Kerala Panchayat Raj (Profession Tax) Rules, 1996, and the income slabs and tax amounts were revised accordingly. However, when the authors were collecting the data for their research, local governments confirmed that the village panchayats had only started to levy the new rate in 2003 and the municipalities had only started to do so in 2005. The succeeding State Finance Commissions reported that not all potential taxpayers are being brought into the tax net.

The Kerala Panchayat Raj Act 1994 (Profession Tax Rules) stipulated that the secretary to the local governments should keep a register of all institutions and employees who are liable to pay profession tax. However, this is not practiced in most of the local governments. A wide gap has been observed between the actual and potential amount of key taxes levied and collected by local governments. Tax evasion is high among employees in private businesses and establishments, and among self-employed professionals (GoK, 2021). Thus, the mobilisation of profession tax revenue has been partially constrained by omissions and laxity on the part of the central, state, and local governments.

The base of profession tax is the income earned by employed persons and this also comes under the base of income tax, the key shared tax imposed by the central government. It has been empirically proven that expenditure activities that are financed by own revenue resources are more effective than transfers from higher levels of government (Bird, 2001; Boex & Yilmaz, 2010; de Mello, 2000; Meloche et al., 2004; Rodden, 2003; Rodríguez-Pose & Krøijer, 2009). Hence, a rigorous examination of the possibility of revising the profession tax system by giving local governments more power to levy tax on income can throw light on the space for local self-governance in relation to taxation.

Given this backdrop, this paper analyses two specific objectives. First, it analyses the space that would be open to the local governments in Kerala if the present system of profession tax were to be redefined. Secondly, it examines the prevalence and extent of underassessment of the income of traders/dealers and estimates the potential increase in profession tax revenue in different scenarios.

## 3. METHODOLOGY

### Area of Study, Sampling Design, and Approach

Our paper estimates the gap between actual and potential profession tax revenue in Kerala for the financial year 2017–18 by expanding the existing tax base, and examines the possibility of introducing an alternative to the current profession tax system in the light of various forms of local income taxes that prevail in other countries. The estimation was conducted by selecting seven grama panchayats and two municipalities in the Kannur district of Kerala. Kannur ranks first among the districts of Kerala in per capita tax incidence (GoK, 2009), which indicates that it has better revenue mobilisation than other districts. This might mean that the overestimation of the results is avoided. The selection of the sample local governments was based on the share of profession tax revenue within total tax revenue, the number of people employed, the collection efficiency of the local government, and urban proximity. The numbers, categories, and incomes of all taxpayers, and the amounts of profession tax collected from them, were taken from the profession tax registers of the selected local governments. The potential tax revenue is estimated based on the taxpayers' reported income by raising and removing the constraints of the maximum ceiling and slab system.

A hypothetical schedule with progressive increases in the intervals of consecutive income slabs is used to estimate potential revenue at an enhanced maximum ceiling of ₹12000, as recommended by the Fourteenth Union Finance Commission (GoI, Finance Commission India, 2014). For this, the minimum amount of tax to be imposed is calculated based on the minimum wages announced by Government of Kerala.[7] We estimated the minimum wages of persons employed in different occupations in Kerala during the second half of the financial year 2017–18. Hence, as per the minimum wages declared by the Government of Kerala,[8] the minimum six-month salary of the persons employed in different sectors was greater than ₹50000 in the financial year 2017–18. To estimate this, this paper used the Consumer Price Index Numbers for agricultural labourers and industrial workers published by the Department of Economics and Statistics for the respective year (GoK, Department of Economics and Statistics, 2025). The average minimum wages of non-agricultural workers in rural Kerala ranged from ₹689 to ₹783 in June 2015 (GoK, State Planning Board, 2017). The profession tax rate at the time of

[7] Government Order (Ms.) No,100/2009/LBR, 23 July 2009, issued in Thiruvananthapuram.
[8] Government Order (Ms.) No,100/2009/LBR, 23 July 2009, issued in Thiruvananthapuram.

calculation constituted one per cent of the minimum income for each slab. At the time of conducting this research, therefore, the minimum and maximum amounts of profession tax were fixed at ₹500 and ₹6000, corresponding to the income levels of ₹50000 and ₹600000 respectively in a half-year period.

The underassessment of the income of traders/dealers by the local government was examined by comparing the income reported in profession tax registers and the income reported to the Commercial Tax Department in VAT returns. A sample of 128 dealers from Thalassery Municipality and 63 dealers from Kuthuparamba Municipality, both in the Kannur district of the state of Kerala, was used in order to estimate this. The underassessment was estimated for the year 2016–17 to avoid the initial issues of implementing GST in India in the year 2017. The dealers were selected from the list of institutions paying ₹450 and more as profession tax because these institutions are required to register under the GST scheme. The number of taxpayers in each higher slab could not be calculated due to problems faced when identifying taxpayers who appear in both registers.

## 4. RESULTS AND DISCUSSION

In Kerala, profession tax is collected under two accounts: institution tax and employee tax. Accordingly, there are four groups of profession taxpayers: public sector institutions, private institutions, public sector employees, and private employees. The data shows that public sector employees account for the largest portion of the revenue. It was found that there was no scope for further notable increases in profession tax receipts from them because the majority of the taxpayers already paid the maximum amount of ₹1250 and the growth rate for taxpayers in the public sector was also significantly less. This is the reason behind the fall in the growth rate of profession tax receipts during the period 2012–13 to 2017–18. This points to the significance of raising or removing the existing maximum ceiling of profession tax.

The comparison of the average tax amounts paid in both the private and public sectors shows that the average tax paid by public sector employees was more than double that of private sector employees. Most private institutions were still paying only ₹180 and ₹300 during a half-year period. This was unbelievable when the collected data stated that most institutions' income still lay within the ₹18000 to ₹30000 range in a half-year period. The performance of one panchayat with relatively low urban proximity was remarkable in terms of collecting institution tax during the years 2015–16 to 2017–18. This panchayat had the highest average tax collection from private institutions even without a significant industrial base or urban-related institutions. This indicates that other panchayats and municipalities could raise institution tax and mobilise more revenue. The GoK reported that the average minimum wage for non-agricultural workers in rural Kerala ranged from ₹689 to ₹783 in June 2015 (GoK, State Planning Board, 2017). This reveals that workers may be under-reporting their income. This supports the argument for the better assessment of income of private employees, institutions, and self-employed persons. Hence, priority should be given to introducing rational assessment of income rather than revising the maximum ceiling or this will further lead to the unequal distribution of tax burden. The questions here are whether there is underassessment or not and, if there is, to what extent and what policy changes should be made?

### 4.1. Potential tax revenue at a maximum ceiling of ₹12000

The revenue of the local governments from profession tax would increase, on average, by 55 per cent in panchayats and 70 per cent in municipalities if the maximum ceiling were to be

enhanced to ₹12000—as recommended by the Fourteenth Union Finance Commission (GoI, Finance Commission of India, 2014)—and the minimum ceiling to ₹500. Therefore, an increase of around 25 per cent would result from increasing the minimum tax amount ceiling to ₹500 and bringing all existing taxpayers who would fall outside of the tax net as a result of the revision into this minimum slab. Otherwise, 50 per cent of the institutions and 25 per cent of employees would be within the tax net. The said ratio is 75 per cent for institution tax in municipalities since most of them belong to the ₹180 and ₹300 slabs. More than 95 per cent of them are from the private sector in all local governments. Implementing a revision without including all existing taxpayers would result in a revenue loss for the panchayats and municipalities. However, the fall in tax revenue from the private sector would be outweighed by the revenue collected from public sector. Therefore, the periodic revision of the schedule in tune with income growth and distribution is quintessential in order to maintain profession tax revenue generation by the local governments. The analysis also reveals that, in order to attain this potential tax increase, state governments should strictly adhere to the timely revision of the minimum amount of profession tax as corresponds to the existing minimum wages, which do not require any constitutional amendment.

The results reveal that the tax amounts of 75 per cent of the public sector employees would be above the existing maximum ceiling of ₹1250 in all local governments. In contrast, the proportion would only be five per cent in the case of private sector employees and institutions. Therefore, the potential increase in tax revenue would be higher in local governments where public sector employees account for a large proportion of tax revenue. The per capita tax incidence for public sector employees would increase from ₹1165 to ₹2156, while the per capita tax incidence for private sector employees would increase from ₹521 to ₹712. There would be a 95 per cent increase in per capita tax incidence for public sector employees compared to a 37 per cent increase in the private sector.

Moreover, the private sector share of potential tax revenue would decline from 51 per cent to 42 per cent in panchayats, and from 42 per cent to 36 per cent in municipalities. Within this, the share of private sector employees' tax would fall from 37 per cent to 28.5 per cent. The authors found that the increase in profession tax revenue from public sector employees would primarily be due to raising the upper ceiling. Conversely, the growth in tax revenue from private employees and private institutions would mainly be accounted for by the revision of the lower ceiling. Raising the ceiling to ₹12000 without introducing any measures for better assessing private individuals' income would lead to the unequal distribution of the tax burden, and profession tax may not satisfy the canon of equity. Therefore, as rightly stated by the Third State Finance Commission of Kerala (2005), priority should be given to improving tax collection through the rational assessment of private individuals' income instead of raising the maximum ceiling.

From discussions with the officials of panchayats and municipalities, it is noted that political intervention is one of the major constraints faced by the authorities when raising even a single slab rate for private taxpayers. In addition, political cost/benefit calculations usually result in leaders deciding against making the seemingly unpleasant decision to raise the maximum ceiling. Another constraint is a lack of professionalism among officials. If local or state governments were to be empowered to fix the tax rate at a flat rate with a maximum allowable rate, frequent revisions to income slabs and slab rates would not be made.

### 4.2. The Tax Space of Profession Tax

The potential of profession tax, which is estimated by removing the legal constraints—particularly the upper ceiling and the slab system—is called economic revenue potential. The difference between economic revenue potential and actual revenue collection is defined as the "tax space" of profession tax in this paper. When estimating economic revenue potential, the exemption is given only to low-income groups.

### 4.3. Revenue Potential at a Flat Rate of One Per Cent[9] of Income

The existing slab rate for profession tax is fixed as one per cent of the minimum income level of each slab. Although a tax on income with a flat rate is regressive, the main arguments for this are "to introduce simplicity, broaden the tax base, reduce administrative costs, and improve tax compliance" (Khwaja & Iyer, 2014, p. 4). Moreover, in the case of profession tax, central income tax is charged at a progressive rate on the same base.

The authors' estimation of the tax space of profession tax at a flat rate of one per cent by giving exemption to low-income groups reveals a possibility of an 80 per cent increase in tax revenue in municipalities and a 65 per cent increase in panchayats. The average potential increase in tax revenue at a flat rate over the slab system, on an average, is 10 per cent in both panchayats and municipalities. The local governments could mobilise this extra revenue without any additional cost, and have the potential to increase revenue mobilisation further by raising the flat rate or by fixing tax at a progressive rate. A one per cent increase in the tax rate would generate a 100 per cent increase in tax revenue.

One limitation of this flat rate is the tendency to under-report income in order to reduce the tax amount as much as possible. Local governments can overcome this problem by adopting mechanisms to minimise administrative loopholes. However, with this increase, the authors calculate that the ratio of profession tax to the total expenditure of local governments increases from 2.1 per cent to 8.7 per cent in panchayats, and from 4.5 per cent to 15.5 per cent in municipalities. The ratio of total tax revenue to total expenditure rises from 7.11 per cent to 11.2 per cent in panchayats, and from 14.9 per cent to 23.6 per cent in municipalities. These low ratios demand further increases in tax revenue mobilisation.

### 4.4. Forms of Local Income Taxes: A Comparison

Among the four types of local income taxes identified by Sjoquist (2015),[10] the tax base is broader when tax is imposed on gross income without exemptions, deductions, and credits.

[9] The most common tax rates are a flat rate of one per cent to be levied on gross income and gross earned income, and a rate of greater than one if the tax is levied on taxable income under the central or state income tax, or as surcharge on state tax liability.

[10] Local income taxes are mainly imposed on four bases: gross earned income, gross income, taxable income, and a surtax on state tax liability (Sjoquist, 2015). Tax on gross earnings without personal exemptions, deductions, or credits (known as payroll tax) is the most used tax. Gross earnings comprise wages, salaries, other allowances, and net profits from business (Sjoquist, 2015). In some places, gross income (which includes "all state taxable sources of income" without any deductions, exemptions, or credits) is taken as the base (Sjoquist, 2015, p. 37). Taxable income under the central or state income tax is another base used for local income tax (Sjoquist, 2015). This allows "all of the exemptions and deductions of the state income tax" scheme (Sjoquist, 2015, p. 37). Finally, local income tax is imposed as a surtax on state income tax, which "incorporates the progressivity of the state's income tax rate structure" (Sjoquist, 2015, p. 37). Sjoquist (2015) notes that such "alternative tax bases…differ in terms of the equity of the tax, i.e., the degree of regressivity or progressivity, as well as administrative and compliance costs" (p. 38). See also, Bird (1999).

Therefore, tax on gross income levied at a flat rate will generate more revenue than tax on earned income levied at a flat rate. The sector-wide analysis of the distribution of the burden of profession tax shows that the tax burden falls more upon public sector employees and the majority of the taxpayers employed in the private sector are still within the low income slabs. The estimated monthly income, based on the average minimum wage of non-agricultural workers according to the GoK State Planning Board (2017), was greater than the reported income of the taxpayers. It needs to be stressed that the existing administrative system of the local government is not efficient when assessing the income of persons employed in the private sector. Therefore, tax on gross income may not mobilise more tax revenue than the existing tax on earned income (profession tax) that is collected by the local governments in Kerala.

The under-reporting of income by traders, professionals (such as lawyers and chartered accountants), and other self-employed persons is an important constraint faced by authorities when attempting to mobilise profession tax revenue. It is beyond the administrative domain of the local government to assess the actual gross income earned by these persons. The GOI's successes in bringing private individuals into the income tax net during the period 2001–08 are a tribute to the Income Tax Department's effective tax efforts. There was a 40 per cent increase in the number of people paying tax between 2015 and 2018 (GoI, Central Board of Direct Taxes, 2018). Therefore, tax on gross income as reported in income tax returns can be used as the basis for local income tax and this could lead to increased tax collection by local governments. In 2018, the state of Punjab introduced this type of tax for all persons[11] whose income exceeded the minimum exception limit chargeable under the Income Tax Act of 1961 (India), i.e. everyone with an income above ₹250,000 (2.5 lakhs) in the 2018–19 financial year was liable to pay ₹200 per month (see the Punjab State Development Tax Act, 2018).

The statistics of income tax payers during the 2017–18 financial year reveal that persons with an annual gross income above ₹500,000 rupees (five lakhs) were liable to pay income tax (GoI, Central Board of Direct Taxes, 2018). As per the profession tax register, only 17 per cent of the total number of taxpayers in the panchayats earned under this income level. In the municipalities, this increased to 25 per cent. 95 per cent of these taxpayers were public sector employees. Suppose that local income tax is only levied on gross income as per the income tax of the central government. In that case, the majority of the existing profession taxpayers would escape the tax net. Moreover, the entire tax burden would fall upon public sector employees. The same problem would arise if local governments were to impose tax on taxable income and surcharges on personal income tax liability. Such a surcharge would have the following advantages: it would incur relatively low administrative costs, taxation would be according to the ability to pay, and the distribution of tax burden would be more equitable. However, this could only be implemented at the expense of the fiscal freedom of the local government. Hence, local income tax on gross income, taxable income, or tax liability cannot be advocated, at present, from the point of view of revenue and accountability. Therefore, priority should be given to improving the existing tax system rather than revising the existing tax base and rate.

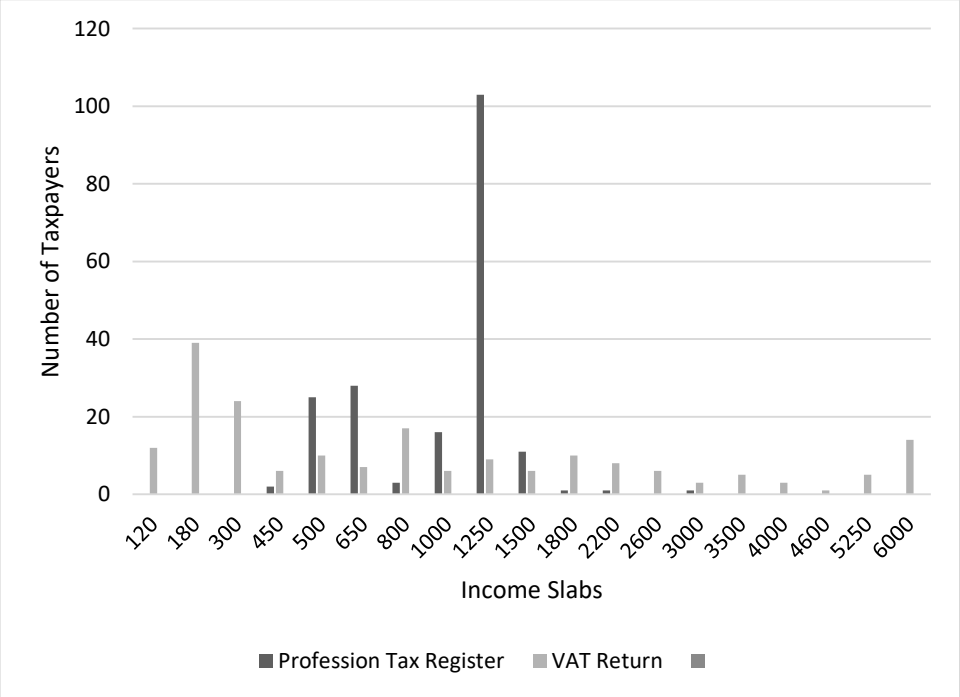
### 4.5. Potential Tax Revenue Through the Rational Assessment of Income

A dealer's income is based on their turnover as reported in their VAT return and is assessed as per the schedule prescribed by the state government. 45 per cent of dealers fall within the lower tax slabs according to the profession tax register 2017–18, and the authors' tax revenue

[11] Exceptions are made for senior citizens, those who earn wages on a casual basis, and workers who are exclusively engaged in agriculture.

estimations, based on VAT turnover, are 33 per cent lower than the actual revenue collected. This highlights the inefficiency of the Commercial Tax Department in respect of assessing the turnover of the dealers. However, when tax revenue is estimated at a maximum ceiling of ₹12,000, the potential revenue would be 26 per cent higher than the estimated revenue as per income reported in the profession tax register. This increase is attained when 45 per cent of taxpayers are removed from the tax net due to an increase in the minimum ceiling to ₹500. By bringing all of these dealers into the tax net by imposing a minimum tax rate, potential revenue would increase to 46 per cent. The potential increase is 74 per cent if the estimation is made using both records. Therefore, revenue mobilisation through profession tax can be enhanced by assessing the income of private institutions based on information obtained from the Commercial Tax Department when the tax base is expanded. There is a possibility that profession tax revenue can be increased further if the advantages of GST are realised. The theoretical arguments for decentralising the administration of local taxes due to the comparative advantage of identifying the tax base is visible at low income levels (Figure 1). At the same time, the analysis supports the coordination of different departments functioning at various levels of government in order to achieve a better result.

*Figure 1: Distribution of Taxpayers By Income Slab*




Source: Author's Compilation

A similar trend of increases is also observed in potential profession tax revenue when an estimation is carried out at a flat rate of one per cent, without any maximum ceiling or slab system (Table 2).

*Table 2. Actual and Potential Yields of Institution Tax at 1% (in ₹)*

| Actual Tax Revenue | Potential Tax Revenue* | | |
|---|---|---|---|
| | 1 | 2 | 3 |
| 199700 | 209710.00 | 393993.00 | 489664.00 |
| Actual as % of Potential | 95.2 | 50.7 | 40.8 |
| Potential Increase (%) | 5.0 | 97.3 | 145.2 |

Source: Authors' Calculations

Note: * 1. Estimation as per profession tax register, 2. Estimation as per VAT register, 3. Estimation based on both registers.

The potential increase is only six per cent when the estimation is based on the income reported in the profession tax register. Although 45 per cent of taxpayers are removed from the tax net when tax is assessed as per VAT returns, the tax revenue would increase by 97 per cent. This is because 14 dealers earned income of more than ₹600,000 (6 lakhs). The highest income assessed was ₹3,600,000 (36 lakhs). Therefore, when profession tax is assessed at a flat rate, it will generate more revenue than other taxes and ensure a more equitable distribution of the tax burden. Suppose provision is included in the income tax rule to deduct profession tax from the amount of tax payable rather than at source: there would be no need to fix a maximum ceiling for profession tax. The possible yield in profession tax revenue would increase to 145 per cent if the potential revenue is estimated at a flat rate of one per cent based on the records of both registers.

The under-reporting of income by traders is visible in both the profession tax register and VAT returns. There is no significant correlation between the income reported in both registers. The correlation coefficient for one municipality is 0.078 and the value is close to zero i.e. -0.00047 in another. Therefore, it would be better to impose profession tax by collecting information about turnover from a state's GST department in order to augment own revenue mobilisation. The impact of adopting a new method of assessment on tax revenue can be analysed by estimating the elasticity of profession tax with respect to taxpayers' income.

The use of a new method of income assessment in order to respond to changes in profession tax revenue due to changes in dealers' income shows how the tax system keeps up with such developments. The elasticity of profession tax is estimated by regressing tax amounts on taxpayers' income using the ordinary least squares (OLS) method. The estimation is made in three different scenarios, i.e. tax revenue at the existing maximum ceiling of ₹1250 (scenario A), at an enhanced rate of ₹12,000 (scenario B), and at a flat rate of one per cent (scenario C), using the following econometric specification:

$$logTR_i = \propto + \beta_1 \log Y_i + u_i \qquad (1)$$

where *TR* represents the profession tax amount and $Y_i$ represents the taxpayers' income. The coefficient value of $\beta_1$ gives the elasticity of profession tax with respect to changes in income.

*Table 3: Regression Results Showing the Elasticity of Profession Tax in the Proposed Tax Regime*

| | Scenario A | | | Scenario B | | |
|---|---|---|---|---|---|---|
| | coefficient | *p*-value | $R^2$ | coefficient | *p*-value | $R^2$ |
| constant | 4.867 | 4.15e-052 *** | 0.31 | −2.417 | 4.77e-024 *** | 0.92 |
| $\beta$ | 0.177 | 3.74e-017 *** | | 0.808 | 5.39e-106 *** | |

Source: Authors' estimations.

* Significant at 10% level ** significant at 5% level *** significant at 1% level

The elasticity coefficient in scenario A is very low (0.176) with a highly significant *p*-value. A coefficient lower than one and close to zero implies poor tax performance on behalf of local governments at the existing maximum ceiling of ₹1250. Although the elasticity coefficient at the enhanced ceiling of ₹12000 is less than one (0.808), it is higher than in scenario A. Therefore, profession tax collection in scenario B would improve the tax revenue mobilisation capacity of municipalities. Since the elasticity coefficient at a flat rate of one per cent is one, the estimation has not been made for scenario C and is not presented in Table 3.

The comparison of the elasticity coefficients in the three scenarios also supports the need for revenue mobilisation from private individuals to be improved through better income assessment. The largest portion of the tax burden will, otherwise, fall upon public sector employees.

## 5. Conclusion and Policy Recommendations

The theoretical and empirical components of the literature suggest that local governments could function efficiently if their expenditure activities were funded by own revenue rather than by transfers from higher level governments. In India, the 73rd and 74th Constitutional Amendment Acts have the provision to transfer 29 functions and 24 taxes to the local governments. Some states have transferred all 29 functions, some states have transferred some of them, and others have not taken the initiative yet. However, no states have taken the initiative to transfer more power to levy and collect taxes to the local governments. Therefore, the discrepancy between revenue and expenditure, often referred to as the vertical imbalance, has increased after the amendment. The literature also recommends that local income tax and business tax should be used when developing a revenue base for local government (Bird, 2010).

Country-level experiences show that local taxes are designed poorly and in a presumptive way, and "administered with low coverage rates, arbitrary assessments, and large delinquent lists" (Bird, 2015, p. 18). In India, profession tax, which is imposed on earned income, is levied and collected by the local governments. The authors' analysis reveals the inefficiency of the local governments in respect of assessing the incomes of private employees and institutions, and of the self-employed. The authors found that six out of the nine selected local governments have kept separate registers of default taxpayers. The number of default taxpayers is relatively high in the municipalities. Therefore, this paper supports the above argument. Raising the maximum profession tax ceiling, as recommended by the Fourteenth Union Finance Commission (GoI, Finance Commission India (2014), without the rational assessment of private individuals' income would increase the unequal distribution of the tax burden, and the lion's share of the tax burden would fall upon public sector employees. The authors' findings show that tax mobilisation capacity can be increased by improving coordination between departments that

function at higher levels of government. Therefore, attention should first be given to increasing own tax revenue mobilisation through the coordination of departments functioning at various levels of government, rather than to decentralising the tax administration.

The following practices could be used to improve tax collection. First, to overcome the inefficiency of local governments when assessing the income of the self-employed and private institutions, a list of those paying income tax and their gross earned income should be provided by the income tax department, and turnover details should be provided by the relevant state's GST department, so that profession tax can be levied accordingly. Secondly, a dual system, comprising of tax collection by the local governments from those who do fall within the income tax net, together with the introduction of a flat rate tax on the gross earned income of individuals who are paying income tax, with that amount being transferred to the local governments after collection. State governments should be given the freedom to fix the rate of tax within the maximum rate allowed. Provision could also be included in the Income Tax Act for profession tax to be deducted from the tax liability rather than, as happens now, from gross income. This would also mean that there would be no need to fix the maximum ceiling. Thirdly, local governments could be given the power to demand annual GST returns at the time of renewal of the traders' licenses or issue of their ownership certificates etc. Finally, local governments could reduce their reliance on grants from the higher levels of government by imposing tax at a progressive rate within the maximum allowable rate fixed by the central government. Such a tax would be convenient for taxpayers and have the dynamism to raise civic consciousness and accountability. Therefore, it would also be essential to have political will at various levels of government.

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