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CONTENTS

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CONTENTS

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Editorial Announcement

We note with profound sadness the untimely passing of Professor John Tiley CBE LLD FBA QC (Hon), a founding member of the Editorial Board of the *eJournal of Tax Research*. Professor Tiley, a Fellow of Queens' College, founder of Cambridge University's Centre for Tax Law and a Fellow of the British Academy, was a pre-eminent tax law academic in the United Kingdom for three decades. In 2003, Professor Tiley became the first person to be appointed CBE for research in the tax field. He was also appointed an honourary Queen's Counsel in 2009.

Professor Tiley was an enthusiastic supporter of the *eJournal of Tax Research*, becoming one of the first members of the Editorial Board of the *eJournal of Tax Research* in 2003. His passing represents a great loss to tax academia in general and the *eJournal of Tax Research* in particular. On behalf of the *eJournal of Tax Research* and the School of Taxation and Business Law of The University of New South Wales, we wish to extend our deepest sympathy to his widow and children.

The *eJournal of Tax Research* plans to publish a special issue in 2014 to honour Professor Tiley's many contributions to tax law. This special issue will be edited by Professor Margaret McKerchar, a long-time friend of Professor Tiley. Please send your submissions to Professor McKerchar <m.mckerchar@unsw.edu.au> by 28 February 2014.

Binh Tran-Nam
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The developing international framework and practice for the exchange of tax related information: evolution or change?

Michael Dirkis* and Brett Bondfield[#]

Abstract

In an increasingly globalised economy it becomes more likely that taxpayers under investigation are not necessarily in the country of the relevant tax agency and the impacted revenues may be those of several jurisdictions. In order to ensure a rational consideration of this important issue in Australia it is crucial to understand the international organisational context and international instruments that underpin the practice of the Commissioner of Taxation's investigatory powers and their place in an internationalised commercial environment.

The areas of focus in this paper are: the increasing collaboration between Australia's domestic agencies when investigating tax minimisation that has an international dimension; the growth of international collaborative initiatives to improve the transparency and exchange of tax information (mainly driven through the Organisation for Economic Co-operation and Development (OECD)); developments in information exchange including Australia's comprehensive double taxation agreements; tax information exchange agreements; and the relevance of domestic legislative provisions such as ss 263, 264 & 264A of the *Income Tax Assessment Act 1936* (*ITAA 1936*).

1. INTRODUCTION AND CONTEXT[1]

In an increasingly globalised economy it becomes more likely that taxpayers under investigation are not necessarily in the country of the relevant tax agency and the impacted revenues may be those of several jurisdictions. In order to ensure a rational consideration of this important issue in Australia it is crucial to understand the international organisational context and international instruments that underpin the practice of the Commissioner of Taxation's investigatory powers and their place in an internationalised commercial environment.

This paper explores this issue in the context of the current concerns over the use of globalised commercial transactions to avoid or minimise domestic tax. These concerns are often put in terms of the abuse of tax havens and/or bank secrecy and the responses often summarised in the term: minimising harmful tax competition.

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[1] This paper draws upon earlier work by Michael Dirkis published as "Looking beyond Australia's Horizon: The internationalisation of Australia's domestic taxation information gathering and debt collection powers" in Michael Walpole and Chris Evans (Eds) Tax Administration: Safe Harbours and New Horizons (2009), 79.

The areas of focus in this paper are: the increasing collaboration between Australia's domestic agencies when investigating tax minimisation that has an international dimension; the growth of international collaborative initiatives to improve the transparency and exchange of tax information (mainly driven through the Organisation for Economic Co-operation and Development (OECD)); developments in information exchange including Australia's comprehensive double taxation agreements; tax information exchange agreements; and the relevance of domestic legislative provisions such as ss 263, 264 & 264A of the *Income Tax Assessment Act 1936* (*ITAA 1936*).

The paper commences with a brief consideration of the tax information gathering powers available to the Commissioner under the *ITAA 1936*. Following that the domestic collaborative tax investigatory arrangements are detailed to provide a comparison to the international tax information gathering and exchange initiatives in which Australia is involved. The purpose of this approach is to explore the expanding internationalised framework for the exchange of tax information and its relevance to Australia.

2. THE AUSTRALIAN DOMESTIC PERSPECTIVE

2.1. Historic limitations of access to international information using the *Income Tax Assessment Act 1936*

The Commissioner of Taxation has three broad statutory powers to collect information in respect of income tax. The Commissioner has a general power of access to information under s 263 of the *ITAA 1936*[2] and to gather information and evidence under s 264of the *ITAA 1936*[3]. Despite the breadth of these provisions it was believe that they were ineffective where information was located offshore[4] therefore s 264A was enacted in 1991.[5]

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[2] A similar access power also is available in respect of the Goods and Services Tax (GST) under s 353-15 of the Taxation Administration Act 1953 (Tax Administration Act). For a more detailed analysis of the operation of s 263 see Robin Woellner, "Section 263 powers of access - why settle for second-best?" (2005) 20 Australian Tax Forum 365 and Michael Dirkis, "1984 Revisited? - Review of the Commissioner of Taxation's powers under section 263 of the Income Tax Assessment Act 1936" (1989) 12 Adel LR 126.

[3] A similar information and evidence gathering power also is available in respect of the GST under s 353-10 of the Taxation Administration Act. See generally: Ken Lord, "International tax cooperation: Recent trends and challenges (Part 1)" (2010) 13 The Tax Specialist 272. For a more detailed analysis of the operation of s 264 see Michael Dirkis, "An Orwellian Spectre - A review of the Commissioner of Taxation's powers to seek information and evidence under section 264 of the Income Tax Assessment Act 1936 and under section 10 of the Crimes Act 1914 (Cth)" (1989) 12 Adel LR 63. Search warrants are now issued by a Court to the police under s 3E of the Crimes Act 1914 and can be used to search premises and seize documents where there is evidence of a tax law crime, but as it is not a power exercised by the Commissioner they are not discussed.

[4] Paul Keating, Commonwealth, *Taxation of Foreign Source Income: An Information Paper* (1989). As regards their use within DTAs see B L Jones, "The Use of the Commissioner's Formal Powers and Requests for the Exchange of Information under Double Tax Agreements" (2001) 30 Australian Tax Review 39.

[5] *Taxation Laws Amendment (Foreign Income) Act 1991*. The following analysis of s 264A updates earlier work in Michael Dirkis, "Australia: Over there, but undeclared - offshore information" (1995) 49 Bulletin for International Fiscal Documentation 466-71.

The first problem is that the general access power under s 263 relies on the documents or person being located in Australia, as does the Commissioner's power under s 264 to compel a person to submit to an oral examination. Therefore, they are inapplicable where the materials or persons are located offshore. Similar problems arose with the Commissioner's powers to compel production of documents under s 264. These powers are based on the presumption that the person served with a s 264 notice has control of the documents. Even though the High Court has held that s 264 "is not concerned with the legal relationship of the person to whom the notice is given to the documents which he is required to produce: it is concerned with the ability of the person to whom the notice is addressed to produce the documents"[6] it is often difficult to establish who has control in complex commercial structures.[7] However, it has been held that a s 264 notice can be effective in accessing information held domestically that relates to a foreign jurisdiction.[8]

The Full Federal Court has recently held that a bank was required to produce certain information, held in Australia, relating to clients' accounts in an offshore subsidiary and it was no defence to the validity of the notice that such disclosure may conflict with the bank secrecy laws of the foreign state.[9]

To overcome limitations with ss 263 and 264 when the powers were applied to international transactions, s 264A was introduced in 1991. In general, s 264A empowers the Commissioner to issue an "offshore information notice" to a taxpayer requiring the taxpayer to produce information in a specified period. Failure to comply will trigger evidentiary exclusionary sanctions that deny the admission of information that was the subject of the notice (or secondary evidence of that information) in proceedings where the taxpayer challenges their assessment. As the evidentiary sanction is only available where the taxpayer seeks to challenge an assessment issued by the Commissioner, s 264A's coercive impact may also limited in cases where the requested information, if provided, is considered by the taxpayer likely to increase their liability. However, a s 264A notice may be effective in causing relevant information that may be adverse to the Commissioner's position to be disclosed early in the investigatory process.[10]

Since being introduced in 1991 there has been some judicial consideration of s 264A. In *FH Faulding and Co Ltd v FCT* (1994) 54 F CR 75 s 264A was held to be constitutionally valid with the court also considering the administrative law that underpinned the issue of a notice.[11]

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[6] *Federal Commissioner of Taxation v Australia & New Zealand Banking Group Ltd ("Smorgon case")* [1979] HCA 67 Gibbs ACJ at 5.

[7] For a detailed discussion on the international limitations of Australia's information gathering powers see Michael Dirkis "Foreign Income: Out of sight: not out of mind" (1992) 1(1) *Taxation in Australia Red Edition*, 26-33.

[8] *Australia and New Zealand Banking Group Limited v Konza* [2012] FCAFC 127 (12 September 2012). See also: Angela Lee "The Commissioner's power to obtain foreign bank account details under s 264" (2012) 47 *Taxation in Australia* 331.

[9] Ibid.

[10] Ken Lord (2010), above n 3 at 280.

[11] *Pilnara Pty Ltd v FCT* 99 ATC 5343 considered *FH Faulding* and provided further guidance on the required substance of a s 264A notice. A similar provision in Canada's tax legislation has been considered to have a broad scope: s 231.6 of the *Income Tax Act 1976* (Can.) in *John Merko v The Minister of National Revenue* (1990) 90 DTC 6643.

In conclusion, it can be seen that the domestic information gathering powers of the ATO under the *ITAA 1936* have remained unamended for a considerable time. Before exploring the more dynamic international environment the development of collaborative investigatory techniques within Australia is considered.

2.2. Wickenby: the collaborative present

Recently there has been an increased public profile of the Australian Taxation Commissioner's access and information gathering powers, with widespread media coverage of the ongoing cross agency taskforce: Project Wickenby that is led by ATO[12] and was established in 2006.[13] The stated overall objective of this project is to:

> "Make Australia unattractive for tax fraud and evasion, as both promoters and potential participants perceive the risk/benefit ratio as weighing heavily against them. To achieve this objective, four primary goals have been identified:
>
> a. Reduce international tax avoidance and evasion on the Australian taxation system.
> b. Enhance strategies and capabilities of Australian and international agencies to collectively deter detect and deal with international tax evasion.
> c. Improve community confidence in Australian regulatory systems, particularly confidence that the Australian Government addresses serious non-compliance with taxation laws.
> d. Reform administrative practice, policy and legislation."[14]

The government asserts that Project Wickenby remains important to its "fight against the use of secrecy jurisdictions by people to avoid paying tax" and allocated the agencies involved in it additional funding totalling $76.8 million in the 2012 budget.[15] This should not be confused with the high profile prosecutions[16] that arise from

[12] The taskforce includes the ATO, the Australian Crime Commission (ACC), the Australian Federal Police, the Australian Securities and Investments Commission, the Attorney-General's Department, the Commonwealth Director of Public Prosecutions, and the Australian Transaction Reports and Analysis Centre.

[13] For example: Hannah Low, "Wickenby target Agius jailed for seven years", *The Australian Financial Review*, 24 August 2012, 6. A section of the ATO website lists major Project Wickenby announcements from its inception in 2006 at URL: http://www.ato.gov.au/corporate/content.aspx?menuid=0&doc=/content/00220075.htm&page=20&H20 accessed on 26 January 2013.

[14] Project Wickenby terms of reference at paragraph 4. Located at URL: http://www.ato.gov.au/corporate/content.aspx?menuid=0&doc=/content/00220075.htm&page=24#P751_49658 located on 26 January 2013.

[15] This additional funding is for the period to 30 June 2015 and includes funding for an independent review of Project Wickenby, see: Assistant Treasurer and Minister Assisting for Deregulation, "Maintaining the cross-agency approach to preventing abuse of secrecy jurisdictions (Project Wickenby) and other tax compliance measures", Press Release No 24, 8 May 2012 located at URL: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/024.htm&pageID=003&min=djba&Year=&DocType=0 on 26 January 2013.

[16] The last media release of a prosecution referring to Operation Wickenby was in May 2010: Australian Crime Commission and Australian Tax Office, "Operation Wickenby—Tax fraud jails Perth accountant for 13 months", Joint Media Release, 13 May 2010 located at URL: http://www.crimecommission.gov.au/media/operation-wickenby%E2%80%94tax-fraud-jails-perth-accountant-13-months on 10 September 2012. For an example prior to this see: Mark Dunn, "Wealthy battle Operation Wickenby tax probe", Heraldsun.com.au, 5 June 2009 located at URL:

Operation Wickenby that was led by the Australian Crime Commission (ACC) since 2004 that is a component of Project Wickenby. Operation Wickenby was in place to develop intelligence on, investigate, and prosecute promoters and participants who facilitate and profit from abusive tax haven arrangements. It also provided for the application of the ACC's investigative and intelligence resources in close collaborations with agencies including the ATO and the Australian Federal Police.[17]

Regardless of whether it is Operation or Project Wickenby many of the significant transactions under investigation are across international borders. Thus information gathering needs to be able to follow and substantiate each step in a transaction regardless of the jurisdiction. This complexity was focussed on in late 2011 as part of the ACC's announcement that it was discontinuing its high profile investigation relating to the Australian born actor Paul Hogan and his business associate John Cornell:

> The ACC has been investigating this matter since 2005. The delay in resolving this long running investigation hinges on the international complexity of the structures put in place by those who are the subject of the investigation *and a clear strategy by those being investigated to legally challenge the ACC's attempt to establish the facts in the case*. [emphasis added][18]

Paul Hogan, litigated aspects of the ACC's investigation into his tax affairs twice in the High Court.[19] He and his associates also litigated the legality of the ATO's gaining access to information relating to their tax affairs. This litigation focussed on the fact that much of the information was originally obtained by the ACC and it was argued that the ATO was not entitled to have obtained the material on the grounds of administrative law and practice[20] as well as claims of legal professional privilege.[21] Though some claims of legal professional privilege were upheld, the ATO's power to access the information in the circumstances was upheld.

Given that collaborative investigations are very often complex, relationships between agencies are tested. In the case of Paul Hogan and his associates it is reported that the ATO had taken steps to progress matters independently of its Wickenby partners,

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http://www.heraldsun.com.au/news/wealthy-battle-operation-wickenby-tax-probe/story-0-1225721980979 on 26 January 2013.

[17] Australian Crime Commission, "What is the difference between Project Wickenby and Operation Wickenby?", located at URL: http://www.crimecommission.gov.au/node/108 on 7 September 2012. The ACC's ability to apply its coercive powers to Wickenby matters is now covered by the *Targeting Criminal Wealth Special Investigation* approved by the ACC Board on 15 June 2011 located at URL: http://www.crimecommission.gov.au/our-work/determinations on 12 September 2012.

[18] Australian Crime Commission, "Investigation Update", Media Release, 23 November 2010, located at URL: http://www.crimecommission.gov.au/media/investigation-update on 7 September 2012.

[19] *Hogan v Australian Crime Commission & Ors* [2009] HCATrans 252 (2 October 2009), *Hogan v Australian Crime Commission & Ors* [2010] HCATrans 4 (4 February 2010), culminating with *Hogan v Australian Crime Commission* [2010] HCA 21 (16 June 2010).

[20] *Stewart & Ors v DCT* [2011] FCA 336 (8 April 2011).

[21] *Australian Crime Commission v Stewart & Ors* [2012] FCA 29 (30 January 2012) affirmed by the Full Federal Court in: *Stewart v Australian Crime Commission* [2012] FCAFC 151 (29 October 2012).

frustrated with the slow progress of the ACC.[22] As set out previously the ACC discontinued its investigations citing cross border complexities and it is reported that the ATO has reached a confidential settlement in its dispute with Paul Hogan.[23]

The internationalisation of transactions noted above requires an international approach to support investigating those transactions. In the tax context this was historically supported by bilateral tax treaties.

2.3. Historic limitations of domestic access to, and exchange of, international information using Article 26 of the OECD Model Convention

The current OECD exchange of information article is Article 26 in the Model Tax Convention on Income and Capital (the Model Convention).[24] Exchange of information articles have been an essential aspect of the various OECD Model Conventions (Double Tax Agreements (DTAs)) since 1963 and were part of many earlier DTAs.[25] Thus, the process in respect of enhancing exchange of information between tax authorities has had a long history.

According to Burns and Woellner the scope of these exchange of information articles could be historically classified as ranging from a narrow or limited exchange model (such as the Swiss DTA), a United Kingdom colonial model (such as 1968 United Kingdom and the 1969 Japan DTA), the 1977 and 1992 OECD models (the modern models) and a compulsion model (the 1982 United States DTA).[26]

The historic express limitations on these exchange of information articles include:

- The fact that the information requested can only relate to taxes to which the agreement applies. For example, a request for GST information need not be complied with by the foreign State, as GST lies outside the agreement.[27]
- That a Contracting State is not obliged to supply information that would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.
- That the exchange of information articles may be limited by the Convention and by any other ". . . subsequent agreement or practice of the parties or

[22] Susannah Moran, "ATO's Paul Hogan probe to defy Operation Wickenby" 22 July 2008, *The Australian.* Located at URL: http://www.theaustralian.com.au/news/nation/atos-hogan-probe-to-defy-wickenby/story-e6frg6nf-1111116978762 at 26 January 2013.

[23] Adele Ferguson, "Tax Office leads surplus cash drive", 10 September 2012, *The Sydney Morning Herald*, Business Day page 1.

[24] The history and operation of Article 26 is briefly explained on the OECD website at URL: http://www.oecd.org/ctp/taxtreaties/article26oftheoecdmodeltaxconventiononincomeandcapital.htm located on 26 January 2013.

[25] An exchange of information clause was part 1928 League of Nations model convention and included as Article XIII of Australia's first DTA with the United Kingdom. The DTA was signed on 29 October 1946 and incorporated into the Third Schedule of *ITAA 1936* by the *Income Tax Assessment Act 1947* (Cth).

[26] Lee Burns and Robin Woellner "Bilateral and Multilateral Exchanges of Information" (1989) 23 *Taxation in Australia* 656, 658. Under Australia's current DTA policy a number of earlier existing DTAs would not be negotiated as the countries do not have robust internal information gathering powers and bank secrecy rules operate (e.g. the Philippines and Indonesia).

[27] OECD, *Model Double Tax Convention on Income and on Capital, Report* (1977), 184.

relevant rules of international law".[28] However, the extent to which the treaties limit the operation of such articles will depend upon their incorporation into Australian law.[29]

There are three fundamental principles which underlie the use of these articles: secrecy, necessity and reciprocity.[30] However, due to the undermining of these three fundamental principles by governments, practical limitations have historically arisen. In many jurisdictions revenue authorities' access powers can be extremely limited by domestic judicial restraint and/or their having a narrow scope (i.e. specific categories of information being exempted) and/or by local laws (i.e. bank secrecy and privacy laws).[31]

How the treaty powers are used is the other practical limitation on the effectiveness of treaties to obtain information held offshore. Often governments and tax administrators will have a strong arsenal of information gathering and exchange powers but are either incapable or unwilling to use them. Examples of operational weakness in the international context could include:

- the reluctance of some governments to provide information;
- the lack of power to ensure that the treaty partner provides timely information; and
- that some revenue offices may not pursue information from third parties.

From the foregoing it is demonstrated that there were very real constraints for the Commissioner to obtain overseas information. The followings sections of the paper explore whether the most current developments in tax information exchange represent significant change or evolution and then consider their effectiveness.

3. THE EVOLVING INTERNATIONALISED ENVIRONMENT OF TAX ADMINISTRATION

3.1. Introduction

The scale of domestic exposure to tax minimisation and evasion through the use of tax havens alone is demonstrated by Australians sending an estimated $16 billion to offshore tax havens in just one year (2008).[32]

[28] Article 31(3) of the *Vienna Convention on the Law of Treaties.* This follows from the acceptance by the High Court in *Thiel v Federal Commissioner of Taxation* (1990) 171 CLR 338, 356 that the *Vienna Convention on the Law of Treaties* could be used in interpreting Australian treaties.

[29] *Minister of State for Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR 275.

[30] Lee Burns and Robin Woellner (1989) above n 26, 660.

[31] Some specific examples of these protected categories are the papers of a tax adviser or statutory appointed auditor are safe from disclosure in the United Kingdom and in the United States, the Internal Revenue Service is only given limited access to Church papers. Similar limitations also occur in Australia where the information sought on behalf of a Contracting State is subject to legal professional privilege.

[32] Assistant Treasurer, "Anti-Tax Evasion Strategy Paying Major Dividends", Press Release No 73, 20 October 2009 located at URL: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/073.htm&pageID=003&min=njsa&Year=2009&DocType=0 on 26 January 2013.

An evolutionary driver in the tax environment is the challenge of the design of a nation's tax system being "generally structured around national jurisdictions but economic activity and the flow of people and finance [are] becoming increasingly global."[33] While, in theory, public international law does not impose any limitations on a government's power to tax, under private international law sovereign nations cannot enforce the laws of foreign governments in a home jurisdiction to collect taxes levied in a foreign country,[34] except where formal reciprocal enforcement agreements exist between states.[35] This creates a substantial limitation on the ability of revenue authorities to exercise the essential taxation administrative processes (such as information gathering) needed to counter cross border tax avoidance and evasion.[36]

With the trade in services outstripping the trade in goods and the communications revolution there is a reduced need for traditional physical linkages to tax jurisdictions. These developments in this increasingly borderless world have given rise to concerns about the increase in the risk of cross border tax avoidance and evasion and the ability of revenue authorities to counter these activities.[37]

This challenge is in part being met through the formalisation of the international relationships between revenue authorities, which has aided in the internationalisation of domestic taxation information gathering and debt collection powers through unilateral and bilateral treaties.

These initiatives are discussed in the following sections of this paper after a review of current international trends in responding to offshore tax evasion through transparency and information exchange. In doing so the parallel to the domestic landscape should not be forgotten. The identified challenge of offshore tax evasion to Australia has led to a change in approach with Project Wickenby that brought with it advantages and tensions.

3.2. Evolution of cooperative organisms within the internationalised tax administration environment

Australia's active involvement in forums and bodies seeking to deal with tax administration issues raised by trans-border transactions can be traced back to 1919.[38]

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[33] Item 5 National Tax Liaison Group (NTLG) minutes 20 March 2007 referencing Michael D'Ascenzo, "Commissioner's reflections on 2006 and thoughts for the coming year" (2006).

[34] Eg see United Kingdom precedent (*In re Visser* [1928] 1 Ch 877, 884, *Government of India v Taylor* [1955] AC 491) and in Australia (*Jamieson v Commissioner for Internal Revenue* [2007] NSWSC 324 and *Foreign Judgments Act 1991* (Cth), ss 3(1) and 5(4)).

[35] Eg, see *The Reciprocal Enforcement of Judgments Act, 1959 (Qld)* and *Hunt v BP Exploration Co. (Libya) Limited* (1979) 144 CLR 565.

[36] For a detailed discussion on the international limitations of Australia's information gathering powers see Michael Dirkis (1992) above n 7 and Michael Dirkis (1995) above n 5.

[37] Jeffrey Owens, Director of the Center for Tax Policy and Administration at the Organisation for Economic Co-operation and Development (OECD), testifying before the United States of America's Senate Finance Committee on Offshore Tax Evasion (May 2007) cited in Australian Taxation Office, *Tax havens and tax administration* (October 2007), 6. Copy located at URL: http://www.ato.gov.au/businesses/content.aspx?doc=/content/46908.htm accessed on 26 January 2013.

[38] As early as 1919 the then Dominions of Australia (represented by Mr GH Knibbs CMG (Commonwealth Statistician)), Canada, India, New Zealand and South Africa participated in a sub-committee of the United Kingdom's Royal Commission on the Income Tax to discuss their views on double taxation within the empire – see Commonwealth, Royal Commission on Taxation, Reports

A current feature of this international context is the rate of their proliferation and power, especially in the burgeoning field of transparency and information exchange. As will be explored in the following sections, these initiatives include standing bodies under the umbrella of the OECD, multilateral arrangements between revenue authorities and the impact of US unilateral action on bank secrecy.

The OECD is the most active international organisation in the area of transparency and tax information exchange. The OECD's involvement in this area can be traced from the OECD Committee on Fiscal Affairs (CFA) that was established in 1971 and the various forums, sub groups, technical advisory groups established under this initiative, in particular, five working parties on specific taxation topics.[39]

The main OECD tax administrative forum is the Forum on Tax Administration (FTA), which was created by the CFA in June 1997 (as the "Forum on Strategic Management") to act as the focal point for CFA work on tax administration.[40] The FTA seeks to enhance co-operation between revenue bodies at commissioner-level with participation from 43 countries, including every G20 member and selected non-OECD countries.[41] It provides a forum through which tax administrators "can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world".[42]

The following section illustrates the evolution of a major international forum in response to international tax avoidance and harmful tax competition. This OECD body will be used as illustrative of initiatives that focus on transparency and exchange of tax information. The issues of the expense and effort required to obtain and use tax related information in the domestic context discussed earlier in this paper need to be borne in mind when reflecting on the potential effectiveness of these international initiatives.

3.3. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes

Australia is a member of the OECD's Forum on Harmful Tax Practices, another subsidiary body of the CFA. The forum was established following the endorsement by OECD Ministers in May 1999 of the April 1998 OECD report on harmful tax competition entitled *Harmful Tax Competition: An Emerging Global Issue*.[43] The report was prepared following a request by the OECD countries to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases."[44]

(1920-24), 32, Edwin RA Seligman, , Double Taxation and International Fiscal Cooperation (1928), 47-50, and United Kingdom, Report of the Royal Commission on the Income Tax Cmd 615 (1920).

[39] For a detailed discussion of these forums see Michael Dirkis (2009) above n 1 and Jan Farrell "Current cross border arrangements with revenue authorities", presented at the Taxation Institute of Australia's NSW Corporate Intensive, 2 November 2007.

[40] The CFA changed the Forum's name and modified its mandate in June 2002.

[41] OECD, Forum on Tax Administration website located at URL: http://www.oecd.org/site/ctpfta/ on 26 January 2013.

[42] Ibid.

[43] OECD, *Harmful Tax Competition: An Emerging Global Issue,* 1998, located at URL: http://www.oecd.org/tax/harmfultaxpractices/1904176.pdf on 26 January 2013.

[44] Jeffrey Owens, "Curbing harmful tax practices" (January 1999) *OECD Observer,* 215.

The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes[45] (formerly the Global Forum on Taxation),[46] was established in 2000 by the OECD. Since 2000 the Global Forum has played a central role in the development and promotion of what are now internationally accepted standards of transparency and exchange of information across tax issues.[47] The internationally agreed tax standard was developed by the OECD in co-operation with non-OECD countries and endorsed by G20 Finance Ministers at their Berlin Meeting in 2004, then by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting.

The standard requires exchange of information *on request* in all tax matters where it is *foreseeably relevant* to the administration and enforcement of the domestic tax laws of the requesting jurisdiction without regard to domestic tax interest requirements or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged.[48]

The Forum consists of some 122 jurisdictions drawn from OECD countries and non-OECD members (referred to as committed jurisdictions) plus the European Union and 12 international organisations as observers. It is committed to the process of achieving the objective of a global level playing field based on high standards of transparency, effective exchange of information in tax matters and removing limitations such as excessive bank secrecy.

As part of a reform and strengthening process the Forum gained independent funding and a dedicated secretariat. Australia was elected for a two-year term as the inaugural chair of the reformed Global Forum.[49] The Global Forum's main achievements have been the development of the standards of transparency and exchange of information through the publication of the Model Agreement on Exchange of Information on Tax Purposes (TIEA) in 2002[50] and the issuance of a paper setting out the standards for the maintenance of accounting records.[51]

On an ongoing basis the main work of the Forum is to ensure that high standards of transparency and exchange of tax information are met through a comprehensive, rigorous and robust peer review process conducted by teams of expert, independent

[45] OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes website located at URL: http://www.oecd.org/tax/transparency/ on 26 January 2013.

[46] Treasurer, "Treasurer Opens 2005 Global Forum on Taxation", Press Release No 98, 15 November 2005, located at URL: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2005/098.htm&pageID=003&min=phc&Year=2005&DocType=0 on 26 January 2013.

[47] OECD above n 45.

[48] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Restoring Fairness to the Tax System (Information Brief April 2013)*, located at URL: http://www.oecd.org/tax/transparency/ on 26 April 2013.

[49] Assistant Treasurer, "Australia Elected Chair of Global Forum", Media Release 58, 24 August 2009. Located at URL: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/058.htm&pageID=003&min=njsa&Year=&DocType on 26 January 2013.

[50] OECD, *Model Agreement on Exchange of Information on Tax Purposes,* 2002, located at URL: http://www.oecd.org/ctp/exchangeofinformation/2082215.pdf on 26 January 2013.

[51] Joint Ad Hoc Group on Accounts, *Enabling Effective Exchange of Information: Availability Standard and Reliability Standard,* 2005, located at URL: http://www.oecd.org/ctp/harmfultaxpractices/42179473.pdf on 26 January 2013.

assessors and overseen by a 30 member Peer Review Group.[52] Considerable effort and resources have been devoted to this work since the Global Forum was restructured in 2009, with the following results:

- More than 1,100 exchange of information relationships have been established that provide for the exchange of information in tax matters to the international standard have been entered into since 2008;
- 126 peer reviews have been launched;
- 100 peer review reports have been completed and published;
- 652 recommendations have been made for jurisdictions to improve their ability to cooperate in tax matters;
- More than 68 jurisdictions have already introduced or proposed changes to their laws to implement the standard; and
- There has been continuous support by the G20, with 5 progress reports sent, including 1 f or the G20 Leaders' Summit in Los Cabos, Mexico in June 2012.[53]

3.4. Non-OECD initiative: Joint International Tax Shelter Information Centre (JITSIC)

A key arrangement to supplement the on-going work of identifying and curbing tax avoidance and shelters and those who promote them and invest in them was the creation of JITSIC in September 2004.[54] JITSIC consists of the tax administrations from nine member countries: Australia, Canada, Japan, United Kingdom, United States, South Korea, China, France and Germany and has offices in Washington and London.[55] The Commissioners have also made plans for the future development of JITSIC, along with measured expansion to cover Asia in addition to North America and Europe.[56]

JITSIC was established to support international co-operation for the identification, understanding and mitigation of risk arising from those who promote or take part in abusive tax schemes. JITSIC's focus is not limited to schemes involving tax secrecy jurisdictions nor to facilitating exchange of information. It extends to:

- obtaining and providing intelligence to support broader communication strategies aimed at increasing the community's awareness of the potential risks of promoting and investing in tax schemes;

- sharing practices and ideas on how to identify and address schemes;
  enhancing capability to use technology for the early identification of promoters and investors involved in schemes;

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[52] Global Forum on Transparency and Exchange of Information for Tax Purposes, *Restoring Fairness to the Tax System (Information Brief April 2013)*, above n 48.

[53] Ibid.

[54] For a copy of its memorandum of understanding go to URL: http://www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf accessed on 26 January 2013.

[55] Commissioner of Taxation, "Expansion of Joint International Tax Shelter Information Centre (JITSIC)", Media release 2007/17, 23 May 2007. Located at URL: http://www.ato.gov.au/corporate/content.asp?doc=/content/00100154.htm on 26 January 2013.

[56] Fraser Dickinson, "JITSIC: new initiatives on international tax avoidance" (29 January 2009) IBFD Tax News Service.

- identifying emerging trends and patterns to anticipate new abusive tax schemes; and
- improving knowledge of techniques used to promote cross-border abusive tax schemes.[57]

The ATO has invested considerable resources to its involvement in JITSIC and considers that "JITSIC participation is a key part of the Tax Office's overall strategy in dealing with aggressive tax planning."[58] By way of concrete example, in the 2010-11 year, the ATO worked with Canadian authorities via JITSIC to investigate a compliance issue with superannuation funds, uncovering $23.4 million in omitted tax.[59]

3.5. The outcomes of unilateral action: US *Foreign Account Tax Compliance Act* (FATCA)

FATCA was passed in March 2010 to improve compliance with US tax laws by imposing certain due diligence and reporting obligations on non-US financial institutions. The Act imposes a 30% withholding on US source payments to foreign financial institutions that do not participate/cooperate by supplying account information to the US Internal Revenue Service [IRS].

Intergovernmental agreements[60] (developed with France, Germany, Italy, Spain and the United Kingdom) may be entered into with the US in which the partner country agrees to require local financial institutions to report information on US account holders to local tax authorities. Under Model Agreements[61] local tax authorities will send information to the IRS *automatically*. If this is agreed financial institutions in the partner country are deemed compliant with FATCA and will not suffer nor make withholdings. To date there have been six such bilateral agreements signed by the US with the UK, Denmark, Mexico, Ireland, Switzerland and Norway.[62] The Treasurer has announced that Australia has entered into discussions with the US to negotiate an

[57] Commissioner of Taxation, "It's a small world after all - Australia's place in a Global Environment", Speech to the Australia Israel Chamber of Commerce, Melbourne, 5 July, 2012. Located at URL: http://www.ato.gov.au/corporate/distributor.aspx?menuid=0&doc=/content/00326002.htm&page=1#P89_19603 on 26 January 2013.

[58] ATO website, "Joint International Tax Shelter Information Centre (JITSIC)". Located at URL: http://www.ato.gov.au/atp/content.aspx?doc=/content/00103300.htm&mnu=49276&mfp=001 on 26 January 2013.

[59] Commissioner of Taxation, (5 July 2012) "It's a small world after all - Australia's place in a Global Environment", above n 57.

[60] US Treasury, "Treasury Releases Model Intergovernmental Agreement for Implementing the Foreign Account Tax Compliance Act to Improve Offshore Tax Compliance and Reduce Burden", Press Release 26 July 2012 located at URL: http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx on 26 January 2013.

[61] There are two types of Model Intergovernmental Agreement: Reciprocal and Non-Reciprocal and they are located respectively on the US Treasury website at URLs: http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf and http://www.treasury.gov/press-center/press-releases/Documents/nonreciprocal.pdf on 26 January 2013.

[62] The US Treasury, FACTA Treaty Resource Center website at URL: http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx located on 26 April 2013 contains links to these agreements. The UK agreement was entered into on 12 September 2012 followed by: Denmark (19 November 2012), Mexico (19 November 2012), Ireland (23 January 2013), Switzerland (14 February 2013) and Norway (15 April 2013).

Intergovernmental Agreement.[63] Under the negotiated UK/US agreement and the Model Agreements there is a commitment to enhance and expand automatic exchange of information.

3.6. Impact

The activities of the OECD, in particular the Global Forum on Transparency and Exchange of Information for Tax Purposes, have developed an international institutional framework to enhance and monitor tax information exchange. Three outcomes of the OECD's activities will be considered in the following section. These are the revised Article 26 of the Model Convention, the multilateral Convention on Mutual Administrative Assistance in Tax Matters and TIEAs.

As set out above there are initiatives that Australia is actively involved in such as JITSIC and FATCA which are outside the OECD processes. This gives rise to a multiplicity of avenues through which to obtain and provide tax information, spontaneously and/or on request, between jurisdictions. When compared to the Australian domestic environment, specifically Project Wickenby, we see b road parallels with the demonstrated need to develop complementary policy, administrative and legal responses and a tendency to formalise and expand bodies originally set up for a specific short term purpose.

4. THREE OUTCOMES OF THE OECD'S ACTIVITIES

4.1. DTA Reform: Article 26 of the Model Convention

4.1.1. Setting a context for assessing the evolution of Australia's exchange of information powers

Before discussing the specifics of Australia's exchange of information powers it is important to sketch the international currents that have shaped the environment in which those powers have grown. OECD forums have shaped DTA reform. From that reform, and informed by the debates that generated them, there have been changes in domestic law in respect of exchange of information between countries and mutual co-operation more generally.

The current OECD exchange of information article is Article 26 in the Model Tax Convention on I ncome and Capital (the Model Convention).[64] Exchange of information articles have been an essential aspect of the various OECD Model Conventions since 1963 and were part of many earlier DTAs.[65] Thus, the process in

[63] Deputy Prime Minister and Treasurer, "Australia and the US commence discussions on Foreign Account Tax Compliance Act", Press Release No 110, 7 November 2012 located at URL: http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/110.htm&pageID=003&min=wms&Year=&DocType=0 on 26 January 2013.

[64] The history and operation of Article 26 is briefly explained on the OECD website at URL: http://www.oecd.org/ctp/taxtreaties/article26oftheoecdmodeltaxconventiononincomeandcapital.htm located on 26 January 2013.

[65] An exchange of information clause was part 1928 League of Nations model convention and included as Article XIII of Australia's first DTA with the United Kingdom. The DTA was signed on 29 October 1946 and incorporated into the Third Schedule of ITAA 1936 by the Income Tax Assessment Act 1947 (Cth).

respect of enhancing exchange of information between tax authorities has had a long history.

In 2002 the CFA undertook a comprehensive review of the exchange of information Article: 26. Both the Model Agreement on Information Exchange on Tax Matters[66] (TIEA agreements) and the 2000 report on the ideal standard of access to bank information[67] were used by the Working Party on Tax Evasion and Avoidance as a basis for revising Article 26. A new Article 26 was adopted on 15 July 2005.[68]

The new Article attempts to enable the exchange of information to the widest possible extent adopting a foreseeable relevance test, allowing for the exchange of third party information and allowing the exchange of information outside the taxes dealt with by the convention (i.e. includes indirect taxes). To provide practical assistance to officials dealing with exchange of information for tax purposes the CFA approved a new Manual on Information Exchange on 11 May 2006. The Manual, developed with the input of both member and non-member countries, is also intended to assist in designing or revising national manuals.[69]

4.1.2. Article 26 of the OECD Model Convention

As well as entering TIEAs, the Australian government has placed an increased priority on exchange of information arrangements when negotiating DTAs. Currently Australia has 44 comprehensive DTAs and the special treaty with East Timor (governing activities in the Timor Sea).[70]

The revised Article 26[71] has been generally adopted in the 2009 DTA with New Zealand (that carried forward the 2005 amended provisions), Norway, France and Finland in 2006, Japan and South Africa in 2008, Belgium and Singapore in 2009, Chile, Malaysia and Turkey in 2010 and India 2011. As mentioned above the new article encourages the automatic exchange of information overcoming the short comings of the former Article 26. Further, the scope of the information that can potentially be exchanged under the new Article 26 is wide and includes GST

[66] The Model Agreement is available on the OECD website at URL: http://www.oecd.org/dataoecd/15/43/2082215.pdf at 26 January 2013.

[67] OECD, *Improving Access to bank information for tax purposes* (2000). Located at URL: http://www.oecd.org/tax/exchangeofinformation/2497487.pdf on 26 January 2013.

[68] OECD, *The 2005 Update to the Model Tax Convention* (2005). It had its basis in a Report (entitled OECD, *Changes to Articles 25 and 26 of the Model Convention* (2004)) adopted by the CFA on 1 June 2004.

[69] The Manual on Information Exchange can be found at URL: www.oecd.org/ctp/eoi/manual accessed on 26 January 2013.

[70] Argentina, Austria, Belgium, Canada, Chile*, China, Czech Republic, Denmark, Fiji, Finland, France, Germany, Hungary, India (but not 2011 Protocol*), Indonesia, Ireland, Italy, Japan, Kiribati, Republic of Korea, Malaysia, Malta Mexico, Netherlands, New Zealand, Norway, Papua New Guinea, Philippines, Poland, Romania, Russia, Singapore, Slovakia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Taipei, Thailand, Turkey*, United Kingdom, United States of America and Vietnam (*indicates that the tax treaty is not yet in force).Sourced from: Treasury, "Australian Tax Treaties", located at URL: http://www.treasury.gov.au/Policy-Topics/Taxation/Aus-Tax-Treaties/HTML on 26 January 2013.

[71] Article 26 was adopted by the OECD on 28 January 2003 following the OECD report, The 2002 Update of the Model Convention (2002). The history and operation of Article 26 is briefly explained on the OECD website above n 64.

information. However, any information provided under a tax treaty must relate to taxes to which the treaty applies.[72] Therefore the only jurisdictions with which GST information can be exchanged under DTA's are New Zealand, South Africa, Turkey, Norway, France, Finland and Japan.[73]

Underlying the new exchange Articles is a requirement for the competent authority (the ATO) to enter into a range of exchange of information protocols (memorandums of understanding) in order to reinforce exchange protocols by providing for a range of mechanisms to facilitate the exchange of information, usually spontaneously.[74] These protocols are normally supported by internal controls, including instructions to ATO staff.[75]

A number of major limitations remain, including the fact that:

- the exchanged information must be "foreseeably relevant" to the administration or enforcement of the tax laws of the other country (i.e. it must be established that the information is of some demonstrable benefit or assistance to the other country);[76]
- the information must be transmitted through the competent authority;[77] and
- the secrecy and privacy rules in respect of exchange of any material are generally tighter than that contained in the general Australian tax law.[78]

Thus, there are questions as to whether the new article will have any major impact.[79] In a recent speech the Commissioner made the point that the ATO was active and

[72] Practice Statement PS LA 2007/13: "Exchange of information with foreign revenue authorities in relation to goods and services tax under international tax agreements," Para 28(a).

[73] The access to information relating to GST and VAT taxes is achieved by either Art 26 prescribing that the exchange of information is not restricted by Art 2 (Taxes covered Article) or by inserting a specific paragraph in Art 2 that widens the scope of taxes covered specifically for the purposes of Art 26 eg: the tax treaties with France (Art 2(3)), Finland (2006) (Art 2(4)), Norway (2006) (Art 2(4)), South Africa (Art 2(4)) and Turkey (Art 2(3)).

[74] For a more detailed explanation of the process for exchange see Jan Farrell (2007), above n 39 at 5 to 7.

[75] For example PS LA 2007/13 above n 72 at Paras 7 to 9, identifies two classes of GST information that may be sent to foreign tax authorities or other foreign government agencies outside the express treaty authority. These classes are information that has already been made publicly available and information that does not directly or indirectly identify a taxpayer or other person even if the information is not publicly available (eg statistics about the GST paid by businesses in various industries or a description of a scheme whose participants cannot be identified directly or indirectly). The process for seeking voluntary cooperation from foreign sources for GST information, without the backing of a treaty, is set out in Practice Statement PS LA 2007/14: "Gathering and use of information from foreign agencies or sources in relation to goods and services tax, wine equalisation tax and luxury car tax administration."

[76] Despite the existence of the new Art 26 in the DTA between Singapore and India the High Court of Singapore in Controller of Income Tax v AZP [2012] SGHC 112 could not find the "requirement of foreseeable relevance" despite unsigned transfer instructions remitting funds to Company X's Singapore bank account where an Indian national did not admit to any connection between he and X. This and another transfer were amongst documents seized from the Indian national and three other associates.

[77] Ibid at Paras. 28(b) and (c).

[78] It is not possible to divulge the details of specific exchanges that have been made using our tax treaty network, as that would be a breach of Australia's international treaty obligations to foreign governments – see Item 5 of the National Tax Liaison Group meeting minutes of 20 March 2007.

[79] For example Controller of Income Tax v AZP [2012] SGHC 112 above n 76. The impact of the new Article is also dependent on the domestic laws of the relevant jurisdiction as pointed out by Andrew

enthusiastic in its exchange of information under DTAs. In fact some of Australia's major treaty exchange partners had presented the ATO with a series of "meritorious achievement" awards.[80] In the same speech the Commissioner referred to the use of the DTA provisions by the ATO, including a case where requests were made to multiple treaty partners to establish residency.[81]

Legal professional privilege remains as a significant limitation to the effective use of Article 26. In the long running litigation regarding Mr Petroulias relating to his conduct as an Assistant Commissioner of Taxation and as an officer of the ATO the ATO had sought the assistance of the New Zealand Inland Revenue Department (IRD) in 2004 to obtain documents held in New Zealand. In *Petroulias v FCT* [2010] FCA 1464, Mr Petroulias had sought an interlocutory injunction to restrain the Commissioner from accessing the documents received by the Commissioner from the IRD on the basis of a claim of legal professional privilege. As part of this litigation the request made by the ATO under Article 26 of the Australia New Zealand DTA was considered valid. On appeal it has been held that Mr Petroulias be able to argue the claim of legal professional privilege before the Full Federal Court.[82] This situation does demonstrate the difficulty in using the DTA exchange of information provisions to bring matters to a timely resolution where there are claims of privilege.

In a recent case arising from Project Wickenby the ATO's use of Article 26 (Article 27 in the 2003 Australia United Kingdom DTA in question) was tested from an administrative law perspective. In *Hua Wang Bank Berhad v Commissioner of Taxation (No 2)* [2012] FCA 938 it was claimed that the Commissioner's power to make a request was ultra vires where that request was made where his sole or dominant purpose was to gain an advantage in current legal proceedings (in this case under Part IVC of the *ITAA 1936*). In dismissing this aspect of the proceedings the court held that this proposition may be arguable but on the facts before there was no evidence that this was the sole or dominant purpose of the Article 27 request.[83] In considering Article 27 the Court observed that requests for information are made pursuant to the Commissioner's general power of administration[84] and are not limited

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Mills in "International Acts: Current Developments in Tax Treaties" presented at the Taxation Institute of Australia's National Convention, 13 March 2008. Mills argues that, in the context of discovery of documents under New Zealand law, the new Article 26 seems to have little impact. The High Court of New Zealand considered the impact of the new Article in Avowal Administrative Attorneys Ltd and Ors v District Court at North Shore and CIR CIV-2006-404-007264 (unreported interim judgment delivered in 2007). The case involved the ability of the taxpayers (including Mr Petroulias, a former Assistant Commissioner of Taxation in Australia) to discover pre-trial ATO information supplied to the New Zealand Internal Revenue Department (IRD) under Art 26. The issue before the Court was whether documents containing ATO requests for information, which were the basis upon which searches were performed on the taxpayer's premises, could be the subject of an order for discovery against the Commissioner of Internal Revenue. The High Court concluded they were bound by the decision of the Court of Appeal case of CIR v ER Squibb (1992) 14 NZTC 9. Consequently, the law in relation to the discovery of documents by taxpayers containing information requests under the Australia-New Zealand DTA would appear to remain the same as it was prior to the latest protocol.

[80] The treaty partners referenced were: the US, the UK and Japan: Commissioner of Taxation, (5 July 2012) "It's a small world after all - Australia's place in a Global Environment", above n 57.

[81] The treaty partners included the UK, Netherlands and New Zealand and related to $26.5 million in undeclared income: Commissioner of Taxation, Ibid.

[82] *Petroulias v FCT* [2011] FCA 795 (18 July 2011).

[83] *Hua Wang Bank Berhad v Commissioner of Taxation (No 2)* [2012] FCA 938 para 33-39.

[84] Ibid para 23-24.

to being authorised by s 23 of the *International Tax Agreements Act 1953 (Cth) (International Agreements Act*) (considered in the following section of this paper). Further that the DTA information exchange article did not of itself authorise the making of a request, rather it set out the responsibilities of the recipient of that request.[85] This may provide fertile ground for litigation of the domestic legal basis of Commissioner's decisions to request information through the DTA provisions.

4.1.3. Section 23 of the International Tax Agreements Act 1953 (Cth)

To give support to the new Article 26, a new s 23 of the *International Agreements Act* was enacted in 2006.[86] Section 23(1) expressly authorises the Commissioner to use the information-gathering provisions for the purpose of gathering information to be exchanged under both DTAs and TIEAs. The information provided is not restricted to information relating to Australian tax.[87] The "information-gathering provisions" are any taxation law provision that allows the Commissioner to:

- access land, premises, documents, information, goods or other property;
- require or direct a person to provide information; or
- require or direct a person to appear before the Commissioner or an officer and give evidence or produce documents.[88]

The term "taxation law" is also broadly defined in the *Income Tax Assessment Act 1997* (*ITAA 1997*) to be any act administered by the Commissioner and any regulation made under such an act; thus, the potential scope of the information that may be exchanged is wide and includes information regarding the GST.

Despite these changes, it is not certain that the new s 23 overcomes the argument that if a request for access under s 263 of the *ITAA 1936* is made for purposes of the *International Agreements Act*, that request is beyond the Commissioner's power. The illegality arises because s 263 may not have been effectively incorporated by s 4 of the *International Tax Agreements Act* as the operation of s 263 is limited to purposes of the *ITAA 1936* (ie "this Act").[89] However, in reality, any challenge to s 263 will merely gain a taxpayer time and inconvenience the Commissioner. The issue of the validity of incorporation into the *International Tax Agreements Act* does not arise in respect of s 264 as it is not subject to an express restriction.

Finally, the new s 23(2) of the *International Agreements Act* ensures that the disclosures will not violate the secrecy provisions. Consequential amendments have

[85] Ibid para 21-22. Though not impacting on the point discussed above, in *Hua Wang Bank Berhad v Commissioner of Taxation* [2013] FCAFC 28 the Full Federal Court refused leave to appeal by the bank which argued that compliance with a notice would require employees of the bank to breach the *International Banking Act 2005* (Samoa).

[86] By Schedule 2 of the *International Tax Agreements Amendment Act (No 1) 2006*.

[87] *International Agreements Act*, s 23(3).

[88] *International Agreements Act,* s 23(4).

[89] See: "Limitations on the use of s 263, where access is sought to satisfy the Commissioner's obligations under double tax agreements", [1993] *Butterworths Weekly Tax Bulletin*, Para 158. See also B L Jones (2001) above n 4, 46 and Ken Lord (2010) above n 3, 276-277.

also been made to the *Taxation Administration Act* to ensure that such disclosures are not a breach. These amendments apply to requests for exchange of information made from 15 September 2006, provided the relevant international agreement under which the request was made has entered into force.[90]

4.2. Convention on Mutual Administrative Assistance in Tax Matters

A major development outside of the Model Convention occurred in the late 1980's, when the OECD and the Council of Europe jointly developed a Convention on Mutual Administrative Assistance in Tax Matters.[91] The Convention was opened for signature on 25 January 1988 and entered into force in 1995. It covers all taxes and allows exchange of information, multilateral simultaneous tax examinations and assistance in tax collection. It provides extensive safeguards to protect the confidentiality of the information exchanged.

In April 2009, the G20 called for action "to make it easier for developing countries to secure the benefits of the new cooperative tax environment, including a multilateral approach for the exchange of information."[92] In response, the OECD and the Council of Europe developed a Protocol that came into effect on 1 June 2011[93] amending the multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Protocol made the Convention consistent with the international standard on exchange of information for tax purposes developed by the Global Forum and opened it up to all countries (previously membership was limited to members of the OECD and of the Council of Europe).[94]

Australia has become a signatory to the Convention on Mutual Administrative Assistance in Tax Matters. It has lodged its instrument of ratification with OECD with the Convention to enter into force for Australia on 1 December 2012.[95] In August 2012 the Joint Standing Committee on Treaties had recommended the Convention be

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[90] The treaties with New Zealand, Norway, Finland, Japan, France and South Africa have all entered into force.

[91] Copy of the Convention and explanatory materials can be found at URL http://www.oecd.org/ctp/exchangeofinformation/Convention_On_Mutual_Administrative_Assistance_inTax_Matters_Report_and_Explanation.pdf accessed on 26 January 2013.

[92] Referenced on the OECD website at URL: www.oecd.org/ctp/eoi/mutual accessed on 26 January 2013.

[93] Copy of the amending Protocol can be found at URL: http://www.oecd.org/ctp/exchangeofinformation/2010_Protocol_Amending_the_Convention.pdf accessed on 26 January 2013.
As at 1 March 2013 there were 43 signatories to the amended Multilateral Convention: Albania Argentina, Australia, Belgium, Brazil, Canada, Colombia, Costa Rica, Czech Republic, Denmark, Finland, France, Georgia, Germany, Ghana, Greece, Iceland, India, Indonesia, Ireland, Italy, Japan, Korea, Lithuania, Malta, Mexico, Moldova, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russia, Slovenia, South Africa, Spain, Sweden, Turkey, Tunisia, Ukraine, United Kingdom, and United States. Information located at URL: http://www.oecd.org/directorates/guatemalacommitstointernationalexchangeoftaxinformation.htm on 26 April 2013.

[95] Assistant Treasurer and Minister Assisting for Deregulation, "Australia Ratifies Multilateral Tax Cooperation Agreement", Press Release No 114, 5 October 2012 located at URL: http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/114.htm&pageID=003&min=djba&Year=&DocType on 26 January 2013.

ratified.[96] In doing so the Committee noted that the Convention will "complement Australia's network of comprehensive tax treaties and TIEAs by providing an additional tool for detecting and preventing tax evasion as well as recovering outstanding tax debts."[97] It was further noted that no new legislation was required to implement the obligations imposed by the Convention.[98]

4.3. TIEAs

The Global Forum on Taxation's Working Group on Effective Exchange of Information was responsible the Model Agreement on Information Exchange on Tax Matters (TIEA) that countries can use to guide their bilateral negotiations. The Model Agreement is not a binding instrument. It covers information exchange upon request for both civil and criminal tax matters.[99] The Model Agreement incorporates important safeguards to protect the legitimate interests of taxpayers (i.e. disclosure can be declined if the information would disclose a trade or business secret or if the information is protected by the attorney-client privilege) and the information exchanged has to be treated as confidential.[100] There are now just fewer than 520 exchange of information agreements in place.[101]

Australia has concluded 34 TIEAs[102] all of which contain specific exchange of information provisions. Less than a third of those negotiations have resulted in a separate "Additional Benefits Agreement" (ABA). The list of countries with which these agreements have been made indicates that they are small and many are popularly

[96] Joint Standing Committee on Treaties, Report 127 Review into Treaties tabled on 20 March and 8 May 2012, tabled 15 August 2012 located at URL: http://www.aph.gov.au/parliamentary_business/committees/house_of_representatives_committees?url=jsct/20march2012/report.htm on 26 January 2013.

[97] Ibid at paragraph 4.36.

[98] Ibid at paragraph 4.28: "Australia is able to fulfil its obligations under the Convention under existing legislation, specifically, section 23 of the International Agreements Act in respect of exchange of tax information. Similarly, Division 263 of Schedule 1 to the Taxation Administration Act 1953 applies to any agreement in force between Australia and a foreign country that contains an article relating to assistance in collection of foreign tax debts."

[99] The Model Agreement specifically provides that information must be provided even where the requested country itself may not need the information for its own tax purposes. Contracting parties further agree that their competent authorities must have the authority to obtain and provide information held by banks and other financial institutions. However, countries are not at liberty to engage in fishing expeditions or to request information that is unlikely to be relevant to the tax affairs of a specific taxpayer a requesting country needs to demonstrate the foreseeable relevance of the information requested – see OECD, The OECD's Project on Harmful Tax Practices: The 2004 Progress Report (2004) at 13.

[100] Ibid.

[101] A list of jurisdictions and the TIEAs they have entered is located at: OECD website at URL: http://www.oecd.org/tax/transparency/exchangeoftaxinformationagreements.htm accessed on 26 January 2013.

[102] Sourced from: Treasury, Australian Tax Treaties- Tax Information Exchange Agreements, located at URL: http://www.treasury.gov.au/Policy-Topics/Taxation/Tax-Treaties/HTML accessed on 26 January 2013. These are: Bermuda (2005); Antigua and Barbuda and Netherlands Antilles (listed as an agreement with 2 states: Curaçao and Sint Maarten on the Organisation for Economic Co-operation and Development (OECD)'s table of tax treaties) (2007); British Virgin Islands (2008); Aruba, Cook Islands, Gibraltar, Guernsey, Isle of Man, Jersey and Samoa (2009); Anguilla, Bahamas, Belize, Cayman Islands, Dominica, Grenada, Marshall Islands, Mauritius, Monaco, Montserrat, San Marino, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Turks and Caicos Islands; Vanuatu (2010); Andorra, Bahrain, Costa Rica, Liberia, Liechtenstein and Macao (2011) and Uruguay (2012).

considered "tax havens" (now referred to as "low taxing jurisdictions"), but there may be a significant economic importance of TIEAs to Australia. For example, in 2004 Bermuda was the fourth leading investor into Australia investing $A2.2 billion.[103] In a recent speech the ATO Commissioner noted that in the 2010-11 financial year, funds leaving Australia to low taxing jurisdictions had decreased since 2007-08 by 22%,[104] the first TIEAs came into force in 2007.

As at 21 December 2009 only two out of the 11 TIEAs then signed had come into force and those were between Australia and Bermuda and the Netherlands Antilles.[105] As at 28 April 2013 only one signed TIEA was yet to come into force: Uruguay (signed 10 December 2012)).[106] TIEAs have not been given domestic force by legislation and it is unclear whether such legislation is required. This is despite the Joint Standing Committee on T reaties having recommended in February 2006 and again on 13 June 2007 that binding treaty action should be undertaken.[107]

Legislation is required to give effect to the ABAs.[108] Even though ABA's are not part of the information exchange of a T IEA they are an integrated part of the TIEA negotiation process.[109] ABA's generally cover the allocation of taxing rights over certain income derived by retirees, government employees and students and provide a mechanism to help resolve transfer pricing disputes.[110] Australia negotiated these types of agreements alongside the TIEAs in more than half (seven) of those 11 signed to December 2009, but very few ABAs were negotiated after that with nine in total at September 2012.[111] This change of approach has not been explained but may be linked to the Australian government being less inclined to provide benefits to other countries in more stringent economic circumstances post 2009.

Under the TIEAs a primary obligation exists between Australia and the specific treaty partner to exchange information upon request. There is no provision for the routine or voluntary exchange of information between the two parties. The information sought must be:

- relevant to the determination, assessment and collection of taxes;
- relevant to the recovery and enforcement of tax claims;

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[103]See Parliament of Australia, Joint Standing Committee on Treaties, *Report No 73* (2006), 31.
[104]Commissioner of Taxation, (5 July 2012) "It's a small world after all - Australia's place in a Global Environment", above n 57.
[105]Sourced from: Treasury, Australian Tax Treaties- Tax Information Exchange Agreements, above n 102.
[106]Ibid.
[107]See *Report No 73* above n 103 at 35, Recommendation 4 and Parliament of Australia, Joint Standing Committee on Treaties, *Report No 87* (2007), 24, Recommendations 3 and 4.
[108]International Tax Agreements Amendment Act (No 1) 2009.
[109]See: Treasury, Australian Tax Treaties- Tax Information Exchange Agreements, above n 102.
[110]For example: Treasury, "Australia-Isle of Man Tax Information Exchange Agreement" (30 January 2009) at URL: http://archive.treasury.gov.au/contentitem.asp?NavId=&ContentID=1467 at 26 January 2013.
[111]Treasury, Australian Tax Treaties- Tax Information Exchange Agreements, above n 102. Assistant Treasurer, above n 32 and Assistant Treasurer, "Another Boost for Tax Transparency Program" Press Release No. 110, 16 December 2009 at URL: http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/110.htm&pageID=003&min=njsa&Year=&DocType=0 at 26 January 2013.

- relevant to investigation or prosecution of tax matters; and
- treated confidentially by all parties.

Countries cannot engage in fishing expeditions or request information that is unlikely to be relevant to the tax affairs of the specific taxpayer. However, it is irrelevant whether the conduct being investigated is a crime under the domestic law of each treaty partner. Where the information available is insufficient to enable compliance with the request, each partner must use all relevant information gathering methods to furnish details to the other, even where it is not needed for domestic tax purposes.

The TIEAs Australia has negotiated are with states with which Australia does not have DTAs, most of which are considered low taxing jurisdictions. After this initial phase of negotiating and bringing most the TIEAs into force there is evidence they are being used. As at 1 July 2012 the ATO had made 53 exchange of information requests to 13 different TIEA jurisdictions, with several leading to significant assessments being issued by the ATO.[112] The Commissioner has also expressed the view that:

> In the majority of cases our TIEA partners have shown a high level of co-operation including providing additional information relevant to the request and in processing requests promptly.[113]

To date there is no reported litigation related to the garnering of tax information through TIEA requests.

It is apparent from the foregoing that the evolving cooperation between the various tax authorities has led to internationalised, as well as institutionalised, responses to tax evasion focussed on transparency and tax information exchange. As discussed, these initiatives are relatively recent and their effectiveness in protecting the revenue and influencing taxpayer behaviour will, in part, depend on how robust the information exchange measures are when challenged. The Australian domestic experience detailed in section 1 of this paper suggests that such challenges will often arise.

5. CONCLUSION

5.1 The Domestic perspective

Australia's domestic laws as regards ATO information gathering have not significantly changed in recent times. Sections 263 and 264 of the *ITAA 1936* have not been subject to significant revision for over 60 years.[114] Section 264A has been the subject of some litigation since its insertion in 1991 but this has not brought into question its validity or operational effectiveness. Finally s 23 of the *International Agreements Act* was inserted in 2006 but, as discussed at 4.1.3 of this paper, this did not represent a significant change.

[112] Commissioner of Taxation, (5 July 2012) "It's a small world after all - Australia's place in a Global Environment", above n 57. The main jurisdictions to which TIEA requests were made: British Virgin Islands (16 requests); Bermuda (11 requests); Isle of Man (7); and Jersey (6).
[113] Commissioner of Taxation, Ibid.
[114] Robin Woellner (2005), above n 2.

The significant domestic response to accessing tax related information in an internationalised commercial environment has been inter-agency cooperation. Project Wickenby has been deemed a success by government and its continued funding in the 2012 federal budget suggests it will have a permanent presence. This brings with it the tensions of coordination and cooperation between agencies detailed at 2.2 in this paper as well as increased avenues of legal challenge as demonstrated by the Paul Hogan litigation. There have been more recent legal challenges relating to the ATO's accessing international tax information, some of which have been considered in this paper: the Petroulias litigation and Hua Wang Bank Berhad. However, there is no evidence that Australia intends to change its domestic laws.

5.2 The internationalised environment to facilitate the exchange of tax related information

As discussed in part 3 of this paper an international institutional framework is starting to develop to facilitate the exchange of tax related information and promote tax information transparency more generally. This has been driven by the OECD, in particular the Global Forum on Transparency and Exchange of Information for Tax Purposes. The three specific outcomes of this activity considered in part 4 of this paper are: the revised Article 26 of the Model Convention and the multilateral Convention on Mutual Administrative Assistance in Tax Matters and TIEAs. As well there are initiatives outside the OECD processes that Australia is actively involved in such as JITSIC and FATCA.

5.3 Australia's evolving internationalised information gathering powers

By joining the multilateral Convention on Mutual Administrative Assistance in Tax Matters (effective 1 December 2012), adopting the model TIEAs and having enacted the domestic legislation and procedures to support the adoption of the new Article 26 in DTAs entered into since 2005, Australia has, for those new agreements, internationalised its exchange of information powers.[115] This represents a step in the evolution of Australia's exchange of information powers rather than some quantum leap. Firstly, this internationalisation only applies to those new agreements. Gradually, through the re-negotiation of pre-existing DTA's (on average a DTA has currency for 30 years) and the entering of new TIEAs this internationalisation will spread (most likely slowly in the case of DTA's). Secondly, internationalisation was occurring prior to these initiatives. They seek to enhance pre-existing measures and strategies in the arena of international information sharing. Thus it is unlikely there will be a marked sudden change of practice.

The ATO appears to have devoted considerable effort to the development and maintenance of these relationships in all its 78 tax information exchange agreements, both DTA and TIEA. There is an overlap between the parties to these 78 agreements and the 41 parties that are currently signatories to the Convention on Mutual Administrative Assistance in Tax Matters with Australia. Yet the ATO will have to

[115] John McLaren, "The OECD's "harmful tax competition" project: is it international law?" (2009) 24 Australian Tax Forum 423 argues that a number of the projects facilitated by the OECD, such as the OECD Model Tax Conventions and the 1979 OECD report on Transfer Pricing and Multinational Enterprises, have been adopted to a large extent by the Australian Government and transformed into Australian domestic law.

devote resources to the operation this new treaty as well as building relationships with any new counterparties the treaty includes. In addition, the ATO is actively involved in JITSIC and when the FATCA treaty with the US is concluded there will be yet another available source of international tax information. It can be expected that this multiplicity of information sources will be complex and resource intensive to manage.

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Interpreting tax statutes: imposing purpose on a results based test

Rodney Fisher*

Abstract

The general anti-avoidance provisions in Part IVA include specific provisions to bring within the scope of Part IVA those schemes which are by way of or in the nature of dividend stripping, and schemes having substantially the effect of a dividend stripping scheme. Judicial interpretation of the application of this provision has favoued a construction whereby purpose is implies as an element in the operation of the provisions, although there is no legislative requirement for a purpose.

This paper critically examines and evaluates this judicial construction, arguing that principles of statutory interpretation would suggest that the test in relation to identifying schemes having substantially the effect of dividend stripping is a test based on the effect or outcome of the scheme, and as such, purpose should not be a relevant consideration. It is suggested that the additional requirement for purpose changes the threshold test for the operation of the provision, which, from the legislation, is a results based test based on the effect or result of a scheme.

1. INTRODUCTION AND OUTLINE

This paper examines the judicial approach to statutory interpretation of results based taxation legislation, the particular example for analysis being s 177E in Part IVA of the *Income Tax Assessment Act* 1936. The current general anti-avoidance provision in Part IVA of the *Income Tax Assessment Act 1936* contains a general component requiring for its operation a scheme, a tax benefit, with a dominant scheme purpose being obtaining the tax benefit, with more specific components, including s 177E, providing conditions which are deemed to meet the requirements for the operation of Part IVA.

While the main focus of attention by the courts in the interpretation and application of the general anti-avoidance provision in Part IVA of the *Income Tax Assessment Act* (ITAA) 1936 ha s been directed to the general component, an arguably equally significant component of the anti-avoidance regime is contained in s 177E(1), which can operate to deem a scheme to be one to which Part IVA applies. Section 177E is attracted in circumstances where the scheme is 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

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This paper is concerned with an examination of the judicial interpretation of the alternative limbs in the threshold conditions for s 177E, being a scheme 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'. The paper is particularly concerned with an analysis of the judicial approach of implying the general threshold tests of a tax benefit and a dominant avoidance purpose, on provisions where the statue specifically excludes these additional threshold tests.

The approach taken is to outline the legislative provision and the purpose behind the statutory approach taken, as explained in the Explanatory Memorandum accompanying the bill, applying principles of statutory interpretation in understanding how the provision may operate. The analysis then critically examines the judicial interpretation of the provision in the light of the statutory purpose, as gleaned from the Explanatory Memorandum and applying principles of statutory interpretation.

2. LEGISLATIVE BACKGROUND

Australian federal income tax legislation has, almost since its inception, employed a general anti-avoidance provision to curb what were seen as abuses of the tax system by taxpayers seeking to minimise their income tax. The provision in force in unchanged form from the enactment of the *Income Tax Assessment Act* 1936 until the early 1980s was s 260,[1] which was a widely drafted provision broadly directed to making certain transactions void as against the Commissioner of Taxation. Prior to 1936, similarly worded Commonwealth legislation had been in operation.

However, from as early as 1921 courts had started to read down and limit the scope of the operation of these broadly drafted general anti-avoidance provisions, and by the late 1970s there had developed a stark contrast between the broad nature of the statutory language and the limited and restricted scope of operations afforded to the statutory provisions. A significant contributing factor, if not the decisive factor, in the emasculation of the general anti-avoidance provision in s 260 and the introduction of the replacement anti-avoidance provision in Part IVA was undoubtedly the literal approach to statutory interpretation of tax statutes followed by the Barwick High Court.

In broad terms, the limitations which courts had developed in restricting the intended operation of s 260 included:

[1] Section 260(1) applied until 27 May 1981, and provided that:
Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly:
(a) altering the incidence of any income tax;
(b) relieving any person from liability to pay any income tax or make any return;
(c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
(d) preventing the operation of this Act in any respect,
be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

- the choice principle, which precluded the operation of the anti-avoidance provision in circumstances where the principal act provided choices of forum for a taxpayer;
- the purpose was not that of the taxpayer but the purpose of the arrangement, and this could only be ascertained by examining the arrangement;
- when s 260 applied, it was unclear whether the section operated to wholly void an arrangement, or whether it could partly void an arrangement; and
- the Commissioner had no power to reconstruct a taxable transaction.

The government response to the judicially imposed limitations[2] was to introduce in 1981 a new general anti-avoidance provision, comprising a general component, and specific components. In broad terms, the general part of the provision applied when a scheme produced a tax benefit, and the dominant purpose of the scheme was the production of that tax benefit.[3] When the operation of the general component was attracted, the operative provisions allowed the Commissioner to amend a return, and make compensating adjustments to other returns.[4]

In addition to the provisions directed to anti-avoidance in general terms, s 177E(1) contained measures more specifically directed to preventing avoidance arrangements through the use of dividend stripping, which essentially involved a distribution being made in a more tax effective manner than would otherwise have been the case. It is with the provisions of s 177E that this paper is concerned.

3. SECTION 177E

The operation of s 177E[5] is structured such that there are four threshold tests which must all be satisfied to trigger the operation of the provision, these broadly being:

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[2] Primary limitations included the 'choice principle' whereby the section would not be operative if the principal act offered choices for a transaction; and the inability to reconstruct a taxable transaction if the transaction was made void by s 260.

[3] Section 177A defines a scheme; s 177C identifies a tax benefit; and s 177D provides matters to consider in the objective determination of the purpose of the scheme.

[4] Sections 177F & 177G.

[5] Section 177E(1) Where -
(a) as a result of a scheme that is, in relation to a company -
(i) a scheme by way of or in the nature of dividend stripping; or
(ii) a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping,
any property of the company is disposed of;
(b) in the opinion of the Commissioner, the disposal of that property represents, in whole or in part, a distribution (whether to a shareholder or another person) of profits of the company (whether of the accounting period in which the disposal occurred or of any earlier or later accounting period);
(c) if, immediately before the scheme was entered into, the company had paid a dividend out of profits of an amount equal to the amount determined by the Commissioner to be the amount of profits the distribution of which is, in his opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this subsection referred to as the "notional amount") would have been included, or might reasonably be expected to have been included, by reason of the payment of that dividend, in the assessable income of a taxpayer of a year of income; and
(d) the scheme has been or is entered into after 27 May 1981, whether in Australia or outside Australia;
the following provisions have effect:
(e) the scheme shall be taken to be a scheme to which this Part applies;

- a scheme by way of or in the nature of dividend stripping, or having substantially the same effect as a scheme by way of or in the nature of dividend stripping;
- the Commissioner forms the opinion that the disposal of property represents a distribution of profits of the company;
- if the company had paid a dividend out of profits immediately before the scheme was entered into, the amount might reasonably be expected to be included in assessable income; and
- the scheme was entered into after 21 May 1981.

In circumstances where all four threshold tests are satisfied, the provision provides for three consequences, broadly being:

- the scheme is a scheme to which the Part IVA provisions apply;
- the taxpayer is taken to have received a tax benefit (thus satisfying a threshold condition for the general Part IVA provisions); and
- the amount of the tax benefit is the notional amount that would have otherwise been included in assessable income.

It is significant that, unlike the general Part IVA provisions, s 177E(1) has no legislative threshold dependency on either an objective or subjective purpose of the taxpayer or the scheme. On meeting the threshold tests, s 177E(1) could arguably automatically apply, with the scheme being one to which Part IVA applied, and the taxpayer being deemed to obtain a tax benefit.

The consequence of making a dividend stripping scheme a scheme to which Part IVA applies was that the Commissioner could then cancel the tax benefit, and make compensating adjustments to assessments of other taxpayers.[6]

In explaining the need for a separate provision, the Explanatory Memorandum (EM) accompanying the Bill explained that while dividend stripping schemes may fall within the general provisions of Part IVA, it may not always be concluded that without the scheme the relevant dividend might reasonably be expected to have been included in assessable income, in which case there would be no identifiable tax benefit which could attract the operation of the general Part IVA provisions. To overcome this difficulty, s 177E provided a supplementary code to deal with dividend stripping schemes, and variations on these schemes, the effect of the schemes being to distribute company profits in a tax free manner, in substitution for a taxable dividend.[7]

The Explanatory Memorandum (EM) accompanying the Bill also suggested that s 177E(1) was intended to be a self-contained code to apply to dividend stripping schemes which effectively placed company profits in the hands of shareholders in a tax free form.[8] While it was not clear from the legislation whether s 177E(1) was

(f) for the purposes of section 177F, the taxpayer shall be taken to have obtained a tax benefit in connection with the scheme that is referable to the notional amount not being included in the assessable income of the taxpayer of the year of income; and

(g) the amount of that tax benefit shall be taken to be the notional amount.

[6] Sections 177F & 177G.

[7] *Explanatory Memorandum* accompanying *Income Tax Laws Amendment Bill (No 2)* 1981 p 3.

[8] EM at page 8.

intended to be an exclusive code in relation to dividend stripping arrangements, it would be expected that, as a matter of statutory construction, the existence of a special provision would prevail over the more general provisions of Part IVA.[9]

It is suggested that by placing the provision dealing with dividend stripping schemes outside of the general Part IVA threshold provisions, and by explaining in the EM that s 177E was intended to be a stand-alone code, the drafters were denoting a clear and manifest intention that the threshold conditions to attract the operation of s 177E would be separate and distinct from the threshold conditions under the general Part IVA rules. If this is the intention, then it is suggested that the threshold conditions for s 177E should stand alone, and not be read in conjunction with the threshold tests to attract the general Part IVA operation.

The critical threshold condition to attract the operation of s 177E(1) is the identification of a scheme 'by way of or in the nature of dividend stripping' or a scheme 'having substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

In identifying schemes 'by way of or in the nature of' dividend stripping schemes, the EM outlined a traditional dividend stripping scheme as involving a stripping entity which purchased shares in a target company with accumulated profits, with the stripping entity then paying former shareholders a capital sum that reflected those accumulated profits, and then drawing off the profits in a non-assessable form.[10] It would appear that the use of the wider terminology 'by way of or in the nature of' is to grant a wider purview to attract the operation of the provision than being limited to schemes which align with a traditional dividend stripping operation.

The use in the legislative provision of the terminology of 'schemes having substantially the effect' of a dividend stripping scheme must be seen as providing a potentially very wide ambit in relation to identifying such schemes, the intent being to preclude the use of variations on a theme to circumvent the first limb of s 177E(1)(a) or the general provisions in Part IVA. To identify schemes 'having substantially the effect' of a dividend stripping scheme it is necessary to identify what is the effect of a dividend stripping scheme, and the intent of the drafters is explained in the EM as "… the effect … is to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends".[11]

In relation to schemes having substantially the same effect as a scheme by way of or in the nature of a dividend stripping, the EM provides examples whereby the profits of the target company are not stripped by way of dividends, but by other transactions such as making irrevocable loans to associates of the stripper, or using profits to purchase near-worthless assets from an associate.[12] By the use of such devices the same result is achieved, namely to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends

[9] Broadly *generalia specialibus non derogant*; also see *Reseck v FCT* 75 ATC 4213.
[10] EM at page 9.
[11] EM page 3.
[12] EM at page 9.

Tax Ruling IT 2627 suggests a wider interpretation for a scheme having the effect of a dividend stripping scheme, with a scheme having the same effect as a dividend stripping scheme if company profits are stripped not only to a shareholder, but to an associate or other party.[13] Further, this second limb of the threshold test looks to the result or effect of the scheme, rather than the process undertaken. The example given is of a company with substantial accumulated profits owned by an individual who sells assets to the company for approximately ten times their real market value. While conceding that this arrangement may not strictly be a scheme by way of, or in the nature of, dividend stripping since there is no dividend or liquidator's distribution, the Ruling notes that it may well be a scheme having substantially the effect of such a scheme since it could involve the removal of profits of a company in a non-taxable form.[14]

It is suggested that this second test as to a scheme having substantially the effect of a dividend stripping scheme should be interpreted, then, in terms of the outcome or result of the scheme, looking more to the result achieved by the scheme rather than the nature or mechanics of the processes undertaken. This approach identifies a clear distinction between the two limbs in the threshold test, with the first limb looking to the nature of the scheme, suggesting a consideration of the steps or processes undertaken, while the second limb is concerned only with the outcome or effect of the scheme, thus being an outcome based test.

While this threshold condition in relation to the scheme is not the only test to be satisfied, in the absence of identifying such a dividend stripping scheme the remaining tests become redundant. The remainder of the paper is concerned with examining how this test has been interpreted and applied by the courts, and whether the interpretation adopted is the better reflection of the legislative intention.

4. INTERPRETING TAXATION STATUTES

Prior to an examination of judicial consideration as to the operation of s 177E, it is worth briefly noting the development in statutory interpretation of taxation statutes in particular, and some of the relevant principles of statutory interpretation, as they may be applied to s 177E.

As discussed earlier, it is generally considered that the Barwick era in the High Court saw a tendency for the High Court to adopt a more literal interpretation of tax statutes, particularly when such an approach would produce a result favourable to the taxpayer. Such an interpretation arguably reached its high water mark in the previously discussed case of *FCT v Westraders Pty Ltd*.[15] In this case, Barwick CJ expounded the view that:

> It is for Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. The function of the court is to interpret and apply the language in which the Parliament has specified those

[13] IT 2627 para 15.
[14] IT 2627 para 16.
[15] (1980) 11 ATR 24.

> circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament which is discoverable from the language used by the Parliament. It is not for the court to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve, though not expressed in the actual language employed.[16]

In his strongly worded dissenting judgement, Murphy J sought to limit the literal approach, expressing the view that:

> It is an error to think that the only acceptable method of interpretation is strict literalism. On the contrary, legal history suggests that strict literal interpretation is an extreme, which has generally been rejected as unworkable and a less than ideal performance of the judicial function.
>
> It is universally accepted that in the general language it is wrong to take a sentence or statement out of context and treat it literally so that it has a meaning not intended by the author. It is just as wrong to take a section of a tax Act out of context, treat it literally and apply it in a way which Parliament could not have intended.[17]

However the dominance of the literalist approach appears to have begun waning with the departure of Barwick CJ from the High Court. Decisions such as *Cooper Brookes (Wollongong) Pty Ltd v FCT*[18] demonstrate a more equivocal approach to the vexed question of statutory interpretation of taxation statutes,[19] with Mason and Wilson JJ elaborating on those situations which contemplate a departure from strict literalism, noting that:

> If the choice is between two strongly competing interpretations, as we have said, the advantage may lie with that which produces the fairer and more convenient operation so long as it conforms to the legislative intention.[20]

At around the same time, the Parliamentary preference and endorsement for the purposive approach in preference to the literal approach was confirmed with the introduction of section 15AA of the *Acts Interpretation Act 1901* (Cth).[21] In addition to sanctioning the purposive approach, this Act provided in s 15AB for extrinsic material to which regard may be had in eliciting the legislative purpose, in those circumstances where there may be uncertainty arising as to the intent when regard was had to the statute alone. The relevant extrinsic material includes, among other resources, the EM and Second Reading Speech.

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[16] *Westraders* at 25.
[17] *Westraders* at 40.
[18] (1981) 11 ATR 949.
[19] Neither Barwick CJ nor Murphy J sat on this case.
[20] *Cooper Brookes* , Mason & Wilson JJ at 966.
[21] This provides that "In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object."

The significance of this provision in displacing the common law approaches was recognised by Dawson J in suggesting that "… the literal rule of construction, whatever the qualifications with which it is expressed, must give way to a statutory injunction to prefer a construction which would promote the purpose of an Act to one which would not, especially where that purpose is set out in the Act."[22]

In relation to the current discussion, s 177E effectively provides that schemes by way of or in the nature of dividend stripping, or having the same result as a dividend stripping scheme, would be schemes to which Part IVA would apply. In applying a purposive approach to s 177E, it is suggested that by placing these threshold conditions separate from the main component of Part IVA, the legislative intent was to provide a separate, alternative and stand-alone test which could attract the same consequences as the general Part IVA threshold tests of a scheme, tax benefit, and dominant scheme purpose. It is suggested on this basis that it is arguable that the tests for the general component of Part IVA, namely a tax benefit and scheme purpose, would not be attracted as elements required for s 177E.

This much is made clear in the EM, which explains that the need for a separate s 177E arose as schemes to which s 177E applied may not be caught within the general component of Part IVA, because it would not be possible to identify a tax benefit or a dominant scheme purpose.

Accordingly, it would be suggested that on the face of the legislation, both the plain language of the statute, and the intent of the legislature, would appear to suggest that neither identifying a tax benefit, nor identifying a dominant scheme purpose, would be relevant to the operation of the threshold tests in s 177E, particularly in relation to the second limb which is based only on the result or outcome of the scheme.

Additionally, it is further suggested that some of the principles of statutory interpretation would also advocate for the position that there was no requirement in the threshold tests in s 177E for a tax benefit or dominant scheme purpose.

The syntactical presumption *generalia specialibus non derogant* provides, in general terms, that a specific provision will prevail over a more general provision. In relation to Part IVA, the general component requires a scheme, tax benefit and dominant scheme purpose. However, s 177E constitutes a more specific provision requiring a scheme of a certain type (by way of or in the nature of dividend stripping), or a scheme having a particular result (the same effect as a dividend stripping scheme). Being the more specific provision, it is suggested that s 177E should stand alone, as explained in the EM, rather than incorporating the threshold elements for the general component of Part IVA This would preclude the tax benefit and dominant scheme purpose from being elements in the s 177E threshold test, again particularly in relation to the results based test.

[22] *Mills v Meeking* (1990) 91 ALR 16 at 30-1.

Finally, it is also suggested that the syntactical presumption *expression unius est exclusion alterius*, the express reference to one matter means other matters are excluded, also indicates a legislative intent that the s 177E tests be limited to the type of scheme, or the result of the scheme. These tests should apply without importing additional requirements which the legislature had chosen not to include in the specific provision s 177E, but had included in the general component of Part IVA. It is suggested that this elicits an intention that the further tests of tax benefit and scheme dominant purpose were not intended to form part of the s 177E threshold, in particular where the test is based on the result of the scheme.

5. JUDICIAL CONSIDERATION OF DIVIDEND STRIPPING SCHEMES

The identification of dividend stripping schemes, and the application of s 177E, was at issue in *CPH Property v FCT*[23] in the Federal Court. Hill J recognised that the legislative purpose in enacting s 177E as a separate code from the general Part IVA provisions was clear, as there could be difficulty identifying tax benefit and purpose, both of which are essential threshold elements under the general Part IVA regime. By having a separate code, his Honour considered that these difficulties were overcome by s 177E, in that a tax benefit could be deemed if s 177E applied, and there was no requirement to test the scheme against conclusion as to dominant purpose.[24] As noted earlier, the statute makes no mention of any requirement to identify a purpose as a threshold condition for attracting the operation of s 177E, and the comments of Hill J appeared to confirm this.

However, what was not so clear to his Honour was identifying the distinction between a scheme of dividend stripping, a scheme that was in the nature of dividend stripping, and a scheme that had the effect of dividend stripping.[25]

5.1 First limb - Schemes in the nature of dividend stripping

In looking to identify the first two of these types of schemes, Hill J had regard to the judgment of Windeyer J in *Investment & Merchant Finance v FCT*, that:

> Dividend stripping is a term applied to a device by which a financial concern obtained control of a company having accumulated profits by purchase of the company's shares, arranged for these profits to be distributed to the concern by way of dividend, showed a loss on the subsequent sale of shares of the company, and obtained repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividend.[26]

Windeyer J continued, "In the course of the duel provoked by them between the tax avoider and the legislature they have developed a protean variety of detail, but their essence remains the same."[27]

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[23] *CPH Property* (FC) (1998) 40 ATR 151.
[24] *CPH Property* (FC) at 171.
[25] *CPH Property* (FC) at 171.
[26] *CPH Property* (FC) at 172 quoting *Investment & Merchant Finance* from Windeyer J quoting Halsbury's Laws of England, 3rd ed, Vol 20, p 201.
[27] *CPH Property* (FC) at 172 quoting Windeyer J.

In seeking to identify this essence of such a scheme, Hill J concluded that "… a scheme will be a dividend scheme or in the nature of a dividend scheme if a reasonable observer looking at the transaction would say of it that its essential character is dividend stripping."[28] His Honour identified the essential character as involving a number of elements, including:

- a company with profits or likely to receive profits;
- out of which a dividend is reasonably likely to be declared;
- shareholders would be liable to pay tax on the dividend;
- shares are sold or allotted in the target company to a stripper; and
- subsequent payment of a dividend or deemed dividend to the stripper to recoup the outlay for the shares.

While questioning whether a dividend stripping scheme was a significantly different thing from a scheme in the nature of dividend stripping,[29] Hill J recognised that not all transactions with these features would constitute dividend stripping. His Honour identified as a critical factor in the characterisation the conclusion that an objective observer would reach as to why the scheme had taken place, thus raising purpose as an element in categorising schemes as dividend stripping schemes, or schemes by way of or in the nature of dividend stripping.

His Honour considered purpose to be a defining element in these schemes, and considered that:

> … a scheme will only be a dividend stripping scheme if it would be predicated of it that it would only have taken place to avoid the shareholders in the target company becoming liable to pay tax on dividends out of the accumulated profits of the target company. It is that matter which distinguishes a dividend stripping scheme from a mere reorganisation.[30]

The requirement to identify a purpose for the scheme had not been an element of the legislative provision, and Hill J had recognised this, as discussed above. However, in looking to the essential elements that would qualify a scheme as dividend stripping, or in the nature of dividend stripping, his Honour appears to add a judicial gloss to the statutory requirement by suggesting that there was not only a requirement to look to purpose, but that this purpose element was the critical factor in distinguishing a scheme in the nature of dividend stripping from more benign transactions.

On appeal to the Full Federal Court in *FCT v CPH Property*,[31] their Honours[32] considered the operation of s 177E, noting that the provision required four threshold tests be met, resulting in the consequence of the scheme being within the general provisions of Part IVA, without anything further needed. In particular their Honours noted that "The effect of subpara (e) is that a scheme satisfying the conditions laid down in s 177E(1)(a)-(d) need not independently satisfy the terms of s 177D (which identifies the characteristics of a scheme to which Part IVA applies, including the

[28] *CPH Property* (FC) at 173.
[29] *CPH Property* (FC) at 174.
[30] *CPH Property* (FC) at 174.
[31] *CPH Property* (FFC) (1999) 42 ATR 575.
[32] Joint judgment of French J (as he then was), Sackville & Sundberg JJ.

necessary purpose of 'enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme'."[33]

This would appear to be an recognition by the court that s 177E operates independently as a se parate code in terms of the threshold tests, and in particular an acknowledgement that there was no requirement to meet a threshold purpose test in s 177D for a scheme to be classed as a dividend stripping scheme, and thus attract the operation of s 177E.

As Hill J had done at first instance, their Honours looked to the authorities to provide guidance as to what would constitute a dividend stripping scheme or a scheme having the nature of a dividend stripping scheme, noting that Gibbs J had identified cases involving dividend stripping, with the court noting that characteristics common to these cases included:[34]

- a target company with substantial undistributed profits, creating a potential tax liability;
- sale or allotment of shares in the target company to another person;
- payment of a dividend from the profits to the purchaser or allottee of the shares;
- the purchaser escaping Australian income tax on the dividend; and
- the vendors receiving a capital sum for their shares in an amount close to the dividend paid to the purchasers.

Their Honours further opined that "A further common characteristic of each of the schemes in the cases considered by Gibbs J, was that they were carefully planned, with all parties acting in concert, for the predominant if not the sole purpose of the vendor shareholders, in particular, avoiding tax on a distribution of dividends by the target company."[35]

On this basis, despite having earlier noted that the operation of s 177E precluded the requirement to establish the purpose of the scheme, and despite the omission of any express reference to purpose in the statute, their Honours went to some lengths to justify the inclusion of a purpose test as an element in a dividend stripping scheme.

The judgment suggested, without further explanation, that the lack of an express reference to purpose was consistent with the drafter intending that the first limb test required a scheme with a tax avoidance purpose. Further, the concept of dividend stripping scheme carried a "widely understood connotation" that such schemes invariably had as their dominant, if not exclusive purpose, the avoidance of tax otherwise payable by vendor shareholders. Their Honours suggested that case law preceding the introduction of s 177E strongly supported the view that Parliament intended dividend stripping operations would necessarily involve a predominant tax avoidance purpose.[36]

[33] *CPH Property* (FFC) at 607.
[34] *CPH Property* (FFC) at 610.
[35] *CPH Property* (FFC) at 610.
[36] *CPH Property* (FFC) at 617.

In relation to extrinsic materials, their Honours noted that the EM and second reading speech emphasised that Part IVA was to deal with "blatant, artificial and contrived" arrangements, and that s 177E was to deal with "dividend stripping schemes of tax avoidance and certain variations on such schemes." The court took the view that these "… carefully formulated observations, in our opinion, clearly indicate that s 177E was intended to apply only to schemes which can be said to have the dominant purpose of tax avoidance."[37] What was not noted by the court was that if the drafter intended purpose to be a threshold test this could have been easily expressly incorporated, thus avoiding the need to contrive these rather opaque 'carefully formulated observations'. Ultimately, the court took the view that the first limb of s 177E(1) only embraced schemes which could objectively be said to have a dominant purpose of tax avoidance, since the "… requirement of a tax avoidance purpose flows from the use by Parliament of the undefined expression 'a scheme by way of or in the nature of dividend stripping."[38] Purpose was to be the objective purpose of the scheme as judged by a reasonable observer, having regard to the scheme characteristics and the objective circumstances of the design and operation of the scheme.[39]

The court appears not to have specifically addressed the Commissioner's submission that to imply a purpose test as an essential ingredient of a dividend stripping scheme was to introduce the purpose test into s 177E by the 'back door method'.[40] Neither did the court appear to turn its attention to the reason why the drafter specifically excluded purpose from the s 177E regime, while including purpose in s 177D as part of the general Part IVA provisions.

Rather, the court appears to have affirmed the view of Hill J that purpose should be an element in identifying a scheme as a dividend stripping scheme, or a scheme by way of or in the nature of a dividend stripping scheme, but to have done so by straining the language of the extrinsic material, and by straining the intention of the drafter that the test apply even though omitted.

The Full Federal court finding was not the end of the matter, however, as the case went on appeal to the High Court in *FCT v Consolidated Press Holdings*.[41] In a joint judgment, the High Court had regard to the context in which s 177E appeared, and to the history of the use of the expression 'dividend stripping', in reaching the conclusion that notions of tax avoidance inevitably attached to the concept of dividend stripping in s 177E(1)(a)(i).

In response to the notion that s 177E acted independently of the general Part IVA provisions, the court articulated the opinion that:

> If 'dividend stripping scheme' were a term of art with a defined or definable literal meaning that could be identified separately from the context in which it appears, then it might be possible to construe and apply s 177E uninfluenced by notions of tax avoidance. But the expression does not have such a meaning. In

[37] *CPH Property* (FFC) at 617.
[38] *CPH Property* (FFC) at 618.
[39] *CPH Property* (FFC) at 618.
[40] *CPH Property* (FFC) at 617.
[41] *Consolidated Press Holdings* (2001) 207 CLR 235.

> framing s 177E, the legislature has adopted the language of tax avoidance, and it has placed s 177E in Part IVA, for a reason related to the necessity to supplement, in a particular respect, the general anti-avoidance provision. This is not an example of a statutory provision in respect of which a purposive construction is merely an available choice; such a construction is necessary.[42]

Because s 177E stands apart from, but extends, the operation of Part IVA, the suggestion is that the elements for the general Part IVA operation, being a scheme, tax benefit, and relevant purpose, in ss 177A, 177C and 177D, would not be threshold elements to attract the operation of s 177E. The link between the provisions is that when the separate threshold requirements for s 177E are satisfied, thus triggering the operation of the section, the outcome is that the scheme is one to which the general Part IVA outcomes apply, being cancellation of the tax benefit, and compensating amendments, in ss 177F and s 177G.

Accordingly, there is no statutory requirement under s 177E to satisfy either the tax benefit test, or the dominant purpose test.

However, in relation to the first limb of s 177E(1)(a), the judicial view at all levels from the Federal Court at first instance, to the Full Federal Court on appeal, and subsequently the High Court was that in identifying a scheme 'by way of or in the nature of dividend stripping', one of the core elements in the nature of a dividend stripping scheme would be identifying a tax avoidance purpose.

It is considered that, based on judicial reasoning in these cases, with the rationale possibly best elucidated by Hill J at first instance, it is arguable that the reference to a dividend stripping scheme, or a scheme 'by way of or in the nature of dividend stripping' in s 177E(1)(a) must carry with it the implication that one of the intrinsic elements of such a scheme must be a tax avoidance purpose. As explained by Hill J, it was only by importing this element of purpose into the test that schemes which attract the operation of s 177E may be distinguished from those which are 'mere reorganisations'.

Whether the same reasoning applies in relation to s 177E(1)(a)(ii) may be a more contentious issue, as this threshold test looks not to the nature of a scheme, but only to the effect or result of a scheme.

5.2 Second limb - Schemes having the effect of a dividend stripping scheme

There are two limbs of the threshold test to identify a scheme which triggers s 177E, and if a scheme is not found to be a scheme by way of or in the nature of dividend stripping, the provision can still be activated if the scheme has substantially the effect of a scheme by way of or in the nature of dividend stripping. From the plain words of the statute, the legislative intent embodied in this test would appear to be an intention that the test be an outcome or results based test, and if a particular scheme produced substantially the same result as would be associated with a dividend stripping scheme, then it might be expected that this threshold test had been satisfied, and the remaining

[42] *Consolidated Press Holdings* at para 132.

threshold tests would come into play; if a particular scheme did not have substantially the same result as would a dividend stripping scheme, then it might be expected that this threshold test had failed, the consequence of which would be that s 177E would not be triggered.

If this was the legislative intent, then the application of the test would turn on what would be the expected outcome or effect from a dividend stripping scheme, and it is suggested that to assist in identifying what is the effect of a dividend stripping scheme, the EM provides useful guidance. The EM explains that s 177E would be a supplementary code to deal with dividend stripping schemes of tax avoidance, and variation on such schemes, "… the effect of which is to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends."[43] On this basis, if a particular scheme had substantially the result of placing company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends, then the scheme would satisfy this threshold test and the other threshold tests would become relevant; if a scheme did not substantially have this result, this threshold would not be satisfied, and the other tests in s 177E(1) would be redundant.

Further, the EM provides examples of schemes that would be considered to have the substantially the same effect as a dividend stripping scheme, including schemes where the profits of the company were not stripped by a formal dividend payment, but by other means such as irrevocable loans to associates, or the use of profits to purchase near-worthless assets from an associate at an inflated price.[44]

On this interpretation of the test, whereby the effect or result of the scheme is the critical issue, with the relevant effect being explained in the EM, it would appear that there would be no role for other matters to be relevant considerations in determining whether the scheme was one to which the section applied. In particular, as the provision would clearly appear to be an results based test, with the criterion for evaluation delineated in the EM, there would be appear to be no role for consideration of the purpose of entering the scheme, as this would have no relevance to a judgment as to the result of the scheme.

Such an interpretation of s 177E(1)(a)(ii) found favour with Hill J at first instance in *CPH Property* (FC), with his Honour suggesting that for this alternative second lime, the focus shifted from the nature and essential character of the scheme to the effect of the scheme.[45] In addressing the relevance of purpose to the second limb, his Honour opining that:

> Here purpose plays no part of the statutory language, but is present only so far as it aids the characterisation of the scheme. In my view there is a clear difference between a dividend stripping scheme on the one hand and one that has the effect of such a scheme on the other. In my view the relevant 'effect' is to be judged by reference to the vendor of the shares in the target company and

[43] EM at page 3.
[44] EM at 9.
[45] *CPH Property* (FC) at 175.

> the target company itself, although there may be some relevance in the effect of the scheme upon the purchaser.[46]

In addressing the issue of what was added by the qualification of the effect being substantially the same, Hill J suggested that this may mean that while some of the effect may be different, overall the effect would be either virtually the same or to a large extent the same.[47]

However, on appeal to the Full Federal Court these views of Hill J did not find favour with the court, with the court expressing the view that purpose was still an element in the second limb test, despite the test being an results based test couched in terms of the effect of the scheme.

In the opinion of their Honours, if the second limb test was based only on effect, then the second limb would subsume the first limb, meaning the only test would become the effect of the scheme, as there would be no case within the first limb which was not also within the second limb. By reference to the examples in the EM as to when a scheme would have substantially the effect of a dividend stripping scheme, their Honours approach appeared to have effectively incorporated the first limb test into the second limb, being of the view that:

> … the second limb of s 177E(1)(a) is intended to catch schemes by way of or in the nature of dividend stripping, where the distribution by the target company takes a form other than a formal dividend or a deemed dividend. The reference to 'having substantially the effect of' a dividend stripping scheme is to a scheme that would be within the first limb, except for the fact that the distribution by the target company is not by way of a dividend or deemed dividend. If the distribution has substantially the effect of a dividend or deemed dividend, it will be within the second limb.[48]

By incorporating the first limb test, for schemes by way of or in the nature of dividend stripping, as a component of the second results based test, the court was able to ascribe a purpose test into the second limb. In justifying this, the court considered that the ordinary meaning and statutory definition of scheme connoted a purpose, suggesting then that a scheme could not fall within the second limb unless the dominant purpose of the scheme was tax avoidance.[49] Their Honours found support for a purposive construction from the policy rationale underlying Part IVA, being to attack contrived arrangements while saving normal commercial transactions.[50]On appeal to the High Court, the court was in agreement with the Full Federal Court. The court took the view that:

> The expression 'dividend stripping' must have the same meaning in sub-para (ii) as it has in sub-para (i). If it is proper to import a particular element of purpose into that meaning in sub-para (i), it is proper, and consistent, to do the

[46] *CPH Property* (FC) at 175.
[47] *CPH Property* (FC) at 175.
[48] *CPH Property* (FFC) at 619.
[49] *CPH Property* (FFC) at 620.
[50] *CPH Property* (FFC) at 620.

> same in sub-para (ii). The reference in sub-para (ii) to effect does not require the element of purpose to be discarded. In particular, it does not require that any scheme which produces a substantial consequence which is in any respect the same as a consequence of a dividend stripping scheme is within the sub-paragraph.[51]

It is suggested that by importing the dominant scheme purpose test into what is legislated as effectively a results based test, the judiciary may be acting to limit the scope of s 177E, in a similar way to the manner in which the implication of additional requirements operated to limit the scope of the former s 260. By imposing the additional test as a further requirement to the threshold compelled by the legislative provision, there is then an added burden of proof to establish the operation of s 177E, thus acting to raise the threshold and making it more unlikely that the provision would be triggered.

The operation of s 177E again arose for judicial consideration in the Federal Court case of *Lawrence v FCT*,[52] which went on appeal to the Full Federal Court in *Lawrence v FCT*.[53] While the cases dealt with transactions which could probably reasonably be characterised as 'blatant, artificial and contrived', being the terms used in the EM to identify schemes to which Part IVA was intended to apply, there are some noteworthy comments from their Honours[54] in the Full Court judgment.

While agreeing with the judgment of Jessop J at first instance, their Honours evidently felt compelled to make some observations on the considerations of the court in the three *CPH* and *Consolidated Press* cases. In particular, their Honours pointed out that the comments in relation to whether scheme purpose was an element to be considered in applying the second limb of the threshold in s 177E(1)(a) were clearly obiter. In relation to the primary judge, the court considered the comments of Hill J obiter, as his Honour had decided the case on the basis of the Commissioner's opinion under s 177E(1)(b) having miscarried. The comments of the Full Federal Court and High Court were obiter as the case had been decided in each circumstance under the first limb of s 177E(1)(a), and the only reason that the courts had expressed an opinion in relation to the second limb was because Hill J had reasoned that the second limb did not require the presence of a tax avoidance purpose.[55]

Their Honours noted that:

> The first limb is concerned with schemes which are by way of or in the nature of dividend stripping; the second limb is concerned with other schemes, that is, schemes that are not by way of or in the nature of dividend stripping but which are schemes having substantially the same effect. A scheme falling within the second limb may not, as in this case, fall within the first limb. On the other

[51] *Consolidated Press Holdings* at para 138.
[52] *Lawrence* (FC) [2008] FCA 1497.
[53] *Lawrence* (FFC) [2009] FCAFC 29.
[54] Ryan, Stone, Edmonds JJ.
[55] *Lawrence* (FFC) at para 52.

> hand, a scheme falling within the first limb will never fall within the second limb.[56]

As noted earlier, there is no statutory requirement that there be identification of a tax benefit or a dominant tax avoidance scheme purpose for the operation of s 177E, but the courts have expressed the view that the purpose test is relevant to the second limb of s 177E(1)(a), despite the test being a test of effect or outcome.

In relation to the operation of the second limb of s 177E(1)(a), it is suggested, with respect, that the approach taken by the Full Federal Court and the High Court of implying a purpose test to the second limb is, applying principles of statutory interpretation, arguably at odds with the legislative intent.

The earlier discussion has recognised that, while there is no statutory requirement for a purpose test in applying the first limb of s 177E(1), it is arguable that principles of statutory interpretation would be consistent with implying a purpose test in identifying schemes within the first limb, that is schemes 'by way of or in the nature of dividend stripping'. It is suggested that such an interpretation may be justified on the basis that, to identify a scheme by way of or in the nature of dividend stripping, it is necessary to distil the essential core elements that constitute the nature of such a scheme, and a tax avoidance purpose is arguably one of these essential ingredients.

However, it is suggested that in relation to the operation of the second limb, the approach taken by the courts is arguably not consistent with principles of statutory interpretation, and with the legislative intent revealed by applying principles of statutory interpretation. In particular, the two limbs of s 177E(1)(a) are enacted as distinct and separate alternative tests, the tests being either a scheme by way of or in the nature of dividend stripping scheme, or a scheme having substantially the effect of such a scheme.

The principles of statutory interpretation, it is suggested, would classify the first limb as relating to a scheme with certain characteristics, namely the features that would be identifiable in a scheme in the nature of a dividend stripping scheme. The second limb, it is suggested, is not related to the character or nature of the scheme undertaken, but to the outcome or effect of the scheme, being an outcome or results based test. It is suggested this much is made clear in the EM, which specifies the effect of a scheme by way of or in the nature of a dividend stripping scheme, with the legislation providing that a scheme which has this effect of result is to satisfy the first of the threshold tests in s 177E(1).

While the EM provides examples of schemes which may generate an outcome which may satisfy the second limb, it is suggested that this was not intended to be an exhaustive enumeration of possible alternatives. Rather, it is suggested that the particular approach was taken as the drafters could not hope to foresee all or every possible scheme that may be designed to produce an effect or outcome substantially the same as would be generated by a dividend stripping scheme, but which may not be classified as a scheme by way of or in the nature of dividend stripping, consequently

[56] *Lawrence* (FFC) at para 52.

taking a broad approach to enliven the second limb when a scheme generated a result or effect substantially the same as would be expected from a dividend stripping scheme.

Further, it is suggested that by incorporating the first limb as an additional precursor element in the second limb, that is, by stating the second limb test as applying to 'schemes by way of or in the nature of dividends stripping schemes which produce an effect substantially the same as a scheme by way of or in the nature of a dividend stripping scheme, it is arguable that the court has substantially narrowed the operation of the second limb in a way not intended by the legislature. As argued above, it is suggested that principles of statutory interpretation would allow the second limb an alternative independent operation based on the effect or outcome of the schemes, whether or not the scheme was a scheme by way of or in the nature of dividend stripping scheme.

By implying the first limb as a pre-condition in the second limb, the second limb would only apply to schemes by way of or in the nature of dividend stripping schemes which have the effect substantially of a scheme by way of or in the nature of dividend stripping. On this basis it may be arguable the second limb then becomes redundant. If the second limb can only apply to a scheme by way of or in the nature of a dividend stripping scheme, then the scheme must of necessity fall within the first limb. If the scheme is a scheme by way of or in the nature of a dividend stripping scheme, arguably nothing is added by the requirement that the effect be substantially the same as a dividend stripping scheme, as it must be seen as rather unlikely that a scheme by way of or in the nature of a dividend stripping scheme would produce an effect not substantially the same as a scheme by way of or in the nature of a dividend stripping scheme.

A consequence of importing the first limb as an element of the second limb would be that the purpose test applicable to the first limb would then become an element of the second limb. As noted earlier, it is suggested that principles of statutory interpretation would envisage that the first and second limbs in s 177E(1)(a) have an independent and alternative operation. While the first limb related to identifying a scheme of a particular nature with particular features, the second limb looks only to the effect of result of a scheme. This would appear to suggest that, being an outcome based or results based test, there is no legislative intent that the second limb carry the requirement element of purpose. The intent would arguably appear to be that consideration be given to the effect of the scheme, and if the effect as specified in the EM had been satisfied, the threshold test would be satisfied.

It is suggested that the approach taken by the courts would operate to narrow the operation of the threshold test in s 177E(1)(a), as the approach would require the establishment of a tax avoidance purpose underlying the scheme, while the legislation itself looks only to the effect of the scheme, with no suggestion that an element of purpose need be established.

It should be noted that it is suggested that the broader approach suggested for the operation of the second limb of s 177E(1)(a) would not automatically attract the operation of s 177E, and thus Part IVA, in inappropriate circumstances. The threshold tests in the two limbs of s 177E(1)(a) are not the end of the matter, with further

threshold requirements in s 177E(1)(b), (c) and (d). By broadening the test in the second limb to be a results based or effect based test, without a need for consideration of purpose, it is suggested that the provision would not ipso facto be triggered by any scheme having the substantially the effect of a dividend stripping schemes, as there are further conditions to be satisfied before the provision is triggered.

6. CONCLUSION

This paper has been concerned with an examination of the judicial interpretation of results based legislation, the particular example being examined relating to the threshold conditions to enliven the operation of s 177E dealing with schemes 'by way of or in the nature of dividend stripping', or a scheme which has 'substantially the effect of a scheme by way of or in the nature of a dividend stripping'.

The paper has suggested that, applying principles of statutory interpretation, it is arguable that the legislative intent was not to include within the threshold tests for s 177E a requirement for a tax benefit, or a dominant scheme purpose. Rather, the threshold should be limited to the two elements of the nature of the scheme, of the result of the scheme.

As outlined, the approach adopted by the judiciary has been to imply a general threshold requirement for a dominant tax avoidance purpose to the s 177E tests of a scheme by way of or in the nature of dividend stripping, or a scheme having substantially the effect of dividend streaming. The paper has suggested that in relation to the first limb of s 177E(1)(a), being a scheme by way of or in the nature of dividend stripping, it may be arguable that a dominant purpose test can be implied, as a feature of the nature of a dividend stripping scheme may be a dominant tax avoidance purpose.

However, in relation to the second limb, being a results based test for a scheme having substantially the effect of a dividend stripping scheme, the paper argues that principles of statutory interpretation require that the test be interpreted as a result based or outcome based test, with no scope for implying a purpose test. Rather, the test should be evaluated on the basis of the effect of the scheme, with the EM explaining the relevant effect as being to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends.

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Attitudes toward municipal income tax rates in Sweden: Do people vote with their feet?

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Abstract
The factors shaping people's preferences for municipal labor income tax rates in Sweden are assessed using survey data. The tax rate actually faced by the respondents does not have explanatory power for their attitudes toward the tax rate. The hypothesis that this small or nonexistent effect of the actual tax rate is caused by a Tiebout bias finds no support, yet instrumental variable estimations indicate that the actual municipal tax rate may be of importance for attitudes toward the tax rate. Also, people with higher education, people who regularly read a newspaper, people who agree with the political left, and people who state that they are satisfied with their municipal services are less likely to want to decrease the municipal tax. People with low income, people who claim to have a low level of knowledge about society, and people who agree with the political right are conversely more likely to want to decrease the municipal tax.

1. INTRODUCTION

Individual income taxes are an important part of government revenues in all western countries. To be able to collect these taxes, and since politicians want to get reelected, these taxes need to be perceived as legitimate. What determines people's preferences about income taxes is therefore of great interest. Previous research on tax attitudes has been able to identify several characteristics that are of associated with people's tax preferences. Education, income, self-assessed knowledge about society, and political preferences are some of the most important factors (e.g., Edlund, 1999, 2000, 2003; Hammar et al., 2009). It has also been shown that what shapes people's tax preferences varies significantly according to the particular tax involved (Hammar et al., 2009).

In this paper I analyze whether the tax rate an individual faces affects her willingness to change that same tax. Is it the case that people living in high-tax municipalities are more willing to decrease the tax, and individuals living in low-tax municipalities are more willing to increase the tax? Or, following the Tiebout (1956) argument, (that people will move to localities that satisfies their preferences for government provided goods and taxes) do people vote with their feet − by moving − to pay taxes that accord with their preferences? These questions are central to this paper, which focuses on Swedish municipal taxes on labor income.

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Sweden has among the highest taxes in the world (OECD, 2005). The municipal labor income tax constitutes the largest source of revenue for the Swedish government, making it very important for the financing of the public sector. It is also of great significance for individuals since it is the largest tax they pay (Swedish Tax Agency, 2006). That this tax is set at the local level and varies between, but not within, the 290 municipalities also makes it possible to investigate how preferences toward it vary with the actual tax rate faced by individuals.[1]

There is a broad literature studying attitudes toward taxation. The earliest study of individual tax preferences (David, 1961) used interview data from Detroit, Michigan. Studying both attitudinal and socio-economic variables, David found that the most important variables are those reflecting self-interest; income and education are most important for preferences regarding income tax. Labor union membership, political party preference, and preferences regarding the size of the public sector are also important. Edlund (1999, 2000) used Swedish survey data to investigate people's opinions about taxes on earned income (including those at the national level). He found that most people regard income tax positively and prefer a progressive system, with lower rates for low-income earners and higher rates for high-income earners. He also found that younger people, highly educated individuals, and high-income earners favor less progressivity. Furthermore, research in the U.S. found that people generally have little understanding of tax policies (Roberts et al., 1994). However, using Swedish survey data on tax progressivity, Edlund (2003) found that people have a quite good understanding of tax progressivity, suggesting that the U.S. finding of little understanding is not necessarily generalizable to other countries.

If people misperceive the taxes they pay, then having more knowledge could affect their opinions. In particular, if they overestimate the taxes they pay and underestimate the benefits received, then having more knowledge might induce them to support higher taxes, and vice versa (Gemmell et al., 2004). Using Swedish survey data, Hammar et al. (2009) investigated people's opinions about eleven types of tax and found that people who claim to have a low level of knowledge about society preferred to reduce municipal income taxes more than did others. In line with the results in Edlund (1999), the highly educated were less likely to prefer reduced municipal income taxes and more likely to support raised. The same was true for frequent newspaper readers. Those who supported the public sector more (i.e., who identified themselves as left, rather than right, on the political scale), and those with a favorable impression of politicians also generally supported higher municipal income taxes. That trust in the political system is important for willingness to pay taxes is also shown in an experimental setting by Wahl et al. (2010). On the other hand, Kumlin (2007) found that dissatisfaction with public services in fifteen western European countries was unrelated to support for the welfare state and the taxes required to finance it.

Previous studies have not investigated the effect of the tax rate itself on people's opinions about taxes. My hypothesis is that since people are not perfectly mobile across municipalities, people living in high-tax municipalities should be more

[1] In Sweden, the tax rates on labor income are decided by the municipalities, and vary substantially across municipalities (of which there are 290 in 2004). Unearned income is taxed only at the national level, and there are surtaxes on labor incomes above certain levels. For more information on the Swedish tax system, see the Appendix.

supportive of decreasing the tax rate and people living in low-tax municipalities should be more supportive of increasing the tax rate. Using survey data, with a net response rate of 64 percent, of a random sample of Swedes aged 15–85, the present paper assesses what factors are important for people's willingness to change the municipal income tax rate. My findings are that the tax rate actually faced by survey respondents is not very important in determining the respondent's tax preferences. The reason that there is not a clearer effect of the actual tax rate on tax preferences may be related to Tiebout sorting, yet the evidence for this is not strong. Possible explanations are that people do not know the actual tax rate in their municipality (or in others) or that they are subject to status quo bias which means they come to accept the tax rate they face. Also, people with higher education, people who regularly read a newspaper, people who agree with the political left, and people who state that they are satisfied with their municipal services are less likely to want to decrease the municipal tax. Conversely, people with low income, people who claim to have a low level of knowledge about society, and people who agree with the political right are more likely to want to decrease the municipal tax.

The next section describes the data, while Section 3 presents the empirical strategy and theoretical background. Section 4 presents the empirical results, and Section 5 summarizes and draws conclusions.

2. DATA

The main data consist of responses from a survey mailed to a random sample of 3,000 Swedes aged 18–85 by the SOM Institute (www.som.gu.se/english) in 2004. Addresses were collected from the National Register, which includes all legal residents of Sweden; 1,774 individuals (64 percent) responded (from 267 of the 290 municipalities). The respondents are representative of the Swedish adult population (Nilsson, 2005).

Data from Statistics Sweden (www.scb.se) on municipal income tax rates in 2004 is also used. The dependent variable in the analysis is people's attitudes toward the municipal income tax, shown in Table 1. More specifically, people are asked the following question: "Do you think that the following taxes should be increased or decreased?". Attitudes toward the corporate income tax and the real estate tax are shown for comparison. The corporate income tax appears to be the most popular, though more people favor decreasing than increasing it, and the real estate tax is clearly the least popular.[2]

Most people seem to care about the taxes they pay. Half the respondents favor decreasing the municipal income tax, and 8 percent favor decreasing it a lot, while only 5 percent favor increasing it (a little). Nevertheless, 82 percent are fairly satisfied with it and favor no or small change. In comparison, 21 percent favor decreasing the corporate income tax a lot or a little, and 71 percent favor decreasing the real estate tax a lot or a little. Thus, more people are at least somewhat satisfied with the municipal income tax.[3]

[2] The real estate tax was abolished in 2008 and replaced with a municipal fee.
[3] This is also true when compared to all eleven taxes in the survey (Hammar et al., 2009).

The actual municipal tax rates faced by the respondents (Table 2) varied from 28.9 percent (in Kävlinge) to 34.04 percent (in Dals-Ed). The mean was 31.58 percent, and the median 31.74 percent, indicating a distribution skewed very slightly to the right. The three municipalities with the most inhabitants had rates of 30.35 pe rcent (Stockholm), 31.8 percent (Gothenburg), and 31.23 percent (Malmö), while the three with the fewest inhabitants all had a slightly higher rate of 32.6 percent (Bjurholm, Sorsele and Dorotea).

Table 1: Swedish tax attitudes, 2004, in percent

	Abolish/ decrease a lot	Decrease a little	Keep unchanged	Increase a little	Increase a lot	No opinion	No response
Municipal income tax	8	42	35	5	0	8	2
Corporate tax	6	15	29	11	2	32	5
Real estate tax	39	32	16	1	0	10	1

No. of obs. 1,683

Table 2: Swedish municipal income tax rates, 2004, in percent

Minimum	10th percentile	25th percentile	Median	75th percentile	90th percentile	Maximum
28.90	30.35	30.93	31.74	32.20	32.70	34.04

Table 3 provides summary statistics for the background characteristics for respondents that expressed an opinion about the municipal tax rate. There are approximately equal numbers of men and women; 21 percent were 65 or older; 32 percent were on a low income; 29 percent had studied at university; 14 percent had preschool children; 28 percent worked in the municipal sector; 35 percent lived in or near one of the three largest cities; one-third regarded themselves as sympathetic to the political left, one-third to the right; 62 percent regularly read a morning newspaper; 46 percent reported fairly good or very good public services in their municipality; and 34 percent trusted their local politicians.

Table 3: Summary statistics, background characteristics

Variable	Description	Mean	Standard deviation	Percentage 0	Percentage 1	Obs.
Women	=1 if woman	0.478	0.500	52.2	47.8	1,554
Old (65-85)	=1 if 65-85 years old	0.214	0.410	78.6	21.4	1,554
Children	=1 if child 0-6 in household	0.138	0.345	86.2	13.8	1,554
Low income	=1 if household yearly income is less than 11k euro (single adult) or 22k euro (two or more)	0.310	0.463	69.0	31.0	1,475
High income	=1 if household yearly income exceeds 43k euro (single adult) or 65k euro (two or more)	0.193	0.395	80.7	19.3	1,475
Low education	=1 if no high school degree	0.362	0.481	63.8	36.2	1,554
High education	=1 if studies at university or for a university degree	0.293	0.455	70.7	29.3	1,536
Municipal employee	=1 if working in municipal sector	0.280	0.449	72.0	28.0	1,357
Newspaper	=1 if read morning newspaper 6-7 days/week	0.631	0.483	36.9	63.1	1,543
Left	=1 if 1 or 2 on a political scale 1-5	0.340	0.474	66.0	34.0	1,495
Right	=1 if 4 or 5 on a political scale 1-5	0.344	0.475	65.6	34.4	1,495
Good services	=1 if services in municipality fairly good or very good, last 12 months	0.463	0.500	53.7	46.3	1,404
Low knowledge	=1 if 1-3 on a scale 1-10	0.186	0.389	81.4	18.6	1,519
Low trust	=1 if low trust for municipal board	0.350	0.477	65.0	35.0	1,520
Tax base	per capita as percentage of national mean	99.215	14.629			1,552
Grants	intergovernmental grants per capita in thousands SEK	3.889	4.705			1,552
Urban	=1 if living in one of 3 largest city regions	0.351	0.477	64.9	35.1	1,552
Change '03	percentage point change in municipal taxrate 2002-2003	0.569	0.713			1,552
Change '04	percentage point change in municipal taxrate 2003-2004	0.297	0.387			1,549
Moved	=1 if moved to the municipality less than 3 years ago	0.087	0.283	91.3	8.7	1,532

Table 4 shows the distributions of preferences toward the municipal income tax by the independent variables, and there are some clear patterns in the data. A Wilcoxon rank-sum test showed that the differences between men and women, young and old, people with preschool children and those without, and people who lived in cities and those who did not are not statistically significant. Those with high or low income are more likely to favor decreasing the tax (and those with middle income are more likely to favor increasing it); the difference between low and middle income earners is statistically significant at the 1% level. Those with low education are much more likely to favor decreasing the tax (and less willing to increase it). Similarly, private sector employees are much more likely to favor decreasing the tax (and less likely to favor increasing it).

Table 4: Distribution of Swedish municipal income tax preferences, in percent

	Abolish/ decrease a lot	Decrease a little	Keep unchanged	Increase a little	Increase a lot	No opinion
Full sample	8.4	42.7	35.3	5.2	0.1	8.3
Women	8.4	40.0	35.7	3.9	0.1	11.8
Men	8.3	45.3	34.9	6.4	0.1	4.9
Young (18-30)	9.9	35.9	36.2	2.1	0.0	15.9
Old (65-85)	6.5	44.9	32.0	4.8	0.3	11.5
Children	10.3	42.0	36.6	5.8	0.0	5.4
No children	8.1	42.8	35.1	5.1	0.1	8.8
High income	7.6	46.5	35.0	4.3	0.0	6.6
Middle income	***7.1***	***43.3***	***39.2***	***6.1***	***0.0***	***4.4***
Low income	***10.5***	***41.3***	***30.0***	***4.8***	***0.4***	***13.1***
High education	***6.5***	***39.0***	***40.9***	***6.5***	***0.0***	***7.1***
Low education	***9.6***	***44.1***	***31.2***	***4.7***	***0.2***	***10.3***
Municipal employee	***8.3***	***38.3***	***39.8***	***6.0***	***0.3***	***7.5***
Private employee	***8.8***	***46.5***	***33.3***	***5.0***	***0.1***	***6.4***
Newspaper	***6.6***	***42.8***	***37.8***	***6.0***	***0.1***	***6.8***
No newspaper	***11.3***	***42.5***	***31.7***	***3.8***	***0.2***	***10.5***
Left	***4.8***	***35.3***	***43.1***	***9.2***	***0.0***	***7.6***
Right	***9.7***	***52.0***	***30.5***	***2.7***	***0.0***	***5.1***
Good services	***6.5***	***41.6***	***39.4***	***5.9***	***0.3***	***6.3***
Bad services	***11.8***	***48.4***	***27.5***	***5.2***	***0.0***	***7.2***
High trust	***6.3***	***38.1***	***44.4***	***7.6***	***0.0***	***3.6***
Low trust	***10.7***	***47.0***	***30.7***	***5.6***	***0.2***	***5.8***
High knowledge	***7.1***	***42.1***	***40.5***	***6.4***	***0.0***	***4.0***
Low knowledge	***13.3***	***43.5***	***23.5***	***4.3***	***0.3***	***15.1***
Urban region	8.4	46.2	32.6	5.4	0.2	7.3
Not urban region	8.4	42.2	35.6	5.5	0.1	8.2
High municipal tax	9.6	44.0	35.0	3.0	0.0	8.4
Low municipal tax	9.7	39.5	36.8	6.1	0.0	7.9

Bold characters indicate a statistically significant difference between the pairs (at least at 10%).

As expected, people supporting the political left are much less likely to favor decreasing the tax (and more likely to favor increasing it) than are those supporting the right. Regular newspaper readers and those self-reporting a high level of knowledge about society are also less likely than others to favor decreasing the tax (and more likely to favor increasing it). Those reporting good publ ic services in their municipality and those trusting their municipal politicians are less likely to favor decreasing the tax. All these differences are statistically significant according to the Wilcoxon rank-sum test. Finally, those living in low-tax municipalities (the 10 percent of the sample paying the lowest tax rate) are less likely than the 10 percent living in high-tax municipalities to favor decreasing the tax (and more likely to favor increasing it). However, this difference is not statistically significant.

3. EMPIRICAL STRATEGY AND THEORETICAL BACKGROUND

3.1 Empirical strategy

Following a general choice framework developed by Bergstrom et al. (1982) and used in a similar context by Bergstrom et al. (1988), Ahlin and Johansson (2001), and Ågren et al. (2007), I assume that an individual's preferred municipal income tax rate is given by

$$t_i^* = \beta_0 + \mathbf{x}_i\boldsymbol{\beta} + \varepsilon_i, \qquad (1)$$

where x_i is a vector of variables explaining the unobserved preferred tax tare (t_i*), and ε_i is an independently and identically distributed random error term. We do not observe t_i* directly, but we assume that an individual expresses dissatisfaction with the actual tax rate (t_i) if it deviates from her preferred level with a sufficiently large amount (formalized by the parameters $\delta<0$ and $\gamma<0$). Individuals will respond

"abolish/decrease a lot" if $t_i^* < t_i - \delta - \gamma$
"decrease a little" if $t_i^* < t_i - \delta$
"keep unchanged" if $t_i - \delta \leq t_i^* \leq t_i + \delta$
"increase a little" if $t_i^* > t_i + \delta$
"increase a lot" if $t_i^* > t_i + \delta - \gamma$.

For example, the probability that individual *i* will choose response alternative "keep unchanged" is the probability that the unobserved preferred tax rate falls in between the cut-points $t_i-\delta$ and $t_i+\delta$. Thus, the variable is inherently ordered but the distances between the categories (δ) are unknown. Assuming that ε_i are normally distributed we can estimate the model using ordered probit estimation (see e.g., Bergstrom et al., 1982, 1988).[4]

[4] If we instead assume that the error has a logistic distribution ordered logit regressions would be preferred.

3.2 Theoretical background

If location of residence is exogenous and respondents are randomly distributed over municipalities, we would expect those paying higher taxes to be more supportive of decreasing tax rates than those paying lower taxes. In a Tiebout setting, where location is endogenous, a person who does not like the tax rate in her municipality could move to one with a tax rate more to her liking (Tiebout, 1956). That is, some of those who prefer low tax rates might already have moved to lower tax municipalities. If this "vote-with-your-feet" mechanism worked perfectly, everyone would be satisfied with the municipal taxes that they pay, but, given (among other things) that people are not perfectly mobile and that there are not enough different municipalities to choose from, we should not expect Tiebout sorting to work perfectly. Studying how movement is related to local public services, Dahlberg and Fredriksson (2001) do not find strong evidence of Tiebout sorting in Sweden.[5] In light of this we expect that people living in high tax municipalities should be more willing to decrease the tax and individuals living in low tax municipalities should be more willing to increase the tax.

In studying the relationship between the municipal tax rate that people face and their willingness to change that same tax we include a number of control variables that have been argued to be important for tax preferences. Families with incomes below the mean, by the standard Meltzer-Richard argument, would have an incentive to favor policies that redistribute income from families with high incomes to families with low incomes (Meltzer and Richard, 1981); we thus expect both high income earners to be more willing to decrease the tax and low income earners to be more willing to decrease the tax, as compared to middle income earners. Simple theoretical models of demand for local public goods imply that personal income, intergovernmental grants, and tax base should affect demand for local public goods and thus also tax preferences (Bergstrom et al., 1982; Ahlin and Johansson, 2001). Hess and Orphanides (1996) construct a model showing that families with more children prefer higher taxes than others, due to them benefiting more from government spending. Edlund (2003) argues that social class should also be an important explanatory variable, as a self-interest effect. For example, manual workers tend to have a higher risk of unemployment and thus a greater need for public support than do highly educated workers.

Since women may be more dependent on the public sector when it comes to employment, benefits, and social services, Edlund (2003) argues that they should be less likely to promote lower taxes. Empirical studies of policy preferences typically find that women are more supportive of activist government policies (e.g., Svallfors, 1997), as well as income redistribution and assistance for the poor (Alesina and La Ferrara, 2005). Alvarez and McCaffery (2003) find that while women want to use a potential budget surplus on child care (or express no opinion on how to spend the surplus), men want to spend the surplus on tax reductions. Furthermore, Courant et al. (1979) argue that public employees should have preferences for more public spending and should thus favor higher taxes. In line with the self-interest assumptions, municipal employees are more dependent on the municipal sector, they should be less likely to promote a decrease in the municipal income tax. Relatedly, elderly individuals benefit more from public spending, than do those of working age, and should thus also demand more municipal spending, and thus higher taxes.

[5] See Dowding et al., (1994) for a review of the empirical literature on Tiebout sorting.

4. EMPIRICAL RESULTS

4.1 Factors related to tax preferences

The aim of this section is to assess what determines people's attitudes toward the municipal labor income tax and how attitudes are affected by the taxes people face. Following the discussion in Section 3.1, ordered probit regressions are used to analyze attitudes to the municipal tax rate, with willingness to change it ranging from 1 for "abolish/ decrease a lot" to 5 for "increase a lot" as dependent variable. We run three models, including progressively more explanatory variables. The idea is that the variables included in the latter specifications could be regarded as less exogenous since they are attitude variables, and a successive introduction of variables thus helps us spot odd events. In all three models we hold the number of observations constant. Table 5 shows the estimated coefficients, and Table 6 shows the marginal effects for specification 3.

Specification 1 focuses on a few socio-demographic variables, chosen following the discussion above. The municipal tax rate itself has a n egative but statistically insignificant effect. Low income has a st atistically significant negative effect, indicating a tendency for those with low income to favor reduced municipal tax rates. The same is true for high-income earners. That low-income earners would like to cut the tax rate is not in line with the standard Meltzer and Richard (1981) argument. One possible reason for this may be that the municipal income tax is not progressive, thus low-income earners prefer increases in other taxes instead. These results are also similar to the results in Edlund (1999) and Hammar et al. (2009).

Having at least some higher education (as compared to only high school) has a statistically significant positive effect (while having low education has a negative but not statistically significant effect), perhaps indicating that these respondents do not overestimate the taxes they pay. Gender, being old, and having preschool children do not have statistically significant effects, which does not support the previous theoretical arguments indicating that females, the elderly, and families with children should be more supportive of taxes used to finance public services, due to self-interest. The tax base in the municipality where the respondent lived and the intergovernmental grants to that municipality are not statistically significant.

Specification 2 includes two new variables expected to affect preferences regarding municipal taxes: whether respondents are regular newspaper readers, and whether they are municipal employees. Regular newspaper readers are more supportive of municipal taxes, perhaps because they are better informed about the taxes they pay and what the tax payments are used for, as proposed by Gemmell et al. (2004). Municipal employees also tend to support municipal taxes; this relation is however not statistically significant.

Specification 3 adds five subjective variables: supporting the political left, or the political right; perceiving good municipal services; distrust in local politicians; and claiming to have a low level of knowledge about society. Pseudo R^2 is higher with these new variables included; also a link test for model specification implies that this specification fits the data better than the other two specifications.

Table 5: Estimation of attitudes toward municipal income tax, ordered probit

	(1)	(2)	(3)
Tax rate	-0.054	-0.044	-0.046
	(0.039)	(0.038)	(0.040)
Tax base	-0.007	-0.006	-0.008
	(0.005)	(0.005)	(0.005)
Grants	-0.012	-0.012	-0.019
	(0.015)	(0.015)	(0.014)
Women	-0.010	-0.036	-0.034
	(0.061)	(0.061)	(0.061)
Old (65-85)	0.129	0.080	0.117
	(0.088)	(0.092)	(0.094)
Children	-0.019	0.000	-0.004
	(0.113)	(0.115)	(0.115)
Low income	-0.209**	-0.180**	-0.159**
	(0.082)	(0.080)	(0.078)
High income	-0.176*	-0.190**	-0.124
	(0.093)	(0.096)	(0.096)
Low education	-0.069	-0.077	-0.113
	(0.086)	(0.085)	(0.093)
High education	0.242***	0.218***	0.212**
	(0.079)	(0.079)	(0.085)
Municipal employee		0.091	0.026
		(0.075)	(0.077)
Newspaper		0.211**	0.235***
		(0.086)	(0.090)
Left			0.312***
			(0.084)
Right			-0.277***
			(0.087)
Good services			0.139*
			(0.071)
Low trust			-0.047
			(0.073)
Low knowledge			-0.259***
			(0.092)
Observations	1,093	1,093	1,093
Municipalities	242	242	242
Log likelihood	-1,192	-1,187	-1,154
Pseudo R^2	0.011	0.015	0.043

Dependent variable ranges from 1 for "abolish/decrease a lot" to 5 for "increase a lot." Standard errors in parentheses. Standard errors are clustered at the municipalities. *** p<0.01, ** p<0.05, * p<0.1.

The coefficients on political views (left and right) are highly significant, as is the coefficient on low level of knowledge about society. The coefficient on perceived good municipal services is less significant, while that on the level of distrust is not statistically significant at conventional levels. Reverse causality may be a problem when it comes to the variables on political views, though not including these variables does not change the significance levels and marginal effects of the other variables very

much. An explanation for why tax base and intergovernmental grants do not have statistically significant effects could be that people do not know or assess this information when it comes to their preferences for the municipal income tax rate.

While most of the previous coefficients (and their significance levels) do not change much in the three different specifications, the coefficient on high income is now insignificant. Apparently, after controlling for political views and level of knowledge about society, perceptions about public services, and newspaper readership, the pure effect of income on support for municipal taxes becomes less pronounced. This implies that it is not high income per se, but rather political views and knowledge that is important. As in the other specifications, gender, being old, and having preschool children have no statistically significant effects.

Table 6: Marginal effects based on ordered probit estimations of attitudes toward municipal income tax

	Abolish/ decrease a lot	Decrease some	Keep unchanged	Increase some
Tax rate	0.006	0.012	-0.013	-0.005
Tax base	0.001	0.002	-0.002	-0.001
Grants	0.002	0.005	-0.005	-0.002
Women	0.004	0.009	-0.010	-0.003
Old (65-85)	-0.014	-0.032	0.033	0.013
Children	-0.001	0.001	-0.001	-0.000
Low income	0.022*	0.040**	-0.046*	-0.015**
High income	0.017	0.032	-0.036	-0.012
Low education	0.015	0.029	-0.033	-0.011
Higher education	-0.026***	-0.058**	0.060**	0.022**
Municipal employee	-0.003	-0.007	0.007	0.003
Newspaper	-0.032***	-0.060***	0.069***	0.022***
Left	-0.038***	-0.085***	0.088***	0.034***
Right	0.038***	0.070***	-0.081***	-0.027***
Good services	-0.018*	-0.037*	0.040*	0.014*
Low trust	0.006	0.012	-0.014	-0.005
Low knowledge	0.038**	0.062***	-0.077***	-0.023***

Marginal effects for continuous variables and first difference for dummies following Specification 3, Table 5. Increase a lot not presented due to few observations.
*** p<0.01, ** p<0.05, * p<0.1.

Also in this specification, the coefficient on the tax rate is statistically insignificant. Thus, the tax rate that people actually face in their municipality does not seem to have an effect on their level of support for municipal taxes in this specification. But what drives this result? As noted above, high education and regularly reading a newspaper are associated with living in a low tax municipality. Excluding both these variables (*High education* and *Newspaper*) turns the coefficient on actual tax rate statistically significant at the 10 percent level. Another variable for indicating media consumption, whether the respondent listens to or watches local news broadcasts regularly, is not associated with whether the respondent lives in a low-tax municipality. Including this

variable as an explanatory variable in place of *Newspaper* shows that it has no explanatory power for attitudes to the tax rate. Neither does it change the significance levels or marginal effects of the other variables very much.[6] This indicates that it is not information per se that is of importance for tax preferences. The results regarding the effect of the actual tax rate are clearly sensitive to model specification; only in some specifications is it statistically significantly associated with tax attitudes. In the next section, the possible effect of the actual municipal tax on attitudes toward this tax will be investigated further.

4.2 Tiebout bias

Why does the actual tax rate not seem to have a clearer effect on respondent attitudes toward municipal taxes? It is possible that some kind of Tiebout effect is at work (Tiebout, 1956). The municipal labor income tax is the only tax that varies across municipalities in Sweden and respondents might be more satisfied with this tax because of the possibility of moving to a municipality with a tax rate more to their liking. An indication of this is that the municipal income tax is the tax that most people are satisfied with according to the data used in this study (as we saw in Table 1).

If location of residence is exogenous and respondents are randomly distributed over municipalities, we would expect those paying higher taxes to be more supportive of decreasing tax rates than those paying lower taxes. In a Tiebout setting, where location is endogenous, a person who does not like the tax rate in her municipality could move to one with a tax rate more to her liking. In this case, the estimated coefficient of the effect of tax rates on desire to change them would be underestimated in our regressions. That is, some of those who prefer low tax rates might already have moved to lower tax municipalities. The more their choice of residence has already been affected by the municipal tax rate, the smaller the coefficient for the effect of the tax rate. We could call this a Tiebout bias. Following Rubinfield et al. (1987) and Ahlin and Johansson (2000), the problem can be described in the following way. We know from before (equation 1) that an individual's preferred municipal tax rate is given by

$$t_i^* = \beta_0 + \mathbf{x}_i \boldsymbol{\beta} + \varepsilon_i, \tag{2}$$

where x_i is a vector of variables explaining the unobserved preferred tax tare (t_i*), and ε_i is an independently and identically distributed random error term. Not all individuals in a municipality will have the tax rate they prefer because they may have moved there (or not moved away) based on other factors. The difference between the actual rate they pay (t_i) and their preferred tax rate (t_i*) can be expressed as

$$t_i - t_i^* = \gamma_0 + x_i \gamma + u_i \tag{3}$$

[6] These results are available upon request.

Variables in (3) include variables in (2); for example, income might affect both the preferred tax rate and mobility. There can also be variables in (3) not affecting the preferred tax rate; i.e. some β's and γ's might be zero. If ε_i and t_i are correlated there is a Tiebout bias; the preferred tax rate affects the choice of residential municipality. That is, if the choice of which municipality to reside in is influenced by the preferred tax rate we will underestimate the actual relation between the actual and preferred tax rate.

As proposed by Rubinfield et al. (1987), instrumental variable estimation might correct the bias due to the endogeneity problem. Instrumental variable estimation is conducted via a two-step procedure where the endogenous variable is regressed on the instrumental variables and the exogenous variables from the original estimation. In the second stage, the regression of interest is estimated as usual, except that in this stage, the endogenous variable is replaced with the predicted values from the first stage regression.

We use four variables assumed to affect the preference municipality mismatch but not the preferred tax rate; the choice of variables follows Rubinfield et al. (1987) and Ahlin and Johansson (2000). The idea is that these variables should explain the tax rate that an individual faces but not the tax rate that she actually prefers. The first variable indicates whether the individual lives in one of the three major urban regions in Sweden (*Urban*), and is meant to measure the availability of municipality choice. There are multiple municipalities within commuting distance in each region, and this should decrease the mismatch, since it is possible to choose from several municipalities with different tax rates. By the same token, a variable indicating a recent move is included (*Moved*), since more recent movers should be more satisfied with the tax rate in the municipality they have chosen to move to. The other two variables measure the change in the municipal tax rate from 2002 to 2003, or from 2003 to 2004 (*Change '03* and *Change '04*). Since moving is costly, people might choose not to move even though the tax rate has recently changed from their preferred level. A large change in the tax rate would, at least if unexpected, make the mismatch larger.

Using these variables (*Urban*, *Moved*, *Change '03*, and *Change '04*) as instruments for the actual tax rate, we can test for a potential Tiebout bias and, in the case of a bias, improve the estimation of the causal effect of the actual municipal tax rate on the attitudes towards this tax. The instrumental variable regressions, as well as an ordered probit comparison, are presented in Table 7.

The dependent variable in the first step is the actual tax rate in the municipality where the respondent lives. In Table 7, Panel B we can see that the municipal tax rate is indeed correlated with the chosen instruments (which are supposed to affect municipal choice but not the preferred tax rate).[7] This is supported by the Cragg-Donald statistic,

[7] People living in urban regions tend to face higher tax rates, while those who have moved recently live in municipalities with lower tax rates. When it comes to municipalities that recently changed their tax rates, the effects go in different directions; municipalities that increased their tax rates in 2003 tend to have lower tax rates than others, while those who increased their tax rates in 2004 instead tend to have higher tax rates than others. The reason for this is that municipalities that increased their tax rates in

which indicates that the instruments are not weak. This implies that the instruments are good predictors of the actual tax rate and that the predicted values have enough variation to be used as instruments. The Sargan test suggests that the instruments are valid. This implies that the instruments do not seem to affect tax rate preferences directly, but only the mismatch, as we have assumed.

Table 7: Testing for Tiebout bias

Dependent variable: attitudes towards municipal income tax rate

	Oprobit	IV 1	IV 2	IV 3
	Panel A: Second stage results			
Tax rate	-0.046	-0.233**	-0.217**	-0.210**
	(0.026)	(0.105)	(0.104)	(0.069)
	Panel B: First stage results for tax rate			
Urban		0.052	0.051	
		(0.169)	(0.169)	
Change '03		-0.419***	-0.422***	-0.405***
		(0.137)	(0.138)	(0.141)
Change '04		0.742***	0.741***	0.739***
		(0.164)	(0.166)	(0.165)
Moved			-0.076	
			(0.107)	
Observations	1,093	1,085	1,085	1,085
Hausman p-value		0.110	0.145	0.156
Cragg-Don. F-value		62.45	46.40	92.12
Sargan p-value		0.359	0.145	0.495

Estimated with 2SLS. Only results for tax rate and instruments presented. Standard errors clustered at the municipal level in partenthesis. The Hausman-, Cragg_Donald-, and Sargan tests were conducted using a linear version of the IV-procedure.
*** p<0.01, ** p<0.05, * p<0.1.

The dependent variable in the second step is the level of support for municipal taxes, ranging from 1 for "abolish/decrease a lot" to 5 for "increase a lot." This step was conducted using ordered probit regressions. Here the tax rate is replaced with the predicted values of the tax rate from the first stage regression. The second-stage results show that (instrumented) tax rate has a statistically significant negative effect on tax attitudes (Table 7, Panel A).[8]

Using the Hausman test, we can test whether the tax rate is endogenous in our estimations; i.e., whether the tax rate is correlated with the error term. The Hausman test does not suggest that the IV-specification is preferable for any of the tested combinations of instruments. That is, the null that the municipal tax rate is exogenous is not rejected (the p-value ranges from 0.110 to 0.156 in the three specifications presented in Table 7). This is true for all possible combinations of our four instruments. The specifications presented in Table 7 are closest to passing the

2003 increased it from a relatively low level, while this is not the case for municipalities that increased their rates in 2004.

[8] A modified Breuch-Pagan test (not presented) suggests that heteroskedasticity is not a problem, hence I do not use robust standard errors (although doing so does not change the results).

Hausman test. Thus, the results of the test are robust to the inclusion of different instruments.

This suggests that a Tiebout bias is not a problem in this setting, yet the results from previous studies have been sensitive to the choice of instrumental variables (Ahlin and Johansson, 2000). The result of the Hausman test should therefore be accepted only with some caution. Even though it is not possible to reject the null of no Tiebout bias, when the municipal tax rate is instrumented for, the coefficients get considerably larger (and statistically significant at the 5 percent level) than in the non-instrumented ordered probit counterpart (see second stage in Table 7). This is at least an indication that some kind of Tiebout sorting may be going on, and that actual tax rates may matter for attitudes. From descriptive statistics we know that the highly educated and people regularly reading a newspaper − two factors related to not wanting to decrease the tax rate − tend to live in municipalities with lower taxes. This is what we would expect if these people have moved to municipalities with tax rates to their liking. However, for other variables which are important for tax preferences (political affiliation, satisfaction with municipal services, and income) there is no tendency for these groups to reside in either high- or low-tax municipalities.

But why is the case for Tiebout not sorting stronger? One reason could be that people are not aware of the different tax rates in nearby municipalities, or do not know whether they live in a high- or low-tax municipality. Such systematic misconceptions about key fiscal parameters are called fiscal illusion (Oates, 1988). In this case, their desire to change the municipal tax rate might depend, to some extent, on misperceptions of how high their tax rate actually is (see e.g.Gemmell et al., 2004 for a similar argument). An indication of this is that people have unrealistic expectations about taxes and government budgets: about 64 percent of the respondents would like to decrease their tax rate, while only 27 percent would like to decrease the public services provided by the public sector financed by the taxes. That knowledge about taxes in the Swedish general population is sparse is also supported by Sandaji and Wallace (2010), who find that people underestimate the share of an average worker's income that is transferred to the public sector. Another reason why people might not move as a result of differences in municipal tax rates is "editing," whereby people rule out less important factors in their decision-making (Kahneman and Tversky, 1979); the municipal tax rate may be one such less important factor. A status quo bias, in which individuals prefer the tax rate they have to a tax rate that they do not have, may also be a possibility (Kahneman et al., 1991). John et al. (1995) found that, although there is some support for Tiebout sorting, there are generally more important factors to consider when deciding where to live, such as buying a first home, and job opportunities.

5. CONCLUSION

Coming back to the questions in the opening paragraph: Is it the case that people living in high-tax municipalities are more willing to decrease the tax and individuals living in low-tax municipalities are more willing to increase the tax? Or, following the Tiebout (1956) argument, do people vote with their feet − by moving − to pay taxes that accord with their preferences? People in high-tax municipalities are to some extent more likely to want lower tax rates, and people in low-tax communities are to some extent more likely to want higher tax rates. While it is tempting to interpret this

modest effect of the actual tax rate on tax preferences as a Tiebout effect − i.e., people move to municipalities with their preferred tax rate and do not like to change the tax − the evidence for this is not very strong. Another possible explanation is that people do not always know their actual tax rates or how they compare to tax rates in nearby municipalities, as suggested by previous work showing that knowledge about taxes tend to be low in the general public (Gemmell et al., 2004). Since better informed people may be less likely to want to decrease tax rates, measures to increase public knowledge about taxes may be important for the legitimacy of income tax collection.

But what other factors are important for municipal tax rate preferences? Possible self-interest variables, such as being a municipal employee, having young children, or being 65 or older, do not seem to be important in determining people's desire to change tax rates. This is in line with survey evidence indicating that voting and political preferences are not only driven by self-interest (e.g., Carlsson and Johansson-Stenman 2010). Those with low or high income (as compared to middle-income earners) are more likely to want to decrease their tax rates, however. That low-income earners would like to cut the tax rate is not in line with the standard Meltzer and Richard (1981) argument. One possible reason for this might be that the municipal income tax is not progressive, thus low-income earners prefer increases in other taxes instead.

Unsurprisingly, political views seem to be important in determining people's tax preferences: those who support the political right are more likely to want to decrease tax rates, while those who support the left are less likely. Of course, the self-interest factors (as having children or being a municipal employee) might affect political views, rather than tax preferences directly. Also, reverse causality may be a problem when it comes to including the variables on political views, though not including these variables does not change the results regarding the other variables to any great extent (as demonstrated by the successive introduction of variables in Specifications 1-3).

To further address the questions concerning what is important for people's tax preferences, it would be interesting to ask whether people know their actual tax rates and whether they know what their tax payments are used for. This would make it possible to ascertain whether people who know what their taxes are used for have different preferences regarding tax rates to those who do not.

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APPENDIX - TAXES IN SWEDEN

In 2004 the tax to GDP ratio in Sweden was 50.3 percent; the highest ratio in the world (Swedish Tax Agency, 2006). This is almost 15 percentage points higher than the OECD average. Note that many transfers are taxed in Sweden compared to other countries, if this is taken into account the tax to GDP ratio in Sweden is not particularly higher than many other European countries (Andersson et al., 2003). 64 percent of total tax revenues were taxes on labor (tax on earned income and social security contributions), 26 percent taxes on goods and services, and 10 percent taxes on capital. The main expenses of the public sector in 2004 were social security, education and health care (Swedish Tax Agency, 2006).

The earned income tax consists of a local income tax and a state income tax. The local earned income tax is proportional and includes two parts: one levied by the municipalities, and one levied by the counties. The average combined rate was 31.5 percent in 2004 (the average municipal tax was 20.8 percent, and the average county tax was 10.7 percent). It is the combined local tax that is generally considered when the municipal earned income tax is discussed in Sweden. The tax is paid in one chunk to the central government and then distributed to the municipalities (all taxes are collected by the Swedish Tax Agency). In 2004 the municipal income tax varied from about 29 percent to about 34 percent. The municipal income tax is the greatest source of revenue for the Swedish public sector (Swedish Tax Agency, 2006).

16 percent of the income earners above 20 years of age paid the state earned income tax in 2004, this tax consisted of an additional 20 percent on incomes exceeding SEK 291,800 ($ 41,700). Those earning more than SEK 460,600 ($ 65,800) paid an additional 5 percent tax on earnings above that amount (Swedish Tax Agency, 2006). For an individual living in an average tax municipality, the top marginal tax rate was thus 56.5 percent.

Other than the municipal earned income tax, all taxes are decided about on the central government level. Tax deductions, progressivity, income tax credits and other potential variations in the tax system are not in the hand of the local government to decide on. Thus, the only variation regarding taxes between municipalities is regarding the rate of the proportional earned income tax (Swedish Tax Agency, 2006).

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Strengthening the validity and reliability of the focus group as a method in tax research

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Abstract

Contemporary tax research appears to be becoming increasingly multi-disciplinary and using mixed methodologies as researchers seek deeper understandings and thereby more critically 'real' solutions to research problems. This article provides a detailed discussion and demonstration of how analytical tools more commonly associated with quantitative research can be successfully applied to qualitative data (collected by either quantitative or qualitative methods). The demonstration herein is based on data collected by two focus groups conducted as part of a broader study into determining the value of land for the purposes of taxation. It is argued that the techniques used herein, including data coding focused not only on themes, but on points of agreement and disagreement, and considered weighting of data can allow qualitative researchers to strengthen the (construct and internal) validity and reliability of their findings without compromising the richness of the understandings gained.

1. INTRODUCTION

Taxation is an area of research populated by scholars from diverse disciplines including law, accounting, economics, psychology, sociology and political science. Over time this diversity has both enlarged and enriched the approaches evident in tax research. Historically, tax researchers tended to discretely employ methods reflective of either the quantitative, qualitative or legal research paradigms, by and large reflective of their underlying disciplinary backgrounds. However, there is evidence that contemporary tax researchers are seeking to use more flexible and innovative approaches in their research and the use of mixed methodologies and mixed methods is no longer uncommon,[1] and indeed, is regarded by some as an imperative.[2]

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[1] For example see EC Loo, *The Influence of the Introduction of Self Assessment on Compliance Behaviour of Individual Taxpayers in Malaysia* (PhD Thesis, The University of Sydney, 2006); WA Yesegat, *Value added tax in Ethiopia: A study of Operating Costs and Compliance* (PhD Thesis, The University of New South Wales, 2008) <http://handle.unsw.edu.au/1959.4/43317>; and P Lignier, *Identification and Evaluation of the Managerial Benefits derived by Small Businesses as a Result of Complying with the Australian Tax System* (PhD Thesis, The University of New South Wales, 2008) < http://handle.unsw.edu.au/1959.4/41018>.

[2] C Alley and D Bentley, 'The Increasing Imperative of Cross Disciplinary Research in Tax Administration' (2008) 6 (2) *eJournal of Tax Research* 122.

By and large this cross-fertilisation of research paradigms is driven by tax researchers seeking deeper understandings of their research problems and more critically 'real' solutions. Knowing how many people in a particular location agree with a certain view or behave in a certain way (i.e. the 'where' and 'what' more questions traditionally associated with quantitative research underpinned by positivism) is often insufficient in articulating the rationale for a phenomenon; particularly for researchers seeking to drive change hence needing more complete answers including to the 'why' and 'how' questions more traditionally associated with qualitative (i.e. non-positivist) research.[3] However, whilst there may be increasingly willingness to consider the appropriateness of methodologies from the qualitative paradigm and associated methods (including in-depth interview and focus group) to a given research problem, there usually remains some scepticism towards the findings generated. The perceived major weaknesses in qualitative research have been discussed at length in the literature[4] and centre on the validity or robustness of the findings generated (in that they are subjective to some extent) and their reliability, or the ability to replicate such studies. These perceived weaknesses have been attributed to the difficulty of data analysis in qualitative research generally, but in particular, with the focus group method.[5] Researchers using a method from the qualitative paradigm will often note that they have relied on thematic analysis of the data collected (for example, from in-depth interviews)[6] and developed a systematic coding technique to improve the robustness of their research,[7] but the steps taken are rarely, if ever, explained in any detail.

This leads to the underlying purpose of the article. That is, to present a detailed example of the techniques used to analyse data collected using the focus group method in the context of tax research. The intention is to demonstrate that greater validity and reliability can be achieved in the use of the focus group in tax research, if so desired, though it does require some willingness to adopt a more positivist approach. It is felt that the techniques presented herein are innovative and could be of interest to other tax researchers.

By way of context, the example of a focus group method which forms the basis of this article was part of a mixed methodological study into making the base of an efficient land tax simple and transparent.[8] In the study as a whole, four research methods were employed: namely simulation (or experiment), survey, semi-structured interview (these first three being aligned with the quantitative paradigm) and focus group (being

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[3] M McKerchar, *Design and Conduct of Research in Tax,Law and Accounting* (Law Book, 1st ed, 2010).

[4] See for example E Babbie, *The Practice of Social Research* (Thomson, 11th ed, Belmont CA, 2007); W Neuman, *Social Research Methods: Qualitative and Quantitative Approaches* (Pearson Education, 6th ed, Boston MA, 2006); MQ Patton, *Qualitative Research and Evaluation Methods* (Sage Publications Inc, 3rd ed, Thousand Oaks CA, 2002); and M Miles and A Huberman, *Qualitative Data Analysis* (Sage Publications Inc, 2nd ed, Thousand Oaks CA, 1994).

[5] J Smithson, 'Focus Groups' in P Alasuutari, L Bickman and J Brannen, *The Sage Handbook of Social Research Methods* (Sage Publications Inc, Thousand Oaks CA, 2008) 357.

[6] For example see M McKerchar, H Hodgson and M Walpole, 'Understanding Australian Small Businesses and the Drivers of Compliance Costs: A Grounded Theory Approach' (2009) 24(1) *Australian Tax Forum* 39.

[7] D Ezzy, *Qualitative Analysis: Practice and Innovation* (Allen & Unwin, Sydney, 2002).

[8] V Mangioni, *Codifying Value in Land Value Taxation* (PhD Thesis, The University of New South Wales, 2013)<http://handle.unsw.edu.au/1959.4/52404>.

aligned with the qualitative paradigm). Again, the intention of the article is not to focus on the findings of the research per se, but on the analytical techniques employed on data collected using the focus group method. The article is presented in 4 parts. Following on from this Introduction, the theoretical underpinning of the focus group method is discussed in part 2, along with the design and conduct of the focus group method used in this study. In part 3 there is detailed discussion on the techniques used in data analysis, followed by concluding comments in part 4.

2. THEORETICAL UNDERPINNINGS OF THE FOCUS GROUP METHOD

An extensive body of literature exists on research methodology from both theoretical and applied perspectives and different paradigms or schools of thought exist depending on the way in which the researcher believes knowledge is created. Researchers who believe knowledge is created inductively and that it is subjective, create theories regarding observed phenomena and adopt methods and practices that are in accordance with the expectations of the qualitative paradigm. Researchers who believe knowledge is created deductively and that it is objective, develop hypotheses that can be tested using empirical methods and practices in accordance with the expectations of the quantitative paradigm. There is undoubtedly blurring around the edges, but researchers usually have an underlying position or set of beliefs that guide them and their choices, and these choices may include a mixed methodological approach such as was adopted in this context.[9]

A mixed methodology approach draws on both the quantitative and qualitative paradigms and their methods, thereby using multiple methods, either concurrently or sequentially.[10] The rationale for using multiple methods is that it can strengthen the overall research design by allowing for the findings of one method to inform another (and thereby allow for greater exploration) or to triangulate findings.[11] Further, the considered use of multiple methods can allow the researcher to draw on the strengths of one method or paradigm and, at the same time, minimise the inherent weaknesses of another. Again, this reflects the desire on the part of the researcher to draw meaningful and more holistic conclusions.

It is important to consider the issues of validity and reliability as their importance is regarded quite differently by quantitative and qualitative researchers. Validity, as a test of the quality of the research, is typically regarded as being able to be established in three ways namely construct validity, internal validity and external validity.[12] Construct validity requires that appropriate measures have been used for the concepts being studied. Internal validity requires that the method used (and any related instruments or protocols) provide the data appropriate to the research (whether it is descriptive, explanatory and/or exploratory) so that conclusions drawn are authentic. External validity refers to the extent to which the findings can be generalised to

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[9] For more detailed discussed on research methodology and methods see M McKerchar, 2008, 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation' (2008) 6 (1) *eJournal of Tax Research* 5. See also Babbie (2007) and Neuman (2006) at n 4.

[10] JW Creswell, *Research Design Qualitative, Quantitative and Mixed Methods Approaches* (Sage Publications Inc, 2nd ed, 2003).

[11] See McKerchar, at n 3.

[12] R Yin, *Case Study Research – Design and Methods* (Sage Publications Inc, 4th ed, Thousand Oaks CA, 2009) 40.

broader populations. Reliability refers to the ability to replicate the study (and thereby confirm/reject its findings) and is regarded as t est of the quality of the research. However, external validity and reliability are generally not as important issues for qualitative researchers in that they are not making generalisations to broader populations. N evertheless, qualitative researchers remain concerned about the accuracy and appropriateness of the data collected, so construct validity, internal validity and reliability can still be relevant and worthy of pursuit where strengthening the quality of the research is desired.[13]

The key to strengthening the validity and reliability of data analysis (or interpretation) in qualitative research lies in the techniques used, beginning with the coding of data. Coding is a generic process by which data is organised into categories on the basis of themes, concepts or similar features that will reduce the data into more manageable forms or categories for the purposes of interpretation.[14] The categories may be determined in advance or may emerge from the data. It is acknowledged that coding of qualitative data does have its shortcomings, including that data may become fragmented and lose its depth of meaning. Further, too few or too many codes (and/or codes that inappropriate or inadequate to catch the essence of the data) can also undermine the quality of analysis.[15]

There are proponents of a more systematic three stage coding process – open coding, axial coding and selective coding – where each stage represents a g reater level of refinement[16] and this process has been used previously by tax researchers.[17] Open coding is the first pass (or read) through of data. It tends to be quite broad and directed at identifying similarities and differences in the data,[18] though this is by no means to a straightforward process.[19]

During axial coding the researcher focuses more on the appropriateness of the initial codes than on the detail in the data, considering the relationships between the concepts and whether or not some of the codes can be collapsed and the themes further refined (to simplify the analysis). During selective coding, the final pass of the data, the researcher looks specifically for cases that either illustrate or provide contrasts to the general themes that emerged during axial coding. This third stage involves almost working backwards – from the codes to the data.[20] Coding is considered complete when the researcher is satisfied that the theory is "saturated" – that it adequately supports and fills out the emerging theory.[21]

Whilst the three stage coding process is systematic and this strengthens internal validity to some extent, the extent to which it enables replication is uncertain. Further,

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[13] See McKerchar, at n 3. It is recognised that not all qualitative researchers would concur with this view and indeed some reject the relevance of validity, reliability and generalisability to qualitative research. See for example DJ Clandinin and FM Connelly, *Narrative Inquiry: Experience and Story In Qualitative Research* (Jossey-Bass, San Francisco, 2000) 184.

[14] Neuman, at n 4, 460; Ezzy, at n 7, 94.

[15] See for example A Bryman, *Social Research Methods,* (Oxford University Press, Oxford, 3rd ed, 2005) 552-553; and McKerchar, at n 3.

[16] Neuman, at n 14.

[17] See for example McKerchar et al, at n 6.

[18] A Strauss and J Corbin, *Basics of Qualitative Research* (Sage Publications Ltd, London, 1990) 9.

[19] Ezzy, at n 7, 89.

[20] Neuman, at n 4, 464.

[21] Ezzy, at n 7, 93.

it is unclear whether three passes through the data allows for full extraction of its meaning and robust interpretations to be made. This gives rise to a real dilemma for qualitative researchers who want their contributions to be taken seriously by qualitative and quantitative researchers alike. There are advocates for applying forms of quantitative techniques to the analysis of qualitative data, including Miles and Huberman[22] and Bryman;[23] and they have provided some of the inspiration for the techniques used herein as described in the next part of this article.

In particular, Miles and Huberman[24] emphasise the importance of thinking *display* (such as matrices) when it comes to data, and then invent the most appropriate formats for the purposes of the research. Similarly, Bryman[25] cites content analysis (which is basically a data coding process) as an example of a quantitative analysis tool successfully used to analyse qualitative data collected as part of qualitative research, and recognises that this combination could have potential in other areas of social research by qualitative researchers with more positivist leanings. Further, Bryman argues that content analysis offers greater transparency and the ability to replicate, but does caution that it is not well suited to answering "why" type questions and that its emphasis on measurement may mean that the theoretical significance of the content may be overlooked.[26] However, Bryman concedes that some precise quantification of qualitative data may be better than the use of imprecise terms such as 'rarely' and 'many' and concludes that there may be merit in quantifying qualitative data, but only to the extent that it enhances the qualitative research.[27]

Returning to the context of this article, the focus group method was one of four methods employed by the researcher who was more inclined towards positivism and objectivity. A focus group is regarded as a qualitative method, its primary aim being to describe and understand perceptions, interpretations and beliefs of a select population to gain an understanding of an issue from the perspective of a group of participants.[28] A focus group is not a group interview. The key difference is that a focus group is a discussion led by a moderator who seeks to get the participants to actively engage with each other and draw out their views. Smithson[29] explains that they are not a well-understood research method and that there is a lack of theoretical

[22] M Miles and AM Huberman, *Qualitative Data Analysis: A Sourcebook of New Methods* (Sage Publications Inc, Beverly Hills CA, 1984); M Miles and AM Huberman, *Qualitative Data Analysis: An Expanded Sourcebook* (Sage Publications Inc, 2nd ed, Thousand Oaks CA, 1994).

[23] A Bryman, *Social Research Methods* (Oxford University Press, 2 ed, 2004).

[24] Miles and Huberman (1994), at n 22, 11.

[25] See Bryman, at n 23, 566. At pp 287-287 Bryman provides a detailed example of content analysis based on the reporting of crimes subject to court proceedings. The dimensions of interest include the nature of the offence, the gender of the perpetrator, the social class of the perpetrator, the age of the perpetrator, the gender of the victim, the age of the victim, the depiction of the victim and the position of the news item. As the content is examined, it is coded accordingly to allow for quantification (such as the number of occurrences; the number of years) and statistical analysis.

[26] Bryman, at n 15, 291.

[27] Bryman, at n 15, 598-599.

[28] Khan and Manderson (1992) 57 cited in P Liamputtong and D Ezzy, *Qualitative Research Methods* (Oxford University Press, 2005) 76. Focus Group 1 had a strong legal and educational representation, balanced with two practising valuers with rating and taxing valuation experience. In contrast, Focus Group 2 comprised two legal representatives, a recent property economics graduate and a larger contingent of valuers.

[29] Smithson, at n 5, 357.

and analytical literature on their use. This is partially attributed to the fact that in the past they have been used mainly as a market research tool for gathering quick "opinions", though they are now being used more widely in the social sciences including by tax researchers.[30]

Focus groups can be homogeneous or heterogeneous and can vary in size from 6-12 and optimally run for 90 to 120 minutes.[31] In this study it was decided to conduct two focus groups to enable comparative analysis, and that the focus groups would be formed on the basis of multi-professional disciplines (i.e. valuers, property solicitors, educators and tax administrators). Participants were recruited via the Australian Property Institute as the intermediary and an independent facilitator was engaged to moderate the focus groups. The researcher gave a brief introductory presentation of the research objectives and results of the three previous methods (simulation experiment, survey and in-depth interview) to each group before departing (to enable free and frank discussion). The researcher returned for the final 15 minutes of each session during which the group presented its conclusions.

The broad objective of the focus groups was to discuss refinements and reforms for determining the value of land in highly urbanised locations. The facilitator led the discussion along the lines of four broad themes that had emerged in the literature and the other three research methods already completed. These themes were codification, valuation practice (including sales evidence, frequency and method), information, and education and training. Participants were asked to discuss and draw recommendations on the following points:

i. Requirements for the training and education of valuers;

ii. The importance of information and what additional information could assist in the valuation of land process;

iii. Measures which could be adopted to ensure consistency in the assessment of value within valuation of land legislation and procedures for assessing value, for a codified process. This included three broad areas of i) sales analysis, ii) frequency of valuation and iii) method of valuation; and

iv. The extent and limitations of the codification process. This was broken up into two areas being i) the codification of legislation governing the valuation of land and ii) codification of the valuation process.

The focus groups were audio taped in their entirety and independently transcribed. Table 1 identifies the participant by reference to their profession and the abbreviated code assigned to each which is used in the focus group transcripts, extracts of which follow in the next section of the article.

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[30] See for example C Coleman and L Freeman, 'Cultural Foundations of Taxpayer Attitudes to Voluntary Compliance' (1997) 13(3) *Australian Tax Forum* 311; and R Woellner, C Coleman, M McKerchar, M Walpole and J Zetler, 'Can Simplified Legal Drafting Reduce the Psychological Costs of Tax Compliance?: An Australian Perspective' (2007) 6 *British Tax Review* 717, although neither of these articles explain in any detail the analytical tools used in respect of the focus group method used.

[31] RA Krueger and MA Casey, *Focus Groups A Practical Guide for Applied Research* (Sage Publications Inc, 4th ed, 2009).

Table 1: Focus group participants

Focus Group 1		Focus Group 2	
Property Solicitor	PS	Barrister / Valuer	BV
Property / Construction Solicitor	CS	Solicitor / Valuer	SV
Valuer	V1	Valuer	V3
Valuer	V2	Valuer	V4
Valuer / Educator	VE1	Valuer	V5
Valuer / Educator	VE2	Valuer	V6
Researcher	R	Property Graduate	PG
Independent Facilitator	FAC	Researcher	R
		Independent Facilitator	FAC

3. DATA ANALYSIS

Consistent with discussion in the focus groups being moderated in accordance with the four themes identified above, thematic analysis of data began in the same vein. On reflection, it became apparent that some refinement of pre-determined themes was needed as were additional themes to capture the essence of the data. As a result, the nine themes that emerged were as follows: taxation, economics, education, valuation process, valuation frequency, valuation method, information, codification of law and codification of practice.

To simplify analysis, a basic structure was then adopted whereby each theme was labeled, defined, described, and analysed for positive and negative feedback and points of confirmation.[32] Key points of agreement and disagreement were juxtaposed and scored. The scores for each theme were tallied and weighted to provide a measurable outcome for that theme. This method provided a more objective means of determining the most contentious factors. The summaries of each theme are included in table format with points of agreement highlighted in green; points of disagreement in red and additional points and comments which contribute to the debate but are neither in agreement or disagreement are highlighted in blue. In some instances comments were not scored where it was the same participant commenting further or where a point was being clarified by another participant. In concluding this part of the analysis, the average weighted score was assigned the following outcome:[33]

1 – 1.5 = general agreement

1.6 – 2 = neither agreement or disagreement

> 2 = general disagreement

[32] RE Boyatzis, *Transforming Qualitative Information: Thematic Analysis and Code Development* (Sage Publications Inc, 1998) 31. The framework used was adapted from this source.

[33] Miles and Huberman (1994), at n 22, 57 state that '[A]n inductive approach using a general accounting scheme allows codes to be developed in graduating from micro to macro levels in drawing conclusions.'

A detailed account of the first three illustrative themes[34] discussed by the focus groups now follows in table display form with the focus group identified in the left column followed by the page number in the full transcript, commentary and finally, rating. The analysis of both focus group comments is combined for the purposes of analysis. This allows agreement and disagreement on the themes across both groups to be compared. The left hand column allows the reader to distinguish if agreement and disagreement occurred within or across the two groups. The table displays serve to demonstrate the application of the analytical techniques used herein..

Theme 1: Taxation

The average weighted score for a land tax constituting a tax for services was 2.1, which is at the lower end of the 'general disagreement' range. Various views for its justification were discussed, with some level of disagreement emerging between participants on whether or not state-based land tax was an earmarked general purpose tax. Both groups raised the prospect of land tax being replaced with a higher rate of Goods and Services Tax (GST), which would move the taxation from land or capital to a higher tax on consumption. A further discussion point was the practical implications of changing the tax base from land value to improved value. Discussion on this point ranged from the complexity in determining land value in highly urbanised locations, to the enormity of the task and workforce needed to measure and record improvements using improved value. A summary of the discussion of the above points and the interaction within each focus group follows:

FG	Pg	Commentary – Taxation	Rating
1	3	**VE1: … overall in terms of being an investor in property, are you better off tax wise at being an investor in shares or something else. Obviously land tax is just part of a package of taxation structure that goes around being a property investor that's, you know, I don't know whether that's … I see it more as being an easy way, your original point, you know; it's an easy way to raise revenue, you can't duck it; it's given …**	1
1	3	**VE2: A…. About the Government trying to recoup the money it puts in for infrastructure. Because yeah, for land to work, the infrastructure has to be there. And indirectly …**	1

[34] The rationale here is to demonstrate the analysis technique rather than research itself, which in its entirety is beyond the scope of this article. Detailed analysis of all themes is available by contacting the corresponding author.

FG	Pg	Commentary – Taxation	Rating
1	4	**PS: But it appears to me it's a very indirect link between the two. That the people who put the infrastructure in is [sic] not the State in any event, usually. It's in new release areas, it's the developers who are putting it in, being funded by the sales of the properties. And then in existing areas, it's local Councils that are putting it in. And local Councils are starved of resources; they don't have any money to be upgrading their infrastructure. State Government is aware of that and doing nothing about it, and the land tax in NSW is going just to fund recurrent expenditure on employees and other things. It's not, if it was meant to land, I mightn't have such an issue with it; but for me, it really just seems to be about revenue and nothing else. And you can justify; you can think up reasons why it may be more equitable than raising revenue some other way; but I don't think any of that underpinned the reason it was introduced or the reason that it's retained.**	**3**
1	22	**VE2: There's one school of thought – do away with State taxation, and just make GST 15%. Now it's fixed. We have no stamp duty; no land tax.**	**3**
2	30	**FAC:** Oh, yes, but then people like me jump up and down and say, 'But you're letting the rich off the hook, and you're penalizing the poor.' Because GST is regressive, and the other one is progressive.	
2	30	**BV: Yep. So poor Local Government versus States, yeah.**	
		V4: I think it started off being a little bit on the complicated side, and the unimproved value of land. But these days, it's got that complex, and there's so many different concessions.	
2	5	**V5: You can do away with it entirely if you're just looking at a tax thing. You can just make it part of the GST. You can just make it part of the GST; but we have a land tax management. That's what we're talking about, in my book.**	**3**
2	15	**V4: The problem I see is that you've got a system, a tax system, that's based on something that's in many cases difficult to prove. Now, if I'm the tax man and I say, 'All right, R, how much did you earn last year?' you'll tell me. All right, you pay so much in the dollar on what you earn. But when you try to work out the land value on a piece of land, you start to hit a point where there's something in there – which being, most of the time being a house – and you've got to work out what that block of land is worth after you take away that house. And there's so much conjecture about what that house is worth. Whereas the system I think is wrong, because it shouldn't be doing that; it should be taxing people, if they want to have a land tax, tax them on something that's tangible at the time that they do it.**	**3**
		FAC: What would you suggest that would be, then?	
		V4: Well, maybe improved value.	**2**
		V6: Or rental value.	**2**

FG	Pg	Commentary – Taxation	Rating
		SV: Knock on heavy doors; measure on improvements. You'd need a huge workforce to do that. I think land value, if you're going to have a property based tax, they can … land value has got to be it, in my view.	**1**
		Weighted Average Score	**2.1**

Theme 2: Economics

The average weighted score for the economic rationale of a tax on land was 1.67, which is on the border of 'general agreement' and 'neither agreement nor disagreement'. The main point raised under this theme was that a statutory void exists in respect of the meaning of the highest and best use of land. Maximising the use of land and promoting its development was stated by a number of participants in each focus group as the primary economic rationale for taxing land. A point raised by V3 was the importance of capturing the value added by externalities, with public utilities used to demonstrate. This provided a rationale for the distinction in value of land in different locations which captures the added value attached to the efforts generated by the community. A summary of the discussion of the above points and the interaction within each focus group follows:

FG	Pg	Commentary – Economics	Rating
1	**11**	**CS**: Why couldn't you just do it on the value of the improved value, and just charge a lower rate? Is there any objection to that?	
1	**11**	**V1: Some could be not maximizing the highest and best use.**	**1**
1	**11**	**PS: It stimulates free development.**	**1**
2	**4**	**V4: I think the idea that it's based on value probably gives an incentive to land owners to develop their properties to highest and best use, which is probably one good aspect of it, if you look at it that way; so it encourages development.**	**1**
2	**4**	**V3: I agree. But that's what I'm wondering, just what we're talking about. If we're talking about that, I would say land value encompasses all those other things; in that if somebody puts a swimming pool there, and I have used the swimming pool and library and the public utility facilities, and my value goes up 10 per cent, and someone else doesn't get the benefit of those facilities and their value doesn't move because of those things, then they're not … I'm quite prepared to pay more in rates and taxes. Because the value of my asset is going up. Whereas if I want to sell, then I will reap the benefit of that 10 per cent increase, but they get nothing. If my land's worth $1M and that 10% increase of about $100,000 overnight, because of somebody's effort. Whereas if I don't get that, I don't get that $100,000. Or if I've only got a block worth $100,000, I get $10,000. So I get $1M; you get $10,000, okay. So on the basis of that, I would think that land value used as a base for rating land tax is quite reasonable.**	**1**

FG	Pg	Commentary – Economics	Rating
2	4	**V5: I tend to disagree, and it's been done away with in parts of England, where I suppose you say commercial industrial land is rated by way of an assessment, a rental assessment; based on this rental assessment, I suppose you could say that's related to land.**	**3**
2	4	**V5: Victoria. And otherwise, the residential is just done on a block basis. Block, you know, okay there's a … there's Harrington Gardens. Harrington Gardens, every property in Harrington Gardens attracts – I'm just using something as an example – attracts 'X' amount of dollars in land tax. The land tax question, V3, is land tax. It's land tax. It's here; well you can call it what you can call it. You can call it another brand of GST, if you like! But it's land tax. And currently, in my view, the way its raised in NSW is, I'd like to use a stronger term. But it's up to no good whatsoever; it's a ridiculous exercise.**	
2	6	**BV: Can I just go back? I think one of the critical things that you said, that the concept of land tax is to force people to develop their land, or encourage them to develop their properties, to the highest and best use. Now, highest and best use is a term that's bandied around; but a lot of people don't understand what highest and best use is. And there's a recent decision of the Court of Appeal of Victoria in ISPT and the Valuer-General, which does really set out in quite definite terms what highest and best use is; and that's, you know … and I think that's critical. But that's a good theory, to do that; but it doesn't transpose into reality. Because the vast majority of properties developed; people just can't say, 'All right; well I've got my land tax bill; I've got to do something about this. I've got substantial improvements on my property. But they don't represent highest and best use; but I can't economically afford to pull those buildings down and redevelop the property to its highest and best use.' So you know, that's a fallacy that has been complicated over a long period of time. Might have been all right in the early days, when there was a lot of vacant land; said, 'All right, we've got a block of vacant land; it's going to be taxed,' so you'll develop it to its highest and best use to get the best return out of it. But …**	**3**
		Weighted Average Score	**1.67**

Theme 3: Education

The average weighted score for the need for education was 1.17 which is in the mid-range of 'general agreement'. There were no negative points or points of disagreement among the participants of either focus group. The three key points emerging from this theme related to training, practice and the need for valuers to be aware of the relevant law. While the benefit of university and other educational courses was recognised, greater emphasis was needed on on-the-job training. Also noted was the need for valuers working either for government or for taxpayers against government, to be equally aware of the practices and procedures involved in the determination of value. Further, valuers needed to maintain currency of valuation practices including relevant case law. A summary of the discussion of the above points and the interaction within each focus group follows:

FG	Pg	Commentary – Education	Rating
1	34	VE2: I can tell you now that the valuers who are taking the contracts actually have to attend a statistics course. And XYX takes it. And he runs them all through it; I think it runs for a couple of days on how they're arriving, not the actual valuation process, but what's going to happen to their numbers when they update, and what process they use. I think he used the term "normalization" of the valuation results, yeah.	1
1	35	VE2: And exactly as he said, at the base level you'd have it, you've got a subject of statutory evaluation. Most courses, they would have to reflect the new methods that are … not new methods, but how the process is. Then you just have to keep exactly, as you said, all your valuers up to date that are contracting. And it may be a condition of their contract.	1
2	27	V4: Yeah, including improvements. And that I guess is going to come down to making sure that obviously those valuers that are doing it for the Government are doing it correctly, and in private companies as well. Because obviously on the other side of this, when these things do go to court, it's obviously private companies that are often representing the landowner. And their valuers obviously have to be aware of these things and the rules and procedures. And that's, I guess, got to form part of their training within the company. Before that, within uni obviously, or wherever they're trained. But I think there are well known methods of valuation that are out there.	1
1	35	PS: The textbooks seem to be full of law. So I would have thought it's already embedded in what they're learning. I mean, there's not a valuer involved in court work that doesn't know the key cases, that there are certain textbooks that everybody refers to, and the Judges refer to. So I think it's probably already there. And I don't know whether these changes would create a greater need for it; may in fact create, lessen the need for it. Of course, where you're adopting a whole different set of the valuation methodologies, or there are [sic] an armoury of them available to you; you've got to be across all of them, and across the law that applies to them.	1
2	30	V5: When I was a young valuer, we used to … one of the things we used to have were court decisions. And every case in the "Valuer" magazine, there were four or five important court decisions which were recorded. And even today, courts quote the valuer decisions, the valuer …	1
2	30	V5: Well let me say this, under this mass valuation exercise, A…, I can answer your question. When you've got pressure on you to get out something like 22,000 valuations for which you have tendered $3 a time, do you think that anyone is going to bother sending out the forms required under Section 15, or is available under section 15. They spend their time looking at Walt Disney – I won't say that's not Walt Disney – spend their time looking at IT monitors. Never get out there with a map under their arm, right.	
		Weighted Average Score	**1**

The same data analysis technique was undertaken across the nine themes and a summary of weighted average scores for each was determined and is presented in Table 2. It can be seen that 'general agreement' existed between the focus groups on the broader points of training and education, frequency of valuation and the role of information. On valuation themes, 'neither agreement nor disagreement' resulted on sales evidence, valuation method and the codification of the valuation process. 'General disagreement' existed on the taxation of land, and, more specifically, on the purpose of the tax. The second point of 'general disagreement' was on codification, though less existed in the codification of valuation practice compared to codification of the law. The quantification of the qualitative data does provide a more transparent and objective indicator of the extent of agreement/disagreement and thus provided a useful barometer for the appetite amongst stakeholders for reform, which was central to the overarching research problem.

Table 2: Summary of Weighted Average Scores

Theme	Weighted Average Score	Agreement / Neutral / Disagreement
General Themes		
- Taxation	**2.10**	**Disagreement**
- Economics	**1.67**	**Neutral**
- Education/Training	**1.00**	**Agreement**
Valuation Practice		
- Sales Evidence	**1.63**	**Neutral**
- Frequency	**1.00**	**Agreement**
- Method	**1.73**	**Neutral**
Information	**1.00**	**Agreement**
Codification		
- Law	**2.00**	**Disagreement**
- Valuation Practice	**1.78**	**Neutral**

It is believed that the analytical techniques as described above benefited the research in that they improved the validity and reliabilty of its findings without compromising the richness of the data collected. Apart from there being greater transparency and consistency in coding (thereby enhancing the replicability of the method), it is contended that the techniques enabled the identification of areas where reforms were needed, an indication of their priority, and the level of expected stakeholder support for these reforms. The techniques used herein which included thematic analysis (including colour coding) and the juxtaposition and scoring of opinions, allowed for the derivation of more concise and objective differentials and greater reliability in gauging of the factors most likely to inhibit reforms. The contrasting results from Table 2 serve to illustrate this point. For example, taking the general themes of 'Taxation' and 'Education/Training' it is clear that there is substantial general disagreement (based on the weighting) as to the fundamental issue of whether or not

land tax constitutes a tax for service. The implications are that reforms to land tax as a tax base will be challenging for policymakers. In contrast, stakeholders were in general agreement on the importance of education and the need for on-the-job training.

Finally, whether or not the analytical techniques used herein represent an improvement on traditional methods does depend on the ontological and epistemological beliefs of the individual researcher. In this case, the adoption of a more structured approach to qualitative data analysis does reflect a leaning towards positivism, and this bias is acknowledged.

4. CONCLUDING COMMENTS

Tax research is often multi-disciplinary in nature, reflecting both the varied backgrounds of its contributors and the fact that tax is a social phenomenon. This multi-disciplinarity should be regarded as a positive in that it allows tax researchers to see beyond the perceived norms and barriers, to look further afield for new insights and guidance in research design and conduct. This has led to the innovative approach detailed in this article whereby qualitative data has been quantitatively analysed in a transparent and reflective way so as to capture the richness of the data, but at the same time, strengthen the construct and internal validity of the findings, and their reliability. It was never intended to generalise the findings beyond the focus groups hence external validity was not regarded as an issue in this research. The technique used herein could be readily replicated and/or further adapted by other tax researchers – not only in the context of focus groups or other methods associated with qualitative research, but also with qualitative data collected by quantitative methods (for example, open-ended questions included in a survey).

It is argued that this article makes two important contributions to the literature. Firstly, it does demonstrate in detail the actual process of coding and analysing qualitative data, and in doing so does address a significant gap in the tax literature. More importantly, the technique used to quantify the qualitative data by using points of agreement/disagreement and weighting them in the manner described herein is innovative, particularly in the case of tax research and arguably so in broader contexts.

While there is support in the literature for such innovations, they do seem hard to find. It is true that all data begins as qualitative in nature, but that the positivists among us convert this to quantitative data and apply quantitative analysis techniques. Herein we have used a mixed methodology and applied four methods in a sequential manner, including the use of the focus group from the qualitative paradigm, to construct a deeper understanding of the research problem in the pursuit of a more meaningful solution. In analysing the data from the focus group we have endeavoured to develop systematic, rigorous and transparent analytical techniques more consistent with the quantitative paradigm, while at the same time, attempting to retain the richness of meaning extracted from the data.

There is no one ideal solution to the analysis of qualitative data and the techniques used in this study represent one alternative approach that other researchers may consider adopting or adapting further. Undoubtedly the identification of themes, the coding process and the weighting has involved some subjectivity on the part of the researchers and this is acknowledged. Still, the level of transparency displayed herein in the process of data analysis does go some way to countering this weakness, as does

the fact that it is just one part of a larger study. That is, the overall findings made are not based on this one method alone. As the body of knowledge on research design continues to develop, it is hoped that this contribution may stimulate others to continue to innovate in the design and conduct of tax research, as the opportunity to do so is unlimited.

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Taxing capital gains – views from Australia, Canada and the United States

John Minas* and Youngdeok Lim**

Abstract

This paper analyses a series of interviews, undertaken in Australia, Canada and the United States, with capital gains tax (CGT) experts on the preferential taxation of individual capital gains. The interviews explored their views on the taxation of capital gains in their jurisdictions. The interviewees were from academia, government advisory organisations and private practice. This paper focuses on two thematic areas covered in the interviews: the level of convergence or divergence of the experts' views on the benefits, disadvantages and need for CGT rate preferences and the experts' views on how the individual CGT should be reformed.

Key words: Capital Gains Tax, Semi-structured in-depth interviews, Australia, Canada and the United States

1. INTRODUCTION

This paper is based on a comparative research project exploring capital gains tax for individual taxpayers in Australia, Canada and the United States. We present the results of a qualitative study on taxing capital gains for which a number of experts in each individual country were identified and interviewed. These three countries were chosen as they are comparable OECD tax jurisdictions, which all offer a preferential rate for personal capital gains. The preferential rates available to taxpayers in these countries seem to be at odds with much of the literature, which describes taxation of capital gains at full rates as the tax policy ideal – although this view is not universal. The apparent discrepancy between the theory of taxing capital gains and the practice in each of the three countries was one of the motivations for this study.

This paper focusses on two thematic areas discussed in the interviews: the advantages and disadvantages of CGT rate preferences and how to reform the individual CGT in the country where the interviewee is based. One of the principal motivations for the research project was to identify the areas of consensus and disagreement on some of the main issues in taxation of capital gains for individual taxpayers. Another motivation for the research was the fact that the three jurisdictions offer rate

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preferences for capital gains, despite the view in the literature that such preferences do not represent good tax policy.

Arguably, one of the most controversial policy issues for tax systems generally is how to treat capital gains for tax purposes.[1] On the specific issue of the rate at which to tax capital gains, two broadly opposing views have emerged. One of these views holds that in accordance with Schanz-Haig-Simons comprehensive income concepts[2] and in the interests of overall tax system integrity, capital gains should be subject to the same rate of tax as ordinary income. A recurrent argument in the literature against CGT rate preferences refers to the incentive for arbitrage that they can create.[3] Arbitrage in this context describes taxpayers attempting to arbitrarily convert ordinary income into capital in order to take advantage of the rate differential between capital gains and ordinary income. A negative consequence of this arbitrage activity is that, if it is successful, it causes revenue leakage, which in turn requires an increase in tax rates on ordinary income.[4] The literature demonstrates that the ability to raise revenue is not the essential role of a CGT; rather, it is, intended to constitute an integrity measure for tax systems generally, where opportunities for re-characterisation of income are eliminated.[5]

The opposing view is that capital gains should be taxed at preferential rates relative to the tax rates on labour income.[6] A more controversial view is that capital gains should not be taxed at all.[7] The case for preferential CGT rates is usually linked to providing an incentive for entrepreneurship and risk taking, increasing the level of saving, investment and productivity and counteracting the 'lock-in effect'. However, arguments for preferential CGT encouraging risk are much more prevalent in the popular debate than in the economics literature.[8] The literature is critical of capital gains preferences as incentives for risk taking since they are untargeted and, as a result, provide incentives for non-risky CGT assets as well.[9]

In the Australian context, the recommendations of the 2010 Henry Review are considered relevant to this research given that one of the review's recommendations was to increase the rate of CGT, by reducing the level of CGT discount from 50 to 40 per cent.[10] This was part of one of the review's broader recommendations for a

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[1] Reuven Avi-Yonah, Nicola Sartori and Omri Marian, *Perspectives on Income Taxation Law*, (Oxford University Press, 2004) 87.

[2] Under which income is the total accretion to wealth over a period of time consisting of monetary increase in wealth plus imputed income and consumption expenditure for the time period.

[3] See, eg, Chris Evans, 'Curing Affluenza?: A Critique of Recent Changes to the Taxation of Capital Gains in Australia' (2000) 23 University of New South Wales Law Journal 299,302.

[4] Leonard Burman, The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed, (Brookings Institution Press, 1999), pp. 80-81.

[5] Chris Evans, 'Taxing Capital Gains: One Step Forwards or Two Steps Back?' (2002) 5(1) Journal of Australian Taxation 114, 118.

[6] A summary of some of the arguments for and against taxing income from capital at lower rates than income from labour can be found in: John Freebairn, 'Personal Income Taxation' (2012) 31:1 Economics Papers 18, 19.

[7] See, eg, Bruce Bartlett, 'The Case for Ending the Capital Gains Tax' (May-June 1985) Financial Analysts Journal, 23.

[8] Jane G. Gravelle, The Economic Effects of Taxing Capital Income (MIT Press, 1sted, 1994), 68.

[9] Noel Cunningham and Deborah Schenk, 'The Case for a Capital Gains Preference' (1992-93) 48 Tax Law Review 319, 374.

[10] Review Panel, *Australia's Future Tax System: Report to the Treasurer – Part One: Overview* (2009).

savings income discount of 40 per cent which was to apply to various other forms of passive income. The issue of how to tax capital gains is topical as evidenced by the recommendations of the Henry Review, which–if adopted–would have resulted in an effective CGT rate increase.[11] In the United States, a maximum rate of 15 per cent was introduced by the Bush administration. Although the maximum US CGT rate of 15 per cent is highly preferential, relative to the highest tax rate on ordinary income of 35 per cent, the 2010 expiry of these preferential CGT rates has since been extended by President Obama.

The paper draws on a selection of quotes from the interview data. Quotes have been included where they are considered to be representative of the views of several interviewees or because they are considered to be particularly well expressed views. Given the relatively small sample size and the fact that the research is qualitative, it is not considered appropriate to undertake any in-depth quantitative analysis of the interview responses. However, the paper includes a summary of some of the interview responses for the purpose of providing an overview. Interestingly, despite the fact that Australia, Canada and the United States each offer a CGT rate preference for the taxable capital gains of individual taxpayers, we find that preferential rates for capital gains are generally considered inappropriate and that the retention of capital gains preferences in the three countries surveyed is due mostly to political considerations. We conclude that, if the collective views of the experts in the interview sample were considered by policymakers, taxing capital gains at ordinary income rates would be a tax reform goal in each country.

This study is an original contribution to the literature as it is, to our knowledge, the first attempt to analyse the views on taxing capital gains from experts by way of a qualitative approach. One of the justifications for the study is the need to assess how closely aligned the taxation of capital gains in each of the three countries is with the views of capital gains tax experts. Whilst on the one hand, each of the three jurisdictions taxes capital gains realised by individual taxpayers at preferential rates, on the other, much of the literature on taxation of capital gains refers to the need to tax capital gains at full rates.

The remainder of the paper is organised as follows. Section 2 is a brief discussion of CGT and CGT preferences in each of the three countries. Section 3 develops the research questions on the two themes of the paper separately and describes the interview design. Section 4 presents the responses from each of the three jurisdictions and Section 5 contains the conclusions on each theme and discusses the tax policy implications, limitations and possibilities for future research.

2. BACKGROUND

2.1 Capital Gains Tax in the Three Jurisdictions

In Australia, capital gains are not considered to meet the ordinary income concept and several Australian tax law cases have outlined the distinction between income and capital receipts. Before a CGT was introduced in 1985, most capital gains escaped taxation altogether. The current Australian legislative rules in the Income Tax

[11] That is, a reduction of the CGT discount from 50 per cent to 40 per cent is effectively a CGT rate increase.

Assessment Act 1997 define a number of CGT events[12] which are subject to the CGT rules. Australia takes a different approach to taxing capital gains compared to some other jurisdictions in that CGT events are not limited to the disposal of property. In Australia, it is net capital gains that are subject to tax and these net capital gains are aggregated with the taxpayer's other assessable income. Capital losses can only be offset against capital gains, not against ordinary income. When taxpayers are unable to utilise their capital losses in a particular income year, they are carried forward to future income years. If the taxpayer qualifies for the 50 per cent CGT discount, this is applied to their net capital gain.

In the United States, CGT applies when a capital transaction results in a capital gain. A capital transaction occurs when a gain or loss results from the sale or exchange of a capital asset. A capital asset is any property except a number of items prescribed by the Internal Revenue Code.[13] Capital gains and losses are either short-term or long-term[14] and these two distinct categories cannot be netted against each other. The current United States treatment of capital gains is to tax net capital gains under a rate schedule separate from that for ordinary income. This system allows for up to $US3,000 of capital losses to be offset against a non-corporate taxpayer's ordinary income, with any remainder to be offset against capital gains or carried forward to a future year when there are insufficient capital gains in the current year to offset. The United States has provided a preferential rate for capital gains for most of the time that the CGT has been in existence in that country. Presently, the maximum rate of capital gains tax in the United States is 15 per cent,[15] and the top marginal rate of tax on ordinary income is 35 per cent. Thus, the United States has the most preferential rate of CGT rate for higher-income earners, relative to ordinary income, compared to Australia and Canada.

From the time that CGT was introduced in Canada, capital gains have always been taxed on a partial inclusion basis,[16] with the rate of inclusion in income changing at various times. Currently, the inclusion rate is one half, meaning that only 50 per cent of taxpayers' capital gains are included in taxable income. In Canada, capital losses can only be offset against capital gains and the remainder can be carried back to the three preceding years or carried forward. This CGT regime in Canada is quite similar in its operation to Australia's CGT, with one of the main differences being that Australia does not allow for the carry back of losses.

2.2 Capital Gains Tax Preferences in the Three Jurisdictions

Australia, Canada and the United States all provide a rate preference for CGT payable by individual taxpayers. These three jurisdictions were chosen for the research because their tax systems can be seen as somewhat similar and they have all experienced at least one CGT rate change. A notable difference between Australia and the North American jurisdictions is the experience each has had with full rate capital gains tax regimes. The Australian CGT regime was one that taxed capital gains at full

[12] See *Income Tax Assessment Act1997* (Cth) div 104.
[13] IRC § 1221 (2012).
[14] Generally, capital gains are long-term where the taxpayer has held the asset for twelve months or more.
[15] The maximum CGT rate on collectables, however, is 28 per cent.
[16] A certain proportion of taxpayers' net capital gain is included in their taxable income.

rates initially.[17] Compared to the United States and Canada, Australia has the most experience of taxing capital gains at full rates, in terms of the proportion of time that a CGT regime has been in place in each country. Canada has, from the time CGT was introduced, always had a tax on capital gains that is lower than the tax rate on ordinary income. In the United States, capital gains were taxed at ordinary income rates between 1988 and 1990, with preferential rates in place during the remainder of the time that CGT has operated there.

Of the three jurisdictions, the United States has experienced the highest number of CGT rate changes. Canada has had, at various times, a CGT inclusion[18] rate of one half, two thirds and three quarters. Australia has experienced only one CGT rate change. The effective CGT rate change was achieved by changing from the previous system of including the entire net capital gain in assessable income, with an indexed cost base, to the current system of including 50 per cent of the net capital gain in ordinary income, without an indexed cost base.[19] The latter is the basic operation of the 50 per cent CGT discount, a provision that became operational in September 1999.[20] One of the requirements for a taxpayer to qualify for the CGT discount is that they have held the asset subject to the CGT event for at least 12 months.[21]

Canada seemingly has more in common with Australia than the United States in its approach to the taxation of capital gains realised by individual taxpayers. A historical similarity between Canada and Australia is the fact that, in both systems, capital gains were not part of the initial tax base.[22] A more recent similarity is that in Canada, taxpayers are only required to include half of a capital gain in their taxable income.[23] The Canadian system differs from Australia's in that a taxpayer is eligible for the 50 per cent CGT preference irrespective of the amount of time that the asset has been held prior to disposal. Although a minimum holding period requirement for a preferential, or more preferential, CGT rate can be somewhat arbitrary, the absence of one, as in the case of the Canadian CGT regime, might extend the availability of the preference to items that are arguably closer in character to ordinary income rather than capital.

In the American context, the Republicans have generally wanted to reduce capital gains tax rates whereas the Democrats have wanted to keep the rates closer to those on other income.[24] The preferential treatment of capital gains in the United States has reduced the overall progressivity of the American tax system and references to this fact can be found in literature from the last few decades.[25] In the Australian context, the current rate of preferential CGT appears to have bipartisan support. This is

[17] From September 1985 until September 1999, with the indexation of cost base allowed where the asset had been held for 12 months.
[18] In taxable income
[19] The indexation of cost base is, however, still available in the case of pre-21 September 1999 CGT assets. The taxpayer can elect to use either the discount or the indexation method, where they qualify for both.
[20] *Income Tax Assessment Act 1997* (Cth) div 115.
[21] *Income Tax Assessment Act 1997* (Cth) s 115-25.
[22] This is contrast with the United States where capital gains were taxable as income from when the taxation system commenced there.
[23] *Income Tax Act*, RSC 1985, c 1 (5th Supp.) s 38.
[24] Joel Slemrod and Jon Bakija, *Taxing Ourselves,* (MIT Press, 4th ed, 2008), 279.
[25] See, eg, Richard Musgrave, 'The Carter Commission Report' (1968) 1(1), *The Canadian Journal of Economics,* 159,162.

evidenced by the fact that in 1999, the Howard Coalition Government introduced a CGT rate preference[26] and the fact that in 2010, the Rudd Labor Government ruled out adopting the recommendation of the Henry Review to change the rate of CGT discount from 50 to 40 per cent.

Although CGT rate preferences can prevent the inflationary component of a taxable capital gain being subject to tax, they are clearly an imprecise way of achieving this.[27] Factors relating to specific design features of a particular tax system can also be relevant to the rationale for the preferential treatment of capital gains. For example, some of the interviewees in this research project referred to the fact that the United States lacks an income tax provision that integrates the corporate and personal tax system,[28] which in turn causes double taxation. It might therefore be considered that a preferential rate of CGT is an appropriate way of providing an adjustment for this. However, it is noted in the literature that a CGT rate preference does not completely eliminate the problem caused by the double taxation in the classical system; it only reduces its impact.[29] Furthermore, the literature notes that, if a CGT rate preference is considered necessary to reduce the double taxation of corporate stock, it should apply to this specific capital asset only.[30]

Professor Joel Slemrod, in his large-scale research on professional opinions about tax policy, surveyed 503 members of the National Tax Association in the United States to enable a comparison of how views have changed from 1934 to 1994.[31] Slemrod's 1994 survey of tax policy opinions included several questions concerened with taxing comprehensive income and capital gains. The question most closely related to the interview questions in this paper is '*Should capital gains be taxed at a lower rate than ordinary income?*' In the 1994 survey, Slemrod found that there was 32 per cent agreement with this question; the level of agreement by sector was 61 per cent in private, 26 per cent in government and 18 per cent in academia.[32]

3. RESEARCH DESIGN

3.1 Research Questions

This paper looks into two thematic areas: the advantages and disadvantages of CGT rate preferences and the broad question of how to reform the individual CGT in each country. In the first instance, theme one is considered according to the responses provided to the following two interview questions.

[26] The 50 per cent CGT discount.

[27] The indexation system used in Australia prior to the CGT discount and still available in some circumstances is a more precise way of achieving an inflation adjustment. In those situations where the indexation method is available to taxpayers, there is no inflation adjustment beyond the September 1999 quarter.

[28] Such as the Australian imputation credit system for franked dividends which achieves partial integration.

[29] Cunningham and Schenk, above n 9, 331.

[30] Burman, above n 4, 77.

[31] Joel Slemrod, 'Professional opinions about tax policy: 1994 and 1934' (1995) 48 *National Tax Journal* 121, 126.

[32] Ibid.

Question one: What do you consider to be the main benefits and disadvantages of CGT preferences?

Question two: Given the benefits of deferral that apply to capital gains and the ability of the taxpayer to effectively choose when and if they will realise a capital gain, are preferential rates for capital gains considered appropriate?

One of the purposes of question one was to compare the current thinking of CGT experts on CGT rate preferences generally and the specific preferences offered in their country. Although the focus of this question was on CGT rate preferences, respondents were still able to discuss other types of CGT preferences.

Question two was designed to complement question one. Most of the responses provided to this question gave a clear indication as to whether the interviewee was in favour of CGT rate preferences or not. In total, 14 respondents – a majority of those interviewed – responded that rate preferences for capital gains were inappropriate in light of the deferral benefits that applied. Four respondents argued that there was some justification for CGT preferences, whilst a further six either did not provide a conclusive answer to the question or referred to arguments both for and against CGT preferences.

As part of the interviews, another question related to CGT rate preferences was asked:

Question three: Is the case for retaining capital gains preferences due mostly to economic efficiency considerations, political considerations or a combination of both?

The response to question three may be partially dependant on the responses to the previous questions. That is, an interviewee who is of the view that preferential rates for capital gains do not have a strong tax policy foundation, might conclude that it is more likely that the reasons for them being a feature of the respective tax systems of each country are more related to political rather economic efficiency considerations.

The project was also concerned with the experts' views on how the taxation of capital gains might appropriately be reformed in their respective jurisdictions. On this point, the following interview question was asked:

Question four: How do you think that the capital gains tax system in (Australia/Canada /the United States) can best be reformed?

Question four was designed to allow the respondents the opportunity to summarise the main points discussed in their interview and speak about any other CGT issues that had not been covered by the previous questions. At the end of each interview, respondents were able to add any further comments or talk about areas that had not been covered. One of the justifications for question four is provided by the literature that identifies asking a final open-ended question as an approach consistent with inductive reasoning, it is considered that this approach has the potential to uncover ideas that might inform the research.[33]

[33] Margaret McKercher, *Design and Conduct of Research in Tax, Law and Accounting*, (Thomson Reuters, 2010) 159.

Although question four can be considered a fairly broad question, capable of generating a wide range of possible responses, it is nevertheless considered valuable to the study as a whole. Question four enabled the interviewees to talk specifically about what they saw as the priorities for reform of CGT in their jurisdiction. One of the advantages of the question is that it is free from bias and does not limit what respondents can address in their answers.

Question four was intended to be the most open-ended question asked in the interview; this was reflected in the diversity of interview responses as a number of new themes emerged.

3.2 Interview Design

The methodology for the project was individual, in-depth interviews with experts on the topic of capital gains tax. The interviews took place during 2011. As all the interviews were conducted in person, there were budgetary constraints on the number of locations where these could take place. For practical reasons, interview locations were selected in Canada and the United States where several experts were located. Consequently, the selection of interviewees was somewhat limited to the extent that there were locations where a lesser of number of experts were located which were excluded from this study. This is not considered to have too great of an impact on a qualitative study such as this one.

The selection of interviewees for the research resulted in 24 interview participants in total: 11 from Australia, eight from Canada and five from the United States. The interviewees were a mixture of tax academics, tax practitioners and tax experts in government advisory type roles. The distribution of interviewees by country and broad demographic group is shown in Table 1.

Table 1 - Distribution of interviewees

	Academia	**Tax practice**	**Government advisory**	**Total**
Australia	10	1	0	**11**
Canada	6	2	0	**8**
United States	0	1	4	**5**
Total	**16**	**4**	**4**	**24**

The breadth of the interview sample might have been improved had some interviewees from all three demographic groups been interviewed in each individual country, although this is not essential for a qualitative study. Ideally, interviewees would have included academics in the United States and people from revenue authorities or government advisory organisations in Australia and Canada. This would have increased the overall representativeness of the sample in each individual country. Nevertheless, the interviewees are a reasonably good sample of CGT experts. In the

case of the 10 Australian academics who were interviewed, six were either professors or associate professors; the majority had publications on CGT. The tax practitioners and government advisory experts were all identified as having a very high level of CGT expertise and were selected for interview based on their credentials. Some of these interviewees had publications on CGT and others had been identified as CGT experts for other reasons. The requirement for anonymity in this research project necessitates that information which could be used to identify specific interviewees is not presented in this paper.

Semi-structured in-depth interviews were used in the research project, although these were primarily based on a set of prepared questions. The interviews were not considered to be structured as they were not limited to an identical set of questions. The aim of the interviews from the outset was to identify themes and semi-structured interviews were considered to be the best way of achieving this. Interviewees were provided with a list of indicative questions prior to each interview.

The interview questions were considered open-ended rather than closed questions. The literature identifies open-ended questions as a typical feature of qualitative interviewing.[34] It is also considered that an open-ended interview approach is a way of maximising response validity, since there is a greater opportunity for respondents to organise their responses within their own framework.[35] Consideration was also given to informal conversational interviews, which the literature identifies as the most open-ended approach to interviewing.[36]

Quotes from interview responses included in this paper have not been attributed to individual respondents so as to maintain confidentiality, as was agreed to in advance of the interviews. A unique letter code has been assigned to the respondents quoted in the paper.

4. RESEARCH FINDINGS

4.1 Theme One – Capital Gains Tax Preferences

A summary of responses to question two by country are shown in Table 2.

Table 2 – Interview Responses to question two by country

	Yes	No	Inconclusive	**Total**
Australia	1	7	3	**11**
Canada	2	4	2	**8**
United States	1	3	1	**5**
Total	**4**	**14**	**6**	**24**

[34] Annette Grindsted, 'Interactive resources used in semi-structured research interviewing' (2005) 37 *Journal of Pragmatics* 1015-1035, 1021.

[35] Joel Aberbach and Bert Rockman, 'Conducting and Coding Elite Interviews' (2003) 35:4 *PS: Political Science and Politics*, 673, 674.

[36] Michael Patton, *Qualitative research and evaluation methods,* (Sage Publications Inc., 3rd ed, 2002) 342.

A summary of responses to question two by demographic are shown in Table 3.

Table 3 – Interview Responses to question two by demographic

	Yes	No	Inconclusive	Total
Academia	2	10	4	**16**
Tax practice	1	2	1	**4**
Government advisory	1	2	1	**4**
Total	**4**	**14**	**6**	**24**

4.1.1 Responses to Question One and Two from the Australian Interviews

Question one: What do you consider to be the main benefits and disadvantages of CGT preferences?

Question two: Given the benefits of deferral that apply to capital gains and the ability of the taxpayer to effectively choose when and if they will realise a capital gain, are preferential rates for capital gains considered appropriate?

The main disadvantages are…There are clear equity implications and…since capital gains form in an increasing percentage of income as incomes rise…the effect of it is quite regressive. The benefit accrues more and more…as your income rises, but perhaps a more important disadvantage is the economic distortions it causes by altering the efficient allocation of capital…ancillary to that is to take advantage of the distortions requires a lot of reorganisation of transactions which means there's a lot of deadweight losses...

(Respondent M on question one)

M's response is consistent with a view in the literature about the importance of horizontal and vertical equity in a tax system. Not taxing capital gains at full rates can lead to mismeasurements of income and, in turn, horizontal inequity.[37] In Australia, as well as in the other jurisdictions, capital gains are more highly concentrated at higher income levels, which allows for a lower effective tax rate amongst higher income taxpayers with more capital gains.

[37] Richard Krever and Neil Brooks, *A Capital Gains Tax for New Zealand* (Victoria University Press for Institute of Policy Studies, 1990) 44.

…it is inappropriate to have a CGT discount or an exclusion or a lower rate of capital gains than you have for other forms of income because…investors can choose when to realise their assets…so you do potentially get some game playing going on…

(Respondent N on question two)

I don't think you need preferential rates.

(Respondent R on question two)

I think that deferral is a big advantage and that preferential treatments in fact exacerbate lock-in factors… I think the deferral aspects on the whole outweigh the case for any sort of concessional treatment. Tax on a realisation basis is in itself a concessional treatment.

(Respondent S on question two)

Another respondent from Australia referred to the bunching problem. According to some of the literature, bunching is an overstated problem as most capital gains are derived by high-income taxpayers whose income is at the top marginal rate of tax regardless of whether they realise capital gains in a particular year.[38] Furthermore, the benefits of deferral can be seen as counteracting the bunching problem in the case of capital gains that are realised several years after the asset was acquired. In some cases, the deferral benefits may completely offset the bunching effect.[39] The same respondent stated that, although, in their opinion, lock-in could be a problem, they did not see a preferential rate CGT as an effective way to deal with the problem.

Another respondent from Australia referred specifically to the problem of very few capital gains made by non-residents being subject to Australian tax. The respondent referred to this as an inequitable approach to CGT in that foreign residents receive a 'capital gain holiday' in Australia whereas resident taxpayers are subject to CGT on the same type of gains.

As was the case for a number of Canadian respondents, several Australians referred to the incentives to re-characterise income into capital as a specific disadvantage of preferential CGT. In response to an interview question not quoted in this paper, some respondents provided examples of ways in which taxpayers had achieved such re-characterisation.

4.1.2 Responses to Question One and Two from the United States Interviews

I think the big benefit is probably in…not interfering with the realisations of capital gains, so the realisations response. The disadvantages…once you have a differential between capital gains and other assets, you start all this game playing… to turn one kind into another to transform income into a capital gains form. I think it leads to distortions in the kinds of assets you hold and it leads to a lot of gaming of the system…

(Respondent A on question one)

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[38] Richard Krever, The Taxation of Capital Gains, In *Income Tax A Critical Analysis*, (LBC Information Services, 2nd ed, 1996).
[39] Cunningham and Schenk, above n 9, 328.

Respondent A was of the view that there were better forms of saving and investment incentives than a CGT rate preference. This respondent also referred to previous CGT rate reductions in the United States being justified by policymakers on the basis of revenue gains. However, the respondent believed that the literature that estimates a large revenue gain as a result of a CGT rate cut is not very persuasive due to flaws in the econometric techniques used. Respondent A also referred to the potential for politicians to confuse increased CGT revenue from economic growth with that from taxpayers' response to CGT rate reductions. Although there may be some degree of responsiveness of capital gains realisations to lower CGT rates in the short run, there is a lack of empirical evidence of their responsiveness to rate cuts in the long run. If the revenue collected from capital gains is an important consideration, then the level of responsiveness of capital gains realisations to rate cuts needs to be large enough to compensate for the static revenue loss of the rate cut itself.

Probably not, I think they're pretty favoured as is. Relative to dividends they're favoured already because of deferral and exclusion at death…if you hold on to them until death you don't pay any tax. So exclusion cuts it by about half, exclusion and deferral itself cuts the rate by about half all by itself. I think there are other more efficient ways to give up revenue than the capital gains cuts.

(Respondent A on question two)

According to Respondent A, capital gains tax rate preferences lead to lost revenue. That is, the behavioural response to lower CGT rates is too low to compensate for the static revenue losses resulting from the lower rate. It is also implied in Respondent A's response to question two that capital gains realisations tend to be relatively unresponsive to CGT rate cuts in the long run. A number of empirical studies from the United States on the elasticity of CGT realisations to rate changes have reached this conclusion.[40] Respondent A further stated elsewhere in the interview that attempting to reform the effective CGT exclusion at death would be too difficult to deal with politically. The literature considers the failure to tax capital gains at death to be a large impediment to the sale of assets which increases with a taxpayer's age.[41]

About the only possible benefit….of preferential rates on capital gains is…to deal with the fact that the corporate income tax and the individual income tax in the US are not integrated particularly well and so we have a situation where some income is taxed once, some income is taxed twice, at both the corporate and the individual level, and then there is some income that's not taxed at all.

(Respondent B on question one)

I think that the two [benefits] I can see as having some justification are, one, the problem…with people being locked-in to assets and so I think the relief of lock-in, particularly if individual income tax rates are very high, is some justification for having the (capital) gains rate lower. Essentially you've got unrealised gains that are going untaxed and ordinary income that's going taxed and so probably the least distorting thing to do with the realised gains is to tax it somewhere in between….The

[40] See, eg, Leonard Burman and William Randolph, 'Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data' (1994) 84 *The American Economic Review* 794-809.
[41] Gravelle, above n 8, 125.

other piece is to the extent that some gains come from corporate profits and some of those corporate profits have previously been taxed at the enterprise level, that would produce a second level of tax which might lead to over-taxation of corporate enterprises relative to other businesses.

(Respondent C on question one)

The response of Respondent C is consistent with the literature on the lock-in effect. The lock-in effect describes taxpayers choosing to hold their capital assets that have appreciated in value, so that the CGT on the accrued capital gain can be deferred or altogether avoided.[42] The literature describes lock-in as an impediment to selling one asset and replacing it with another which has a higher pre-tax return.[43] According to the theory of the lock-in effect, taxpayers will be responsive to a lowering of the CGT rate and will choose to realise accrued capital gains once they consider the CGT rate to be acceptably low.

The deferral provides a preference even without a special rate, so in that sense, you're adding on to the favourable treatment of capital gains when you give a preference…. It is the deferral or it is the voluntary nature of realisations which means that you kind of get into the situation where if you have high individual rates and you don't have a preference, you're likely to have a lot of gains that might have been realised that aren't, then you sacrifice revenue and you keep people from keeping their portfolios in the form which is most beneficial to them, so you do produce deadweight losses when you do that.

(Respondent C on question two)

As a follow-up question, Respondent C was asked whether something less than full rate capital gains tax is the ideal. The response given to this question was:

…it really depends on the kind of system you have. If you insist on having very high top individual rates I think you have to have some preferential treatment of capital gains. I can imagine a situation where you can get the top individual rate low enough that you don't need that. In fact we did that here in 1986.

(Respondent C)

As was the case for Respondent B, Respondent C also referred to the absence of corporate integration in the US tax system as being a benefit of and reason for preferential CGT. Respondent C also argued that the optimal rate for CGT, in terms of maximising revenue, is a rate lower than that which applies to ordinary income.

A theme to emerge from the American interviews was that CGT should be considered in the context of the budget deficit that the United States was experiencing. A recurring suggestion was that CGT should be reformed as part of an overall tax reform package under which CGT rates were either increased or taxed as ordinary income and ordinary income rates were lowered. The purpose of this type of reform would be to increase overall tax revenue.

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[42] Alan Auerbach, 'Retrospective Capital Gains Taxation' (1991) 81 The American Economic Review 167.

[43] Lawrence Lindsey, Rates, Realizations and Revenues of Capital Gains, in M. Feldstein (ed), *Taxes and Capital Formation*, (University of Chicago Press,1987), 17-26.

4.1.3 Responses to Question One and Two from the Canadian Interviews

> *…preferential [CGT is]…intended to deal with the integration of taxation…at a corporate level together with the taxation of the shareholders…it doesn't seem appropriate that the full amount of the gain should be taxed when the shareholder disposes of the shares because the same income has effectively been taxed twice…. I think the primary disadvantage…is there's an incentive for taxpayers to…characterise one type of income as a capital gain rather than as the income it should be characterised [as].*
>
> (Respondent F on question one).

Respondent H referred to the incentives to re-characterise income into capital in response to a question on how previous changes to individual CGT in Canada had been justified. This response has been included here since it is considered relevant to the theme of question one and question two.

> *…there's a view that the tax rate on capital gains needs to be almost the same as the tax rate on dividends. The rationale is that there is…a set of corporate reorganisations you can do to convert dividends into capital gains or vice versa within a private, closely held corporation…and the Government's view has been that they couldn't do much about it. The argument was that, if you found that capital gains were getting too lightly taxed relative dividends, people would convert what would otherwise be dividends in a private corporation setting into capital gains or ...if dividends were more lightly taxed they would try and create a situation where it would be for tax purposes a dividend.*
>
> (Respondent H)

> *I'm not persuaded there are lots of benefits but [I] see lots of disadvantages. I'm not convinced…that [it] encourages entrepreneurialism… There are other things that drive… entrepreneurial motivations that are much more significant than the prospect of low rate on a gain at the end of it all, when they sell out… The disadvantages…there are vertical equity[44] disadvantages…and the complexity and the games that are played around the borderline… As soon as you've got those discrepancies between one kind of income or another one thing or another, people will fight over those battles and that creates a need for anti-avoidance rules…so those are the huge disadvantages.*
>
> (Respondent I)

Respondent I also referred to previous lifetime exemption for small businesses, for certain types of capital gains that previously operated in Canada. One of the remaining lifetime exemptions still applying in Canada is the exemption for shares in a Canadian-controlled private corporation. The respondent stated that the justification for this exemption appears to be to encourage the growth of Canadian small businesses. A criticism that the respondent provided for this type of justification was that it is not logical in policy terms, given that the exemption applies at the time of the

[44] The general concept of vertical equity is that taxpayers should be required to pay a higher rate of tax as their ability to pay increases.

shares being sold. It was the respondent's view that this policy creates an incentive to sell small businesses rather than grow them.

All the evidence is clear in Canada and other countries that capital gains are realised disproportionately by higher wealth, higher income individuals. Any sort of preference is [from a distributional perspective] somewhat odd… [There are] administrative compliance costs associated with re-characterisation of capital income as capital gain, which is another negative. And the benefits…the…behavioural response….savings decision, lock-in effect, inflation adjustment… risk taking, those are supposed benefits.

(Respondent J on question one)

The main disadvantages are that it's unfair and that it creates inefficiencies and it creates administrative problems and it makes the tax system a less effective instrument for redistributing income… The alleged benefits are that it reduces lock-in, reduces the bunching effect and compensates for inflation and encourages risk taking.

(Respondent K on question one)

Respondent K went on to say that, in giving capital gains preferences, governments have argued that they are necessary for encouraging risk taking and entrepreneurship, but in the interviewee's personal view, these arguments did not have any merits.

No; indeed the fact that you get…to defer it is an additional tax benefit. I mean it's an argument for taxing them at full rates. You've already given them preferential treatment by allowing people to defer the gain and you know, all that does is exacerbates…the lock-in effect.

(Respondent K on question two)

The case for preferences is pretty weak stuff, particularly where you've got some form of dividend imputation.

(Respondent J on question two)

A theme that emerged from the Canadian interviews was that many interviewees, including Respondents F, I and J, referred to problems with the borderline between income and capital and the incentives created for taxpayers to convert ordinary income into capital gains where preferential rates were provided for the latter. According to the literature, the arbitrary conversion of income into capital can be achieved through complex financial instruments designed to provide a cash flow similar to dividends or interest whilst classifying the receipts as something other than either dividends or interest.[45] Inequity and unfairness were also considered to be disadvantages of CGT preferences according to some of the Canadian respondents. One of the Canadian respondents described a benefit of preferential CGT as moving the tax base towards a consumption-type base.

[45] Avi-Yonah, Sartori and Marian, above, n 1.

4.1.4 Responses to Question Three

Question three: Is the case for retaining capital gains preferences due mostly to economic efficiency considerations, political considerations or a combination of both?

I don't think you can separate the two…

(Respondent D)

Political considerations…but when I say political considerations, I don't mean that there's a sentiment in the country. I just mean the political clout of wealthy taxpayers.

(Respondent K)

I think it's a combination…a lot of politicians have been searching…for the magic bullet…something we can do to cut taxes and not (lose) a lot of money…so they readily listen to these arguments that you can't really raise revenues with capital gains or you don't lose much when you cut them because of these realisation responses.

(Respondent A)

The answers to question three revealed an area in which there was a degree of consensus. Specifically, none of the respondents said that the case for retaining CGT preferences was due mostly to economic efficiency considerations. Australia had the highest proportion of respondents who said that CGT preferences were due mostly to political considerations, whilst the lowest proportion of respondents who said the same was in the United States.

Several of the Canadian interviews included some discussion of the influence of political considerations in setting the original rate of CGT, when it was first enacted in 1972. This was explained in terms of policymakers, at that time, perceiving that there would be difficulties in going from a zero rate of CGT to 100 per cent inclusion of capital gains in ordinary income. In this sense, the 50 per cent inclusion might have been seen as a n ecessary political compromise. One interviewee suggested that the CGT preference in the United States at the time may also have contributed to the decision by Canada not to tax capital gains at full rates.

A distribution of the answers to question three is shown in Table 4.

Table 4 – Interview Responses to Question Three

	Political	Both	Economic efficiency	Unanswered	Total
Australia	9	2	0	0	**11**
Canada	4	3	0	1	**8**
United States	2	3	0	0	**5**
Total	**15**	**8**	**0**	**1**	**24**

Although it is not the intention of this paper to undertake quantitative analysis of the results, it was noted that of the three demographic groups, academics had the highest proportion of respondents who answered that CGT preferences were due mostly to political considerations. Interviewees from government advisory organisations had the highest proportion who answered that they were due to a combination of political and economic efficiency considerations.

4.1.5 Conclusions on Theme One – Capital Gains Tax Preferences

An apparent theme from interview questions one and two was that the rate of tax on capital gains should be increased whilst the rates on ordinary income should be decreased. Several respondents stated that the tax rates on ordinary income and capital gains should be the same. Some respondents did not think that the rates of tax on capital gains should be increased. Responses to question three confirm the influence of political considerations on setting CGT rates.

The majority of respondents did not favour CGT rate preferences. This was apparent in many of the answers provided to the question about the advantages and disadvantages of CGT preferences, where most of the interviewees focussed on the disadvantages and some did not refer to any advantages of CGT preferences. One respondent referred to the case for taxing capital gains more heavily than ordinary income, rather than preferentially, given the benefits of deferral. Several interviewees cited the vertical equity disadvantages of CGT preferences and the fact that capital gains are realised disproportionately by higher income taxpayers. The literature describes vertical equity as taxation based on ability to pay which may be achieved by progressive rates of tax.[46] Several interviewees referred to administrative and compliance problems caused by CGT rate preferences.

Some respondents stated that a reduction in the magnitude of the lock-in effect was an advantage of preferential rates. One interviewee described reduced lock-in as of some relevance to an individual seeking to balance their portfolio, but not necessarily more efficient for the whole economy. This is consistent with some of the literature, which argues that lock-in does not require a remedy in the form of a CGT rate preference. One of the reasons given for this is that lock-in at the individual investor level is unlikely to have a significant effect on the overall allocation of capital, since there is enough capital that is not subject to lock-in.[47]

Although a reduced tax rate on capital gains is likely to reduce lock-in, the literature identifies other factors that may be more important in causing lock-in than CGT rates. One such example is the treatment of capital gains at death in the United States, which is said to be the primary cause of lock-in in that country.[48] The fact that a taxable capital gain does not arise at death also contributes to lock-in in Australia. However, the preference for capital gains at death in Australia is less pronounced than in the

[46] Paul Kenny, 'Australia's Capital Gains Tax Discount: More Certain, Equitable and Durable?' (2005) 2 *Journal of the Australasian Tax Teachers Association* 38, 40.
[47] Calvin Johnson, 'Taxing the Consumption of Capital Gains' (2008) 28 *Virginia Tax Review* 477, 501.
[48] Ibid 502.

United States, given that the cost base of an asset in Australia is not 'stepped-up' at death.[49]

Several interviewees referred to an incentive to characterise income as capital gains where the CGT rates are lower. According to one of the interviewees, in a self-assessment tax system, such as Australia's, taxpayers who have the means to engage in this arbitrage are effectively choosing their rate of tax. Clearly, there is a vertical equity problem associated with this as such a choice is not available to all taxpayers. Furthermore, it is most unlikely that the policy intent of a preferential CGT rate includes the facilitation of arbitrage and allowing taxpayers to choose a lower rate on income that would be taxed at ordinary rates in the absence of preferential CGT.

Several interviewees referred to the distributional impact of preferential rate capital gains as one of its disadvantages. That is, since there is a skewed distribution of realised capital gains towards higher-income earners, this same taxpayer demographic group enjoys the benefits of preferential rates at a disproportionately higher level than lower-income taxpayers do.

The responses of the interviewees collectively to the theme one questions confirms our initial view that capital gains rate preferences are at odds with much of the literature on taxing capital gains. It would appear that some of the claimed benefits are overstated or difficult to prove empirically, such as those about the positive effect on the economy, in contrast with some of the disadvantages, especially those related to the equity implications.

4.2 THEME TWO – REFORMING CAPITAL GAINS TAXATION

4.2.1 Responses to Question Four from the Australian Interviews

Question four: How do you think that the capital gains tax system in (Australia/Canada /the United States) can best be reformed?

By the removal of as many preferences as it is possible to sensibly remove without impacting on business creativity and growth and by the introduction of the tax free threshold and…. I would also get rid of the pre-85 exemption….

(Respondent N)

[49] The effect of the *Income Tax Assessment Act 1997* (Cth) s 128-10 is that in most cases, a capital gain or loss arising from the death of a taxpayer will be disregarded. A more important CGT implication in the event of death will be the treatment of the cost base of the inherited asset. Unlike the United States, which allows for a 'stepped-up' basis, in Australia, the cost base of the asset for the inheriting taxpayer is the same as the cost base of that asset for the deceased, as per the *Income Tax Assessment Act 1997* (Cth) s 128-15(4). The exception to this rule, under the *Income Tax Assessment Act 1997* s 128-15(4) is in the case of an inherited asset that was 'pre-CGT' when held by the deceased. In that case, the cost base for the inherited asset will be its market value, meaning that it effectively loses its CGT-free status on the event of death.

…get rid of pre-CGT assets.

(Respondent U)

…dealing with negative gearing…

(Respondent Q)

In response to question four, some interviewees in Australia referred to the need to reduce the complexity of the CGT system. It was suggested by one respondent that more input from tax practitioners should be allowed in formulating CGT policy and tax policy generally and that this would achieve a reduction in the complexity of the CGT provisions. The respondent appeared to be of the view that tax practitioners had a thorough understanding of the effect of proposed tax policy changes and that their input was not being given due consideration before the introduction of some of these changes. The respondent appeared to be arguing that parts of the CGT legislation had become unnecessarily complex and that such complex tax law changes could have been avoided if tax practitioners were allowed more involvement in the tax reform process and in particular the drafting of legislation.

The issue of 'grandfathering' of pre-20 September 1985 CGT assets[50] was considered to be problematic by several of the Australian interviewees. Respondents N and U were amongst those who proposed that the issue of grandfathered pre-20 September 1985 CGT assets be addressed. Their concerns are consistent with a view in the literature that grandfathering is a uniquely Australian CGT characteristic which has bedevilled the CGT since its inception.[51] The problem of grandfathering could have been avoided if Australia had followed the example of the Canadian CGT and implemented a valuation day system for CGT assets. Under such a system, the market value of the CGT asset on the nominated valuation day is its cost base or basis. The introduction of a valuation day system in Australia would eliminate the current grandfathered status of pre-20 September 1985 CGT assets from the valuation day onwards. Taxpayers with pre-20 September 1985 CGT assets may argue that implementing a valuation day system for these assets would constitute a type of retrospective tax reform. However, any gain on a pre-20 September 1985 CGT asset, which had accrued prior to enactment of a valuation day rule, would escape tax and this proportion of the post-19 September 1985[52] gain that is untaxed is effectively a CGT preference. It is therefore difficult to support the view that this type of valuation day system would be retrospective in its application.

4.2.2. Responses to Question Four from the United States Interviews

…getting rid of this rate structure and [implementing] an exclusion…I think we could afford to raise the capital gains tax rate, given our revenue needs without doing much harm to anything and we could raise some revenue…go back to the pre-Bush tax cut level of 20 per cent and maybe higher or its equivalent in proportional rates…Raise

[50] In Australia, a pre-20 September 1985 CGT asset (pre-CGT asset) is one which was last acquired before 20 September 1985. Once the asset is subject to a CGT event, it loses its pre-CGT status.

[51] Gordon Cooper and Chris Evans, *Cooper & Evans on CGT* (Thomson Reuters, 2nd ed, 2010) 8.

[52] Capital gains on pre-20 September 1985 capital gains assets are not subject to CGT in Australia because of the grandfathering rules that accompanied the introduction of CGT.

[CGT rates], make an exclusion and get rid of it entirely for owner occupied housing…. The foremost policy [factor] that I think should drive tax policy of any kind right now, at least in this country, is dealing with the deficit and I think raising taxes needs to be a part of that because it's just too hard to do it on the spending side.

(Respondent A)

Respondent A argues that an exclusion of a set percentage of capital gains from taxable income is a superior form of CGT in comparison to a separate rate schedule. If this reform were adopted, the individual American CGT system would bear a closer resemblance to those currently operating in Australia and Canada. It is clear that the respondent is of the view that CGT rates in the United States should be increased.

…just tax it as ordinary income and… [get] rid of a lot of other tax preferences and…[go] back to the kind of reform we had in 1986. You can have lower tax rates on all income….With capital gains, you have to fill out this whole schedule and…if you got rid of a lot of tax preferences you might get rid of a whole bunch of schedules.

(Respondent B)

I don't think it's just the capital gains tax but [in] our general system, I would prefer to see lower corporate individual rates and higher tax rates on capital gains and dividends, that is, higher tax rates on corporate income at the shareholder level and you know, preferably I'd like to see some form of accrual taxation either through taxation of gains at death or the… accrual taxation of tradable shares, I'm not sure which is the best way to go about that but I think that's going to be very hard to get in a political sense… So moving toward more accrual taxation, equalising rates on gains and ordinary income and bringing in the corporate rate I think are the kind of three legged stool of better taxation of capital income.

(Respondent C)

[If] they wanted to reduce the rate, they could reduce the rate without losing any revenue…if we went back to that it wouldn't be the end of the world.

(Respondent D)

These four responses to the question from the United States demonstrated divergence, particularly between those from respondents A and D, who appear to have differing views on the revenue effects of CGT rate changes. Respondent B suggested that a reform similar to that, which took place in the United States, in 1986, is required. In that year, the top marginal tax rate on ordinary income was reduced from 50 per cent to 28 per cent and the tax rate on capital gains was increased from 20 per cent to 28 per cent. Respondent C also suggests the same kind of reform without specifically referring to 1986.

Another of the respondents suggested the taxation of gains at death and he/she referred to this as a form of accrual taxation. The term *accrual taxation* in this context accurately describes the interviewee's reform proposal given that, in the event of death, no sale or exchange of the asset has taken place, as is generally required for a

capital gain or loss to occur under United States CGT law. The effect of such a reform would be to reduce the incentive to hold assets until death. An alternative would be to remove the stepped-up basis preference, which currently exists in the American system, and replace it with the capital gains treatment at death in the Australian system, in which the cost base of the asset stays the same when the taxpayer's heir inherits it.[53]

4.2.3 Responses to Question Four from the Canadian Interviews

On liquid investments, I'm quite happy with accrual taxation at full rates. Actually on all of it, I'd tax at full rates...I would never get elected

(Respondent H)

I think we ought to be eliminating the general preference for capital gains and… at the same time, eliminating the poor treatment of capital losses in the sense that only half of them are subject to tax and to the extent that we want to justify particular types of investment, we should have targeted rules but they do have to be appropriately targeted…

(Respondent L)

Respondent L's response is consistent with a view from the literature that attempting to encourage risk-taking by way of a CGT rate preference is target-inefficient.[54] One of the specific objections to such a preference is that it benefits investments that do not involve risk as well as assets that are non-productive or those assets which have an inelastic supply.[55]

I'd like full inclusions but…it seems that going back to the 75 per cent inclusion rate is politically feasible. We have… $500,000 capital gains exemption for small businesses… and farms…. I'd certainly get rid of that.

(Respondent K)

I think the capital gains tax system in Canada works fairly well….I think the deferrals we have now are more than sufficient and are appropriate. I don't see the need myself for more exemptions or preferences.

(Respondent F)

Respondent F did not seem to have any strong objections to CGT rate preferences relative to the other Canadian interviewees. Notwithstanding this, he/she did not support any further reduction of the CGT rate or the introduction of other forms of CGT preferences. This suggests that if policymakers consider a preferential CGT rate necessary, they should also consider the appropriate rate that should apply. This is especially important in the context of literature, which asserts that the preferential CGT rates lose revenue in the long run.

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[53] Under the *Income Tax Assessment Act 1997* s 128-15(4), the cost base of a post-19 September 1985 asset is 'the cost base of the asset on the day (the deceased) died.'
[54] Krever and Brooks, above n 37, 84.
[55] Ibid.

Of the three countries referred to in this paper, Canada is the only one that has not taxed capital gains for individuals at the same rate as ordinary income. The proportion of a capital gain that is to be included in a taxpayer's income has, at various times that the Canadian CGT regime has been in operation, varied between half, two thirds and three quarters. The fact that capital gains have been taxed at preferential rates in Canada might have contributed to the perception among some of the Canadian interviewees that taxing capital gains at ordinary income rates could be difficult to achieve in practice. That is, it might be that Canadian taxpayers have an expectation of preferential CGT rates due to Canada's taxing capital gains at less than full rates over the last four decades.

The responses from Canada indicate a diversity of opinion on the appropriate rate at which to tax capital gains. Whereas Respondent H argues for full rate CGT, Respondent K asserts that although, in his/her view, full rates are the ideal, 75 per cent inclusion may be more politically achievable. Respondent F on the other hand, thinks that the current system of 50 per cent inclusion works well. One of the Canadian interviewees referred to problems in defining realisations, citing corporate reorganisations as an example of situations in which definitional issues arise.

4.2.4 Conclusions on Theme Two

Most respondents spoke at length about their suggestions for reform of CGT in response to the final open-ended question. However, a small number of interviewees chose not to answer the final question as they were of the view that their ideas for reform had been covered in responses to the preceding questions.

It is evident that several Australian interviewees who spoke about the issue of grandfathering of 'pre-CGT' assets did not support this policy. The introduction of a valuation day would address the grandfathering problem and improve the CGT regime. The prospects of achieving this type of reform in practice are unclear.

It is arguable that borrowing against an asset is the equivalent to realising a capital gain and that it should therefore give rise to a taxable CGT event. If this view is considered correct, it diminishes the case for negative gearing. Negative gearing was referred to as another problem related to CGT rate preferences by respondents in all three countries.[56] Negative gearing is an issue closely related issue to preferential capital gains tax rates insofar as it creates an incentive for capital gains over other returns regardless of the economic efficiency of the investment.[57] The concerns of some of the interviewees about negative gearing in a preferential rate CGT regime were consistent with the literature on this topic.

Although taxation of capital gains on an accrual basis, for certain types of assets, was a reform suggested by some respondents, several interviewees were strongly opposed to accruals taxation of capital gains in any form, citing unfairness, liquidity and

[56] Although the term *negative gearing* is not in common use outside Australia, several respondents in Canada and the United States spoke about what would be considered the equivalent of negative gearing. In Australia, negative gearing allows taxpayers who have borrowed to purchase a CGT asset, to deduct from their assessable income, the excess of interest payments over taxable receipts, net of other deductible expenses.

[57] Burman, above n 4, 78.

valuation problems as some of the reasons they did not support such a reform. One of the respondents stated that they disagreed with proposals to use an accrual basis CGT for certain types of assets, such as publicly traded shares. It was their view that this would skew investment towards other types of capital gains assets that were taxed on a realisation basis and it would be difficult to see what the benefits of this type of distortion to investment incentives would be.

Several interviewees questioned whether a CGT rate preference was the best means of achieving some of the associated tax policy objectives[58] and some argued that, if such incentives were considered necessary, a better-targeted measure should replace a rate preference.

A qualification to all of the research findings detalied above is that the interviewee sample is arguably unbalanced, in part because of its size. For example, there were no interviews conducted in Australia or Canada with CGT experts in government advisory roles and no interviews conducted in the United States with experts from academia. However, the composition of the interviewee sample is not considered a significant limitation given that the research is qualitative rather than quantitative. According to the literature where interview-based qualitative research is undertaken, statistical conclusions should not be generalised to broader populations.[59]

5. CONCLUSION

5.1 Summary and Tax Policy Implications

In canvassing the opinions of CGT experts in the three countries, one of the purposes of the research project was to ascertain where the main areas of convergence and divergence were on issues associated with CGT for individuals, particularly those related to CGT preferences. Although there were some aspects of the interview responses that may be unique to the country in question, there were several areas of consensus across the three jurisdictions. Some differences of opinion arose in some of the interview responses, and this may reflect some of the difficulties and controversy associated with taxation of capital gains generally. Nevertheless, the research revealed several areas in which the interviewee population agreed. It is particularly noteworthy that despite the fact that each of Australia, Canada and the United States offers a CGT rate preference for the taxable capital gains of individual taxpayers, a significant proportion of the CGT experts interviewed were generally not supportive of such CGT rate preferences and were unconvinced as to their claimed benefits.

One of the United States respondents suggested the abolition of the separate CGT rate schedule in that country, to be replaced by a system of aggregating and taxing capital gains with taxpayers' ordinary income. The same interviewee suggested that a form of exclusion would be a superior method of providing a CGT rate preference. If such a change was enacted, it would bring the American system of taxing capital gains of individuals closer to those operating in Australia and Canada. This would be considered a worthwhile reform for the United States CGT system given the simplicity

[58] These might include objectives such as encouraging investment in new capital, increasing entrepreneurship and reducing the extent of the 'lock-in' effect in relation to capital gains realisations.
[59] McKercher, above n 33, 161.

benefits it would afford as well as the fact that it would facilitate a closer relationship between the taxpayer's tax rate on their ordinary income and their CGT rate, especially at the highest marginal tax rate. None of the Australian or Canadian interviewees suggested that a separate CGT rate schedule should replace the current CGT rate preference systems in those countries.

Some Australian respondents were critical of the grandfathered status of pre-20 September 1985 CGT assets. Grandfathering of CGT assets did not occur in Canada or the United States when CGT was introduced there, and it was originally intended that the Australian CGT system would use a valuation day system before a late and unexpected policy change. Australia's grandfathering of pre-20 September 1985 assets provided a windfall, in the form of preferential tax treatment, to taxpayers who held these assets at the time of the tax law change. In this context, it is unclear why Australia's 1999 50 per cent CGT discount was designed to apply to capital gains from assets that were acquired prior to the introduction of this reform. Preferences afforded to capital gains that are accrued are another form of windfall gain for assets purchased by taxpayers before the tax law change was introduced. Furthermore, extending the preference to accrued gains conflicts with one of the more common rationales for CGT preferences, that of encouraging new investment in capital.

The interviews, arguably, confirmed what appears to be the political imperative of retaining CGT rate preferences in all three tax jurisdictions. However, the interviews served to reinforce the point that the tax policy advantages and disadvantages of CGT preferences need to be considered on their own merits. If policymakers considered the collective views of the experts in the interview sample, the case for taxing capital gains at ordinary income rates would be, at a minimum, a longer-term tax reform goal in each country. This is notwithstanding the fact that some of the experts presented the case in favour of preferential CGT rates. Even where a preferential rate is considered necessary, it is our view that there should be objective and transparent tax policy reasons justifying the chosen CGT rate and that these should be reiterated whenever the CGT rate is changed.

Although some interviewees were of the view that an accrual-based CGT was feasible, there appeared to be a higher number who strongly opposed this type of CGT regime for practical reasons.[60] It is the authors' view that although accrual-based CGT is very unlikely to be introduced in Australia, policymakers should consider a system of deemed disposal, after a given number of years, for CGT assets in cases in which taxpayers have used negative gearing. Given that investors use negative gearing in anticipation of a capital gain, there is currently potential for a significant mismatch between deductions and taxable income in many individual cases, favouring the former over the latter. This will often be the case in those instances where a taxpayer chooses never to realise a capital gain for the asset in question. In these instances, the overall costs to the revenue are significant.

[60] It was noted in Australia by the Taxation Review Committee (Asprey Report) 1975 that 'the impracticability of taxing capital gains as they accrue is universally recognised: the tax can only attempt to deal with realised gains.'

5.2 Limitations and Future Research

The interviews primarily sought to discover more about the experts' thoughts on how to tax capital gains and their views on the rate preferences that are a feature of all three jurisdictions so that these could be analysed and compared. Notwithstanding the expertise of the sample, the conclusions in this paper need to be qualified in respect to the relatively small sample size and the demographic skewing that resulted from the sample used.[61] Another limitation is that, whilst the interviews sought the views of experts on how to best reform the CGT system in each country, it did not seek their views on the best means of achieving these reforms or specifically address whether the suggested reforms were achievable in practice. Nevertheless, numerous interview responses made specific references to potential political impediments to suggested CGT reforms.

If the recommendations of the majority of the interviewees are to be balanced with the political considerations that restrain tax reform generally, CGT rate reform for individual taxpayers should be concerned with increasing the effective CGT rate in each country so that more than 50 per cent of capital gains are taxable at all levels of income. Increasing the rate of CGT, whilst maintaining a rate preference relative to ordinary income, may constitute a second-best type of improvement to the current respective CGT systems. It would result in a compromise, which would to some degree, address the concerns expressed by the majority of the interviewees about current CGT rates being too low, with the apparent expectation from individual taxpayers of some form of CGT rate preference. Although we consider that this paper has made an original contribution to the literature by way of a unique methodology for the topic, we also consider that the project is conducive to further research using the same interview data, as there were several other themes discussed that were outside the scope of this paper. One such example is the experts' views on CGT preferences other than rate preferences, such as the use of the main residence exemption in Australia and the equivalent provisions in Canada and the United States.

[61] The use of a convenience sample necessarily requires that the research findings need to be qualified. That is, the research findings might have been different if the interviews were not restricted to the locations used in this project.

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Tax experiments in the real world

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Abstract

This article reports on the findings of a tax experiment conducted online with 2,600 individuals comprising a representative sample of the New Zealand population. We find that, in agreement with previous research, compliance increases with age. We find the population sample is significantly more compliant than previous experiments using student subjects. In contrast to prior experiments, we find no significant response to audit probability and no significant differences in behaviour among males and females. We find our experimental results produce compliance outcomes that are similar to those found in practice. Overall, the results suggest that caution should be exercised in the interpretation of experimental results from student subjects.

Keywords: tax experiments, student subjects

1. INTRODUCTION

The potential contribution to be gained from tax experiments is well established. The experimental environment facilitates control over variables and non-compliant behaviour is readily apparent. Actual levels of tax evasion, through non-declared income or over-declared expenses, cannot be accurately gauged through taxpayer filed data, while they are immediately evident in an experimental environment. Nonetheless, several criticisms have been attached to experimental research on tax evasion. Perhaps the primary criticism is that experimental research frequently utilises student subjects.[1]

As is typical of experimental research in tax, the objective of this research is to examine behavioural responses to hypothetical tax situations. Thus, the research uses an experimental design to elicit preferences in taxpaying behaviour in response to selected variables. However, this research departs from previous experiments in a number of ways. First, it uses 'real world' taxpayers in an online experiment. The authors have previously used a student sample using a similar experimental design in a lecture theatre environment (Marriott, Randal and Holmes, 2010). This research follows a similar method, but in an online setting. Second, a large sample of 2,600 subjects is used. Previously, experimental designs have been limited by access to participants. The online environment utilised in this research design has facilitated access to a large sample. Third, and again due to the research design utilised, a

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[1] For a comprehensive discussion on laboratory experiments, see Levitt and List (2007).

representative sample of the New Zealand population is presented. This departs from previous experiments that have not used students, as these typically use organisational samples, which limits the external validity of the research findings.

The primary objective of this article is to report the findings of the online experiment. However, the article also compares the results from the online experiment with previous data collected using a student sample. As with prior research, we find that age has a positive relationship with compliant behaviour. However, we do not find any significant relationships with the 'traditional' variables of tax rate, audit probability, audit penalty or gender when the experiment subjects are a sample of the population. In addition, we find compliance levels in the online experimental environment are more aligned with those found in practice, suggesting that the experiment design and the population sample used may provide greater generalizability to the taxpaying population.

The paper commences with a discussion of the current state of the literature on tax experiments. We briefly outline prior research findings on the primary variables tested in this experiment in section two. This is followed by an overview of the research design and demographic characteristics of the sample in section three. The findings are outlined in section four, with conclusions drawn in the final section.

2. WHERE ARE WE NOW WITH TAX EXPERIMENTS?

There is no shortage of research on tax evasion behaviour. A number of common variables are frequently investigated to test their impact on tax payment behaviour. Specifically, individual characteristics such as age, gender, amount and source of income, and education are frequently considered. Also of interest are tax variables: the likelihood of audit, penalties in the event of detected non-compliance and tax rates are all frequently investigated for their explanatory potential for tax behaviour. Each of these variables is tested in our experiment. Thus, a brief outline of the current literature pertaining to these variables is provided in this section. Individual characteristics are discussed first, with tax variables subsequently outlined.

2.1 Age and Gender

There are few variables that research tends to agree influence tax behaviour. Two exceptions to this are age and gender. A number of researchers have found a correlation between younger taxpayers and tax evasion (e.g. Vogel, 1974; Mason and Calvin, 1978; Warneryd and Walerud, 1982; Clotfelter, 1983). In addition, researchers have typically found greater tax evasion by male taxpayers (e.g. Vogel, 1974; Mason and Calvin, 1978; McIntosh and Veal, 2001; Birch, Peters and Sawyer, 2003). The correlation between females and tax compliance also extends to more general ethical decision making, where a number of researchers find higher levels of ethical behaviour among females (e.g. Burton, Johnston and Wilson, 1991; Barnett and Brown, 1994; Shaub, 1994; Borkowski and Ugras, 1998).

One of the limitations of much experimental research that uses students as a proxy for the population is that students represent a younger cohort. Moreover, often their experience as a taxpayer is minimal and it is possible they have no experience of paying income tax. This research avoids this limitation with the use of a population based sample.

2.2 Amount and Source of Income

Literature on the impact of income source and level of income is relatively scarce. However, in general, research concurs that there is a positive relationship between opportunity to engage in tax evasion and actually doing so (e.g. Mason and Calvin, 1978; Warneryd and Walerud, 1982; Weigel, Hessing and Elffers, 1987; Wallschutzky, 1988). Opportunity is more prevalent in certain forms of employment and, in particular, from individuals who are self-employed, or earn revenue that is not taxed at source. By way of example, Wallschutzky (1988) finds that taxpayers, such as the self-employed, that had greater opportunity to either increase deductions or reduce income declarations are more likely to evade their tax obligations. A similar study by Madeo, Schepanski and Uecker (1987) also finds that the source of income is important in explaining compliance. Research by Clotfelter (1983), which uses observations from individual tax return data to investigate tax payment behaviour finds that levels of after-tax income have a significant effect on under-reporting of income. Clotfelter also finds that wages, interest and dividend income was associated with high levels of compliance. Clotfelter suggests that this high level of compliance may be the result of a simple reporting structure for these forms of income, together with a perception of high probability of detection for non-compliant behaviour. However, limited opportunity for non-compliance may be a further contributing factor in this behaviour.

2.3 Education

There is limited literature on the relationship between education and tax evasion. However, the literature that does exist tends to produce contrasting findings. For example, Mason and Calvin (1978) find that individuals with higher levels of education believe that their chances of detection by audit are lower, but this does not translate into higher levels of tax evasion. Research by Birch, Peters and Sawyer (2003) uses a questionnaire survey to investigate New Zealanders' attitudes towards tax evasion. The survey is undertaken on university students. One of the key findings is the positive relationship between tax education and taxpayer compliance. In particular, participants from a tax course and those with a post-graduate degree were least likely to consider non-compliant behaviour as acceptable. However, the tax course participants were those most likely to have actually engaged in non-compliant behaviour in the five years immediately prior to the course. Conversely, experimental research carried out by Tan and Chin-Fatt (2003) also in the New Zealand environment finds that increased tax knowledge did not impact significantly on perceptions of fairness and tax compliance attitudes. However, it has been suggested that education, and in particular, tax education, is helpful for tax evasion in practice. By way of example, Vogel (1974) suggests that some familiarity with the tax system may facilitate evasion through awareness of opportunities to evade tax.

2.4 Audit Probability

There is no shortage of experiments, and other methodological approaches, investigating the impact of audits on tax behaviour. In general, most research finds that increased audits, or the perception of increased audits, act as a deterrent to tax evasion (e.g. Dubin and Wilde, 1988; Dubin, Graetz and Wilde, 1990; Sheffrin and Triest, 1992; Beron, Tauchen and Dryden Witte, 1992; Iyer, Reckers and Sanders,

2010; Kleven, Knudsen, Kreiner, Pedersen and Saez, 2010). Indeed, Mason and Calvin (1978) find that the independent variable with the strongest correlation to admitted tax evasion is the belief that the individual is unlikely to be detected by audit. Typically, experiments find that greater certainty of audit likelihood is positively correlated with tax compliance (Spicer and Thomas, 1982; Alm, Jackson and McKee, 1992; Alm and McKee, 2006; Alm, McClelland and Schulze, 2006).

Recent research by Gemmell and Ratto (2012) uses taxpayer data to investigate the impact of a random audit process on behaviour. Gemmell and Ratto use 8,300 United Kingdom tax returns to compare randomly selected taxpayers that were audited and not audited. Gemmell and Ratto's research analyses compliant and non-compliant taxpayers independently, finding that compliant taxpayers, once audited, reduce their subsequent compliance. In addition, the authors find that non-compliant taxpayers increase their compliant behaviour after audit.

An alternative methodological approach was used by Slemrod, Blumenthal and Christian (2001) who investigate real world taxpayers in an experiment. Slemrod, Blumenthal and Christian find that when sent letters indicating that an audit would be forthcoming, low- and middle-income taxpayers increased their subsequent tax payments. However, somewhat perversely, high-income earners decreased their tax payment. One suggestion offered for this unusual result, is the possibility that high-income taxpayers sought specialist tax advice in response to the letter, which then facilitated legal avenues of minimising tax payments. These research findings, using 'real' people and data that challenge the results from experimental tax research, provide support for the use of real world subjects in experimental research in order to provide greater insights into behaviour.

2.5 Penalties for Detected Tax Evasion

One of the most counter-intuitive findings from much of the research on tax evasion, is that evasion does not often appear to decline as penalties for evasion increase. Researchers frequently find little or no impact from increased fines or sanctions applied for tax evasion (e.g. Mason and Calvin, 1978; Weigel, Hessing and Elffers, 1987). Research by Devos (2002) in Australia illustrates this point. Penalties increased significantly over a 2 0-year period investigated: fines increased from A$5,000 to A$200,000 and the number of tax offences with potential terms of imprisonment also increased, allowing Devos to explore whether the levels of compliance with tax law in Australia were influenced by increased penalties. Devos (2002) finds that over the 20-year period investigated, there were not significant changes in taxpayer compliance. However, Devos does not attempt to control for increasing sophistication of audit processes at the tax authority, which may provide some explanation for this outcome.

One of the key contrasting findings is the experimental research of Friedland, Maital and Rutenberg (1978) that suggests that fines provide a greater deterrent than frequent audits. However, as this experiment was undertaken on a small group of students (15), the findings are not widely generalisable. More often recent research indicates that severity of penalty has little impact on tax compliance.

2.6 Tax Rates

Tax rates have frequently been investigated for any possible link to increased tax evasion. This is a further area where the research field is dominated by contrasting findings. A wide range of intuitively attractive ideas have been raised for why high tax rates may result in higher levels of tax evasion. These include general dissatisfaction with the tax system due to perceived unfairness, lack of 'benefits' from taxes paid, or beliefs that others are not paying tax: any of which may result in an attempt to seek 'relief' from taxes paid (Vogel, 1974; Mason and Calvin, 1978). Graetz and Wilde claim *'the myth that high marginal tax rates cause non-compliance is the most pervasive of all. In fact, that lowering tax rates will induce greater compliance is a claim supported neither by the theory of tax compliance nor by the empirical evidence'* (1985:355).

Sweden has been a common case study for investigation of the impact of tax rates on tax evasion. In part, this is motivated by Sweden's historically high tax rates. Research by Vogel (1974) using a sample of nearly 1,800 Swedish taxpayers found high levels of tax evasion, which were exacerbated by the high tax rates of the time.[2] The high tax rates created incentives to evade tax, which then had the corresponding result of tax increases to meet revenue requirements. Clotfelter (1983) uses data from the United States Internal Revenue Service and finds that tax rates have a significant impact on reporting behaviour. However, challenging Vogel (1974) and Clotfelter (1983), Wahlund (1993) finds that no changes to tax evasion were found during the period of tax reform, despite significant reductions in the marginal tax rate. This finding may be partially explained by the time period used for investigation: during this time the highest marginal tax rate reduced from 65 per cent to 50 per cent, thus it may not have reduced sufficiently to influence behaviour. Wahlund suggests that higher tax rates create an animosity towards taxes, which in turn generates greater acceptance of tax evasion.

3. EXPERIMENT OVERVIEW

The experimental design used in this study is loosely based on those of Friedland, Maital and Rutenberg, 1978), and Spicer and Becker (1980). However, a number of changes are made to the original experimental design. Perhaps most significant was that the experiment was run in an online environment. This approach was facilitated with the use of an independent research company with a database of individuals who were members of New Zealand's largest retail rewards programme. The research company was employed to email the experiment to individuals on their database. Individuals emailed were rewarded with 'points' for participation.[3] In addition, a charitable donation was made on behalf of participants. Participants were advised that the amount donated to charity would link to the 'net income' earned in the experiment. The primary advantage with using an independent research company to target their

[2] During the period of most of the Swedish-based research, marginal tax rates were high even for average income taxpayers. The average tax rate was 60 per cent in the late 1960s/early 1970s (Vogel, 1974).

[3] The contractual arrangements allowed for a specified number of responses. A total of 7,589 invitation emails were sent out, 2600 responses were received: a response rate of 34.2 per cent.

members is that it was possible to email a representative sample of the New Zealand population. We excluded those aged under 18 due to their limited experience with the tax system.

Upon receipt of the email, individuals were provided with a link to the experiment. Completion of the experiment provided individuals with a code that allowed collection of the reward points. The research commenced with a screen explaining that the research was undertaken by Victoria University of Wellington. Participants were advised that the research was investigating individual responses to hypothetical tax decisions, with the objective of investigating behavioural responses to certain elements of the tax system. Individuals were also advised that responses were anonymous. In order to move from the first screen, individuals had to choose a charity that they would be 'playing for' in the experiment. Individuals could choose from three charities: the Royal Forest and Bird Society; the New Zealand Red Cross; or the New Zealand Society for the Prevention of Cruelty to Animals (SPCA). Logos and mission statements for the charities were provided on the first screen, along with links to their respective websites.

Once the charity was selected, the research commenced. There were three primary components to the research. First, information was requested on age, gender, location of residence in New Zealand, ethnicity, qualifications, total annual income, industry of employment, and sources of income over the previous 12 months. Second, individuals were asked to answer 14 questions on the tax system. A 5-point Likert Scale was used for this purpose: strongly disagree, disagree, neither agree or disagree, agree, strongly agree. The questions asked are reproduced in Appendix A.

The third component of the research was an experiment, run over eight rounds. Prior to the experiment commencing, individuals were told that they would need to decide how much gross income they would declare. They were advised that they did not need to declare all of their income in each round, but there was a chance of being audited and incurring penalties if they did not. Moreover, they were advised that if they were audited, the previous round would also be investigated, and penalties applied for any non-payment of tax obligations in that round also. At this point individuals were advised that the amount donated to charity would be determined by the net income at the end of the tax experiment.

Tax rates and income in the experiment were allocated to individuals based on their earlier declaration of actual income. Those indicating a high income were allocated a high or medium income bracket in the experiment; those indicating a medium income were allocated high, medium, or low income in the experiment; and those indicating a low income, were allocated a medium or low income in the experiment. The high incomes were taxed at 45 per cent in the experiment, the medium incomes were taxed at 33 per cent and the low incomes were taxed at 20 per cent. Audit probabilities of 10, 20, 40 and 50 per cent were randomly allocated. Similarly, fines of 1.5, 3, 5 or 10 times the amount of evaded tax were randomly allocated.

Once participants clicked on a button, the experiment commenced and an income amount was provided. The individual would disclose how much income he or she would declare. Once this information was received, a screen would advise if that individual had been audited in that round. In the event of an audit, and non-declaration of income, penalties were applied. This information was displayed on the screen, so the participant could clearly see the financial implications of behaviour.

The experiment was repeated over eight rounds. Retrospective audits occurred when an individual was audited and income had not been declared. However, when an individual was audited twice consecutively, penalties for the previous round were not applied: that is, there was no 'double counting' for fines. On completion of the experiment, participants were advised if they were better or worse off due to their behaviour, together with the positive or negative value of their experimental outcome.

3.1 Demographic Information

The experiment produced 2,614 responses from locations throughout New Zealand. After excluding non-response answers, 2,556 responses were used for further analysis. Respondents were asked to provide eight different categories of demographic information: age, gender, ethnic group, educational qualification, total income, occupation, geographic location, and income sources during the past 12 months. The key characteristics of the experiment participants are outlined in Table 1, with the exception of occupation and geographic location. Responses were received from individuals located throughout New Zealand, and from 19 different industrial occupations as defined by the Statistics New Zealand census classification.

Table 1 indicates that we had slightly higher participation among females than males, with 54 per cent female participation. We received a wide range of age responses, with the largest numbers in the 31-40 age group (22 per cent) and the 51-60 age group (19 per cent). The data also shows that 12 per cent of respondents do not have any educational qualifications, while 28 per cent have an undergraduate degree and 16 per cent have a postgraduate qualification. The majority of the respondents (90 per cent) earned less than NZ$80,000, while 14 per cent earned less than NZ$20,000.

Overall, we received responses from people identifying with 28 different ethnicities. The primary ethnic groups are outlined in Table 1. Small numbers (that is, those with less than 10 responses) were received from a number of other ethnic groups, including those identifying as: Cook Island Māori, Tongan, Niuean, Fijian, Other Pacific Peoples, Filipino, Japanese, Korean, Sri Lankan, Polish, German, and Latin American.[4] The majority of respondents earned income from employment (69 per cent), with earnings from investment (30 per cent) also common. Those receiving income from their own business accounted for 21 per cent of respondents.

Table 1

Characteristics of Experiment Participants

Gender	%	Count	Total
Male	45.8	1170	2557
Female	54.2	1387	

[4] For the purposes of categorisation we have incorporated Cook Island Māori, Tongan, Niuean and Fijian ethnicities into the 'Other Pacific Peoples' group. Filipino, Japanese, Korean and Sri Lankan individuals are included in the 'Other Asian' group. Polish and Germany individuals are included in the 'Other European' group.

Age	**%**	**Count**	**Total**
18	0.4	10	2556
19-25	10.3	263	
26-30	12.3	313	
31-40	22.3	569	
41-50	18.0	459	
51-60	19.2	489	
61-70	13.7	349	
71-80	3.7	95	
80+	0.4	9	
Qualifications	**%**	**Count**	**Total**
No qualifications	11.8	303	2557
NZ School Certificate, NCEA Level 1	13.2	337	
NZ 6th Form Certificate, NCEA Level 2	14.8	378	
NZ Higher School Certificate, Scholarship, NCEA Level 3	16.3	417	
Under-graduate degree	28.3	723	
Post-graduate degree	15.6	399	
Income	**%**	**Count**	**Total**
None	1.4	36	2559
$1 - $20,000	12.7	326	
$20,000 - $40,000	22.9	586	
$40,000 - $60,000	26.4	675	
$60,000 - $80,000	17.3	443	
$80,000 - $100,000	9.0	230	
$100,000+	10.3	263	
Ethnic Group	**%**	**Count**	**Total**
New Zealand European / Pakeha	78.8	2013	2556
New Zealand Māori	4.2	107	
Samoan	<1	13	
Australian	<1	14	
Chinese	2.7	69	
Indian	1.7	44	
Other Asian	1.5	38	
British/Irish	4.6	117	
Dutch	<1	24	
Other European	2.4	60	
North American	<1	15	
African	<1	11	
Other Pacific Peoples	<1	20	

Income Source[5]	%	Count	Total
Wages, salary, and bonuses paid by an employer	68.6	1784	N/A
Self-employment or own business	21.1	549	
Interest, dividends and other investments	29.8	775	
Rents	13.0	337	
Accident Compensation (ACC) income[6]	3.1	80	
New Zealand Superannuation[7]	10.7	278	
Other pension payments	3.3	86	
Social welfare benefits	7.0	182	
Student allowance	3.8	99	
Other income	5.7	149	

The preferred charity selected in the experiment was the SPCA, with 48 per cent of participants selecting this charity to receive their payment. The other two charities, the New Zealand Red Cross and the New Zealand Forest and Bird Society, were chosen 38 and 14 per cent of the time respectively.

4. FINDINGS AND ANALYSIS

This section discusses the research results from both the questionnaire and the experiment. The analysis commences with an outline of the descriptive statistics, and is followed by analysis based on the 'total proportion of income declared', factor analysis, correlation of grouped variables and univariate analysis of variance.

4.1 Tax Questionnaire

The descriptive statistics are outlined in Table 2, which summarises the results of the questionnaire. Responses are coded from 1 – 5: Strongly Disagree, Disagree, Neither Agree nor Disagree, Agree, Strongly Agree. In order to follow the consistency of the direction of the responses, questions 3, 4, 5, 7, 8 and 10 were reverse coded.

[5] Income source does not total to 100 per cent as individuals could nominate multiple income sources.
[6] The Accident Compensation Corporation provides no-fault personal injury cover for all New Zealand residents and visitors. Injury cover includes assistance with income when individuals cannot work as the result of an accident.
[7] New Zealand Superannuation is a retirement pension paid to individuals aged over the age of 65. The pension is not income- or asset-tested, although individuals must meet a 10-year residency requirement.

Table 2

Descriptive Statistics

	N	Mean	Median	Strongly Disagree (%)	Disagree (%)	Neither Agree nor Disagree (%)	Agree (%)	Strongly Agree (%)
Question 1	2556	3.85	4.00	1	9	19	43	27
Question 2	2556	3.86	4.00	1	8	20	46	26
Question 3	2556	3.38	3.00	3	15	32	38	11
Question 4	2556	1.77	2.00	48	37	10	4	2
Question 5	2556	1.87	2.00	37	46	12	4	1
Question 6	2560	3.70	4.00	1	12	25	38	23
Question 7	2560	2.47	2.00	20	35	25	16	3
Question 8	2560	3.42	4.00	5	14	24	49	8
Question 9	2560	3.69	4.00	3	12	15	52	17
Question 10	2560	2.76	3.00	8	35	32	23	2
Question 11	2556	3.20	3.00	4	16	42	32	5
Question 12	2556	2.59	2.00	23	34	10	27	6
Question 13	2556	2.59	3.00	24	26	24	19	7
Question 14	2556	2.25	2.00	22	44	23	9	2

Results from the questionnaire indicate that 70 per cent of the respondents "agree" or "strongly agree" that existing tax rates are too high and more than 70 per cent "agree or "strongly agree" that the tax system is unfair (questions one and two). Another 20 per cent provided a neutral response to these two questions, leaving approximately 10 per cent of respondents indicating that they did not believe that tax rates are too high or the tax system is unfair. Nearly half of the respondents (49 per cent) "agree" or "strongly agree" with the suggestion that it is common to evade tax (question three) with 18 per cent who "disagree" or "strongly disagree" with this statement. We find a high level of apparent disapproval of tax evasion, where 85 per cent of the respondents "disagree" or "strongly disagree" with the statement that "*it does not matter that some people evade tax*" and 83 per cent of the respondents "disagree" or "strongly disagree" with the statement that "*there is nothing bad about underreporting taxable income*" (questions four and five).

Despite the indication of disapproval of tax evasion, reports on individual behaviour provide weaker results, with 61 per cent of respondents who "agree" or "strongly agree" with the statement *"I would never evade taxes"* and 25 per cent who "neither agree nor disagree" (question six). A similar, albeit also weaker, response was received in relation to question seven *"I would evade taxes if I had the opportunity"* with 55 per cent of respondents disagreeing or strongly disagreeing with this statement, and 19 per cent of respondents agreeing or strongly agreeing. This apparent disapproval of tax evasion is not visible in the response to the following question (question eight) on whether an individual would declare cash income of NZ$200 received in tips. This question reveals that 57 per cent of respondents would not declare this amount. Conversely, question nine, which asks about declaration of a significantly higher amount of employment income (NZ$10,000) produces a higher

level of indicated compliance, with 69 per cent agreeing or strongly agreeing that they would declare this income to the Inland Revenue Department.

Question ten, which queried what respondents would do when they were unsure about the tax treatment of income, produced a weaker response, with 43 per cent of respondents responding that they would report this income. This question resulted in a high level of neutral responses, with 32 per cent of respondents indicating they neither agreed nor disagreed with this statement.

The remainder of the questions (11 – 14) are intended to capture information on attitudes that may influence behaviour, such as whether the individual considers they are a religious person or whether they regularly purchase lottery tickets. Questions 12 (on lottery ticket purchases) and 14 (on whether attention would be desired on an achievement) were included as a proxy for risk seeking behaviour and 'ego' respectively. Prior research indicates that both a higher risk preference and stronger egotistical attitudes are correlated to higher levels of non-compliance with the tax system (e.g. Friedland, Maital and Rutenberg, 1978; Bosco and Mittone, 1997; Holt and Laury, 2002; Trivedi, Shehata and Lynn, 2003). We find that 37 per cent of respondents considered themselves as lucky and 42 per cent are neutral on perceptions of luck; 33 per cent regularly purchased Lottery tickets; 26 per cent regarded themselves as religious; and only 11 per cent would want an award widely reported in the news media. These measures are used in the following analysis.

4.2 Total Proportion of Income Declared

In order to identify the extent to which the respondent evades paying tax, the total proportion of income declared in eight rounds of the tax-simulation experiment are presented in Table 3. The total proportion of income declared was calculated using the following formula. Let $D_{i,t}$ be the declared income in dollars for individual i at round t, where I is gross income in that round:

$$y_i = \sum_t D_{i,t} / \sum_t I_t \qquad (1)$$

Declared income may have been influenced by audit and fines in some respondents and not in others. However, the main assumption is that these events are sufficiently randomly distributed among these sub-groups to enable meaningful comparison.

In the sample data, respondents were divided into three groups based on their actual income (as declared by the respondents in the first component of the research). We classified these as high, medium and low. As outlined in the previous section, those who declared a high actual income were streamed into the high or middle income group; those who declared a medium actual income were streamed into the high, medium or low income groups; and those who declared a low actual income were streamed into the medium or low income groups. The total income ($\sum_t I_t$) over the 8 rounds of the experiment is as follows:

- high income group - NZ$62,300
- middle income group - NZ$39,800

- low income group - NZ$22,700.

Using each individual's income declarations and formula (1) the proportion of income declared was calculated for each individual. The sample distribution of these proportions is summarised in Table 3 for various sub-samples of the entire dataset. The columns are the percentiles for the distributions: the 5th, 10th, 25th (lower quartile), 50th (median), 75th (upper quartile), 90th and 95th.

Table 3

Sample Distributions of Proportion of Income Declared

	5%	10%	25%	50%	75%	90%	95%	Count	Mean
Tax Rate									
20%	0.200	0.493	0.831	0.969	1.000	1.000	1.000	838	0.85
33%	0.203	0.514	0.827	0.986	1.000	1.000	1.000	1,084	0.85
45%	0.429	0.562	0.810	0.972	0.998	0.998	0.998	638	0.86
Audit Probability									
10%	0.196	0.449	0.820	0.982	1.000	1.000	1.000	669	0.85
20%	0.318	0.567	0.808	0.975	1.000	1.000	1.000	653	0.86
40%	0.251	0.504	0.800	0.974	1.000	1.000	1.000	632	0.85
50%	0.253	0.574	0.863	0.982	1.000	1.000	1.000	606	0.87
Audit Fine									
2x	0.217	0.479	0.783	0.970	1.000	1.000	1.000	653	0.84
3x	0.227	0.568	0.837	0.983	1.000	1.000	1.000	650	0.87
5x	0.200	0.479	0.816	0.969	1.000	1.000	1.000	621	0.85
10x	0.269	0.584	0.845	0.987	1.000	1.000	1.000	636	0.87
Age									
0-18	0.000	0.000	0.156	0.707	0.923	0.958	1.000	10	0.58
19-25	0.158	0.280	0.694	0.923	1.000	1.000	1.000	263	0.79
26-30	0.220	0.527	0.795	0.955	1.000	1.000	1.000	313	0.85
31-40	0.222	0.510	0.802	0.958	1.000	1.000	1.000	569	0.85
41-50	0.225	0.546	0.810	0.989	1.000	1.000	1.000	456	0.86
51-60	0.281	0.612	0.885	0.998	1.000	1.000	1.000	489	0.88
61-70	0.341	0.677	0.895	0.997	1.000	1.000	1.000	349	0.89
71-80	0.436	0.687	0.881	0.998	1.000	1.000	1.000	95	0.89
80+	0.096	0.096	0.749	0.995	1.000	1.000	1.000	9	0.84
Gender									
Female	0.211	0.566	0.832	0.982	1.000	1.000	1.000	1387	0.86
Male	0.244	0.490	0.808	0.972	1.000	1.000	1.000	1170	0.85

Qualification									
None	0.031	0.347	0.757	0.965	1.000	1.000	1.000	303	0.82
NZ School Certificate	0.187	0.486	0.793	0.968	1.000	1.000	1.000	337	0.84
NZ 6th Form Certificate	0.209	0.565	0.851	0.973	1.000	1.000	1.000	378	0.87
NZ High School	0.200	0.452	0.736	0.963	1.000	1.000	1.000	417	0.83
Undergrad degree	0.349	0.635	0.857	0.987	1.000	1.000	1.000	723	0.89
Postgrad degree	0.213	0.623	0.854	0.991	1.000	1.000	1.000	399	0.88
Ethnicity									
African	0.157	0.191	0.575	0.904	0.998	0.999	1.000	11	0.75
Australian	0.471	0.498	0.673	0.882	1.000	1.000	1.000	14	0.83
British/Irish	0.159	0.447	0.837	0.978	1.000	1.000	1.000	117	0.85
Chinese	0.043	0.241	0.733	0.947	1.000	1.000	1.000	69	0.81
Dutch	0.580	0.775	0.939	1.000	1.000	1.000	1.000	24	0.95
Indian	0.002	0.095	0.570	0.863	0.998	1.000	1.000	44	0.73
NZ European	0.290	0.592	0.839	0.982	1.000	1.000	1.000	2,013	0.87
NZ Māori	0.243	0.330	0.745	0.952	1.000	.000	1.000	107	0.82
North American	0.000	0.327	0.776	0.998	1.000	1.000	1.000	1	0.84
Other Asian	0.001	0.083	0.811	0.995	1.000	1.000	1.000	21	0.84
Other European	0.015	0.231	0.733	0.972	1.000	1.000	1.000	50	0.82
Samoan	0.010	0.153	0.443	0.960	0.999	1.000	1.000	13	0.73
Others	0.000	0.200	0.648	0.929	0.998	1.000	1.000	59	0.77

The summary of the sample distributions using the measure of total proportion of income declared suggests a number of broad conclusions. Distributions in the low and medium tax rate groups are similar, with only five per cent declaring less than 20 per cent of their income. This 5th percentile is much higher for those in receipt of the highest tax rate, with very few subjects declaring less than 43 per cent of their income. However, it is also at the highest tax rate that fewer subjects declare all their income. Thus, the high tax rate subject declarations are less variable, but tend to be slightly lower. Despite differences in the shape of the distributions the means are almost identical. There is no clear trend on the influence of audit probability or audit fine.

As expected, we find compliance increases with age, with the exception of those aged over 80 years. Tax evasion is highest in younger age groups and female respondents generally declare more income than male respondents. We also find that evasion is higher for those with no educational qualification or New Zealand High School Certificate or equivalent. Respondents with undergraduate and postgraduate degrees demonstrate the highest levels of compliance. While we find lower levels of compliance among those identifying as African, Australian and Indian, and higher levels of compliance with those identifying as Dutch, North American or other Asian ethnicities, the sample sizes of these ethnicities are small, and therefore unlikely to provide significant results.

We have also included sample distributions of the proportion of income declared for two of the questionnaire responses: Question 5 – *"There is nothing bad about underreporting taxable income"*; and Question 6 – *"I would never evade taxes"*. These responses are outlined in Table 4 and show that individuals indicating that they would not evade taxes, or that they viewed underreporting of taxable income as undesirable, declared higher proportions of income in the experiment.

Table 4

Sample Distributions of Proportion of Income Declared

	5%	10%	25%	50%	75%	90%	95%	Count
Q5. There is nothing bad about underreporting taxable income								
Strongly agree	0.0045	0.0227	0.3678	0.8384	0.9984	1.0000	1.0000	31
Agree	0.1369	0.2954	0.5757	0.8764	0.9872	1.0000	1.0000	102
Neutral	0.1230	0.3411	0.7085	0.9296	0.9956	1.0000	1.0000	307
Disagree	0.3292	0.6261	0.8416	0.9758	1.0000	1.0000	1.0000	1,170
Strongly disagree	0.2408	0.6030	0.8611	0.9984	1.0000	1.0000	1.0000	946
Q6. I would never evade taxes								
Strongly disagree	0.0146	0.2577	0.7085	0.9322	1.0000	1.0000	1.0000	31
Disagree	0.3689	0.5156	0.7687	0.9427	0.9984	1.0000	1.0000	314
Neutral	0.2010	0.5247	0.8008	0.9583	1.0000	1.0000	1.0000	639
Agree	0.2335	0.5720	0.8485	0.9849	1.0000	1.0000	1.0000	977
Strongly agree	0.1661	0.5226	0.8342	0.9984	1.0000	1.0000	1.0000	599

4.3 Principal Component Analysis and Correlation Matrix

The questionnaire responses were analysed using a factor analysis to identify common themes among the responses. Principal component analysis was used to examine the underlying structure of responses, as this approach reduces a large number of variables into interpretable factors. Principal component analyses are run and six components are extracted that have eigenvalues of over 1. The component matrix for this analysis is shown in Table 5.

Table 5

Component Matrix

	Component					
	1	**2**	**3**	**4**	**5**	**6**
Question1	-.142	**.830**	.031	-.087	.147	.194
Question2	-.164	**.858**	-.084	-.038	.022	-.042
Question3	**.231**	-.245	.289	-.375	.160	.635
Question4	**.548**	.007	-.674	.095	.139	.203
Question5	**.672**	.000	-.568	.089	.086	.105
Question6	**.696**	.216	.178	-.029	-.051	.159

Question7	**.732**	.048	.206	-.064	-.101	.066
Question8	**.645**	.075	.329	.002	-.057	-.098
Question9	**.607**	.022	.107	.080	-.138	-.204
Question10	**.618**	.119	.207	.103	-.070	-.181
Question11	.033	-.101	.071	**.712**	.166	-.065
Question12	-.109	.170	.156	**.532**	-.430	.283
Question13	.170	.039	.226	.069	**.775**	-.282
Question14	-.179	-.038	.161	.380	.317	**.484**

On the basis of this component matrix, we combined the questionnaire responses into five factors as follows.

Factor 1: Tax Compliance Behaviour
Question 3 (It is common to evade tax), Question 4 (It does not matter that some people evade tax), Question 5 (There is nothing bad about underreporting taxable income), Question 6 (I would never evade taxes), Question 7 (I would evade taxes if I had the opportunity), Question 8 (If I received $200 in cash tips, I would not report it), Question 9 (If I was paid $10 000 in cash for working on a farm, I would report it to the Inland Revenue Department), and Question 10 (If in doubt about whether or not to report an amount of income from a particular source, I would not report it). Note that questions three and four load highly onto component three in Table 5, but we elect to include those responses into a single tax compliance factor.

Factor 2: Attitude to the Tax System

Question 1 (Taxes are too high) and Question 2 (The tax system is unfair).

Factor 3: Luck

Question 11 (I consider myself a lucky person) and Question 12 (I regularly purchase Lotto tickets).

Factor 4: Religion

Question 13 (I regard myself as a religious person).

Factor 5: Award

Question 14 (If I was given an award for an outstanding achievement, I would want it widely reported in the news media, rather than just accepting it and keeping a low profile.)

These groups were created by adding responses to each of the statements in accordance with the above groupings. The correlation coefficients are shown in Table 6. The results show the correlation coefficient of the tax compliance behaviour factor (factor 1) has a statistically significant correlation with four factors (attitude to the tax system, luck, religion and award). The highest positive correlation identified was between factor 1 and factor 4, indicating a relationship between tax compliance behaviour and identification with religion. The highest negative correlation was between factor 1 and factor 5, indicating a negative relationship between tax

compliance behaviour and wishing to have publicity after winning an award. As expected, a significant relationship between tax compliance behaviour and attitude to the tax system is also evident. Of less relevance is the significant correlation between factor 3 (luck) also and factor 5 (award).

Table 6

Correlations

		Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
Factor1	Pearson Correlation	1	-.102**	-.046*	.119**	-.119**
	Sig. (2-tailed)		.000	.020	.000	.000
	N	2556	2556	2552	2552	2552
Factor2	Pearson Correlation		1	.023	.005	.008
	Sig. (2-tailed)			.236	.808	.670
	N		2556	2552	2552	2552
Factor3	Pearson Correlation			1	-.020	.074**
	Sig. (2-tailed)				.324	.000
	N			2556	2556	2556
Factor4	Pearson Correlation				1	.009
	Sig. (2-tailed)					.640
	N				2556	2556
Factor5	Pearson Correlation					1
	Sig. (2-tailed)					
	N					2556

Asterisks denote significance at the 1% (**) and 5% (*) levels

4.4 Experimental Findings

We use univariate analysis of variance and regression analysis to examine the findings of the experiment. First, we use univariate analysis of variance to examine whether the income source of the respondents has an influence on the total proportion of income declared in the study. Table 7 shows the between-subjects factors of the various income source variables. Where individuals report having income of that particular source, the response is coded as 1 , otherwise it is coded as 0. Table 7 shows the numbers of respondents reporting each income type, with the average proportion of income declared. In all cases, with the exception of student allowance income, respondents who report that source of income, declare a higher proportion of income than those who do not report that source of income. The two that are significantly different are in bold: interest income from investments and rental income. The interest income result supports Clotfelter's (1983) finding of higher compliance among those who receive this income source.

Table 7

Between-Subjects Factors of Income Sources

Income Source		N	Mean
Wage salary bonuses	0	697	0.921
	1	1863	0.941
Self employed	0	1997	0.926
	1	563	0.936
Interest Investments	0	1823	**0.908**
	1	737	**0.954**
Rent	0	2244	**0.912**
	1	316	**0.950**
Accident Compensation Corporation Income	0	2511	0.924
	1	49	0.938
NZ superannuation	0	2294	0.917
	1	266	0.945
Pension payments	0	2475	0.907
	1	85	0.955
Social welfare	0	2376	0.929
	1	184	0.933
Student allowance	0	2459	0.940
	1	101	0.922
Other	0	2411	0.913
	1	149	0.949

We undertake a regression analysis to examine the relationship between the total proportion of income declared and the control variables. The independent variable is divided into three different groups: tax parameters (the tax rate, audit probability and fine), demographic characteristics (gender and age), and tax preferences (based on the factors outlined above in section 4.3). Based on the regression model, we propose a null hypothesis and 10 alternative hypotheses to be tested. The null hypothesis is:

H_0: The amount of tax paid is not systematically connected to any of the explanatory variables.

The alternative hypotheses are:

H_1: "Tax rate hypothesis" – The amount of tax paid is systematically connected to the tax rate.

H_2: "Audit probability hypothesis" - The amount of tax paid is systematically connected to the audit probability.

H_3: "Audit penalty hypothesis" - The amount of tax paid is systematically connected to the penalty applied when non-compliance is detected.

H_4: "Gender (Male) hypothesis" - The amount of tax paid is systematically connected to gender.

H_5: "Age hypothesis" - The amount of tax paid is systematically connected to age.

H_6: "Factor 1 hypothesis" - The amount of tax paid is systematically connected to tax compliance attitudes.

H_7: "Factor 2 hypothesis" - The amount of tax paid is systematically connected to attitudes to the tax system.

H_8: "Factor 3 hypotheses" - The amount of tax paid is systematically connected to whether people consider themselves to be lucky.

H_9: "Factor 4 hypothesis" - The amount of tax paid is systematically connected to whether people consider themselves to be religious.

H_{10}: "Factor 5 hypothesis" - The amount of tax paid is systematically connected to whether people are attention seeking.

We separately test these 10 hypotheses to examine the relationships between each of these variables and the total proportion of income declared. The sample has nine different age groups therefore the univariate analysis of variance (ANOVA) was utilised to examine the relationship between these age groups and the total proportion of income declared. The results of the statistical tests are presented in Table 8.

Table 8

Statistical Test Results

	Variable	**Relationship to dependent variable**	***P*-values**	**Significance**
H_1	Tax rate	Positive	0.884	Not Significant
H_2	Audit probability	Positive	0.237	Not Significant
H_3	Audit penalty	Positive	0.123	Not significant
H_4	Gender (Male)	Negative	0.172	Not Significant
H_5	Age	Positive	0.000*	Significant
H_6	Factor 1	Positive	0.000*	Significant
H_7	Factor 2	Negative	0.001*	Significant
H_8	Factor 3	Negative	0.208	Not Significant
H_9	Factor 4	Positive	0.989	Not Significant
H_{10}	Factor 5	Negative	0.000*	Significant

Asterisks denote significance at the 5% (*) level

The results of the regression analysis in Table 8 show that age and Factor 1 have significant and positive relationships with the total proportion of income declared. Factor 2 and Factor 5 also have significant but negative relationships with the total proportion of income declared. This means that the null hypothesis can be rejected in favour of the alternative hypothesis for H_5, H_6, H_7 and H_{10}. However, the null hypothesis cannot be rejected in favour of the alternatives tax rate, audit probability, audit penalty, and gender (male), Factor 3 and Factor 4: hypotheses H_1, H_2, H_3, H_4, H_8 and H_9, respectively. These variables do not have a significant impact on the total proportion of income declared in the sample.

4.5 The New Zealand Population and Students

We have previously used a similar experimental design with 483 undergraduate student subjects (Marriott, Randal and Holmes, 2010). While the experimental designs are similar, the experiment environment is different: our population sample completed the experiment online, while our student sample completed the experiment in a lecture theatre. Despite these differences, some similarities and differences warrant comment. We use the Pearson's chi-squared test to investigate differences in the questionnaire responses between the population sample and the student sample. Results of the chi-squared test are outlined in Table 9.[8]

Table 9
Chi-Squared Test Results

Statement	Pearson Chi-Square	Significance (p value)
1.Taxes are too high	1017.429	0.000**
2.The tax system is unfair	273.493	0.000**
3.It's common to evade tax	61.354	0.000**
4. It does not matter that some people evade tax	107.132	0.000**
5. There is nothing bad about underreporting taxable income	161.772	0.000**
6. I would never evade taxes	43.978	0.000**
7. If I received $200 in cash tips, I would not report it	244.361	0.000**
8. If in doubt about whether to report an amount of income, I would not report it	39.220	0.000**

Asterisks denote significance at the 1% (**) level

Table 9 shows that the value of the chi-squared results for all statements is highly significant, indicating that the respondent group (population or student) has a significant impact on the responses to each of these statements. The detail of each of the responses is shown in Table 10, with more detailed discussion following the table.

[8] All the questions are not included in this table, as the questionnaires were not identical. This table outlines those questions that were the same.

Table 10
Group Responses to Questions

Statement	Response					Total
	Disagree	Strongly Disagree	Neither Disagree nor Agree	Agree	Strongly Agree	
Statement 1: Taxes are too high						
Population (% within group)	1.4	9.0	19.2	43.3	27.0	100%
Students (% within group)	19.3	50.7	21.9	7.9	.2	100%
Statement 2: The tax system is unfair						
Population (% within group)	.9	8.2	20.1	45.3	25.6	100%
Students (% within group)	2.9	26.5	35.8	28.0	6.8	100%
Statement 3: It's common to evade tax						
Population (% within group)	3.4	15.1	32.0	38.4	11	100%
Students (% within group)	5.0	21.3	41.8	29.0	2.9	100%
Statement 4: It does not matter that some people evade tax						
Population (% within group)	47.4	36.7	9.7	4.1	2.1	100%
Students (% within group)	24.6	47.8	18.6	8.1	.8	100%
Statement 5: There is nothing bad about underreporting taxable income						
Population (% within group)	37.0	45.8	12.0	4.0	1.2	100%
Students (% within group)	12.4	50.5	25.9	10.1	1.0	100%
Statement 6: I would never evade taxes						
Population (% within group)	1.2	12.3	25.0	38.1	23.4	100%
Students (% within group)	2.1	20.3	29.6	34.4	13.7	100%
Statement 7: If I received $200 in cash tips, I would not report it						
Population (% within group)	5.1	13.7	23.5	49.3	8.4	100%
Students (% within group)	4.5	12.8	21.4	49.1	12.1	100%
Statement 8: If in doubt about whether to report an amount of income from a particular source, I would not report it						
Population (% within group)	7.9	35.3	32.1	22.5	2.2	100%
Students (% within group)	5.8	35.2	22.4	32.1	4.6	100%

Table 10 indicates that 70.3 per cent of our population sample agree or strongly agree that taxes are too high. However, 70 per cent of our student sample disagree or strongly disagree with this statement. Examination of a standardised residual of each cell can assist in assessing its significance. Table 10 shows that more respondents than expected from the population group agree or strongly agree with the statement that taxes are too high and less respondents than expected from our student group agree or strongly agree with this statement. Conversely, more respondents than expected from the student group disagree or strongly disagree with this statement, while less respondents from our population group disagree or strongly disagree.

In relation to statement two (the tax system is unfair) we find that 70.9 per cent of respondents in our population sample agree or strongly agree with this comment, while only 34.8 per cent of our student sample agree or strongly agree. The results show that significantly more respondents than expected from the population group agree or strongly agree that the tax system is unfair, while significantly less respondents than expected from the student group agree or strongly agree with this

statement. Conversely, significantly fewer of the population respondents disagree with this statement, while significantly more of the student respondents disagree or strongly disagree with it.

In response to the statement that it is common to evade tax (statement three), 49.4 per cent of the population sample agree or strongly agree, in comparison to the student sample where 31.9 per cent agree or strongly agree. For this statement we find significantly less than expected students agree or strongly agree with this statement, while significantly more than expected from our population sample strongly agree.

Statement four suggests that it does not matter if some people evade tax. We find strong responses to this among both our groups, with 84.1 per cent of the population respondents disagreeing or strongly disagreeing with this statement and 72.4 per cent of the student group disagreeing or strongly disagreeing. We find significantly fewer respondents than expected from the student group strongly disagreeing with this statement and significantly more than expected from the population group strongly disagreeing with this statement.

Statement five questions views on underreporting of taxable income. We find that 82.8 per cent of our population respondents, and 62.9 per cent of our student respondents disagree or strongly disagree with the suggestion that there is nothing bad about underreporting taxable income. This statement shows significantly more than expected population respondents strongly disagree and significantly fewer than expected student respondents strongly disagree with this statement. Conversely, significantly fewer than expected population respondents agree with this statement, while significantly more than expected student respondents agree with it.

Statement six is a statement on tax evasion behaviour. Of our population sample, 61.5 per cent agree or strongly agree that they would never evade taxes. In the student sample, the response was 48.1 per cent. All the standardised residuals for the population group are insignificant for this statement. However, significantly more than expected respondents from the student group disagree with this statement, and significantly less than expected strongly agree.

Statement seven questions the likely response to reporting NZ$200 in cash tips. We find 57.7 per cent of our population subjects agree or strongly agree that they would not report NZ$200 in cash tips, while 80.3 per cent of our student subjects respond similarly. We find significantly fewer than expected population respondents strongly agree with this statement, and significantly fewer than expected student respondents disagree or strongly disagree with it.

The final statement questions if income would be reported if there was doubt about how it should be treated. Of the population sample, 24.7 per cent agree or strongly agree that they would not report income in this situation, while 36.7 per cent of the student sample agree or strongly agree. All standardised residuals for the population group were insignificant for this statement. However, significantly more student respondents than expected agree or strongly agree with these statements.

The sample distributions of proportion of income declared for the student subjects are replicated at Appendix B. The most notable difference in behaviour between the two subject groups is in relation to the overall proportion of income declared. In the student sample we find that nearly every sub-sample has 0 per cent disclosed as its

minimum, and 100 per cent disclosed as its maximum. In the population sample, we find only those aged under 18, and those identifying with North American or Other ethnicity have 0 per cent declared as the minimum. By way of comparison, with reference to Table 3, 50 per cent of the population respondents at any tax rate have declared over 95 per cent of their income, whereas 50 per cent of the student respondents at any tax rate have declared less than 50 per cent of their income. These levels of compliance are more aligned with what is expected in practice (Kleven, Knudsen, Kreiner, Pedersen and Saez, 2010). We acknowledge that the experimental environment, at least to some extent, potentially exacerbates a risk-seeking strategy. This may have been mitigated in our online experiment as the 'reward' was paid to a charity rather than the individual, which introduces a third-party impact not present in the student sample.

We observe that those who receive student allowance income within our population sample (affording the assumption that these are students), declare less income in the online experiment than those in the online experiment who declare other sources of income. The student allowance income group is the only income source group to demonstrate this behaviour.

While our age variable adheres to previous research findings (compliance generally increases with age), we did not find alignment between the two samples in response to the audit probability variable or gender. The outcome contrasts with previous findings that suggest audit probability is a significant explanatory variable of behaviour in tax experiments. It similarly contrasts previous studies that find that males are less compliant than females. We witnessed a strong response to the audit variable in our student sample, but this was not evident in our population sample. However, as the population sample is significantly more compliant in their behaviour, the absence of a significant response to audit may be partially explained by this compliant behaviour; that is, most respondents are compliant and an audit experience will persuade those who are non-compliant to become more compliant.[9] Thus, the strong response we see to audit probability among student samples may be partly attributable to risk-seeking behaviour among student subjects in the experimental environment.

We find higher levels of significant results among our student sample. For example, tax rate, audit probability and gender all produce significant results in our student sample, but not in our population sample. Audit penalty is not significant in either sample.

In summary, the responses to changes in variables in the population sample for age are similar to responses from the student sample. However, the response to audit probability is not significant in the population sample nor is any gender impact evident. The population sample responses in the questionnaire are, in all instances, significantly different to those from the student subjects. This finding concurs with research that has investigated the appropriateness of using students as a proxy for a real world population. A number of differences are reported between student and 'real world' subjects, such as:

[9] We acknowledge that the potential remains for audit to cause non-compliant behaviour among compliant individuals, as found by Gemmell and Ratto (2012).

- less-crystallised attitudes, with social and political attitudes developing later in life;
- a less formulated sense of self, with a stronger need for peer approval and over-identification with peers;
- stronger cognitive skills;
- stronger tendencies to comply with authority; and
- less conservative behaviour (Cunningham, Anderson and Murphy, 1974; Sears, 1986).

These factors would lead to the conjecture that student subjects may have weaker opinions on the tax system. This supposition is supported by the results of the questionnaire, but not in the experiment.

The use of student subjects in experimental research remains a contentious issue. This study does not provide support for the use of student subjects as a proxy for the taxpaying population. Similar behaviours among our student population and our population sample are not evident. Moreover, our finding that age has a significant relationship with compliance leads to further weaken the argument that students are an appropriate substitute for taxpayers, as student samples are typically considerably younger than the population as a whole. Thus, in the absence of strong evidence to suggest that students are an appropriate proxy for the taxpaying population as a whole, caution must be exercised in the interpretation of findings from experimental research using student subjects.

5. CONCLUSION

This article has reported on the findings of a large-scale tax experiment using nearly 2,600 'real world' respondents. The objectives of this research are to first report on the findings of a large sample population-based survey, and second to investigate similarities and differences in behaviour witnessed in the population-based experiment and experiments we had previously undertaken with student subjects. We find that only the age variable produces similar responses, both to previous research and to our own experiments using student subjects. No significant response to audit probability is visible in the online experiment. This result may, in part, be driven by the overall significantly higher levels of compliance in the experimental setting by the population sample, which is representative of tax compliance in practice. However, differences in attitudes to paying tax and to the tax system are also visible in response to the questionnaire component of the research. We therefore conclude that caution should be taken when research findings using student subjects are extrapolated to the broader population.

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APPENDIX A: QUESTIONS ASKED IN ONLINE EXPERIMENT

1. Taxes are too high
2. The tax system is unfair
3. It is common to evade tax
4. It does not matter that some people evade tax
5. There is nothing bad about underreporting taxable income
6. I would never evade taxes
7. I would evade taxes if I had the opportunity
8. If I received $200 in cash tips, I would not report it
9. If I was paid $10,000 in cash for working on a farm, I would report it to the Inland Revenue Department
10. If in doubt about whether or not to report an amount of income from a particular source, I would not report it
11. I consider myself a lucky person
12. I regularly purchase Lotto tickets
13. I regard myself as a religious person
14. If I was given an award for an outstanding achievement, I would want it widely reported in the news media, rather than just accepting it and keeping a low profile

APPENDIX B: SAMPLE DISTRIBUTIONS OF PROPORTION OF INCOME DECLARED – STUDENT SUBJECTS [10]

	5%	10%	25%	50%	75%	90%	95%	Count
Tax rate								
20%	0.0000	0.1277	0.3059	0.4920	0.7766	0.9840	1.0000	161
33%	0.0399	0.0878	0.2061	0.3875	0.6436	0.9814	1.0000	161
45%	0.0000	0.0133	0.1676	0.3896	0.6822	0.8750	0.9628	161
Audit probability								
10%	0.0000	0.0293	0.1649	0.3457	0.6144	0.8532	0.9798	243
20%	0.0475	0.1473	0.2919	0.504	0.8005	0.9947	1.0000	240
Audit fine								
5x	0.0000	0.0798	0.2074	0.4255	0.7128	0.9947	1.0000	245
10x	0.0000	0.0604	0.2261	0.4309	0.6888	0.9093	0.9656	238
Gender								
Female	0.0698	0.1064	0.3092	0.4947	0.7934	0.9628	1.0000	222
Male	0.0000	0.0133	0.1729	0.3457	0.6290	0.9069	1.0000	261
Ethnicity								
NZ Euro	0.0000	0.0439	0.2068	0.4043	0.6449	0.9035	0.9992	244
Chinese	0.0810	0.1198	0.2104	0.4747	0.6350	0.887	0.9641	62
Asian	0.0911	0.1463	0.2400	0.3431	0.6117	0.8564	0.9761	46
Indian	0.0372	0.0763	0.2593	0.4548	0.6024	0.8436	0.9665	19
NZ Other	0.0202	0.1505	0.2985	0.4987	0.9189	1.0000	1.0000	34
NZ Māori	0.0824	0.1218	0.2128	0.3404	0.4681	0.6340	0.7771	23
Pacific Is	0.0319	0.1883	0.6782	0.7766	0.9081	1.0000	1.0000	17
European	0.0404	0.0473	0.2028	0.6556	0.8668	1.0000	1.0000	20
Age								
17	0.0000	0.0324	0.2447	0.4521	0.6649	0.8915	0.9585	45
18	0.0000	0.0399	0.1676	0.3245	0.5745	0.8553	0.9713	193
19	0.0000	0.0606	0.2753	0.4043	0.5439	0.7787	0.8872	75

[10] Marriott, Randal and Holmes (2010).

20	0.0379	0.0842	0.2055	0.4455	0.7254	0.9606	1.0000	58
21	0.1138	0.1259	0.2620	0.5851	0.8032	0.9388	0.9705	35
22	0.0638	0.1963	0.3271	0.6250	0.8218	0.9266	1.0000	17
23-58	0.1612	0.2354	0.3919	0.6888	0.9876	1.0000	1.0000	59
Audit fine x audit probability								
0.5	0.0000	0.0304	0.1523	0.387	0.5691	0.8743	0.9994	124
1	0.0128	0.0902	0.2227	0.4096	0.7194	0.9622	1.0000	240
2	0.0120	0.0904	0.2952	0.5059	0.7965	0.9436	1.0000	119
Statement 11: “I would never evade taxes”								
Strongly agree	0.0818	0.1243	0.3570	0.6077	1.0000	1.0000	1.0000	64
Agree	0.0592	0.1064	0.2693	0.4973	0.7467	0.9476	0.9948	158
Neither	0.0122	0.0511	0.2221	0.3596	0.5652	0.8580	0.9649	139
Disagree	0.0000	0.0000	0.1280	0.2766	0.5678	0.7985	0.8414	94
Strongly disagree	0.0000	0.0000	0.0133	0.2367	0.8218	1.0000	1.0000	9
Student ID Number provided for reward purposes								
No	0.0000	0.0000	0.1184	0.4016	0.6792	0.8779	0.9985	48
Yes	0.0094	0.0819	0.2221	0.4362	0.7041	0.9447	1.0000	435