

eJournal of Tax Research

Volume 12, Number 1

June 2014

Special Edition: Tribute to the late Professor John Tiley

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The *eJournal of Tax Research* is a refereed journal that publishes original, scholarly works on all aspects of taxation. It aims to promote timely dissemination of research and public discussion of tax-related issues, from both theoretical and practical perspectives. It provides a channel for academics, researchers, practitioners, administrators, judges and policy makers to enhance their understanding and knowledge of taxation. The journal emphasises the interdisciplinary nature of taxation.

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WEBPAGE

Current and past issues of the *eJournal of Tax Research* are available via the journal's website: <http://www.asb.unsw.edu.au/research/publications/ejournaloftaxresearch/Pages/default.aspx>

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Editorial:

Tribute to the late Professor John Tiley

This issue of the *eJournal of Tax Research* pays tribute to the late Professor John Tiley, a foundation member of the Editorial Board of the journal from its inception in 2003 until the time of his death 30 June 2013. Readers of the articles included in this issue will very quickly appreciate just how profound and far-reaching John's influence was on fellow tax academics globally, and in particular, those with a passion for the history of taxation. They will also see just how respected he was for his intellect and academic contributions, and indeed how popular and appreciated he was as a person.

John Tiley was a Professor of the Law of Taxation and Fellow of Queens' College Cambridge University. He began his academic career in 1963 as a lecturer at Oxford and Birmingham Universities, moving to Cambridge in 1967. In 1990 he became the first Professor of Tax Law at Cambridge and worked tirelessly, and with great enthusiasm, to give the discipline the prominence he believed it deserved. With support from the Chartered Institute of Taxation, the International Fiscal Association Congress Trustees and KPMG, John founded the Faculty's Centre for Tax Law in 2001.

In spite of having 'retired' in 2008, John remained actively engaged in teaching and research up until his untimely death. As noted by several contributors in this issue, John hosted a biennial tax history conference, with the support of his wife Jillinda, a Fellow of Lucy Cavendish College. Having attended and contributed to many of these over the years I can only agree with Professor Ann O'Connell's description (in her article) of these being the hottest tickets in town! John purposively limited the group of attendees, preferring deeper and more collaborative discussion and networking opportunities, rather than simply facilitating a collection of presentations and the making of brief acquaintances as so often happens at larger events. It proved to be a very effective strategy for building up interest and strength in the study of tax history.

The evidence of John's influence and his legacy to the discipline is evident (in part) in the articles in this issue. From Ann O'Connell and Erik Jensen's direct reflections on John's works; through to Dianne Kraal and Jeyapalan Kasipillai's research on tax farming in 18th century Malacca. Many of us have directly benefited from John's wisdom, enthusiasm and encouragement and will long remember him. On behalf of the Editorial Board, contributors and readers of the *eJournal of Tax Research*, we pay respect to the late Professor John Tiley and express our sincere condolences to his wife Jillinda and family.

Professor Margaret McKerchar (Guest Editor)
School of Taxation and Business Law (Atax)
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‘Managing Tax Avoidance: Recent UK experience’

John Tiley – Annual lecture Melbourne 2007

with comments by Ann O'Connell¹ (in blue)

*When John Tiley retired from his position at the University of Cambridge in 2008, his many distinguished friends and colleagues contributed to a book entitled *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley*.² Many of the contributors to the book noted the impact that John Tiley had had not just on their views on taxation but also on the formulation of tax policy and the legitimacy of taxation as an area of study within law schools. It appeared that John Tiley could be all things to all people – he was admired by the profession, especially in the UK where he had taught many of them, by governments as a policy adviser and by academics all over the world for his ability to analyse cases, critique policy proposals and to convey his genuine enthusiasm for the subject of taxation. An article entitled the “Joy of Tax”³ was emblematic of John’s mischievous style and his understanding of the need to encourage academic study of a discipline that was often viewed as number crunching. With this in mind he initiated the hugely successful, invitation only, History of Tax conferences in 2002⁴ which soon became the hottest ticket in town. He formed the Centre for Tax Law in 2000 and went about persuading visiting academics and judges to share their thoughts with those in the UK. John also travelled the world welcoming insights into the practices and policies adopted in other jurisdictions. He was a prolific writer of thoughtful articles containing theoretical and comparative approaches to his chosen subject.⁵ The Melbourne Law School was therefore delighted when he agreed to deliver the third Annual Tax Lecture in 2007.*

¹ Ann O'Connell, Professor, Law School, University of Melbourne; Fellow, Taxation Law and Policy Research Group, Monash University.

² John Avery Jones, Peter Harris and David Oliver (eds), Cambridge University Press, 2008.

³ *The Reporter*, 2003, being the journal of the Society of Legal Scholars previously the Society of Public Teachers of Law.

⁴ The conferences were organized by John and his wife Jillinda at Lucy Cavendish College where Jillinda is a Fellow. The proceedings of each conference were published as *Studies in the History of Tax Law* Vols 1 to 6 by Hart Publishing. The proceedings of the 2012 conference were published shortly after John’s death in 2013.

⁵ In addition to the articles referred to in the lecture I came across more than 12 other articles written by John on the substantive topic of tax avoidance.

*The topic he chose for the lecture was 'Managing Tax Avoidance: Recent UK experience'. It involved an analysis of the position in the UK to that point, starting with the House of Lords decision in *WT Ramsay Ltd v IRC*,⁶ as well as setting out his preference for judicial development of anti-avoidance rules rather than the introduction of a statutory general anti-avoidance rule (a GAAR). Before his death John had agreed to revise the lecture to bring it up to 2013 with a view to publishing it. Based on those discussions, I have revised the lecture, divided it into 6 parts and included a postscript to cover the more immediate period. The 6 parts are:*

- 1. Introduction*
- 2. The development of the 'so-called' Ramsay doctrine*
- 3. Other ways of dealing with avoidance*
- 4. The 1997 GAAR proposal*
- 5. Ramsay to Barclays*
- 6. Conclusions*

Professor Tiley commenced his lecture with brief comments about the previous two Annual Tax Lectures and referred briefly to the 'US doctrines' that he had spent a year trying to understand. But, as John would say, more of that later.

*A clue to his own views on the subject of dealing with tax avoidance can be discerned from his reference to the remarks of Lord Scarman in *Furniss v Dawson*⁷...*

1 INTRODUCTION

Thank you for inviting me. It is a great honour to be asked to give the third Annual Tax Lecture especially when I have two such eminent and 'assiduous' predecessors. I have read their slightly contrasting comments and will try to steer a middle course. The Ramsay case of 1981 will be my equivalent of *Myer Emporium* for Justice Young. I was much taken by Allan Myers' point that Chief Justice Barwick's attitudes could be traced back to the pre-WWII era of individualism soon to be overtaken in the wartime and post-war eras by the need, constantly demonstrated in films and plays as well as judicial decisions, to pull together. I was wondering whether attitudes might swing back when I came across a report of a survey by the Henley Centre for Forecasting,⁸ a prestigious and independent body in the UK. This showed that, for the first time in 10 years, a majority now believe that the quality of life is best improved by putting the individual first.⁹ The report notes that such individualism has its price; the Association of Graduate Recruiters found many candidates far too self-

⁶ [1981] 1 All ER 865, [1982] AC 300.

⁷ [1984] 1 All ER 530, [1984] AC 474.

⁸ *The Henley Centre, University of Reading.*

⁹ In 1997 when Tony Blair came to power 70% adopted a community first approach. [I could not find a reference for this but assume it refers to the policies of New Labour, such as set out in Blair's speech to the Fabian Society in 1998 where he said: 'Our mission is to promote and reconcile the four values which are essential to a just society which maximises the freedom and potential of all our people - equal worth, opportunity for all, responsibility and community.' See *The Independent* 21 September 1998: <http://www.independent.co.uk/arts-entertainment/new-politics-for-the-new-century-1199625.html>]

centred to employ - more than half its members would fail to fill their vacancies this year.¹⁰

It is a great pleasure to be back in Melbourne. My links began with Harold Ford and I spent two months here in 1979. Since then I have tended to spend some of my sabbatical leave in North America not least in 1985—86 when I had the pleasure of being in Case Western Reserve University Law School in Cleveland, Ohio. I spent the year with Leon Gabinet, Erik Jensen and Karen Moore (now a Federal Judge) trying to make sense of the American materials which had just been cited enigmatically by the House of Lords in *Furniss v Dawson*.¹¹ The overwhelming message I came away with was that the US system with its doctrines such as form and substance, step transactions, economic substance and sham were all very well in their natural habitat but I was not at all sure that they would fit well in the UK where, it seemed to me, we place great emphasis on finding rules that are justiciable. As Lord Scarman said in *Furniss v Dawson*: 'the determination of what does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process.'¹²

You will note that Lord Scarman uses the term 'evasion' rather than 'avoidance' thereby showing that he had not taken his basic course in taxation. However Lord Scarman was far too great a judge - and classical scholar¹³ - to have done that without thought and a revisiting of the terminology is overdue – but not this evening.

In Part 2 Professor Tiley outlined the judicial approach to tax avoidance in the UK starting with the House of Lords decision in Ramsay in 1981. Having made the point that he preferred the judicial approach, he took the view that the House of Lords in Ramsay adopted a novel approach but without overturning what had been accepted as the cardinal rule of the Duke of Westminster, and really this was all just a matter of statutory interpretation.....

2 THE DEVELOPMENT OF THE 'SO-CALLED' RAMSAY DOCTRINE

I presented these views in a series of articles in the *British Tax Review*¹⁴ which attracted interested comment from a variety of American scholars. Some suggested that I had over-dramatised the situation by presenting their doctrines as hard rules rather than as devices for use in interpreting statutes. I had not intended to do so but, as my purpose was precisely to prevent the House from turning them into hard rules, I should not complain. As it happened, the English courts did try to treat their own words as rules so my caution was justified. The articles formed part of the taxpayer's paperwork in *Craven v White*¹⁵ in 1988. Now in 2007 we have ended up with a situation not unlike the US in that we have now reduced our questions to ones of interpretation rather than hard rules. But that is simply clearing the decks for a new game. As I like to say, less chaos more uncertainty.

¹⁰ *The Association of Graduate Recruiters*: <http://www.agr.org.uk/>

¹¹ [1984] 1 All ER 530, [1984] AC 474.

¹² [1984] AC 474 at 513.

¹³ Lord Scarman was a classical scholar at Radley College and then Brasenose College, Oxford University where he obtained First Class degrees in the two famous classical exams known as Mods and Greats.

¹⁴ John Tiley, Judicial Anti-Avoidance Doctrines [1987] *British Tax Review* 180 and 220; [1988] *British Tax Review* 63 and 108.

¹⁵ [1988] STC 479, [1989] AC 398.

My, rather large, brief is to talk about how we manage avoidance in the UK, our judicial/legislative responses, including recent UK developments and our 'rash' of anti-avoidance legislation. It includes my views on the approach of the House of Lords as compared, say, to the use of a general anti-avoidance rule (GAAR) or detailed legislation countering specific tax schemes. I must also cover the UK approach to notification or registration of tax schemes and the role of the tax advisor, given your own promoter penalties legislation. We shall look at the work of a new player in our fiscal legislative process, the House of Lords Select Committee on the Finance Bill. This Committee brings the considerable financial expertise existing on all sides of the House to inform consideration of the Finance Bill during its passage through Parliament. However it must not encroach on the financial privileges of the House of Commons and therefore does not address questions involving the rates or incidence of tax but focuses on technical matters of tax administration, clarification or simplification.¹⁶

My own attitude or, if I am on the European mainland, my philosophy, is that I approve of what we call the 'Ramsay approach' or the composite transaction doctrine (what to call it has been the cause of vexed and heated debate as we shall see later) and am hostile to avoidance schemes. I think these schemes give rise to complex legislation and in turn there are increases in costs for everyone. It can also lead to a breakdown of trust between tax authorities and the taxed and such trust, if mutual, is important. Some of you may find this last point an odd, eccentric or even pernicious way of talking and wonder if I also believe in Father Christmas.

Let us turn to the facts of the scheme in *Ramsay v IRC*,¹⁷ peddled in the 1970s, so you will see what I mean. *Ramsay* concerned capital gains tax (CGT). A company (R) had a large gain (£187,977) and wished to create an allowable loss which could be set against the gain and so offset its liability for tax. R bought a scheme from advisers on terms which made the amount of the fee vary with the amount of tax saved. We now enter the fantasy land of tax planning. R bought shares in another company (C) and proceeded to make two, apparently long term, loans to C, each of £218,750 at 11% (a genuine commercial rate at that time) and repayable at par (ie £218,750) after 30 and 31 years respectively. C was entitled to make earlier repayment, if it wished to but was obliged to do so if it went into liquidation. If either loan were repaid before its maturity date, it had to be repaid at par or at its market value, whichever was the higher. As C did not have £437,500 lying around, it borrowed that sum from a bank associated with the scheme's vendors. R had the right to decrease the rate of interest on one loan, on one occasion only, provided there was a corresponding increase on the other loan. R exercised the right causing the rate on one loan (L1) to drop to nil; this meant that the rate of interest on the other loan (L2) had to move in the opposite direction and by the same amount. So the interest rate on L2 rose to 22%, making it a significantly valuable asset, and L2 was sold by R for its market value price of £391,481, a gain of £172,731. Subsequently C paid off L1, at par as it was obliged to do. The very directly connected value of the shares in C dropped and the shares were sold by R at a large consequential loss (£175,731).

R argued that, while the loss on the shares should be recognized, the gain on the loan should not. This was because of a rule that a gain on a debt, as opposed to a debt on a

¹⁶ House of Lords, Select Committee on Economic Affairs, Report on the Finance Bill 2003, 17 June 2003, paras 7–8.

¹⁷ [1982] AC 300.

security, should not be recognised. Accepting a new line of argument based on treating a series of transactions such as these as one composite transaction, the House of Lords decided there was no relevant loss for CGT purposes. The House was surely right. No system can tolerate a situation in which taxpayers up and down the country have a choice – to pay the Revenue or pay a tax adviser. The scheme failed in the Court of Appeal and in the House of Lords.

The approach of the House of Lords in *Ramsay* was a novel one – it was novel because this was the first time that the composite transaction point had been put to one of our courts; it was put by Peter Millett QC, (later Lord Millett) counsel for the Revenue. The members of the House were very conscious of the novelty of the point and Lord Wilberforce was at pains to point out that their decision did not, in his view at least, undermine what he called 'the cardinal principle' of *Inland Revenue Comrs v Duke of Westminster*¹⁸ that where a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance.¹⁹ I think Lord Wilberforce is right on this – we must not undermine the cardinal principle but we can be a little more realistic in our approach to the facts. The *Duke of Westminster* case and others from that era are rightly taken as examples of a strict approach to the interpretation of tax legislation. That was the nature of the judicial approach in many other areas. In 2007 we no longer believe in a strict approach; we prefer a purposive approach. As was said in the *Barclays* decision in 2004,²⁰ the old strict approach went hand in hand with a very formalist approach to the facts and gave rise to an insistence on the part of the court on treating every transaction which had an individual legal identity as having its own separate tax consequences. So the courts were both literal and blinkered. *Ramsay* liberated the court from both these vices.

So the composite transaction approach enabled the court to find a modern real commercial characterisation of the facts. As Lord Wilberforce had said in *Ramsay* the court's task was to ascertain the legal nature of any transaction to which it was sought to attach a tax or a tax consequence and if that emerged from a series or combination of transactions, intended to operate as such, it is that series or combination which must be considered.²¹ This did not upset the cardinal principle set out above but enables the court to be less blinkered in deciding what the genuine transaction is.

The story by which we moved from *Ramsay* in 1981 to *Barclays* in 2004 forms the last – and longest – part of this lecture. It can be seen as a story of judicial development in the traditional common law way – of development followed by doubts, of advance followed by circumspection. While Lord Wilberforce did not treat the case of *Ramsay* as creating a judicial GAAR, it clearly had the potential to do so if further and wider arguments were advanced in later cases or if judges left things less tidily than he had done. Lord Wilberforce does not appear in the later cases – he retired soon afterwards but virtually all the later cases take his comments in *Ramsay* as their starting point. The story that does emerge of the way in which the various decisions were first of all argued by counsel and then how they were viewed by the various participants or, as we now have to call them, stakeholders reacted – by stakeholders I

¹⁸ [1936] AC 1.

¹⁹ [1982] AC 300 at 323.

²⁰ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684 paras 28-32.

²¹ [1982] AC 300 at 322-3.

mean the lower courts, the legal and accounting professions and, above all, Her Majesty's Revenue and Customs (HMRC).

After *Barclays* the question for HMRC will be whether they will be content to accept that approach indicated by the judges. It is not an approach which will stop all instances of what HMRC now call 'abuse'. They have been tempted to look again at a GAAR but I think the temptation is going to be resisted. My feeling about this is that they are not yet willing to set up the sort of rulings system that practitioners think would be needed. The HMRC view of rulings in the context of a GAAR was spelt out by the department's star witness before the House of Lords Committee last year:

...I think there is a very significant issue that arises there: how sensible would it be to offer pre-transaction clearances for what were very clearly tax avoidance arrangements? Again, how sensible is it to offer arrangements like that which then enable planners to refine their product again and again and again, as we have seen with some of our existing clearance measures, until they have got something that they think works. So there are very difficult issues to be sorted out.²²

In Part 3, Professor Tiley outlined some of the other ways in which tax avoidance was being dealt with in the UK. This included the use of targeted anti-avoidance rules, the possibility of retrospective legislation, imposition of penalties for tax advisers, as well as improved relationships with large business. He also discussed the recently introduced (at that time) disclosure of tax avoidance schemes (DOTAS).

3 OTHER WAYS OF DEALING WITH TAX AVOIDANCE

These remarks are of course directed to issues of rulings and avoidance. Elsewhere some progress has been made. In November 2006 the Varney Committee reviewed links with large businesses. The Chancellor announced that he would implement the review in full; hence HMRC has now agreed to bring in advance rulings.²³ However, as far as I can tell, it is not a general system. Its purpose is to give business certainty about the tax consequences of significant investments and corporate reorganisations. I note a) it is confined to business, b) it may be confined to large businesses, c) it is not aimed at Mr Hartnett's avoidance schemes but is available only for those who provide clear plans for investment, reconstructions and reorganisation.²⁴

Even without a GAAR, HMRC can still do much to counter perceived abuse. Over the 40 or so years I have been dealing with our tax system, we have not been short of provisions, some narrow others broad, countering avoidance. Like you we have over the years had many provisions designed to shore up the income tax in response to court decisions or planning schemes that came to light. We pay various prices for all this highly prescriptive legislation; one price pointed out by Lord Hoffman, is that the courts are driven to a non-purposive approach even though this leads to holes in the

²² David Hartnett, Director General of HMRC quoted in House of Lords, Select Committee on Economic Affairs, Report on Finance Bill 2006, para 62.

²³ HM Treasury, Press Release 92/06, 17 November 2006, Proposal 4.6 The Review itself is available via www.hmrc.gov.uk/largecompanies/reviewlinks-largebus.shtml

²⁴ One may contrast the treatment of big business with that meted out to two taxpayers by the Court of Appeal in what is known as the Arctic Systems case, more formally *Jones v Garnett* [2006] 1 WLR 1123. [The decision was overturned by the House of Lords: [2007] UKHL 35.]

net HMRC have persuaded Parliament to enact.²⁵ In recent years we have had a series of major reforms to our corporate tax base. Mercifully each set of provisions has its own code and perhaps not so mercifully for some, though in my view quite properly, each code has its own anti-avoidance rule or targeted anti-avoidance rule (TAAR). Here is the one for capital expenditure on Intangibles:²⁶

111 (1) Tax avoidance arrangements shall be disregarded in determining whether a debit or credit is to be brought into account under this Schedule or the amount of any such debit or credit

(2) Arrangements are 'tax avoidance arrangements' if their main object or one of their main objects is to enable a company—

(a) to obtain a debit under this Schedule to which it would not otherwise be entitled or of a greater amount than that to which it would otherwise be entitled, or

(b) to avoid having to bring a credit into account under this Schedule or to reduce the amount of any such credit.

(3) In this paragraph—

'arrangements' includes any scheme, agreement or understanding, whether or not legally enforceable; and

'brought into account' means brought into account for tax purposes.

You will find slightly longer ones in terms of non-allowable purposes in our legislation on loan relationships,²⁷ on derivative contracts²⁸ (which used to be called financial instruments) and on manufactured payments.²⁹ We have similar provisions to try to counter capital loss schemes for corporation tax - to be extended beyond the corporate sector.³⁰ There is an interesting general rule in the tax credits legislation aimed at those who deprive themselves of income for the purpose of securing entitlement to tax credits.³¹ The year 2005 saw many provisions dealing with avoidance involving financial arrangements.³² As with many changes in 2005 and later, we are able to trace these back to the new information gathering power – the duty to notify (discussed below). There is also a view that moving to an accounting based system of profit determination would reduce avoidance but that raises too many other issues.³³

²⁵ Lord Hoffmann, Tax Avoidance [2005] *British Tax Review* 197 at 205.

²⁶ *Finance Act 2002*, Sch 29 has 143 relatively easy-to-read paragraphs.

²⁷ *Finance Act 1996* Sch 9 para 13 (last amended) 2006-7 version.

²⁸ *Finance Act 2002* Sch 26 paras 23 and 24.

²⁹ *Finance Act 2004* s 137.

³⁰ *Taxation of Chargeable Gains Act 1992* s 8 as amended by *Finance Act 2006* s 69; further amendments promised in 2007. [See *Finance Act 2007* s 27 that inserted a new s 16A entitled 'Restrictions on Allowable Losses'.]

³¹ *Tax Credits (Definition and Calculation of Income) Regulations 2002* para 15 'Claimants depriving themselves of income in order to secure entitlement'.

³² *Finance Act (No 2) 2005* s 39 and Sch 7.

³³ See generally Wolfgang Schoen, 'The Odd Couple: A Common Future for Financial and Tax Accounting?' (2005) 58(2) *Tax Law Review/New York University School of Law*, 111 esp at 144.

HMRC may also increase the price of abuse by retrospective or retroactive legislation. We had a spectacular example of this when we removed loss relief from commodity straddles with effect from a date two years earlier.³⁴ Today, such legislation is only used in clearly delineated circumstances and with clear warnings. For example the employment income tax rules, some will remember as Schedule E, were rewritten as part of the ongoing Rewrite programme in the *Income Tax (Earnings and Pensions) Act 2003*. In an effort to prevent avoidance these had to be immediately revised by the *Finance Act 2003*. Although Revenue spokesmen were optimistically assuring everyone that they had foreseen all that was to be foreseen they were wrong. On 2 December 2004 the Minister, Dawn Primarolo, informed by the schemes reported under the new rules, made a written statement to the House of Commons that new changes would take effect as from that date. She also said that when arrangements designed to frustrate the government intention that a proper amount of tax should be paid arose, further legislation would be introduced to close them down.³⁵ Anecdotal evidence suggests that this has had the hoped for effect.³⁶ We also sometimes change the tax effects of transactions entered into in earlier years, most recently in our inheritance tax. This slightly different technique conforms to the words of Dickson J, the great Canadian judge, who once said 'no one has a vested right to continuance of the law as it stood in the past.'³⁷

In the hope of inducing changes in behaviour we have also found very senior officials from HMRC going into offices to talk with Boards of Directors in an effort to wean them off avoidance schemes. We have the usual corporate governance issues. We also have a more aggressive stance from HMRC when investigating avoidance. As Chris Tailby, now Director of HMRC's Anti-Avoidance Group, but formerly one of our most distinguished private practitioners, has written:³⁸

HMRC's intention is to make avoidance risky for businesses to undertake. Our approach is to deploy our resources in the business areas where the risk to the tax base is greatest... [and] to take them out of the areas of lowest risk to leave business to concentrate on its core activities.From the perspective of HMRC it is difficult to see how it will normally be in the best interest of the client to adopt an arrangement which only arguably escapes the damaging label 'abusive practice' and even then may not succeed in reducing tax liability... The top... professionals will advise their clients to put clear blue water between themselves and any arrangement that might even arguably be described as an abusive practice.³⁹

Like you we have used the criminal law and have put tax advisers, even members of the Bar, in prison for the offence of conspiring to defraud the Revenue when they

³⁴ *Finance Act 1978* now *Income and Corporations Taxes Act 1988* s 399.

³⁵ House of Commons Hansard, Written Statements, 2 December 2004, col 46.

³⁶ Few schemes were notified after that date: Tolley's Yellow Handbook [*presumably 2004-2005*], LexisNexis 71.

³⁷ *Gustafson Drilling (1964) Ltd v MNR* [1971] 1 SCR 271 at 282-3, cited G T Loomer, 'Taxing out of time: Parliamentary supremacy and retroactive tax legislation' (2006) *British Tax Review* 64 at 67. Note that the retrospective *Finance Act 1978* provisions on losses were held compatible with our Convention on Human Rights in *A B C and D v the United Kingdom*, (Application 8531/79) and see the comment by Philip Baker 'Retrospective tax legislation and the European Convention on Human Rights' (2005) *British Tax Review* 1.

³⁸ Writing about *Halifax PLC v Customs and Excise Commissioners* (Case C 255/02) [2006] STC 919.

³⁹ C Tailby, 'Halifax - a Basis for Optimism?' *Tax Journal*, Issue 833, 17 April 2006, 4 at 6.

advised on schemes which failed.⁴⁰ Since 1 January 2001 we have had an offence of being knowingly concerned in the fraudulent evasion of income tax.⁴¹

It is time to talk, briefly, about our notification powers.⁴² We now have four separate regimes: direct taxes, stamp duties,⁴³ VAT and National Insurance.⁴⁴ I will concentrate on the direct taxes. The rules require a promoter⁴⁵ and sometimes the taxpayer (or client) to provide the Revenue with information about a) notifiable arrangements and b) proposals for notifiable arrangements.⁴⁶ For a scheme to be notifiable it must enable, or might be expected to enable, any person to obtain a tax advantage in relation to any tax so prescribed in relation to the arrangements. It is also necessary that the main benefit or one of the main benefits that might be expected to arise from the arrangements is the obtaining of that advantage. There is protection for legal privilege.⁴⁷ So, the key question is whether the tax advantage is the 'main benefit'. The HMRC Guidance says:

In our experience those who plan tax arrangements fully understand the tax advantage such schemes are intended to achieve. Therefore we expect it will be obvious (with or without detailed explanation) to any potential client what they are buying and the relationship between the tax advantage and any other financial benefits. The test is objective and considers the value of the expected tax advantage compared to the value of any other benefits likely to be enjoyed.⁴⁸

In the direct tax area the obligation to notify generally falls upon the promoter of the scheme. It falls on the user of the scheme if the promoter is resident outside the UK and no promoter is resident within the UK.⁴⁹ If there is no promoter (ie the scheme is designed 'in house') the duty to notify falls on those entering into any transaction which is part of the notifiable arrangements.⁵⁰ The same applies where the promoter is prevented by legal professional privilege from making a full disclosure.⁵¹

The promoter must inform HMRC when the notifiable proposal is made available for implementation or, if earlier, when the promoter becomes aware of any transaction

⁴⁰ See John Tiley, *Revenue Law*, 5th ed 2005, Hart Publishing Oxford §4.5.3 and cases such as *R v Cunningham, Charlton, Wheeler and Kitchen* [1995] EWCA (Crim) J0222-1. For a particularly robust criticism see R Venables, 'Double Taxation Treaties: The Antidote to Anti-Avoidance Provisions?' (1996) *Offshore Tax Planning Review* 151.

⁴¹ *Finance Act 2000* s 144. The offence, on summary conviction, is punishable with imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both; and on conviction on indictment, imprisonment for a term not exceeding seven years or a fine, or both.

⁴² I am indebted to Rachel Tooma's article on the Australian provisions: 'New Tax Laws to Deter Promoters of Tax Avoidance Schemes' (2006) 2(1) *Journal of Australasian Tax Teachers Association* 158-177.

⁴³ The stamp duty rules apply if the property is not wholly residential and the applicable value is at least £5m: Stamp Duty Land Tax (Prescribed Description of Arrangements) Regulations 2005 SI 2005/1868.

⁴⁴ On the scope of HMRC powers re direct taxes, see *Finance Act 2004* s 318(1) definition of 'tax'.

⁴⁵ Defined in *Finance Act 2004* s 307.

⁴⁶ Defined in *Finance Act 2004* s 306.

⁴⁷ See *Finance Act 2004* s 314. On the scope of legal advice privilege, see *Three Rivers District Council v Bank of England* [2005] UKHL 48. Section 314 is reinforced by the Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004, para 6 added by SI 2004/2613.

⁴⁸ HMRC Guidance on Disclosure of Tax Avoidance Schemes: Income Tax, Corporations Tax, Capital Gains Tax and Stamp Duty Land Tax (June 2006) para 5.2.

⁴⁹ *Finance Act 2004* s 309.

⁵⁰ *Finance Act 2004* s 310.

⁵¹ The Tax Avoidance Schemes (Information) Regulations 2004 (SI 2004/1864) reg 4 (5A).

forming part of the proposed arrangements.⁵² The promoter does not have to notify HMRC if someone else has already done so.⁵³ Once HMRC has been informed, they may give the arrangements a reference number while further provisions deal with the obligations of promoters and parties to pass the number around.⁵⁴ The normal time limits by which a promoter must disclose a scheme are within 5 days of first making the scheme available for implementation or within 5 days of first becoming aware of a transaction implementing the scheme, whichever is the earlier. Those who fail to comply with a statutory obligation to disclose a scheme - or to advise a client of a scheme reference number issued by HMRC - are liable to penalties. Our approach is different from yours – we want compliance. There is an initial fine (£5, 000) and then a daily fine (£600) until the failure is remedied.

How well are the notification powers working? In 2006 the House of Lords Select Committee on Economic Affairs was pleased to note a broad consensus among witnesses from the private sector that the rules were working well, in particular by excluding unnecessary disclosures:

Setting up the necessary reviewing machinery has created more work for tax professionals and the burden is ultimately passed on to their clients in costs. *However, judged by the results described to us by HMT and HMRC, we concluded that this compliance burden was proportionate and justified by the outcome in terms of reducing the tax gap.*

At the risk of appearing a touch cynical what this shows is that the sort of people who provide evidence to House of Lords Committees are generally content. Before we let all this go to our heads we should note that the Committee has so far considered only the powers as enacted in 2004. In that first flush they were aimed just at certain types of arrangements connected with employment, especially employment related securities, and with financial products. There were also conditions or 'hallmarks' with regard to premium fees and confidentiality.⁵⁵

What were the 2004 rules trying to do? They were designed to improve transparency in the system and to enable the Revenue to counter 'sophisticated and aggressive avoidance schemes [that] thrive on concealment and secrecy'.⁵⁶ They were 'aimed at those marketing and using certain tax avoidance schemes and arrangements [and to ensure] early detection of such schemes and enable more effective targeting of avoiders'.⁵⁷ Our rules are not aimed at mass marketed schemes – we go wider than that. What they were after was not direct blocking, though that might follow, but speed of response by the Revenue. This was thought important because during the 1970s, in the *Ramsay* era, it was often a condition of buying a scheme that claims for the relevant relief should be delayed until the last possible moment). By 2004 it was

⁵² On multiple promoters and multiple proposals see *Finance Act 2004* ss 308(4) and (5).

⁵³ *Finance Act 2004* s 308(3).

⁵⁴ *Finance Act 2004* ss 311–13.

⁵⁵ The Tax Avoidance Scheme (Prescribed Description of Arrangements) Regulations 2004 (SI 2004/1863) Regs 5A and 8 (now repealed).

⁵⁶ Gordon Brown, Chancellor of the Exchequer, Pre-Budget Report 2004, House of Commons Hansard c 329.

⁵⁷ *Ibid.*

apparent that the Revenue needed to know about schemes earlier.⁵⁸ In relation to employment related securities this has been achieved.

The 2006 rules widen the net for direct taxes.⁵⁹ The obligation to notify now arises not where there are those two types of arrangement but with any arrangements when there are 'hallmarks'. The HMRC Guidance includes a useful flowchart.⁶⁰ In theory a person can implement a scheme within the time frame but there is no evidence that HMRC are concerned about this - at present. The 'hallmarks' include tests such as confidentiality, a premium fee, the presence of off-market terms and being a standardised tax product. There are also distinct hallmarks for schemes involving losses and, separately, leases. Most of the tests apply for income tax, capital gains tax, corporation tax and national insurance contributions (NICs). Unfortunately one has to dig through each rule to find that in most cases they do not apply to small and medium size enterprises (defined in European Commission law terms),⁶¹ and that only rarely do they apply to individuals.

One fear was that there would be too many returns; another that there would be too few. So how many have there been? To the end of September 2006 the provisional total of schemes reported was 1,143 of which financial schemes accounted for 443, employment schemes for 198 and Stamp Duty Land Tax (SDLT) for 506. The total for schemes coming within the hallmarks test was 34. Who provided those returns? The Big Four accounting firms provided 353; other accounting firms 194; legal firms 434; financial institutions and others 166. Most of the disclosures (399) by legal firms related to SDLT.⁶²

So how about there being too few? The *Finance Bill 2007* will contain clauses improving the rules. At present the Revenue are limited in what they can do to investigate non-compliance with the notification rules. There are rumoured to be two penalty cases pending but what HMRC wants is earlier information. As HMRC admitted in their note of the 2006 consultation, disclosure is, for the moment, effectively a self-regulatory regime.⁶³ Non-compliance not only undermines the purpose of the disclosure regime (to provide early information about avoidance schemes), it also creates distortions and puts those promoters who comply at a competitive disadvantage.

How do HMRC find out about schemes that are not notified? They monitor disclosures received and developments in the market place for tax schemes through published material, intelligence received and feedback from promoters. They also

⁵⁸ For comment see R Fraser 'Current Notes' [2004] *British Tax Review* 281-96 and 'Finance Act Notes: Tax Scheme Disclosure Provisions ss 19 and 306-19 [2004] *British Tax Review* 454-59.

⁵⁹ 2006/1543 Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006

⁶⁰ HMRC, Guidance on Disclosure of Tax Avoidance Schemes, June 2006 (Available on HMRC website) 18.

⁶¹ European Commission recommendation concerning the definition of micro, small and medium-sized enterprises, 6 May 2003 [*adopted 2005*].

⁶² L Narain, 'Tax Avoidance Disclosure: An Update' (2006) *Tax Adviser*, (September), 4.

⁶³ HMRC, Consultation Paper 'Ensuring Compliance with the Tax Avoidance Disclosure Regime' December 2006, para 14.

increasingly obtain evidence from enquiries into the tax returns of companies and individuals who have used schemes.⁶⁴

Some defaulters tell HMRC nothing more than that they have systems in place to identify whether or not their products are notifiable and that they are satisfied that the particular scheme is not. Such promoters will generally refer to Counsel's opinion they hold that the scheme is not notifiable, but do not explain why the scheme is not notifiable. The proposed new rules are designed to resolve disputes about what is and what is not notifiable. They may well include a power to get more information and a pre-disclosure enquiry to help HMRC get clearer reasons why a promoter thinks the scheme is not notifiable. Where there is a doubt about notifiability there may be a procedure by which HMRC can ask the [First-tier] Tribunal to order that scheme be treated as if it were notifiable – you can imagine the problems of the burden of proof here. Even more dramatically, where there is such a doubt, there may be a procedure by which HMRC can ask the Tribunal to determine that the scheme is notifiable.⁶⁵

In Part 4 Professor Tiley considered the proposal for a UK GAAR put forward by the Tax Law Review Committee of the Institute of Fiscal Studies. He is not a fan. Tellingly he said that in his view a GAAR is 'an admission of failure'. He does not say whose failure: he may be referring to the legislation or HMRC or the judges or the system as a whole.....

4 THE 1997 GAAR PROPOSAL

We have had GAARs in the excess profits taxation rules introduced for the First and Second World Wars.⁶⁶ Similar powers were part of profits tax⁶⁷ and the special charge in 1967.⁶⁸ However, the impetus for the introduction of a GAAR with more general application was provided in the 1990s by the Institute for Fiscal Studies (IFS), our leading tax research organisation and a fiercely independent one. Under the chairmanship of Graham Aaronson QC, the Institute's Tax Law Review Committee (TLRC) produced a report which, without actually recommending a General Anti Avoidance Rule (or GAAR) suggested that a GAAR with proper safeguards might well be preferable to the then uncertain state of case-law and explored what a GAAR should look like if it was to be acceptable;⁶⁹ it looked at a number of other countries including your own.⁷⁰ The Committee recommended first that specific anti avoidance provisions should continue to be used. As to a GAAR it set out certain elements and safeguards.

⁶⁴ HMRC, notes to draft clauses Pre Budget Report 6 December 2006: If HMRC obtains information that indicates a notifiable scheme may not have been disclosed, the normal practice is for HMRC to approach the promoter and invite explanation as to why the scheme has not been disclosed.

⁶⁵ The proposed clauses are 308A, 313A, 306A and 314A.

⁶⁶ On the history, see P Ridd 'Excess Profits Duty' in *Studies the History of Tax Law* Volume 1, J Tiley ed, Hart Publishing, 2004 chapter 5 and 'Excess Profits Litigation' Volume 2, 2007; see his comments on *Finance Act 1941*, s 35 etc and the decision in *Crown Bedding Co Ltd v IRC* [1946] 1 All ER 452; 34 TC 107 (CA) at pp 168-174.

⁶⁷ *Finance Act 1951*, s 32; see J Silberrad, 'Avoidance of Profits Tax Again Counteracted' (1964) *British Tax Review* 129.

⁶⁸ *Finance Act 1968*, s 50.

⁶⁹ Institute of Legal Studies, Tax Law Review Committee, 'Tax Avoidance Report' November 1997, the draft clause is in Appendix II.

⁷⁰ *Ibid*, Chapter 3 and Appendix 1.

The TLRC GAAR had several elements. In broad terms it proposed a purpose clause to deter or counteract transactions designed to avoid tax in a way which conflicted with or defeated the evident intention of Parliament. The basic rule contrasted a 'tax-driven' transaction with a normal transaction; a person was to be taxed in accordance with the normal transaction. Where, because the tax-driven transaction did not have a non-tax objective and so there is no normal transaction, tax was to be charged as if the transaction had not taken place. Among the safeguards was the notion of a 'protected transaction' to which the rule would not apply. An annual report by HMRC would be made to Parliament giving full details of the operation of the rule.

The tax elite of the nation had worked on the TLRC report so the Revenue had to consider it; they produced a consultative document with its own clause.⁷¹ Opinion within the Revenue was divided. Opinion in the profession - outside the 'elite' - was almost completely hostile. In turn the TLRC were severely critical of the Revenue's proposal.⁷² The truth is probably that the GAAR would have worked only with a proper system of rulings. The government was not willing to pay the financial cost of such a system, nor was it willing to pay the political cost of trying to force such a system onto taxpayers.

As we have seen earlier the rejection of a GAAR has not stopped the extensive use of provisions based on 'avoidance' and each major amendment to the tax base, usually corporation tax, has contained its own mini GAAR in the form of an unallowable purpose test—and without the protection of a statutory advance rulings system.⁷³

Since 1997 the Chancellor and the Paymaster [*this position appears to be similar to our Finance Minister*] have often said that they did not plan to bring forward a GAAR but, as it was in their thoughts, HMRC are carrying out a legal study of these sorts of rules around the world. Indications are that HMRC accept that the rules produced very mixed results.⁷⁴ Having read Allan Myers' address I do not think I need say more.

My view of the GAAR is that I regard it as a confession of failure [*emphasis added*]. Moreover it may be too late. Recent - and so far unpublished - work done by the TLRC reviewed the *Finance Acts* from 1997 to 2006. The conclusion reached was that of almost 200 changes in the law reviewed very few would be dealt with better by a GAAR.⁷⁵ More specifically, it was difficult to see how a GAAR could deal with avoidance structured around specific rules and definitions.

⁷¹ Inland Revenue 'General Anti Avoidance Rule for Direct Taxes, A Consultative Document' October 1998. [*The Inland Revenue was replaced by Her Majesty's Revenue and Customs in 2005.*]

⁷² Tax Law Review Committee, 'Response to Inland Revenue's Consultative Document' (IFS, February 1999).

⁷³ *Finance Act 1996* Sch 9 para 13, (Loan Relationships and since 2002 foreign exchange), *Finance Act 2002* Sch 26 para 23 (Derivatives) Sch 29 para 111 (Intellectual Property), *Finance Act 2004* s 137 adding *Taxes Act 1988* Sch 23A para 7A (Manufactured Overseas Dividends) and *Finance Act 2004* s 38 inserting a new *Taxes Act 1988* s 75 (Management Expenses) noting especially s 75(5); see also the reasons for removing annual payments from the category of charges on income in Finance Bill 2005 clause 132 and Inland Revenue Notes on the Bill.

⁷⁴ [*Professor Tiley may have been referring to the work being done at the IFS (see fn 75) where the following comment appears at para 14.2: 'It is clear that no jurisdiction has found a perfect solution and, in particular, the use of GAARs in varying forms has had mixed success.' The survey by the TLRC is Appendix E of the Discussion Paper.*]

⁷⁵ The Tax Law Review Committee published a Discussion Paper 'Countering Tax Avoidance in the UK: Which Way Forward?' IFS, February 2009. The Discussion Paper considers the *Finance Acts* from 1997 to 2008: Appendix D.

With all the activity, legislative and administrative, and with an objective of what HMRC would see as raising the level of taxpayer behaviour by informal means, it is not the right time to make the dramatic and politically demanding switch to a GAAR. I have to acknowledge that in so far as this activity is legislative, the effects on the length of our statute book have been dire. Some see a GAAR as a way of shortening the statute book. You can tell me whether it has that effect here. I believe we can do at least as well - and probably better - with our existing approach, especially as it seems to mesh in well with our schedular approach to the definition of income. We have neither a general definition of income nor a general system of deductions and we are systematically mean on loss reliefs across the schedules.

In Part 5 Professor Tiley charted the development of the judicial approach to tax avoidance in the UK from Ramsay in 1981 through to Barclays in 2004.

5 FROM RAMSAY TO BARCLAYS

It is time to return to the story to what our judges have been up to. We left *Ramsay* (1981) as it had been expounded in *Barclays* (2004) where it was said:

The modern approach to statutory construction is to have regard to the purpose of the particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until the *Ramsay* case, however, revenue statutes were 'remarkably resistant' to the new non-formalist methods of interpretation. The particular vice of formalism in this area of law was the insistence of the courts on treating every transaction which had an individual legal identity (such as a payment of money, transfer of property, creation of debt etc) as having its own separate tax consequence, whatever might be the terms of the statute. The *Ramsay* case liberated the construction of revenue statutes from being both literal and blinkered....Unfortunately, the novelty for tax lawyers of this exposure to ordinary principles of statutory construction produced a tendency to regard *Ramsay* as establishing a new jurisprudence governed by special rules of its own.⁷⁶

This tendency, the House of Lords acknowledged, had been encouraged by two features characteristic of tax law:

The first is that tax is generally imposed by reference to economic activities or transactions which exist as Lord Wilberforce said 'in the real world'. The second is that a great deal of intellectual effort is devoted to structuring transactions in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute.⁷⁷

It is to the story of the 'special rules' in *Ramsay* that we now turn. In the era of 1936 using strict construction and a blinkered view of the facts, the view was that the *Duke of Westminster* was right and, probably, more than right – it was proper. The 1970s with high income tax rates (in 1978 the top rate was 98%)⁷⁸ and a rather unsatisfactory

⁷⁶ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684 paras 28-32.

⁷⁷ *Ibid* para 34.

⁷⁸ In 1974 this was made up of a top rate of 83% plus the investment income surcharge of 15%.

capital gains tax, saw the advent of marketed avoidance schemes. The Revenue continued to argue in traditional ways and so lost cases such as *IRC v Plummer*⁷⁹ or got the right answer by a slightly strained construction as in *Floor v Davis*⁸⁰ where the House divided 3-2 with Lords Diplock and Wilberforce on opposite sides

As we saw, 1981 brought the House of Lord's decision in *Ramsay* the facts of which involved an artificial, circular, self-cancelling transaction: was there a chargeable gain or allowable loss? At the risk of quoting something very familiar to you I repeat Templeman LJ's classic analysis in *Ramsay* in the Court of Appeal:

The facts as set out in the case stated by the Special Commissioners demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax.

The game is recognisable by four rules. First, the play is devised and scripted prior to performance. Secondly, real money and real documents are circulated and exchanged. Thirdly, the money is returned by the end of the performance. Fourthly, the financial position of the actors is the same at the end as it was in the beginning save that the taxpayer in the course of the performance pays the hired actors for their services. The object of the performance is to create the illusion that something has happened, that Hamlet has been killed and that Bottom did don an asses head so that tax advantages can be claimed as if something had happened.

The audience are informed that the actors reserve the right to walk out in the middle of the performance but in fact they are the creatures of the consultant who has sold and the taxpayer who has bought the play; the actors are never in a position to make a profit and there is no chance that they will go on strike. The critics are mistakenly informed that the play is based on a classic masterpiece called 'The Duke of Westminster' but in that piece the old retainer entered the theatre with his salary and left with a genuine entitlement to his salary and to an additional annuity.⁸¹

After *Ramsay* in the House of Lords we had to ask ourselves what the House had done. Lord Wilberforce concluded that nothing the House was doing upset the cardinal principle about substance and form. However, it was not clear what the House would do next. The fact that we can now say, post-*Barclays* in 2004, that it was all a question of construction does not alter that fact that at the time very different views were held. Was the House just adopting a realistic up-to-date approach to questions of fact and law or, was it a watershed case, like *Donoghue v Stevenson*,² rewriting the law and creating at least the opportunity for the development of a judicial GAAR? If the latter, what hedging doctrines or limits would the court develop? If it was less than a GAAR and more like a step transaction doctrine, when was it to be applied? Always or selectively? If selectively, then on what basis? Life was uncertain – and, for an academic at least, great fun. For others things were more serious. What should the Revenue do with their success?

⁷⁹ [1979] STC 793.

⁸⁰ [1979] STC 379.

⁸¹ *W T Ramsay v IRC* [1979] STC 582 (Court of Appeal).

The year 1982 brought the decision in *Burmah Oil*.⁸² The UK corporate reorganisation tax rules did not have a business purpose requirement until the *Finance Act 1978*. In *Burmah Oil*, the House of Lords was dealing with facts which occurred before that Act came into force. With Lord Diplock to the fore, they used *Ramsay* to prevent a company from using corporate reorganisation rules to turn worthless debt into worthless equity. There was little guidance on doctrine; just that *Ramsay* had changed the judicial approach.⁸³ The only distinction from *Ramsay* – in the eyes of the judges – was that here the scheme was tailor-made for *Burmah Oil* not mass-produced and that was not enough of a distinction. The important thing was that *Ramsay* was applied, possibly without too much thought, to a normal corporate planning provision being used by a major taxpayer with very respectable advisers. It was probably right to view it as a circular transaction – like *Ramsay*

And so to 1984 and the high point, *Furniss v Dawson*,⁸⁴ another corporate reorganisation case dealing with pre-1978 facts but this time clearly a linear transaction. D, a shareholder wished to sell his stake in a company (Op Co) to another company, Wood Bastow (WB). He went to respectable solicitors and, as a result, implemented a straightforward plan, the effect of which would be to defer payment of tax until he was ready to receive the proceeds. D first exchanged his shares in Op Co for shares in another company, Greenjacket (GJ), a company resident in the Isle of Man. GJ then sold the shares in Op Co to WB. This left D holding shares in GJ and the money paid by WB still sitting in GJ – so D had not yet got his hands on the cash but could do so by liquidating GJ or, but less likely, causing GJ to pay a dividend.

Using hypothetical numbers, we now need to see what is going on. Suppose D's shares in Op Co had a base cost of £1 and the sale to WB was going to be at £4. If D had simply sold the shares to WB, D would have had a capital gain of £3. Under the scheme D exchanged shares in Op Co for shares in GJ. Provided that the court was satisfied that D had fulfilled the terms of the corporate reorganisation rules for share-for-share exchanges, D would then be treated as acquiring the shares in GJ not at £4 but at his base cost for the original shareholding being exchanged – £1 – so that there would be no gain at this time. GJ would not be liable to tax on any gain as it was non-resident and so, under our rather self-denying rules, not subject to UK tax on any gain. If in the fullness of time D sold the shares in GJ D would pay tax on the gain of £3 – ie £4 price less base cost of £1. So D was really deferring his liability to tax – unless he did anything else in the meantime – like dying or, probably less painfully, going to

⁸² *IRC v Burmah Oil Co Ltd* [1982] SC (HL) 114, 54 TC 200, STC 30.

⁸³ Thus Lord Diplock in *IRC v Burmah Oil Co Ltd* at [1982] SC (HL) 114 at 124 said: 'It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that *Ramsay*'s case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transaction (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach. It does not necessitate the overruling of any earlier decisions of this House; but it does involve recognising that Lord Tomlin's oft-quoted dictum in *IRC v Duke of Westminster* [1936] AC 1 at 19, 19 TC 490 at 520, 'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be', tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straightforward way.'

⁸⁴ [1984] AC 474; [1984] STC 153; 55 TC 324.

reside in another jurisdiction. It is important to note that D had not liquidated GJ - that would have been caught by *Floor v Davis*.⁸⁵

I regard *Furniss v Dawson* as presenting the classic problem of determining the ratio of the case – especially as Lord Brightman was quite determined to make it difficult. The passage which is always quoted begins with denying a distinction:

... [T]he rationale of the new approach is this. In a pre-planned tax saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step serially..... *Ramsay* says that the fiscal result is to be no different if the several steps are preordained rather than pre-contracted.⁸⁶

So *Ramsay* is an approach to schemes whose steps are 'preordained' rather than contractually binding. Then we have 'the rule', taken from Lord Diplock in *Burmah Oil*, who had expressed what Lord Brightman called the 'limitations' of the *Ramsay* principle:

First, there must be a preordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end. The composite transaction does, in the instant case; it achieved a sale of the shares in the operating companies by the taxpayers to Wood Bastow. It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax – not 'no business effect'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.⁸⁷

In the instant case the inserted step was the introduction of GJ as a buyer from the taxpayers and as a seller to WB. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect. What do we make of these as words? What was going on? Were they creating a judicial GAAR? Or simply applying the words of the legislation? Can we make the later cases consistent with this formulation? As with *Ramsay*, but even more so, the judges in *Furniss v Dawson* were very anxious to stress that it was still early in the *Ramsay* era and all seemed content with the lack of intellectual infrastructure or any rigour. The Court had applied the composite transaction doctrine to a linear transaction which was main stream stock of tax practice. Was its doctrine – assuming that it is the right word to use – to be applied in all statutory contexts or only in some? The Court did not seem to mind about the practical uncertainty. It was not clear what arguments the Revenue were going to produce next and the members of the House of Lords were not going to pre-empt things.

⁸⁵ [1979] STC 379

⁸⁶ [1984] AC 474; 2 WLR 226; BTC 71 at 83.

⁸⁷ Ibid.

In 2007, with our new understanding that it is all a question of interpretation, that there is no doctrine or rule, just an approach, things seem different. The difference is shown by one of my favourite paragraphs. It comes from the speech of Lord Nicholls in the *MacNiven* case⁸⁸ in 2001. Anticipating what he was to say in the *Barclays* case in 2004, Lord Nicholls came down decisively in favour of simply applying the words of the legislation. I will quote it and comment (with interpolations and emphasis⁸⁹) as I go:

My Lords, I readily accept that the factual situation described by Lord Brightman is one where, typically, the *Ramsay* approach will be a valuable aid [**JUST A VALUABLE AID, AND IF SO TO WHAT?**]. In such a situation, when ascertaining the legal nature of the transaction and then relating this to the statute, application of the *Ramsay* approach may well have the effect stated by Lord Brightman. **But, as I am sure Lord Brightman would be the first to acknowledge**, the *Ramsay* approach is no more than a useful aid [**CRUX**]. This is not an area for absolutes [**MORE CRUX**]. The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.

I am not convinced that Lord Brightman would have made that acknowledgment but I think he would not have rejected it either. It was far more likely that he would have said that it was too early to say. But Lord Nicholls pushes his argument further:

As I have sought to explain, *Ramsay* did not introduce a new legal principle. [**AND SO**] It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful [**NO HEDGING DEVICES NEEDED**]. The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation, are principles of general application.⁹⁰

You can decide whether it is breathtakingly brilliant or brilliantly breathtaking!

That is all very well but let us be practical - how should the Revenue have carried out their legal duty to collect tax in accordance with the law? Thankfully – for us – the Revenue carefully arranged for three appeals to be heard together in 1988.⁹¹ Of the panel of five hearing the appeals, none had sat in the earlier cases at House of Lords level. These cases resolved the question whether the House of Lords had formulated a judicial GAAR or a more confined composite (or preordained) transaction doctrine – [**IT HAD NOT**] and, by a majority, gave a very narrow interpretation to when transactions were preordained – the ‘no practical likelihood’ test.

It may be best to mention *Bayliss v Gregory* first.⁹² Here the House of Lords looked at another corporate reorganisation similar to *Furniss v Dawson*. However, here the share for share exchange was not followed by a consummation of the later steps. In fact, the company was sold on to a quite different purchaser on quite different terms some 18 months later. This did not affect the fact that the original share for share

⁸⁸ [2001] UKHL 6; [2003] 1 AC 311 at para 8.

⁸⁹ *In bold and capitals*.

⁹⁰ *Ibid*.

⁹¹ *Craven v White*; *IRC v Bowater Property Developments Ltd*; *Bayliss v Gregory* [1988] AC 398; STC 476 and 1 BTC 268.

⁹² *Ibid*.

exchange had been tax driven. The House of Lords held, unanimously and without effort, first that the tax avoidance purpose was not enough to invalidate the exchange⁹³ and secondly that the eventual sale to someone else did not fit the composite transaction test.⁹⁴

*Craven v White*⁹⁵ was more difficult; the House of Lords split 3-2. Once more there was a share for share exchange with an Isle of Man company. This time though the sale *did* go through to the intended purchaser, but only just. At the time of the share exchange (11 July) the prospects for the sale to a company called Oriel (O) did not look promising and an alternative disposal was considered. However, on the same day, O asked for a further meeting. The Commissioners had held that the primary objective of the share exchange was the sale to O and that the taxpayer company was keeping its options open. Following further negotiations, including one 'stormy meeting', the sale to O finally went through on 9 August of the same year. This time the House of Lords said 'no' avoidance, but by a bare majority. The majority consisted of Lord Oliver and the two Scottish law lords – Keith and Jauncey.

Lord Oliver refers to a series of transactions preordained in order to produce a given result and there being at that time no practical likelihood that the pre-planned events would not take place in the order ordained; in such circumstances the intermediate transaction was not even contemplated practically as having an independent life.⁹⁶ Lord Templeman and Lord Goff dissented – they would have said the steps made one transaction. The majority view is current orthodoxy. As Lord Nicholls put it in the *Scottish Provident* case in late 2004:

...There was an uncertainty about whether the alleged composite transaction would proceed to completion which arose, not from the terms of the alleged composite transaction itself, but from the fact that, at the relevant date, no composite transaction had yet been put together.⁹⁷

Sadly, I must pass by cases in which the House of Lords required that the rearrangement for which the Revenue contended should make sense.⁹⁸ Even more sadly I pass by *IRC v Moodie*⁹⁹ where the House of Lords faced with identical facts to those in *IRC v Plummer*,¹⁰⁰ just before *Ramsay*, proceeded to apply the *Ramsay* approach to reach a different conclusion. Lord Hoffmann's name appears in this case but as the first instance judge. Lord Hoffman thought he could apply *Ramsay*; the Court of Appeal thought he was wrong. I gloss over the interesting 1992 non-recourse finance capital allowance case of *Ensign Tankers Leasing Ltd v Stokes*.¹⁰¹ I do so reluctantly because there is a particularly masterful speech by Lord Goff.

⁹³ Among many matters which troubled the House, as they had troubled the Court of Appeal, was what the legal status of the first transaction would be while one waited to see what might ensue, and, in particular, the status of any assessments to tax which might have been made on the basis of that first transaction (as might have occurred in the *Bowater* case).

⁹⁴ [1988] 1 BTC 268. See, for example, Lord Keith at 284 and Lord Goff at 314.

⁹⁵ [1988] AC 398; STC 476 and 1 BTC 268.

⁹⁶ [1988] 1 BTC 268 per Lord Oliver at 302.

⁹⁷ *IRC v Scottish Provident Institution* [2005] HL (SC) 33 at paras 21 and 22.

⁹⁸ *Fitzwilliam v IRC* [1993] STC 502.

⁹⁹ [1993] STC 188.

¹⁰⁰ [1979] STC 793.

¹⁰¹ [1992] 1 BTC 110; STC 226; 1 AC 655.

We move fast forward to late 1997 and *IRC v McGuckian*.¹⁰² The importance of this case lies first in the way in which Lord Steyn and Lord Cooke in particular traced *Ramsay* as an example of purposive construction – to which Lord Nicholls referred in *Barclays*. From their words it appeared that a court could reach a judgment in favour of the Revenue without using the composite transaction approach just by a purposive construction. So this left construction as leading to yet wider powers in the court – and to arguments by HMRC – to counteract avoidance.

In the late 1990s I appeared in a debate with Graham Aaronson QC. You will recall that the TLRC Report's case for a GAAR was driven by his critique of the case law. We can perhaps more clearly comprehend the nature and depth of his unhappiness. For him, relying on case law was unsatisfactory first because, as compared with a GAAR, it was retrospective (like all court decisions);¹⁰³ secondly, the judicial doctrine was too restrictive (in its insistence on having a preordained transaction and a tightly drawn sense of 'preordained'); thirdly, it was arbitrary (in that when it applied it simply knocked out steps). It was also insufficiently targeted as one could not rely on judges to carve out the TLRC GAAR's notion of a 'protected' transaction. Other epithets he used were 'hypocritical' and 'unprincipled' (by falsely presenting itself as a matter of simple interpretation when it was actually a matter of complex application); and uncontrolled (through the lack of any clearance procedure).

And so to 2001 and the new Millennium. Just when we had got our minds round the widening approach in *McGuckian* – and the Revenue were wondering how to make use of it – the Revenue invited the House of Lords to adopt a strong version of the composite transaction doctrine in *MacNiven v Westmoreland Investments Ltd*.¹⁰⁴ They came unstuck. First, the House rejected the strong doctrine.¹⁰⁵ Then, they held that even a weak version of the doctrine was not going to get the Revenue home. It was agreed that the composite transaction doctrine was a question of interpretation (or application). However the judges held that the logically prior question – was the provision one to which the composite transaction doctrine could apply? – was itself to be a question of construction. So even though they had proved that it was 'practically certain' that the various steps would succeed each other, the Revenue might still lose. In what may have begun with points made in argument but became the centrepiece of Lord Hoffmann's speech, with which the other judges expressly agreed though adding points of their own, Lord Hoffmann drew his celebrated – or notorious – distinction between concepts which were commercial (where the doctrine was useful) and those which were legal or juristic where there was no reason to use the test.¹⁰⁶

Westmoreland (W) was a property company that owed £70m including £40m arrears of interest on loans from a pension fund; the pension fund was its only shareholder. If

¹⁰² [1997] 1 WLR 991; 3 All ER 817; STC 907.

¹⁰³ For example, see *Moodie v IRC* [1993] STC 188 where the House of Lords decision reversed its own earlier decision in *Plummer v IRC* [1980] AC 896. The scheme in *Plummer* involved the sale of an annuity to a charity. On the scheme, see M Gillard 'In the Name of Charity: the Rossminster Affair', Chatto and Windus, London 1987, chapter 3.

¹⁰⁴ [2001] UKHL 6; [2003] 1 AC 311; STC 237.

¹⁰⁵ So Lord Hoffmann, *ibid* at para 29 'My Lords, I am bound to say that this does not look to me like a principle of construction at all.... Mr McCall's formulation looks like an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision, save for the possibility of rebuttal by language which can be brought within his final parenthesis.'

¹⁰⁶ The (vigorous) dissenting speech which Lord Templeman would have given if he had not retired is published in 'Tax and the Taxpayer' [2001] 117 *Law Quarterly Review* 565.

the interest could be *paid*, W would be able at that time, thanks to s 338 of the *Taxes Act 1988*, to use that payment as a charge on income so creating a loss which could be set against profits the company might earn in later years, even, subject to s 768 of the *Taxes Act 1988*, profits earned following a change of ownership. The scheme enabled this payment to be made.¹⁰⁷ The pension fund's shareholders lent the money to W, which passed it back as a payment of interest. The facts thus disclosed a preordained series of transactions carried out in order to secure a payment of interest and a tax advantage in that W now had an allowable loss. Lord Hoffmann held that the term 'payment' was to be construed juristically as opposed to commercially. In this case, the juristic meaning was that there was a payment if the legal obligation to pay interest had been discharged. It followed that there was no room for the Revenue's broadly formulated principle.

Of the other members of the House – Lords Nicholls, Hobhouse, Hope and Hutton – only Lord Hobhouse gave a simple concurrence. If you actually want to understand the case however you need to look at Lord Nicholls speech. He confessed that his initial view, which remained unchanged for some time, was that a payment comprising a circular flow of cash between borrower and lender, made for no commercial purpose (other than gaining a tax advantage), would not constitute payment within the meaning of s 338. However, eventually he concluded that in deciding whether a debt had been paid one should not worry how that had come about. Once that was accepted, he did not see it could matter that there was no business purpose other than gaining a tax advantage. A genuine discharge of a genuine debt could not cease to qualify as a payment for the purpose of s 338 by reason only that it was made solely to secure a tax advantage. He also noted that what was upsetting the Revenue was the ability of the pension scheme trustees to reclaim the tax deducted by W from the payments. That was the consequence of the tax exempt status of the pension scheme. For him the concept of payment in s 338(3)(a) could not vary according to the tax status of the person to whom the interest is owed.

There is no time to rehearse criticisms hurled at Lord Hoffmann's distinction¹⁰⁸ but simply to record that from 2001 to the end of 2004 everyone involved in these affairs solemnly did exactly what Lord Hoffmann may have asked them to do which was: first, to identify the concept then ask whether it was commercial or legal and then apply the answer to the facts. Such an intellectual straitjacket was rejected by the House of Lords in 2004 in *Barclays*.¹⁰⁹ I do not doubt the sincerity with which Lord Hoffmann floated the distinction but experience showed that it was not workable; the classification was hard to apply and there is the prior problem of identifying the particular concept which was to be classified.¹¹⁰

¹⁰⁷ It is a nice question whether the problem would not arise under the loan relationship rules in the *Finance Act 1996*. If the connected party rules apply the deduction would be given only if, as in the present case, the interest was actually paid.

¹⁰⁸ For criticism of Lord Hoffmann's distinction see Justice Ribeiro PJ in *Collector of Stamps Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 para 40 and Lord Millet in paras 148–151 citing the problems expressed by the Court of Appeal in *Barclays Mercantile Business Finance Ltd v Mawson* [2002] EWCA Civ 1853; [2003] BTC 81; STC 6 by Peter Gibson LJ at para 44 and Carnwath LJ at paras 69 and 73.

¹⁰⁹ [2004] UKHL 51; [2005] 1 AC 684; STC 1 at para 32.

¹¹⁰ See Court of Appeal in *Barclays Mercantile Business Finance Ltd v Mawson* [2002] EWCA Civ 1853; [2003] BTC 81; STC 6.

And so to 2004 and two decisions: *Barclays Mercantile Business Finance Ltd v Mawson*¹¹¹ and *IRC v Scottish Provident Institution*.¹¹² *Barclays* is the case which stripped out the excrescences which had come to mar what Lord Wilberforce had begun and gives us our new beginning. The courts will not develop a wide ranging GAAR – they have no power to do so. They will scrutinise legislation purposively and interpret words in context. This is a matter of approach not of bright line rules. So they will apply the composite transaction doctrine selectively – but not irrationally. What reasons will they give? What reasons will work? We do not know. This is why *Barclays* is not the end, there never can be an end to Lord Scarman's role, but a new beginning.

In *Barclays*, an Irish company, BGE, had built a pipeline. They sold the pipeline to the taxpayers, Barclays Mercantile Business Finance (BMBF), for £91.3m. BMBF leased the assets back to BGE which granted a sub-lease onwards to its UK subsidiary. The question was whether BMBF was entitled to a capital allowance in respect of the £91.3m spent, as BMBF argued, to acquire an asset used in its business of finance leasing. The simple finance deal was then hedged around with many complex money flows; BMBF argued that the purpose of these arrangements was to ensure that the sums due from BGE under the lease arrangements would actually come through. In the Chancery Division, Park J said that the underlying purpose of Parliament in relation to finance leasing had been to enable capital allowances to be used so as to provide finance to lessees at attractive rates for them to use and to develop their real business activities. So it was not to enable cash payments to be made annually to third parties who were able to provide a major item of machinery or plant which satisfied one of the conditions for a finance lessor to claim the allowances. That was not in accordance with 'the purpose and spirit of the legislation'.¹¹³ The Court of Appeal¹¹⁴ – and the House of Lords¹¹⁵ – could find no warrant for so restricted a view.

The decision in *Barclays* was a very determined effort to clean the law up. Once Park J's analysis of the purpose of the legislation was rejected the taxpayer was going to win. However, this does not end the matter. We are back with Lord Scarman's assertion in *Furniss v Dawson* in 1984 that the determination of what does, and what does not, constitute unacceptable tax [avoidance] is a subject suited to development by judicial process.

The last case I wish to consider is the other 2004 House of Lords case *IRC v Scottish Provident Institution*¹¹⁶ where the House of Lords unanimously gave a slightly wider effect to the composite transaction doctrine. A company had entered into what was clearly a composite transaction within the rule. The parties had then added a term which had the effect that there was now a chance that the rights would not be exercised. As it happened the rights were exercised. The chances of the relevant event, a price movement was, the Special Commissioners held, like an outsider winning a horse race. The House of Lords held that the Special Commissioners had erred in law in concluding that because there was a realistic possibility of the options

¹¹¹ [2004] UKHL 51; [2005] 1 AC 684; [2005] STC 1.

¹¹² [2004] UKHL 52; [2005] STC 15.

¹¹³ [2002] EWHC 1527 (Ch) at para 51.

¹¹⁴ [2003] EWCA (Civ) 1853.

¹¹⁵ HL [2004] UKHL 51; [2005] 1 AC 684; STC 1.

¹¹⁶ [2004] UKHL 52; [2005] STC 15.

not being exercised simultaneously, therefore the scheme could not be regarded as a single composite transaction. At para 23 they state:

We think that it would destroy the value of the *Ramsay* principle if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties; it might not work as planned.

6 CONCLUSION

The notification regime is working well; there is, in my view, no need as yet for a GAAR unless one can simplify the principles or in some areas create them. Nothing is going to stop the drive of legislation from year to year or the endless and quite justified efforts on the part of HMRC to identify and police the areas of abuse.

While the story of the cases may not emerge smoothly and inevitably, it does represent a marvellous example of what courts can do. I have watched all the twists and turns and even participated in some. My view has been that the *Ramsay* approach is, or at least should be, one of statutory interpretation and application and so Lord Nicholls and his colleagues have held. One can trace a coherent thread throughout – but only if one chooses the right thread. It also illustrates Lord Goff's famous statement, in his 1983 Maccabean Lecture on Jurisprudence,¹¹⁷ that the common law develops pragmatically on a case by case basis. He also said, quoting a German student, that in the common law system, unlike the civil law, it is the judge, not the professor, who is God.¹¹⁸ Where the courts go next will depend on which issues are argued and what arguments are used. I think the judges come out of this tolerably well. They have presented their thoughts in wonderful prose sprinkled with occasional irony. They have quite often allowed themselves to become fixated with phrases – and so everyone else has had to too – but they have ended up in a position which is intellectually and constitutionally sustainable. It is however a situation in which, as Lord Nicholls¹¹⁹ said, there will be differences of opinion; that is the nature of issues of interpretation. They have reached a situation which meets some but not all of Graham Aaronson's criticisms. Where the judges, or the system, do not come out of it well is in relation to the American authorities. Lord Wilberforce asked for these – and some Australian ones – in *Ramsay*. They were also cited in *Furniss v Dawson* in 1984. I have not seen what was submitted to the Court but the results are not impressive. In *Craven v White* in 1988 the House of Lords simply told counsel for the Revenue that there was no need for him to take them on his proposed world tour.

¹¹⁷ 'The Search for Principle' 1983 Maccabean Lecture on Jurisprudence, Proceedings of the British Academy, 69.

¹¹⁸ *Ibid.* Lord Goff recalled a brilliant German student saying to him 'In Germany the professor is God; in England the judge is God.' Lord Goff acknowledged that the academic lawyer had an important role to play in the 'search for principle' but concluded that 'the dominant power should be that of the judge, because the dominant element in the development of the law should be professional reaction to individual fact situations rather than theoretical development of legal principle.'

¹¹⁹ Lord Nicholls was on the House of Lords from 1994 to 2007 and sat on many of the significant tax avoidance cases. This appears to be a reference to his judgment in *McNiven v Westmoreland Investments Ltd* [2001] UKHL 6; [2003] 1 AC 311; STC 237.

Now that we have a rule which does not need 'limitations' or hedging devices it may be time to take a closer look at the American experience. They have developed at least three tests of interdependence for their step transaction doctrine; some may be worth looking at. We do not need to be trapped by the strictness of the practical certainty test in those situations where the approach can be used. As Lord Nicholls has told us: it is all a matter of interpretation and so anything can be considered.¹²⁰ What we need is for someone to do the work so that counsel can inform the court.

7 POSTSCRIPT: BEYOND 2007

As Professor Tiley predicted, Barclays was not the end of the story. By 2010 there were renewed calls for a GAAR in the UK. The reasons for this are complex – a global financial crisis from 2008 and beyond, a new coalition government elected in the UK in 2010 imposing strict austerity measures and, perhaps most significantly, a number of high profile tax avoidance cases that made the payment of tax appear to be optional. Although Professor Tiley had articulated a preference for judicial construction of tax legislation over a GAAR, he was a member of the Study Group established by the coalition government to consider the proposal for a statutory GAAR.¹²¹

Perhaps the most significant tax avoidance cases since 2007 are Tower MCashback LLP v HMRC¹²² in 2011 heard by the Supreme Court (which replaced the House of Lords Judicial Committee in 2009) and HMRC v Mayes also in 2011 which was a decision of the Court of Appeal. Tower MCashback was a case that involved circular movements of money with the aim of claiming capital allowances and was decided in HMRC's favour. The Supreme Court held that although capital expenditure was incurred, only some of it was attributable to plant and machinery. The remaining expenditure was part of a payment loop designed to inflate the allowances being claimed, which did not have any real link with the plant and machinery acquired. Accordingly, only part of the expenditure qualified for capital allowances. The Supreme Court adopted a similar approach to Ramsay and confirmed that Barclays and Ensign Tankers¹²³ were still good law.

Mayes may have been the 'last straw'. Mr Mayes was one of a number of participants in a tax avoidance scheme known as SHIPS2. The participants in the scheme were all UK-resident taxpayers with high earnings or significant capital gains. The purpose of the scheme was to minimise the tax liabilities of the participants. The scheme involved the taxpayers purchasing second-hand life assurance policies and surrendering them in order to obtain a deduction for income tax and capital gains tax purposes. The scheme depended on the implementation of seven pre-determined steps. HMRC accepted that all the steps were genuine, but argued that steps three and four, when applying the legislation, should be ignored, on the basis that they constituted a singly, wholly self-cancelling, pre-planned transaction for tax avoidance purposes which had no commercial purpose.

Following conflicting decisions by both the Special Commissioners and the High Court, on 12 April 2011 the Court of Appeal dismissed HMRC's appeal and held that

¹²⁰ *Ibid* at para 8.

¹²¹ Graham Aaronson, Report by GAAR Study Group (11 November 2011) (Aaronson Report).

¹²² [2011] UKSC 19; 2 AC 457.

¹²³ [1992] BTC 110.

the High Court was correct to allow Mr Mayes' claim for relief.¹²⁴ Special leave to appeal to the Supreme Court was refused.

Even before the decision in Mayes was handed down, in December 2010, the government asked Graham Aaronson QC, (who had also chaired the 1997 TLRC study) to chair a study program into the introduction of a GAAR.¹²⁵ The study group was to consider whether a GAAR was possible and if so, the form that it would take.¹²⁶ In the 2011 Budget the government also released a document entitled 'Tackling Tax Avoidance'¹²⁷ that outlined an 'ambitious package of measures' to tackle tax avoidance including a new anti-avoidance strategy, the announcements of reviews in high-risk areas of the tax system, options to reduce the cash-flow advantage from using avoidance schemes and targeted responses to specific avoidance risks. In May 2011 HMRC released a Consultation Paper entitled 'High Risk Tax Avoidance Schemes'¹²⁸ including proposals to introduce legislation to remove cash-flow advantages of entering into certain schemes by providing that users of such schemes would be subject to an additional charge on amounts that were underpaid.

The Study Group chaired by Graham Aaronson did propose a statutory GAAR but the proposal had a number of features that were designed to make it more targeted than those of countries such as Australia.¹²⁹ The GAAR, described as a 'general anti-abuse rule', is contained in Part 5 and Schedule 43 of Finance Act 2013 and came into force on 17 July 2013. It applies to income tax; capital gains tax; Inheritance tax; corporation tax; petroleum revenue tax; stamp duty land tax; and the annual residential property tax.

The GAAR applies to 'tax arrangements' which are 'abusive'. In broad terms a tax arrangement is any arrangement which, viewed objectively, has the obtaining of a tax advantage as its main purpose or one of its main purposes.¹³⁰ 'Tax advantage' in this context is also broadly defined.¹³¹ The broad definitions of 'tax advantage and 'tax arrangements' set a low threshold for initially considering the possible application of the GAAR. A much higher threshold is then set by confining the application of the GAAR to tax arrangements which are 'abusive'.¹³² The Guidance provided to taxpayers sets out what it is that makes the UK GAAR different:

It is recognised that under the UK's detailed tax rules taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made. The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in

¹²⁴ [2011] EWCA (Civ) 409; STC 1269; All E R (D) 116.

¹²⁵ HMRC, Study of a General Anti-Avoidance Rule, Terms of Reference, 6 December 2010.

¹²⁶ Ibid.

¹²⁷ UK Treasury, Tackling Tax Avoidance, 28 March 2011: <https://www.gov.uk/government/publications/tackling-tax-avoidance--2>

¹²⁸ HMRC, High Risk Tax Avoidance Schemes, Consultation Paper, May 2011.

¹²⁹ The Aaronson Report, n 120, para 3.18

¹³⁰ Section 207(1) Finance Act 2013.

¹³¹ Section 208 Finance Act 2013.

¹³² As defined in s 207(2) Finance Act 2013.

*question and, critically, where that course of action cannot reasonably be regarded as reasonable.*¹³³

Another important feature of the UK GAAR is that a number of safeguards are built into the GAAR rules. These include:

- *Requiring HMRC to establish that the arrangements are abusive (so that it is not up to the taxpayer to show that the arrangements are non-abusive);*
- *Applying a 'double reasonableness' test. This requires HMRC to show that the arrangements 'cannot reasonably be regarded as a reasonable course of action'. The 'double reasonableness' test sets a high threshold by asking whether it would be reasonable to hold the view that the arrangement was a reasonable course of action. The arrangement falls to be treated as abusive only if it would not be reasonable to hold such a view;*
- *Allowing the court or tribunal to take into account any relevant material as to the purpose of the legislation that it is suggested the taxpayer has abused, or as to the sort of transactions which had become established practice at the time when the arrangements were entered into. HMRC has with an interim Advisory Panel developed Guidance....; and*
- *Requiring HMRC to obtain the opinion of an independent advisory panel (the GAAR Advisory Panel) as to whether an arrangement constituted a reasonable course of action, before they can proceed to apply the GAAR.*¹³⁴

John Tiley's contribution to the law relating to taxation has been widely commented on. His specific contribution to combatting tax avoidance is also considerable. His academic contributions set out his views of the case law, his understanding of approaches to the problem in other jurisdictions and in his 2007 Lecture he provides a carefully argued case for judicial doctrine as opposed to legislative intervention. His opposition to the proposal for a statutory GAAR in 1997 gave way to participation in the Aaronson study group which produced a different kind of proposal and, it would seem, a change in attitude. One obituary after John's death suggested that he was sceptical about the final legislative proposal for the GAAR.¹³⁵ However, there is no suggestion of that in his written work or conference presentations as the GAAR proposal came to fruition and the observation may simply represent the dismay of those who see their work translated into legislative form. Whatever John thought of the final provisions, the coming into force of Part 5 and Schedule 42 of the Finance Act 2013 just 17 days after his death represents just one more achievement of a man who dedicated his working life to making the tax system more efficient and the place of tax in the academic world more secure.

Vale Professor John Tiley, CBE, FBA, QC. Born February 25 1941, died June 30 2013.

¹³³ HMRC, GAAR Guidance, approved by the GAAR Advisory Panel with effect from 15 April 2013, Part B, para 11.1.

¹³⁴ Ibid, para 12.1.

¹³⁵ The Times, Professor John Tiley Obituary 8 July 2013.

‘Send a strong man to England - capacity to put up a fight more important than intimate knowledge of income tax acts and practice’: Australia and the development of the dominion income tax relief system of 1920

C John Taylor¹

Abstract

The system of Dominion Income Tax Relief, which operated between the United Kingdom and Australia between 1st July 1921 and 30th June 1946, offered a solution to the problem of international juridical double taxation which differed in significant respects from the solution subsequently developed in bi-lateral double taxation treaties. The system allowed a country taxing on the basis of residence (in this case the United Kingdom) to give a credit for underlying foreign tax paid on dividends irrespective of the nature and extent of the shareholding in the foreign company. More fundamentally the system required a sharing of the obligation to relieve international juridical double taxation between the residence and source country that did not depend on a differential treatment of particular categories of income.

Using the archival sources that have been available to the author this paper examines: (1) the views of the then Australian Commissioner of Taxation on the problem; (2) the effect that submissions by the Australian representative (the Commonwealth Statistician) at a conference of Dominion representatives with the Sub Committee of the United Kingdom Royal Commission had on the scheme of Dominion Income Tax; and (3) the reasons for the subsequent demise of the scheme.

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This paper is based in part on a paper presented at the 5th International Accounting History Conference, Banff, Canada, 9th to 11th August 2007. Since writing that paper the author was able to locate two Australian Taxation Office files relevant to the development of the system of Dominion Income Tax Relief and the paper has been substantially revised having regard to the content of those files. The paper was presented at the inaugural meeting of the Australasian Tax History Chapter of the Australasian Tax Teachers Association at QUT on 27th June 2013. The author spent two periods of sabbatical leave at the University of Cambridge in 2005 and 2008. The late Professor John Tiley provided friendship and support for the author on those visits during which much of the research that resulted in this paper was conducted.

From 3rd June 1947 international juridical double taxation between the United Kingdom and Australia has been dealt with through a series of bi-lateral double taxation agreements.² Prior to the entry into the first of these agreements in 1946 the problem of double taxation of income by the United Kingdom was dealt with as part of a system known as ‘Dominion Income Tax Relief’. In the Australian context the Dominion Income Tax Relief system operated from 1st July 1921 and 30th June 1947.

The system of Dominion Income Tax Relief offered a solution to the problem of international juridical double taxation which differed in significant respects from the solution subsequently developed in bi-lateral double taxation treaties. The system allowed a country taxing on the basis of residence (in this case the United Kingdom) to give a credit for underlying foreign tax paid on dividends irrespective of the nature and extent of the shareholding in the foreign company. More fundamentally the system required a sharing of the obligation to relieve international juridical double taxation between the residence and source country that did not depend on a differential treatment of particular categories of income. The system was developed following a conference between a Sub Committee of the United Kingdom Royal Commission On The Income Tax appointed in 1919 and representatives of the Dominions.

Using the archival sources that have been available to the author³ this paper examines the effect that submissions by the Australian representative at the conference of Dominion representatives with the Sub Committee of the United Kingdom Royal Commission had on the scheme of Dominion Income Tax Relief as developed by the Sub Committee. The paper argues that those submissions resulted in a system that produced favourable revenue results for Australia for most of the years of its operation. Ironically this feature of the system meant that the United Kingdom was dissatisfied with it for much of the same period. When, following changes to the Australian corporate tax system in 1939, the Dominion Income Tax Relief system began producing adverse revenue consequences for both jurisdictions they both sought its replacement with a double taxation agreement of a type that was then becoming the international norm. The paper also suggests that administrative difficulties associated with the operation of the system as between the United Kingdom and Australia might have been lessened if an Australian technical expert had been attended the conference and been part of the detailed negotiations.

This paper is divided into five parts. Part 1 outlines the reliefs granted by the United Kingdom resulting from discussions with the Dominions prior to 1919. Part 2 discusses

² Australia – United Kingdom Double Taxation Agreement, signed 29th October 1946, entry into force 3rd June 1947; Australia – United Kingdom Double Taxation Agreement, signed 7th December 1967, entry into force 8th May 1968; Protocol to Australia – United Kingdom Double Taxation Agreement, signed 29th January 1980, entry into force 21st May 1980; Australia – United Kingdom Double Taxation Agreement, signed 21st August 2003, entry into force 17th December 2003.

³ Archival research has been confined to the National Archives of Australia in Canberra and the United Kingdom National Archives at Kew. To date the author has only been able to locate a limited number of files relevant to Dominion Income Tax relief at either archive. Unfortunately an important file in the National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part 1 is incomplete and does not contain copies of several key documents referred to in correspondence within it. Originals and copies of some items of correspondence referred to in National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part I are contained in National Archives of Australia Series A11804 Control Symbol 1926/317. Some documents referred to in National Archives of Australia Series A461/8, Control Symbol D344/3/3 Part I are contained in National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I. The relevant Australian Taxation Office files are National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I and Part II.

the 1919 conference between the Sub Committee of the United Kingdom Royal Commission on the Income Tax and representatives of the Dominions. Part 3 discusses key features of the United Kingdom Royal Commission's scheme namely, Dominion Income Tax Relief. Part 4 discusses the implementation of the Dominion Income Tax Relief system in Australia in 1921. Part 5 briefly discusses the subsequent operation of the system of Dominion Income Tax Relief in relation to Australian sourced income and the reasons for its replacement by a double taxation agreement in 1947. In the process Part 5 reflects on the effect of the Australian representative at the 1919 conference on the development and subsequent history of the system of Dominion Income Tax Relief.

1 DISCUSSIONS AND RELIEFS GRANTED PRIOR TO 1919

The problem of double taxation within the British Empire became apparent as British colonies started levying income taxes in the 19th century. Beginning with the introduction of the Indian Income Tax in 1860 the various British colonies began to tax United Kingdom residents on a source basis on at least some income. The Australian colonies all introduced income taxes between 1884 and 1907. All of the income taxes of the Australian colonies in this period levied tax on income sourced within the colony irrespective of the residence of the taxpayer. Similarly, when Australia first introduced a federal income tax in 1915 it also was a wholly territorial tax which taxed income with an Australian source irrespective of the residence of the taxpayer deriving the income.⁴

From 1803 to 1914 the United Kingdom, by contrast, taxed both on a residence and source basis although foreign source income of United Kingdom residents was only subject to United Kingdom tax when it was remitted to the United Kingdom.⁵ From 1914 onwards, however, the United Kingdom by s5 of the *Finance Act* 1914 subjected major types of foreign source income to United Kingdom tax irrespective of whether they were remitted to the United Kingdom or not.⁶

In 1896 the Royal Colonial Institute sent a memorial on double taxation within the British Empire to the United Kingdom Chancellor of the Exchequer. Discussion of the issue in the United Kingdom House of Commons followed but attempt to enact a provision requiring the United Kingdom to grant a foreign tax credit to income that had been subject to Colonial income taxes proved to be unsuccessful.⁷

The issue of double taxation of income within the British Empire was raised again at the Imperial Conference of 1907.⁸ Cape Colony, following the decision of the House of Lords in *De Beers Consolidated Mines v Howe* [1906] AC 455, sought 'the repeal of enactments imposing double income tax on British subjects by the laws of the separate States and Great Britain'. *De Beers Consolidated Mines Ltd*, although incorporated in and carrying on business in Cape Colony, had been found to be a resident of the United Kingdom on the basis that its central management and control was in the United Kingdom. As a United Kingdom resident De Beers was subject to United Kingdom tax on its worldwide income. Dr Jameson (the Prime Minister of Cape Colony) supported

⁴ *Income Tax Assessment Act 1915 (Cth)* s10(1).

⁵ See the discussion of the history of the jurisdictional scope of United Kingdom income tax laws in P A Harris, *Corporate/Shareholder Income Taxation And Allocating Taxing Rights Between Countries*, IBFD Publications, Amsterdam, 1996, at p287

⁶ See the discussion in Harris *supra* note 5 at p 294.

⁷ See the discussion in Harris, *supra* note 5 at p 294.

⁸ United Kingdom, *Minutes Of The Imperial Conference 1907* pp 183 to 189.

by Louis Botha (the Prime Minister of Transvaal) and Alfred Deakin (Prime Minister of Australia), argued that ‘to us Colonists, it appears that the most equitable arrangement is that it should be a tax on incomes earned in the country where the tax is in force’.⁹ H H Asquith, then the United Kingdom Chancellor of the Exchequer, rejected the request stating, ‘I cannot hold out any hope that the Imperial Parliament will effect any change in that principle of our law. To do so would deprive ourselves here of an amount which I should be very sorry offhand to calculate, and also it would fly entirely in the face of the principle of our income tax law which is that wherever a person, a natural person or an artificial person, chooses for purposes of his or their own, to domicile themselves in this country, to take advantage of our laws for the purposes of carrying on their trade, they are proper subjects of taxation, and we cannot discuss the question amongst whom in what part of the world the ultimate profits are divided.’¹⁰ A subsequent attempt to enact a provision exempting income that had been subject to Colonial income tax from United Kingdom income tax was unsuccessful.¹¹

The issue was raised again at the Imperial Conference of 1911. New Zealand proposed a resolution calling for Imperial legislation exempting United Kingdom residents from United Kingdom tax on income or profits which had already been subject to income or other tax in by a self-governing dependency. The Union of South Africa proposed that the United Kingdom grant a foreign tax credit in respect of tax paid to Colonies.¹² Lloyd George, then the United Kingdom Chancellor of the Exchequer, rejected the New Zealand proposal on the basis that it would be too costly to the United Kingdom revenue but considered that the South African suggestion merited further consideration.¹³ The extension of the United Kingdom income tax base by s5 of the *Finance Act 1914* to tax residents on major items of foreign source income irrespective of their remittance to the United Kingdom together with the increase in income tax rates both in the United Kingdom and in the Dominions to finance involvement in World War I intensified the need for double income tax relief. On 9th July 1914 a deputation from the Dominions met with Lloyd George, then Chancellor of the Exchequer, to object to the income of persons from the Dominions being subject to United Kingdom income tax. In response Sir John Simon and Lloyd George stated in the United Kingdom House of Commons that United Kingdom tax would only apply to foreign source income where the recipient of the income was domiciled in the United Kingdom.¹⁴

Some relief was given by the United Kingdom *Finance Act 1916* which provided in s43:

If any person who has paid, by deduction or otherwise, United Kingdom income-tax for the current income-tax year on any part of his income at the rate exceeding three shillings and sixpence¹⁵ proves to the satisfaction of the Special Commissioners that he has also paid Colonial income-tax in respect

⁹ United Kingdom, *supra* note 8 at p188.

¹⁰ United Kingdom, *supra* note 8 at p 186.

¹¹ See the discussion in Harris, *supra* note 5 at p294.

¹² United Kingdom, *Minutes Of The Imperial Conference 1911* p 358.

¹³ United Kingdom, *supra* note 11 at p362.

¹⁴ Extracts from report of the Australian Cabinet Sub-Committee (Messrs Glynn and Webster and Senator Russell) dated 10th February 1919, The members of the deputation were Sir George Reid, the Honourable G H Perley, and the Honourable T Mackenzie. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁵ Rates were expressed in terms of shillings and pence in the pound. A rate of 3/- 6d represents a rate of 17.5%.

of the same part of his income, he shall be entitled to repayment of a part of the United Kingdom income-tax paid by him equal to the difference between the amount so paid and the amount he would have paid if tax had been charged at the rate of three shillings and sixpence, or, if that difference exceeds the amount of tax on that part of his income at the rate of the Colonial income-tax equal to that amount.

In this section the expression 'United Kingdom income tax' means income-tax charged under the Income Tax Acts; and the expression 'Colonial income-tax' means income-tax charged under any law in force in any British possession or any tax so charged which appears to the Special Commissioners to correspond to United Kingdom income tax.

As Harris points out, for the purpose of this unilateral relief by the United Kingdom, both residence of the taxpayer and source of income were irrelevant. The sole criterion for relief was that income was taxed in both the United Kingdom and a Dominion.¹⁶ As an Australian Cabinet Sub-Committee noted in 1919 the relief offered by the *Finance Act 1916* only benefited persons on large incomes.¹⁷ Subsequently a Sub Committee of the United Kingdom Royal Commission On The Income Tax established in 1919 was to note that a further objection to this form of relief was that it was entirely borne by the United Kingdom Exchequer.¹⁸ Under the system the United Kingdom tax payable prior to relief was calculated by deducting the Dominion tax paid not by grossing up the income for the Dominion tax paid.¹⁹

The relief given by the *Finance Act 1916* was only ever intended to be a temporary measure. The issue of double income tax within the British Empire was considered again at the Imperial War Conference of 1917 which passed the following resolution:

That the present system of double income taxation within the Empire calls for review in relation:

1. to firms in the United Kingdom doing business with the Overseas Dominions, India and the Colonies;
2. to private individuals resident in the United Kingdom who have capital invested elsewhere in the Empire, or who depend on remittances from elsewhere within the Empire; and
3. to its influence on the investment of capital in the United Kingdom, the Dominions and India, and to the effect of any change on the position of British capital invested abroad.

The Conference, therefore, urges that this matter should be taken in hand immediately after the conclusion of the war, and that an amendment of the law should be made which will remedy the present unsatisfactory position.²⁰

¹⁶ Harris, *supra* note 5 at 295.

¹⁷ Extracts from report of the Australian Cabinet Sub-Committee, *supra* note 14.

¹⁸ United Kingdom, *Report Of The Royal Commission On The Income Tax*, London, 1920, Appendix 1, at p169 paragraph 12.

¹⁹ A point noted in United Kingdom, *supra* note 18 at p172 paragraph 32.

²⁰ Quoted in United Kingdom, *supra* note 18 at p169.

Although the need for relief intensified when the United Kingdom raised its top marginal rate to 6/- in the £ (30%) no relief was enacted. The issue was considered again at the Imperial War Conference of 1918. There the then Chancellor of the Exchequer, Andrew Bonar Law, stated:

It is certainly essential that this whole question be settled, and I think it should be settled immediately after the war. It is even in our interest that it should be done – I mean the interest of the British Exchequer – because it is quite obvious that with the income tax as high as it is likely to be after the war, unless adjustment of this kind is made, businesses which can be conducted in the Dominions without having an office in London will be transferred there and we shall lose the whole of the revenue. So that it is in our interest that there should be no delay in doing this. But I do not think it would be wise, nor do I think it would be right, to attempt to deal with more than we have done, during the war.²¹

2 THE 1919 CONFERENCE OF DOMINION REPRESENTATIVES WITH THE SUB COMMITTEE OF THE UNITED KINGDOM ROYAL COMMISSION ON THE INCOME TAX

On 26th March 1919 the United Kingdom Secretary of State for the Colonies, following discussions with the Chancellor of the Exchequer²², advised the Governors General of the various Dominions that a Royal Commission on the Income Tax was about to be appointed and proposed that Royal Commission would confer with financial representatives selected by the Dominion Governments on the question of double income tax.²³ Sir Robert Garran, the drafter of the Australian Federal *Income Tax Act* 1915 made contact with the Royal Commission and was advised that they were not yet ready for a conference on the issue. The Royal Commission proposed to appoint a Sub-Committee to examine the question of double income tax relief within the British Empire and to confer with Dominion representatives. The then Australian Prime Minister, W M Hughes, regarded the deliberations of the Sub-Committee as extremely important and, apparently, did not consider Garran, despite his technical knowledge of the statute, as someone who would be forceful enough in the committee's deliberations. Another logical choice might have been Robert Ewing²⁴, the Commissioner of Taxation, but it may be that Hughes and the Government were already aware of Ewing's views on relief from double taxation. Later correspondence indicates that the Australian Government rejected a scheme developed by Ewing as involving too great a loss of revenue notwithstanding what Ewing regarded as its arithmetical correctness.²⁵ Hughes suggested sending a 'strong man to England' arguing that the 'capacity to put up a fight

²¹ United Kingdom, *Minutes Of The Imperial Conference 1918*, 8th Day p 3. Amendments were made to the rules providing relief in 1918 but these were merely technical adjustments consequent on changes in United Kingdom domestic tax law.

²² United Kingdom, *supra* note 18 at 168.

²³ Secretary of State for the Colonies to Governor General of the Commonwealth of Australia dated 26th March 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁴ Ewing was Commonwealth Commissioner of Taxation from 1917 to his retirement in 1939. He had previously briefly been acting Commissioner in 1917, Deputy Commissioner of Taxation in Victoria in 1916 and 1917 and had been secretary of the land tax branch of the Commonwealth Department of the Treasury from 1911 to 1916. See P D Groenewegen, 'Ewing, Robert' in Bede Nairn and Geoffrey Searle (general editors), *Australian Dictionary Of Biography*, Volume 8, pp 453 to 454.

²⁵ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II at pp. 177 to 179 refers to the scheme he developed and notes that, 'while arithmetically correct', it was 'not acceptable to the Commonwealth Government because it involved too great a loss of revenue.'

more important than intimate knowledge of Income Tax Acts and practice'.²⁶ On Hughes recommendation George H Knibbs, the Commonwealth Statistician, was appointed as the Australian representative at the conference.²⁷

George Handley Knibbs' had been a licensed surveyor, had taught geodesy, astronomy, hydraulics and physics at the University of Sydney and had been New South Wales superintendent of technical education. He had been appointed first Commonwealth statistician in 1906 a position he was to hold until 1921 when he became director of the newly established Commonwealth Institute of Science and Industry. By 1919 Knibbs had represented Australia and many international statistical, scientific and insurance conferences, had been a member of several wartime committees and had chaired the Royal Commission into the taxation of Crown leaseholds in 1918-1919. One biographer summarised Knibbs' career and personality as follows:

With ability and confidence evident in all his work, Knibbs won considerable prestige for the office of Commonwealth statistician, confounding those who had criticised his appointment. His major interest was in vital statistics and it was here that he won his international reputation....His failure to concern himself with current economic questions, coupled with his self-assurance and didacticism bordering on pomposity, may eventually have rendered him unpopular. His written expression, however, may have belied his reputed charm of manner and unnerving kindness of heart. He talked quickly and quietly in a high-pitched voice about his extraordinarily wide interests; one interviewer observed that 'an hour's conversation with him is a paralysing revelation'.²⁸

The Royal Commission formally appointed the Sub-Committee on 3rd July 1919 to: 'consider what arrangements with the various Dominions are practicable in order to ensure that any existing hardship arising from the imposition of Double Income Tax within the Empire may be remedied'.²⁹

Knibbs was not able to leave Australia until 2nd August 1919.³⁰ Prior to Knibbs leaving Australia the Commonwealth Commissioner of Taxation (Robert Ewing) wrote to the Secretary of the Commonwealth Treasury (James R Collins³¹) examining two alternative approaches for dealing with the problems of double and treble taxation.³²

²⁶ Cable dated 4th July 1919 from W M Hughes, London, to Acting Prime Minister (Commonwealth of Australia). Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁷ Australian Cabinet decision, 8th July 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

²⁸ Susan Bambrick, 'Knibbs, Sir George Handley' in Bede Nairn and Geoffrey Searle (general editors) *Australian Dictionary Of Biography*, Volume 9, Melbourne University Press, Carlton, Victoria, 1981. pp 620-621. Knibbs' contribution as Commonwealth statistician is discussed in more detail in Susan Bambrick, 'The First Commonwealth Statistician: Sir George Knibbs' (1969) 102 *Journal and Proceedings, Royal Society of New South Wales* pp 128 to 135.

²⁹ United Kingdom, *supra* note 18 at p 168.

³⁰ Letter Collins (Secretary, Department Of The Treasury, Commonwealth Of Australia) to The Secretary, Prime Minister's Department, 20th August 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

³¹ James Richard Collins was Secretary Commonwealth Department of the Treasury, 1916 to 1926. See K R Page, 'Collins, James Richard' in Bede Nairn and Geoffrey Searle (general editors), *Australian Dictionary Of Biography*, Volume 8, pp 77 to 78.

³² R. Ewing, Commissioner of Taxation to The Secretary of the Treasury (Collins), Melbourne, 17th July 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at pp 82 to 83.

One approach was that the ‘country of origin’ should have the exclusive right to tax income otherwise subject to double taxation and that the other country should surrender any claim to tax it. Ewing rightly surmised that this approach would ‘involve the Imperial Exchequer in such serious reductions in revenue that it may be possibly be found impractical for the Imperial Government to agree to it’.³³

The other approach was that a ‘broad Empire view should be taken on the question’. Under this approach Ewing envisaged that ‘a citizen of the Empire should pay one tax on incomeassessed in more than one part of the Empire’. Ewing considered that the tax payable should be the highest amount payable in any part of the Empire. Ewing’s letter set out, in some detail, how, in his view, relief should be provided under the second approach. First the amount of income actually taxed in both countries would need to be ascertained. Then the highest amount of tax payable on that income in any part of the Empire would need to be determined and that tax would then be apportioned ‘pro rata to the several taxes assessed on the income, between the parts of the Empire in which it has been taxed’.³⁴ What Ewing envisaged is clear from an example that he provided in subsequent correspondence. On an income of £1000 the United Kingdom tax was £150 (representing a 15% rate) while the Australian tax was £45/14/1 (representing approximately a 4.57% rate). Under Ewing’s scheme total tax borne would be the United Kingdom tax of £150 which would be apportioned between the United Kingdom and Australia in the same proportions as the tax that each jurisdiction would otherwise levy bore to the sum of the taxes that would otherwise be levied by those jurisdictions. The total tax that would otherwise be levied was £195/14/1. The United Kingdom tax that would otherwise be levied of £150 represented 76.65% of the total tax that would otherwise be levied. This same percentage would then be applied to the £150 that the United Kingdom levied which meant that the United Kingdom’s would be entitled to retain £114/19/5 of the £150 tax that it levied. Australia’s proportion of the £150 of tax would be 23.35% being £35/0/7.³⁵

Ewing suggested that the income doubly taxed in more than one part of the Empire could be ascertained on a time basis using the Imperial fiscal year and that the comparison of taxes should be made in respect of the income included in the taxpayer’s return to the Board of Inland Revenue which was also taxed in another part of the Empire. In making this suggestion Ewing was concerned with differences in tax bases between jurisdictions (for example Australia exempted income from Commonwealth War loans whereas the United Kingdom did not). Ewing’s object was to ascertain the ‘actual amount of income on which tax is being charged in the two countries’. Ewing realised that the procedure he suggested would involve the Board of Inland Revenue in considerable work in calculations and that other taxing authorities throughout the Empire would have similar difficulties. In Ewing’s view, however, the anticipated difficulties were ‘not likely to prove sufficiently formidable as to warrant much consideration’. Ewing considered that the onus should be on the taxpayer to apply for

³³ Ewing to Collins, 17th July 1919, *supra* note 31 at p82.

³⁴ Ewing to Collins, 17th July 1919, *supra* note 31, at pp82-83.

³⁵ Note ‘The Commr’ dated 28th November 1919 and accompanying schedules. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p147. This note appears to have been prepared by an Australian Taxation Office official and sent to the Commissioner of Taxation. The example in the text is based on Schedule ‘C’ to the note. The note states that ‘Schedule ‘C’ in accordance with your instructions now’.

relief and to provide all necessary particulars to show the manner and extent to which the taxpayer's income had been doubly taxed.³⁶

Ewing also recognised that there would probably be a few cases in which there would be double taxation between Australia and parts of the Empire other than the United Kingdom but considered that those cases would not present any features not found in the United Kingdom – Australia case.³⁷

Ewing also prepared a memorandum summarising the cases where double and treble income tax could arise³⁸ and a memorandum on Australian War Time Profits Tax and United Kingdom Excess Profit Duty.³⁹ Ewing requested that his letter and memoranda be passed on to Knibbs and it is clear that this was done.⁴⁰

Evidently the views of the Australian government did not accord with Ewing's. While en route to London, Knibbs, in a letter to Ewing, referred to a 'long marconigram' and a 'long telegram' that he had received from Collins the Secretary of the Australian Treasury. Knibbs had replied to Collins but states that the government's directions 1,2 and 3 did not appear to him to be wholly unambiguous as they presupposed 'an elementary and clearly defined condition of things which in many cases does not exist'. Knibbs indicated that he would appreciate Ewing's views in writing and assumed that Ewing would be in conference with Collins and the Government on the whole matter.⁴¹

It appears likely that Ewing had not seen the marconigram and the telegram referred to in Knibbs letter to him.⁴² Collins wrote to Ewing on 20th August 1919 quoting the content of a 'wireless' advice to Knibbs dated 4th August.⁴³ The passage quoted (punctuation inserted) was:

Double income tax. One. Commonwealth Government thinks it should be recognised that each part of the Empire is entitled to collect tax on incomes earned within its borders and that the Mother Country should not tax incomes earned in Australia. Two. Commonwealth Government is not prepared to recommend to Parliament any plan which will divert to Mother Country or any other Dominion a portion of the proceeds of any Australian tax levied upon incomes earned in Australia. Three. If principle referred to in number one above cannot be conceded owing to necessities of Imperial Treasury Commonwealth Government's view is that maximum tax on incomes earned

³⁶ Ewing to Collins, 17th July 1919, *supra* note 32 at pp. 82-83.

³⁷ Ewing to Collins, 17th July 1919, *supra* note 32, at p83.

³⁸ 'Double Income Tax' R Ewing 31/7/1919 and 'Income Tax, Double taxation in England and Australia' R Ewing, 31/7/1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I pp 90 and 91 and pp 98 to 103.

³⁹ 'Australian War Time Profits Tax And United Kingdom Excess Profits Duty' R Ewing, 31/7/1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1 at pp 86 to 87.

⁴⁰ G H Knibbs, Commonwealth Statistician cable to Secretary, Department of the Treasury, Commonwealth of Australia, 7th August 1919 refers to Ewing's letter of 17th July. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p107.

⁴¹ G H Knibbs, to R W Ewing, 9 Aug 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.104.

⁴² Ross for Secretary of the Treasury to Commissioner of Taxation 1st October 1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1, p.153 enclosed a copy of the Government's proposals which had been included in the Marconigram sent to Knibbs. This appears to be the first time that the proposals had been sent to Ewing.

⁴³ Collins (Secretary of the Treasury) to Commissioner of Taxation (Ewing), 20th August 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.108.

in Australia should be the rate which is imposed by British law the Australian Treasury getting the proceeds of the tax at its own rate and the British Treasury getting only the excess above that rate.⁴⁴

Collins' letter enclosed a letter from Knibbs to Collins dated 7th August 1919 which is clearly the letter that Knibbs referred to in his letter to Ewing dated 9th August 1919.⁴⁵ It is clear from the letter that Knibbs saw conflict between the directions that he had received from the Government and Ewing's letter to Collins and other documents prepared by Ewing which had been passed on to Knibbs.

Knibbs requested clarification of the application of jurisdictional concepts in actual cases. The first direction from the Government referring to 'income earned within its borders' was not unambiguous in Knibbs' view. For example, was interest received by a United Kingdom resident on a Commonwealth Loan earned within Australia's borders? Knibbs noted that Ewing's letter to Collins had referred to 'the country of origin of the income' and Knibbs requested that Ewing 'could probably indicate, from his experience, the bearing of the two definitions in respect of actual cases.'⁴⁶

Knibbs also questioned, in relation to both the second and third directions by the Government, whether the principles in Ewing's letter should be 'followed modified (sic) perhaps in the way implied?' Knibbs pointed out that in Australia's case, due to the presence of State income taxes, there was triple taxation and raised the issue of whether 'the double taxation within Australia could be used as an argument against the principle indicated in the Marconigram (by way of analogy of course).'⁴⁷

A clearly annoyed Ewing sent a lengthy reply to Collins on 1st September 1919. Although he does not explicitly state so at this point, it is clear from subsequent correspondence from Ewing to Collins that Ewing regarded the Australian Government as having rejected his scheme.⁴⁸ The second point in Collins' cable to Knibbs of 4th August could be seen as a rejection of schemes like the one developed by Ewing as being one which diverted a portion of tax, which Australia had collected on income sourced within Australia, to the United Kingdom or other Dominions. The three decisions of the Government communicated to Knibbs by wireless on 4th August, in Ewing's view involved 'many legal technicalities arising out of the interpretation of the terms "income earned in Australia" and "income earned in the United Kingdom"'.⁴⁹ Ewing considered that the Government's decision 'of course' implied that:

⁴⁴ Collins to Knibbs, 4th August 1919 as quoted in Collins to Ewing, 20th August 1919 *supra* note 42 at p.108.

⁴⁵ Collins to Ewing, 20th August 1919, *supra* note 43 at p.108. Collins letter to Ewing also quotes an extract from another letter from Knibbs to Collins. The extract quoted includes the following: 'the marconigram pre-supposes only an elementary case. The question will have to be treated in more detail.'

⁴⁶ G H Knibbs to Secretary, Department of the Treasury, Commonwealth of Australia, (J R Collins), 7th August 1919, copy in National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, at p.107.

⁴⁷ Knibbs to Collins, 7th August 1919, *supra* note 46, at p.107.

⁴⁸ Ewing to Collins, 17th March 1920, *supra* note 25, at pp. 177 to 179.

⁴⁹ R Ewing, Commissioner of Taxation to The Secretary to the Treasury (J R Collins), Melbourne, 1st September 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp. 109 to 112 at p112.

- (1) The United Kingdom should tax all profits and gains arising in the United Kingdom from sales of Australian goods contracted for within the United Kingdom.
- (2) That the United Kingdom will not divert to Australia any portion of the proceeds of the United Kingdom tax levied upon income earned in the United Kingdom.
- (3) Failing the acceptance of the principle mentioned in (1) above, the Imperial Government would be entitled to retain the maximum tax on income earned in the United Kingdom and also taxed in Australia, and the Australian Treasury would get only the excess (if any) above that rate.⁵⁰

Interestingly to a 21st century reader, Ewing is conceptualising the issues in terms of a claim to tax based not on formal characteristics such as the place of sale but on one which looks more to the extent to which value had been added in different jurisdictions. His own scheme outlined in his letter to Collins of 17th July 1919 and in his previous memorandum to Knibbs would, in these situations have involved a sharing of tax at the larger of the two rates in the same proportions as the rates in each of the countries represented of the combined rate.

Ewing's reply then summarised the jurisdictional base of the United Kingdom income tax and the jurisdictional base of the Australian income tax. In modern parlance the United Kingdom taxed residents on their worldwide income but also taxed non-residents on the annual profits or gains accruing from 'any property in the United Kingdom or (the following words were underlined in Ewing's reply) from any trade or profession, employment, or vocation exercised within the United Kingdom'. The Australian income tax, by contrast, only taxed taxable income derived directly or indirectly from sources within Australia.⁵¹

Ewing then proceeded to summarise what he understood to be relevant English case law. Although Ewing expressed all conflicts in terms of source rules his summary appears to be based in part on United Kingdom decisions concerning the residence of companies. Ewing summarised what he perceived to be relevant English case law as follows:

- (1) The owner of a business with its head office in the United Kingdom resides there; and
- (2) If the head office of a business is in the United Kingdom the business is being carried on in the United Kingdom and all its profits, wherever arising, are earned in the United Kingdom and are taxable there.
- (3) That a trade or business is being conducted in the United Kingdom when contracts are made in the United Kingdom for the sale or delivery of goods there.⁵²

Ewing then pointed out that Australian court decisions had 'supplemented' the decisions of the English courts and cited *Meeks v Commissioner of Taxation (NSW)* (1915) 19

⁵⁰ Ewing to Collins, 1st September 1919, *supra* note 49, pp. 109 to 112 at p112.

⁵¹ Ewing to Collins, 1st September 1919, *supra* note 49, at p111 and 112.

⁵² Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

CLR 568 as authority that in the case of a business which conducts some operations in Australia profits from sales outside Australia arise, at least in part, from sales within Australia.⁵³

Assuming that any or all of the points in the Australian Government's decision were to be accepted, Ewing anticipated that 'great difficulty must be expected in determining whether the United Kingdom or Australia is to take the principal tax'.⁵⁴ Here it appears that Ewing was envisaging a conflict of source rules and, on the basis of the third implication that he drew from the Government's decision, considered that one jurisdiction would 'take the principal tax' and subject all the income to tax at its full rates while the tax collected by the other jurisdiction would be confined to the excess, if any, of tax on the income at its full rates over the primary tax. As the Australian income tax at the time was an entirely source based tax it appears that Ewing could see no conceptual basis on which the source rule of one country should be preferred over the source rule of the other country.

Ewing considered that it would be impractical to arrive at a satisfactory settlement of the issues 'along the lines laid down by the Government'.⁵⁵ The Government's first direction would necessitate an amendment to both British and Australian law to define what 'earned in Australia' or 'earned in the United Kingdom' would mean. The same issue would arise under the Government's third direction with the additional problems of determining which country should have the first claim on the income or, failing that, how taxes on the income should be apportioned between the two countries.⁵⁶ Ewing's view was that, while it was likely that the amount of tax involved was relatively small, it was probable that the loss of revenue to Australia would be greater under the Government's third proposal than it would be under the proposal that Ewing had previously made.⁵⁷

In response to Knibbs' more specific questions, Ewing indicated that the expressions, 'income earned within its borders' and 'the country of origin of the income', although apparently dissimilar, were capable of the same interpretation and considered that the court decisions previously summarised would apply in a similar way to the latter expression. Ewing's view was that the interest in the example referred to be Knibbs would (apparently on an application of the case law that he had previously summarised) have a United Kingdom source if the loans were floated there but noted that in both the United Kingdom and Australia specific provisions would deem the interest to be sourced within each country's jurisdiction.

Ewing stated that, prior to Knibbs' departure, he had discussed with him the possibility that double taxation within Australia might be used as an argument against the Commonwealth Government. Ewing pointed out that the difference between double taxation within Australia and double taxation within the Empire was that, within Australia, the Commonwealth Government taxed the whole of the income within Australia, whereas Britain did not tax the whole of the income within the Empire but discriminated and thus caused dissatisfaction. Nor was discrimination confined to the

⁵³ Ewing to Collins, 1st September 1919, *supra* note 49, at p111. Ewing's summary somewhat overstates the effect of the decision in *Meeks* which was concerned with determining source of income in a business with multi stage operations.

⁵⁴ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁵ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁶ Ewing to Collins, 1st September 1919, *supra* note 49, at p111.

⁵⁷ Ewing to Collins, 1st September 1919, *supra* note 49, at p110.

British Government as Australia taxed ‘considerable amounts of incomes which are received by British purchasers of Australian goods.’⁵⁸

On the question of whether his draft agreement of 22nd July had the Government’s approval Ewing pointed out that the draft merely expressed the policy of the United Kingdom Excess Profits Tax and the Australian War Time Profits Tax and, as no question of policy was involved in the draft agreement, the matter was entirely different from double income taxation within the Empire.⁵⁹

Ewing closed by noting that he was attaching a copy of a memorandum on the causes of double taxation that he had provided to Knibbs prior to his departure and by complaining that Collins’ letter under reply was the first communication that he had received from the Treasury in connection with the present consideration of double taxation within the Empire and that he had not possession of reports of Colonial conferences which Collins had sent to Knibbs.⁶⁰

Collins then sent a Minute Paper to Ewing asking him to draft a cable containing a concise reply to the questions raised by Knibbs in his letter of 7th August. Collins pointed out that Knibbs was due to arrive in London in a few days and that the conference would meet on 23rd September.⁶¹ In reply Ewing protested that ‘the present position of this question renders it impossible for me to prepare a draft cable to Mr Knibbs effectively replying to his queries of 7th August regarding double income tax. Ewing then referred back to the points he had made in his letter of 1st September to Collins referring particularly to: (a) the importance of interpreting the phrase ‘earned in the United Kingdom’ and ‘earned in Australia’ to the application of the three points in the Government’s decision; (b) the difficulties likely to arise in determining which country was to take the principal tax assuming that all three of the Government’s points were accepted; and (c) that in his opinion it would be impractical to arrive at a satisfactory settlement of the question along the lines laid down by the Government. Ewing then went on to point out that, in his view, the Government position would mean that Australia would be unable to collect any income tax from sales of Australian products in the United Kingdom as those profits would be treated as arising exclusively in the United Kingdom. Ewing considered that, if such an approach were applied generally to sales of Australian products in other parts of the world the prospect could not be viewed without serious concern.’⁶²

Having made his points and protest Ewing then, ‘so far as I can, in the circumstances’ suggested that the following cable be sent to Knibbs:

Double Income Tax you letter 7th August point one, phrase income earned within its borders and country of origin of the income have same meaning. Difficulty must be expected in determining whether Britain or Australia is to have principal tax on income assessed both countries. Point 2, treble taxation

⁵⁸ Ewing to Collins, 1st September 1919, *supra* note 49, at p 109 to 110.

⁵⁹ Ewing to Collins, 1st September 1919, *supra* note 49, at p109.

⁶⁰ Ewing to Collins, 1st September 1919, *supra* note 49, at p109.

⁶¹ J R Collins, Department Of The Treasury, Minute Paper, Subject: Double Income Tax – United Kingdom and Australia, undated. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, at p113.

⁶² R Ewing, Commissioner of Taxation to The Secretary to the Treasury (Collins), Melbourne, 3rd September 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp.114 to 115.

Britain, Commonwealth and States, difference between double taxation within Australia and within Empire is that Commonwealth taxes all income in Australia but Britain does not tax all Empire income, War-Profits Tax draft agreement by Ewing merely expresses policy set out in British and Commonwealth Acts. It expresses more clearly and effectually than British draft the means to give effect to both laws.⁶³

Collins and Ewing then discussed the issue⁶⁴ and Collins forwarded to Ewing a copy of a the following cable sent to Knibbs on 8th September:

Your letter 7th August. Following terms used by Treasury and Commissioner of Taxation respectively are to be regarded as having same meaning such terms being 'income earned within its borders' and 'country of origin of income'. Instructions in Treasury radiogram 5th August are basic and elementary only. Intention being that you should discuss with other members of Conference best method of deciding where income is in fact earned. Questions are most complicated and can only be determined with knowledge of taxation practice and technicalities in England as well as in Australia. Views expressed by you at Conference will not bind Commonwealth Government but of course your recommendations will receive serious consideration and you may indicate to Conference that your views are subject to consideration of Commonwealth Government. Part one Treasury radiogram 5th August refers both to Commonwealth and State income tax. The words Australian Treasury in part three should be read as including both Commonwealth and State. General principles indicated in Ewing's letter of 17th July should not be followed. War Profits Tax draft agreement by Ewing merely expresses policy set out in British and Commonwealth Acts. It expresses more clearly than British draft means to give effect to both laws.⁶⁵

The cablegram represents both a clear rejection of the approach Ewing had set out in his letter to Knibbs of 17th July and also a significant restriction on Knibbs' freedom to negotiate at the Conference. Knibbs could negotiate but could not bind the Australian Government. Technical issues would have to be sent back for further consideration. Knibbs had been sent for his skills in negotiation and argument not for his technical knowledge of taxation law and practice.

Knibbs arrived in London on 13th September 1919.⁶⁶

It is clear from the report of the Sub Committee that Knibbs led the argument of the Dominions seeking greater relief from double taxation. The report of the Sub-Committee records Knibbs as having put two propositions to it. First, that the State in which income arises has the primary right to tax it to the exclusion, if necessary, of the country where the income is received. Knibbs alternative contention was that if the place of residence was an equally significant factor in deciding whether liability to tax arises then any Dominion which abstains from basing a charge for Income Tax on

⁶³ Ewing to Collins, 3rd September 1919, *supra* note 62.

⁶⁴ J R Collins to R W Ewing Esq, Commissioner of Taxation, 8th September 1919. Ewing, to Collins, 3rd September 1919, *supra* note 61. Collins' letter encloses a copy of the cable and refers to 'our conversation of Friday last, on the subject of double income tax'.

⁶⁵ Cablegram 8th September 1919 to G H Knibbs, C/o High Commissioner of Australia, London. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I at p.126.

⁶⁶ United Kingdom, *supra* note 18 at p 168.

residence has already made it proper sacrifice in any reciprocal arrangement for eliminating Double Income Tax.⁶⁷ Knibbs' cables to the Australian Prime Minister's Department and Treasury make reference to the three principles which Treasury had instructed him to adhere to in negotiations. In a cable to the Australian Prime Minister's Department dated 30th September 1919 Knibbs states:

Harrison, Assistant Secretary, Inland Revenue, exhaustively analysed double tax question. Think acceptance of principle 1 wireless August 4th hopeless. Acceptance principle 2 likely. Acceptance last part principle 3 highly improbable, since notion here is that parties might share equally. Advise immediately if in argument I might concede more.⁶⁸

The Australian Treasury forwarded a copy of Knibbs' cable to Ewing on 1st October 1919 asking for Ewing's opinion in relation to it.⁶⁹ Ewing's reply was conveyed on his behalf by an Assistant Commissioner of Taxation. Ewing considered that Harrison's views represented 'an inescapable position on this question.' Ewing, however, did not agree with the view that 'parties might share equally' unless that phrase was interpreted to mean that the higher tax on the income common to both assessments should be divided between the two Governments proportionately to their separate taxes on that income. Ewing here was clearly seeing the phrase 'parties might share equally' as capable of being interpreted consistently with the approach that he had advocated in his letter to Collins of 17th July 1919. If the phrase meant that the tax should be divided so that Britain retained half and Australia retained half Ewing considered that the proposition should not be agreed to due to the differences in basis of assessment between the United Kingdom and Australia. Understandably Ewing considered that the only practical scheme to obviate double taxation within the Empire was the second scheme that he had advocated in his letter to Collins of 17th July. In Ewing's view it would be futile for Knibbs to continue to press the Government's proposals and that Knibbs should be advised to advocate the scheme that Ewing had proposed in his letter of 17th July.⁷⁰

Collins advised Knibbs by cable dated 10th October 1919 that he could not concede more but was at liberty to discuss the matter fully with representatives of the British Government and to indicate what his recommendations to the Australian Government would be subject to the proviso that those recommendations would not be binding unless the Australian Government agreed to them.⁷¹

The first principle in Knibbs' cable and in the Australian Government's directions to him amounted to an assertion of the primacy of the taxing rights of the State of source. Knibbs' position in relation to this principle was indeed hopeless. The Sub-Committee of the Royal Commission rejected Knibbs' contention comprehensively:

⁶⁷ United Kingdom, *supra* note 18 at p170, paragraph 21.

⁶⁸ Cable G H Knibbs to Secretary Prime Minister's Department 30th September 1919. The cable notes that a copy was sent to Treasury for urgent advice on 1st October 1919 (the date of receipt of the cable). Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁶⁹ Ross, for Secretary of the Treasury to Commissioner of Taxation, 1st October 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.130.

⁷⁰ A F Twine, Assistant Commissioner of Taxation to The Secretary of the Treasury, Melbourne, 3rd October 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I p.131.

⁷¹ Cable dated 10th October 1919 Collins (Secretary of Australian Treasury) to Australian Prime Minister's Department recommending that cable in terms set out be sent to Knibbs. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I

The contention, without qualification, that a primary right to tax income is possessed by the country whence the income is derived – to the exclusion of the right to tax it in the country of residence – violates the principle that each country has complete freedom to choose its own measure of liability in imposing taxation, and its difficult to justify on theoretical principles. If this contention were admitted, the United Kingdom would be called upon to surrender a right which it has exercised ever since the imposition of its Income Tax, a right which is common to the systems of many foreign countries and some Dominions, and is based on an admitted canon of taxation, that of ability to pay. It cannot be conceded that any State which taxes the residents of another State should be entitled, because it has done so, to expect that the other State should surrender its right to tax those residents.⁷²

The Sub Committee further noted that acceptance of the Knibbs' contention would produce inequity between a United Kingdom resident who invested in the United Kingdom only and one who invested in a Dominion unless the rates in the United Kingdom and the Dominion happened to be the same.⁷³ In addition, giving a sole right to tax to the county of source would, the Sub-Committee noted, mean that the cost of solving the Double Income Tax problem would be thrown almost entirely on the United Kingdom Exchequer given the disproportion between the amount of United Kingdom capital invested in the Dominions and vice versa.⁷⁴ As he indicated in a letter to Collins dated 23rd October 1919, Knibbs' at this point was also satisfied that the principle of the primacy of source basis taxation could not be 'equitably urged.' Knibbs, in terms more consistent with a benefit theory of taxation, summarised one view on this issue in the Sub-Committee as:

The advantages to the U.K. of persons earning their money in Australia is (sic) fully understood, but the view is that if they elect to live in the U.K. they must take the place of ordinary citizens, subject however to a concession – made for Imperial reasons – in regard to total tax, ⁷⁵

One implication of this passage seems to be that relief from international double taxation was a concession made for imperial reasons rather than one based on in principle objections to international double taxation.

It appears that the Sub-Committee regarded Knibbs' third point and the Australian Government's third direction to him as modification of his first point. The Sub-Committee noted an argument that the country of residence should only have a right to tax to the extent to which its own tax exceeds the tax imposed by the source country. The Sub-Committee characterised an argument to this effect as a modification of Knibbs' first contention but does not expressly attribute the modified argument to Knibbs.⁷⁶ An Australian Cabinet Sub-Committee had reported to the Australian Cabinet on the question of double income tax relief on 10th February 1919. That report

⁷² United Kingdom, *supra* note 18 at p171, paragraph 22.

⁷³ United Kingdom, *supra* note 18 at p171, paragraph 23.

⁷⁴ United Kingdom, *supra* note 18 at p 171 paragraph 23.

⁷⁵ G H Knibbs to The Secretary Department of the Treasury, Melbourne, 23rd October 1919, Ross, for Secretary of the Treasury to Commissioner of Taxation, 22nd November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part 1, p.153. It appears that this letter was not received in Australia until approximately 2nd December 1919 when the Department of the Treasury passed it on to Ewing.

⁷⁶ United Kingdom, *supra* note 18 at p171 paragraph 24.

included a recommendation that: 'Incomes of persons resident in on part of the British Empire should not be altogether exempt on the ground that they are derived from another part; Rebates, based upon a reasonable arrangement between the Government of the United Kingdom and the Dominions and not limited to [illegible] in receipt of large incomes should, however, be allowed in respect of total tax paid.'⁷⁷ It seems likely, therefore, that Knibbs would have put forward a rebate or foreign tax credit as a mechanism for achieving what the Sub-Committee describes as a modification of Knibbs' first contention. For a rebate or foreign tax credit to give full effect to the modified contention noted by the Sub-Committee the foreign tax credit would need to be unrestricted and fully refundable by the country of residence.⁷⁸ The Sub-Committee rejected the granting of an unrestricted foreign tax credit in these terms:

Unless it were practicable, as clearly it is not, to establish a ratio between the tax to be levied on the ground of origin, and that to be levied on the ground of residence, it would be possible for any State in which income arises to increase its rate of taxation, either generally or on incomes arising therein, or in particular on the incomes of non-residents, solely at the expense of the State of residence, whose tax would automatically be diminished by the amount by which the State of origin chose to increase its own tax.⁷⁹

Although this principle was rejected by the Sub-Committee its ultimate recommendation adopted a form of foreign tax credit with limits imposed which ensured that the United Kingdom would not, in effect, be refunding tax paid to Dominions. The ultimate result here might be thought to be consistent with Knibbs' second point being the second of the Australian Government's directions to him.

It appears that Knibbs' also argued that a Dominion which abstains from taxing its residents on their foreign source income has already made its proper sacrifice. This was not an argument that Knibbs had been directed to make by the Australian Government but it was consistent with the first of Australian Government's directions to him and can be regarded as a supporting argument for that viewpoint. The Sub-Committee rejected what it described as Knibbs' 'alternative contention' summarily:

it is obvious that it is open to a State on the accepted principle that every State has complete liberty to impose its own taxation in its own way, to enlarge the scope of its Income Tax so as to cover liability due to residence; and it cannot be argued that a State which abstains from charging such a tax (which in certain circumstances in certain States might be almost entirely non-productive) necessarily makes a tangible sacrifice.⁸⁰

Knibbs' comment, 'notion here is that parties might share equally', may also reveal something of the thinking behind the solution ultimately proposed by the Sub-Committee. E R Harrison an assistant secretary of the United Kingdom Board of Inland

⁷⁷ Extracts from report of the Australian Cabinet Sub-Committee, *supra* note 14.

⁷⁸ The United States had introduced an unrestricted foreign tax credit in 1918 the first of its kind in the world in relation to income tax. Limitations on the United States foreign tax credit were not introduced until 1921. See the discussion in M J Graetz and M M O'Hear, 'The 'Original Intent' Of U.S. International Taxation' (1997) 46 *Duke Law Journal* 1021. The United States was able to have an unrestricted foreign tax credit between 1918 and 1921 because its income tax rates in that period were high relative to the rest of the world.

⁷⁹ United Kingdom, *supra* note 18 at p171, paragraph 24.

⁸⁰ United Kingdom, *supra* note 18 at p171 paragraph 25.

Revenue put forward a proposal which the Sub-Committee considered embodied the principles which should govern the allocation of the cost of relief ‘on the basis of mutual sacrifice’.⁸¹ The initial proposal by Harrison was that a United Kingdom resident should receive a credit for Dominion income tax against the appropriate rate of United Kingdom tax (including Super-tax) up to 1/- in the £ (ie 5%) and one half (if any) of the Dominion rate beyond the first shilling. This would have been subject to an overall limit of relief equal to one half of the rate chargeable to any taxpayer in the United Kingdom (ie the top marginal rate of 6/- in the £ or 30%).⁸²

The Sub-Committee observed that the initial Harrison proposal ‘was particularly acceptable to several members because it gave broadly the same results as a method of apportionment which was regarded as theoretically just, or natural, but more difficult to administer, viz., the division of relief in such a way that the ratio between the rates in the United Kingdom and those in the Dominions remained unchanged.’⁸³

The Sub-Committee noted that the Harrison proposal ‘did not altogether satisfy the representative of the Commonwealth of Australia, and would involve complexity in the claims for repayment’.⁸⁴ In a letter to Collins dated 23rd October 1919 (but apparently not received in Australia until 2nd December 1919) Knibbs’ outlined the difficulty that he had with what was evidently Harrison’s initial scheme:

The present scheme submitted – which meets the views of most of the members of the Sub-Committee – but is not agreeable to Canada (I believe) or myself, - involves considerable losses of revenue to Australia but not to the United Kingdom: in other words does not involve equality of sacrifice. I am inclined to think that it can be arranged for equal sacrifice of revenue from the existing scheme of taxation, the double taxation disappearing.⁸⁵

Knibbs and Harrison were asked to develop a compromise proposal. Knibbs cabled the Australian Prime Minister’s Department on 12th November 1919 as follows:

Strongly urged views of Government Harrison Inland Revenue and self asked to suggest solution. After conferring unable to recommend greatest possible concessions have claimed country’s origin full tax at its graduated rate Great Britain to get considerable balance of tax since it claims on aggregate all incomes at corresponding rate. Situation appears hopeless. Possible final meeting Tuesday. Please advise.⁸⁶

The Australian Treasury, on Collins’ behalf, forwarded a copy of Knibbs’ cable to Ewing asking him for ‘an early report’.⁸⁷ Ewing sent a curt reply to Collins on 18th November 1919 suggesting that ‘Mr Knibbs be informed that in the circumstances

⁸¹ United Kingdom, *supra* note 18 at p171 paragraph 26.

⁸² United Kingdom, *supra* note 18 a p 171 paragraph 26.

⁸³ United Kingdom, *supra* note 18 at p 171 paragraph 26.

⁸⁴ United Kingdom, *supra* note 18 at p171 paragraph 27. Ewing to Collins, 17th March 1920, *supra* note 25 states that the Australian representative rejected Harrison’s initial scheme.

⁸⁵ Knibbs to Collins, 23rd October 1919, Ross, for Secretary of the Treasury to Ewing, 22nd November 1919, *supra* note 75.

⁸⁶ Cable dated 12th November 1919 Knibbs to Australian Prime Minister’s Department. Cable notes copy sent to Treasury 14th November 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁸⁷ Ross, for Secretary of the Treasury to Commissioner of Taxation, 17th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, page 134.

disclosed by him it is not possible to further advise him as to what may be done by him in this matter.⁸⁸

The author has been unable to locate a reply by the Australian Government's to Knibbs' cable of 12th November 1919.

In the meantime Knibbs sent a further cable to the Australian Prime Minister as follows:

Believe representations to sub-committee Double Income Tax will completely fail.

If you think it desirable I should discuss matter unofficially with high members commission itself, please advise. Probably this best done through meeting them socially, in which case liberal allowances are absolutely necessary.

Please telegraph early reply.⁸⁹

The Australian Treasurer, W. A Watt, replied by cable on 18th November 1919 that there was no objection to Knibbs discussing problems with high members of the Commission but that the scale of allowances for Knibbs previously determined was 'quite sufficient for the purpose'.⁹⁰

Knibbs' next cable to the Australian Treasury dated 22nd November 1919 advised:

Double Income Tax Committee rejects both our proposals, but favours mutual sacrifice. Scheme on existing Federal and New South Wales rates implies no Australian sacrifice incomes less than £800. Sacrifice then progressively increases. At income £50,000 Australian equals three-fourth British sacrifice Federal and New South Wales Treasuries then receive slightly over 5/-. Propose provisionally approve this unless you direct otherwise. Reply urgently required.⁹¹

Collins asked Ewing for a reply to Knibbs' cable.⁹² Ewing's response was to advise that Knibbs be asked whether the scheme he described was identical with or similar to the one Ewing had proposed as an alternative to asserting the priority of source basis taxation. Ewing indicated that if the proposed scheme was identical or similar to his own it would be much easier for him to advise the Government than would be the case if the scheme were entirely different from his.⁹³

Although the author has been unable to locate a reply to Knibbs' cable of 22nd November it appears that Knibbs was asked whether the proposed scheme was identical or similar to Ewing's as Knibbs' next cable dated 24th November 1919 stated:

⁸⁸ R Ewing, Commissioner of Taxation to The Secretary of the Treasury, Canberra, 18th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.135.

⁸⁹ Cable dated 15th November 1919 Knibbs to Australian Prime Minister. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁹⁰ Cable dated 18th November 1919 W A Watt to G H Knibbs. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

⁹¹ The cable is quoted in Ross, for Secretary of the Treasury to Commissioner of Taxation (Ewing), 22nd November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.136.

⁹² Ross, for Secretary of the Treasury to Ewing, 22nd November 1919, *supra* note 91.

⁹³ R W Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 28th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I

Scheme proposed Inland Revenue Officer here somewhat similar principle Commonwealth Commissioner of Taxation. Total tax payable British rates distributed among Commonwealth, State and Great Britain, former two receiving their full tax incomes under £800. When Dominion rate reaches half British rate each share equally. This implies larger absolute loss to Great Britain effect aggregation of incomes all sources reduces Dominions sacrifice since British rate consequently high.⁹⁴

The Australian Treasury, on behalf of Collins, forwarded Knibbs' cable to Ewing 'for your information and for favour of an immediate report.'⁹⁵

Ewing's reply was that the scheme proposed for incomes under £800 should be adopted by both the Commonwealth and State Governments as it would mean that both Governments would receive the full amount of their tax. Ewing doubted whether the scheme meant that, for incomes over £800, where the combined Commonwealth and State rate did not exceed half of the British rate, the British tax would be divided between the Imperial, Commonwealth and State Treasuries pro rata to the respective taxes payable on the income subject to double tax. If so then, in this respect, the proposed scheme was identical to the one that Ewing had proposed in his letter of 17th July 1919. Ewing pointed out that there would be few cases in which this aspect of the scheme would operate as the combined Commonwealth and State tax rates were almost always more than half of the British rate except in the case of incomes in the region of £2,000 and £4000. Ewing noted, however, that the true effect of this aspect of the scheme could not be measured due to differences in assessment in different parts of the Empire. The final part of the scheme which applied when the Dominion rate became equal to or greater than one half of the British rate was, Ewing thought, more advantageous to the Dominions than his proposals of 17th July. Overall Ewing considered that the scheme proposed by the Board of Inland Revenue appeared to be more advantageous than his own scheme of 17th July.⁹⁶

Before a reply could be sent to Knibbs he sent a further cable to Australia which was passed on to the Treasury and then passed on by Collins to Ewing. The cable, as quoted in a letter from the Australian Treasury to Ewing asking for his immediate report, stated:

Sub-Committee final meeting Tuesday, believe that Commission morally forced to accept any unanimous recommendation. With existing practice but after abandoning concession section 55 British Act, percentage loss on taxation now received from Australians resident in England would be Australia 27, Great Britain 33. Recommend provisional agreement.⁹⁷

Ewing's reply to Collins referred him to Ewing's letter of 28th November and indicated that he had roughly checked the percentages of loss quoted by Knibbs and considered that they were probably correct. Ewing calculated that on incomes over £800 per annum the average loss to England was from 47% to 50% but ranged from 20% to 30% incomes up to £800. The loss to Australia ranged from 0 on incomes up to £800 to about 44%

⁹⁴ The cable is quoted in Ross, for Secretary of the Treasury to Commissioner of Taxation, 26th November 1919, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.140.

⁹⁵ Ross, for Secretary of the Treasury to Ewing, 26th November 1919, *supra* note 94.

⁹⁶ R Ewing, Commissioner of Taxation to The Secretary of the Treasury, Melbourne, 2nd December 1919 National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, pp. 148 – 149.

⁹⁷ Ross, for Secretary to the Treasury, to Commissioner of Taxation, 1 December 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.150.

on incomes of £100,000. Ewing commented that this was a ‘rare income for an individual, if it actually exists’.⁹⁸

As a result of Ewing’s letters of 28th November and 2nd December, Collins sent a cable to Knibbs advising him that in the absence of full reports of discussions and details of the recommendations placed before the Sub-Committee it was impossible to give him definite instructions. Knibbs was further advised that ‘on receipt of full information careful consideration would be given to whole matter.’⁹⁹

On 16th December 1919 Knibbs sent a memorandum to Collins and a copy of the report of the Sub-Committee of the Royal Commission and also forwarded a copy of a draft agreement prepared by the Board of Inland Revenue.¹⁰⁰ The author has been unable to locate a copy of Knibbs’ memorandum, the detailed Report, or the draft agreement but it is highly likely that the draft agreement and the detailed Report referred to in Knibbs’ letter and in cables were one and the same document and were identical with the final recommendations of the Sub-Committee which reported on 2nd January 1920.¹⁰¹ This conclusion can be drawn from the fact that the Australian Treasury does not appear to have responded to the draft agreement until 8th January 1920¹⁰² after the Sub-Committee had presented its report to the Royal Commission. Hence the Australian comments on the draft agreement could not have influenced the recommendations contained in the Sub-Committee’s report. The Sub-Committee’s report notes that the proposal that it outlines had been submitted to the various Dominion Governments but that no reply had been received as at the date of the Sub-Committee’s report. The Sub-Committee further noted that all Dominion representatives except one personally approved of the proposal and were prepared to recommend it to their respective Governments. One representative had indicated that he preferred to await instructions from his Government.¹⁰³ It is likely that the recalcitrant representative was Knibbs given Collins’ instructions to him of 10th October 1919 and the subsequent consideration of the draft agreement by the Australian Treasury. The First Report of the Australian Royal Commission On Taxation dated 2nd November 1921 notes that all other Dominions had by that time accepted the recommendation on Double Income Tax by the United Kingdom Royal Commission On The Income Tax.¹⁰⁴

⁹⁸ R W Ewing to The Secretary to the Treasury, Melbourne, 2nd December 1919. National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.151.

⁹⁹ Ross, for the Secretary to the Treasury, to Commissioner of Taxation, 21st January 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2 Part I, p.161. The letter quotes a cable sent by Collins to Knibbs dated 21st January 1920.

¹⁰⁰ G N Knibbs to Mr Ewing, 2nd January 1920, National Archives of Australia, Series A 7072/21 Control Symbol J245/2 Part II, p.176, encloses a copy of Knibbs’ memorandum sent to Collins on 16th December 1919 and a copy of the ‘detailed Report’ which he had also sent to Collins on 16th December 1919. Knibbs asked that these documents be returned to him and a copy of neither document is currently contained in National Archives of Australia, Series A 7072/21 Control Symbol J245/2 Part II. A cable sent by the Australian Treasury to Knibbs dated 8th January 1920 refers to a cable sent by Knibbs to the Australian Government on 17th December 1919 and to a ‘Draft agreement submitted by Board of Inland Revenue’. The cable to Knibbs dated 8th January 1920 is contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I. Neither Knibbs’ cable dated 17th December 1919 nor a copy of the Draft Agreement are currently contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰¹ United Kingdom, *supra* note 17 p173. The Sub-Committee’s report is dated 2nd January 1920.

¹⁰² Cable Australian Treasury to Knibbs 8th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰³ United Kingdom, *supra* note 18 p172 paragraph 34.

¹⁰⁴ Australia, First Report Of The Royal Commission On Taxation, Melbourne, 1920, p31 paragraph 168.

Cables in early to mid January contained in files in the National Archives of Australia then make reference the treatment of United Kingdom Excess Profits Tax and Australian Wartime Profits Tax. It is unclear from the cables whether the United Kingdom Royal Commission proposal at this point was intended to cover these taxes or whether the United Kingdom proposed a separate scheme for these taxes. The latter appears to be more likely, as the cables refer to the scheme relating to these taxes which Ewing had developed, and, as discussed earlier, Ewing's view was that his scheme on these taxes was not relevant to the question of double income tax. The first of these cables, from the Australian Treasury to Knibbs on 8th January 1920, notes that the draft agreement submitted by the Board of Inland Revenue would require that the higher of the two taxes be collected and distributed between the two countries. As will be seen this was to be the substantive effect of the recommendation of the Sub-Committee on income tax which was adopted by the United Kingdom Royal Commission. The 8th January 1920 cable to Knibbs notes that the draft would require this result irrespective of whether the whole or part of the profits was being doubly taxed. This appears to be a reference to problems associated with differing tax bases. If a separate scheme was developed on Excess Profits Tax and War Time Profits which was perceived to have this problem then it was one which it shared with the system of Dominion Income Tax relief. Problems of differing tax bases were to return for consideration throughout the life of the Dominion Income Tax relief system. The cable further comments that:

It seems essential to ascertain amount of excess profits which is being doubly taxed and Ewing's draft would attain that end. That result would apparently be impossible of attainment under scheme proposed by Board of Inland Revenue. Can you conveniently cable full reasons why Ewig's scheme is said to be non-conformable to that contemplated by the British Finance Act.¹⁰⁵

Knibbs responded by cable to the Australian Prime Minister's Department on 15th January 1920 as follows:

FOLLOWING FOR COLLINS, Treasury – Your telegram 9th January – British Authorities now admit non-conformability section 23 Finance Act 1917 Ewing's scheme only doubtful but expresses opinion that owing temporary nature War Profits it is outside intention on which section was deliberately framed/in British opinion scientifically correct scheme involves complexities in analysing profits and standards taxation both countries and would necessitate setting up appeal machinery taxpayer would naturally desire double taxation as much profits possible and must be given right appeal against revenue decision owing temporary nature Acts British strongly advocate their scheme letter of 6th January fully expounds case.¹⁰⁶

The author has to date been unable to locate the letter from the United Kingdom Board of Inland Revenue referred to in Knibbs' cable or a draft agreement on Excess Profits Tax and War Time Profits Tax developed by the United Kingdom Board of Inland Revenue or the draft scheme relating to these taxes developed by Ewing.

¹⁰⁵ Cable Australian Treasury to Knibbs dated 8th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁰⁶ Cable Knibbs to Australian Prime Minister's Department dated 15th January 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

3 KEY FEATURES OF UNITED KINGDOM ROYAL COMMISSION'S SCHEME FOR DOMINION INCOME TAX RELIEF

Notwithstanding lack of agreement from Australia the United Kingdom Royal Commission accepted the recommendations by the Sub Committee in full. The United Kingdom Royal Commission's view was that a sound solution to the problem would have regard to the following principles:

- a) that where Income Tax is charged on the same income in both the United Kingdom and a Dominion the total relief to be given should be equivalent to the tax at the lower of the two rates imposed;
- b) that there should be no interference either by this or by a Dominion with the basis of assessment adopted by any other part of the Empire, and further that settlement should be independent of increases and decreases in rate of tax, and alternations in the bases of assessment, whether here or in the Dominions;
- c) that so far as practicable, relief should be given before payment of tax;
- d) that so far as is possible, the adjustment should be made in the country where the taxpayer resides;
- e) that there should be no inter-payments of tax between the Government of the United Kingdom and the Governments of the respective Dominions.¹⁰⁷

The solution ultimately proposed by the Sub Committee and adopted by the Royal Commission was:

Firstly, that in respect of income taxed both in the United Kingdom and in a Dominion, in substitution for the existing partial reliefs there should be deducted from the appropriate rate of United Kingdom Income Tax (including Super-tax) the whole of the rate of Dominion Income Tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of United Kingdom Income Tax (including Super-tax) to which the individual taxpayer might be liable; and

Secondly, that any further relief necessary in order to confer on the taxpayer relief amounting in all to the lower of the two taxes (United Kingdom and Dominion), should be given by the Dominion concerned.¹⁰⁸

The Sub Committee had noted that both the source of the income and the residence of the taxpayer represented legitimate jurisdictional taxing claims and that each State had an unrestricted right to adopt its own method of taxation within the sphere of its jurisdiction.¹⁰⁹ The Sub Committee had further considered that double income taxation was inequitable as representing two contributions to the common purpose of the well-being of the British Empire. In the Sub Committee's view the demands of equity would

¹⁰⁷ United Kingdom, *supra* note 18 at p 16 paragraph 69.

¹⁰⁸ United Kingdom, *supra* note 18 at p16 paragraph 70 (Royal Commission Report) and at p 171 paragraph 27 (Sub-Committee report).

¹⁰⁹ United Kingdom, *supra* note 18 at p 170 paragraph 16.

be met by the elimination of excessive taxation by remitting an amount equal to the lower of the taxes imposed by the two States. The Sub Committee also adopted what would nowadays be described as a principle of capital export neutrality by noting that an Empire citizen should not be penalised for investing in a part of the Empire outside his State of residence.¹¹⁰ Moreover, the Sub Committee had regarded double income taxation as a hindrance to Imperial trade and the free circulation of capital within the Empire.¹¹¹

Remitting the lower of the taxes imposed by the two States could be achieved by several different means. The Sub Committee had considered two alternatives: (a) the collection of the higher tax and its subsequent apportionment between the two States concerned in an agreed ratio; or (b) by each State remitting a portion of its tax so that the aggregate remission would be equal to the amount of the lower tax. Note that both of these alternatives involved a sharing of the burden of relief between the residence and source jurisdiction. By contrast, both of the alternatives apparently proposed by Knibbs (exemption by the residence jurisdiction or an unlimited foreign tax credit granted by the residence jurisdiction) would have placed the whole burden of relief on the residence jurisdiction. Although Ewing's proposal would have been of a similar type to alternative (a) discussed in the Sub-Committee Report it had not, in his view, been put to the Sub-Committee.¹¹²

The Sub Committee rejected the apportionment of the higher tax between the two States in an agreed ratio as obscuring the independent right of taxation inherent in every State and as possibly creating the false impression that a State is exempting a class of income which it is in fact charging or that it is contributing to the revenue of another State. Hence the Sub Committee had concluded that the alternative of each State remitting a portion of its tax was to be preferred.

The Sub Committee noted that it was freely admitted in its conferences that any sacrifice must be a mutual sacrifice and that the real difficulty lay in determining what share of remission should equitably be borne by each of the respective States. The comment is consistent with the sense of hopelessness that Knibbs' cables convey following his attempts to argue for relief being entirely given by the residence jurisdiction and particularly with his comment that, 'notion here is that parties might share equally'.¹¹³

The Sub Committee noted that the initial proposal (referred to above) by Harrison of the Board of Inland Revenue 'was particularly acceptable to several members because it gave broadly the same results as a method of apportionment which was regarded as theoretically just, or natural, but more difficult to administer, viz., the division of the relief in such a way that the ratio between the rates in the United Kingdom and those in the Dominions remained unchanged'.¹¹⁴ The extent to which this was true depended on the relationship between the rates in the two countries. The effect of the proposal would have been that the ratio between the rates of tax following rebates under the proposal diverged as the ratio between the initial rates converged.

The Sub Committee's description of the initial Harrison proposal makes no mention of rebates or remissions being given by the Dominions. However, it is clear that the initial

¹¹⁰ United Kingdom, *supra* note 18 at p170 paragraph 15.

¹¹¹ United Kingdom, *supra* note 18 at p170 paragraphs 15 and 16.

¹¹² Ewing to Collins, 17th March 1920, *supra* note 25.

¹¹³ Knibbs to Secretary Prime Minister's Department 30th September 1919, *supra* note 68..

¹¹⁴ United Kingdom, *supra* note 18 at p171, paragraph 26.

Harrison proposal would have involved rebates being given by the Dominions in some circumstances. Indirect support for this conclusion is found in the Sub Committee's express requirement that any sacrifice had to be a mutual sacrifice, in its comments on preserving the ratios of taxation between the United Kingdom and the Dominions and in its description of its final proposal (which did provide for a rebate by the Dominions) as being more generous in its effects.¹¹⁵ These statements, together with Knibbs' objections to the initial Harrison proposal,¹¹⁶ make it likely that the Dominions were expected to give a rebate so that the total tax represented taxation of the higher of the two rates. Direct support is found in an example, in a letter to Collins dated 17th March 1920, of what Ewing understood to be the effect of Harrison's initial proposal. Ewing's example showed a rebate by Australia in the hypothetical situation it illustrated.¹¹⁷

The Sub Committee described its recommended proposal as being more generous in its effects than the initial Harrison proposal and as being made in an endeavour to secure a unanimous acquiescence on the part of the Dominions and to obtain simplicity in operation.¹¹⁸ Assuming that the initial Harrison proposal would have required the Dominions, in some circumstances, to grant a rebate in addition to that granted by the United Kingdom, the key difference between the Sub Committee's recommended proposal and the initial Harrison proposal was that the recommended proposal involved the United Kingdom in remitting the whole of the rate of Dominion tax payable up to a limit of one half of the applicable United Kingdom rate of income tax and super tax. By contrast, under the initial Harrison proposal, the relief provided by the United Kingdom was equal to the Dominion tax up to 1/- in the £ (or a rate of 5%) and thereafter half of the Dominion rate up to a maximum limit of half the applicable United Kingdom rate of income tax and surtax. The lower level of relief granted by the United Kingdom under the initial Harrison proposal would have meant that, for the total tax to be limited to the greater of the two rates, the Dominions would have been required, in some circumstances, to give larger rebates of tax to taxpayers. It is reasonable to infer from Knibbs' cable of 12th November 1919 that this key feature of the Sub Committee's recommended proposal was a concession that Knibbs wrought from Harrison. Note, in particular, the following portion of the cable:

greatest possible concessions have claimed country's origin full tax at its graduated rate¹¹⁹

The Sub Committee contemplated that for United Kingdom taxpayers on lower incomes the adjustment would be at nominal rather than effective United Kingdom rates and for those on higher incomes the adjustment would be based on United Kingdom tax inclusive of Super-tax. The Sub-Committee observed that this approach resulted in the United Kingdom providing greater relief than would have been the case had the United Kingdom rate be calculated by reference to the taxpayer's Dominion sourced income

¹¹⁵ United Kingdom, *supra* note 18 at p171 paragraph 27. The final proposal was more generous in its effects for the Dominions only if the initial Harrison proposal included a requirement that the Dominions give a rebate to ensure that the total tax payable did not exceed the higher of the two rates.

¹¹⁶ Given the principles that Knibbs argued during the conference it seems unlikely that he would have objected to a proposal that involved the United Kingdom bearing the sole burden of relief.

¹¹⁷ Ewing to Collins, 17th March 1920, *supra* note 25.

¹¹⁸ United Kingdom, *supra* note 18 at page 171, paragraph 27.

¹¹⁹ Cable dated 12th November 1919 Knibbs to Australian Prime Minister's Department. Cable notes copy sent to Treasury 14th November 1919. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

only.¹²⁰ The rate of United Kingdom tax was to be calculated by reference to the taxpayer's gross income without first deducting Dominion income tax. The Royal Commission observed that calculating the appropriate United Kingdom rate by reference to the gross amount was necessary if relief were to be granted consistently with the principle that only the higher tax should ultimately be paid on the same source of income.¹²¹

An important feature of the proposal was the treatment given to dividends. The Sub Committee proposed that there would be an adjustment at the United Kingdom resident company level by reference to the rates charged to the company by the United Kingdom and by the Dominion respectively and that a subsequent adjustment of United Kingdom rates could be made by reference to the total income of individual shareholders. This amounted to giving individual shareholders a credit for underlying Dominion corporate tax irrespective of their level of shareholding.¹²² Where the Dominion provided further relief by reference to the total income of the shareholder any additional relief for the shareholder beyond that offered by the United Kingdom within the limit of one half of the appropriate United Kingdom rate would be borne by the Dominion. Where the Dominion did not provide further relief the Sub Committee stated that the tax ultimately borne by the shareholder would be: (1) the United Kingdom tax at the rate determined by reference to the shareholder's total income; and (2) the Dominion tax at the rate borne by the paying company. The Sub Committee noted that under current rates in most cases the total relief necessary for a complete adjustment could be granted by the United Kingdom.¹²³

The Sub Committee regarded one advantage of the proposal as being that it had an element of permanency as it allowed each State to alter its tax rates without reviving the issue of the division of relief. The Sub Committee considered that the proposal represented 'a generous contribution towards relief from Double Income Tax on the part of the United Kingdom' which the Sub Committee hoped would form the basis for complete reciprocal action by the Dominions. The majority of the Sub Committee thought that relief by the United Kingdom should not be conditional upon reciprocal action by Dominions. Some of the Sub Committee members, however, considered that the United Kingdom should reserve the right to apply the scheme only where the Dominion had taken the necessary steps to allow the individual taxpayer the balance of relief necessary to represent total taxation at the higher of the two rates.¹²⁴

The United Kingdom Royal Commission also considered that if the recommendation were adopted the United Kingdom Government would have acted generously and that the Governments of the various Dominions would provide taxpayers with the balance of total relief necessary to ensure that the total tax payable did not exceed the higher of the two rates.¹²⁵

Both the Sub Committee and the United Kingdom Royal Commission contented themselves with stating broad principles as to how the scheme would operate, although

¹²⁰ United Kingdom, *supra* note 18 at p 172, paragraphs 28 and 29.

¹²¹ United Kingdom, *supra* note 18 at p16, paragraph 71.

¹²² The current practice of many countries today is to limit the availability of credits for foreign underlying tax to shareholdings above a minimum level.

¹²³ United Kingdom, *supra* note 18 at p172 paragraphs 30 and 31 deal with the application of the system to companies and shareholders.

¹²⁴ United Kingdom, *supra* note 18 at p172 paragraph 33.

¹²⁵ United Kingdom, *supra* note 18 at p 16 paragraph 72.

the United Kingdom Royal Commission did provide some simple examples of its application.¹²⁶ The Sub Committee suggested that detailed rules would be worked out by the relevant department for applying the broad principles in practice and stated that such rules should allow repayment in respect of adjustments made, where practicable, in the taxpayer's State of residence.¹²⁷

The United Kingdom Royal Commission's recommendations were accepted by the United Kingdom Government and were enacted as s27 of the *Finance Act 1920 (UK)*. The procedure for claiming relief was set out in s28 of the *Finance Act 1921 (UK)*. The approach of the United Kingdom Inland Revenue Department to the implementation of the Dominion Income Tax Relief scheme can be seen in a circular to H.M. Inspectors of Taxes United Kingdom titled *Finance Act, 1920 – Section 27; Relief In Respect Of Dominion Income Tax* was published in December 1920.¹²⁸ The circular makes clear that for individuals average rates of United Kingdom tax after taking personal allowances into account were to be used for purposes of calculating the appropriate rate of United Kingdom tax. Average rates of Dominion tax on income sourced in the Dominion, taking into account depreciation allowances but not any Dominion personal allowances, were to be used in determining the Dominion rate of tax. The Dominion taxation year ending in the United Kingdom tax year to which the claim related was to be adopted as the basis for relief except in exceptional circumstances. It was noted that differences in tax base would arise but, as the relief depended on the rates of tax, Inspectors were advised that there was not necessarily any correspondence arithmetically between the amount of Dominion tax paid and the United Kingdom relief allowed for any particular year. Separate computations of relief were made in respect of each source of Dominion income (for example where a United Kingdom resident had income from more than one Dominion).¹²⁹

Proviso (b) to *Finance Act 1920 (UK)* s27(4) dealt with the situation where the Dominion did not provide reciprocal relief:

where under the laws in force in any Dominion no provision is made for the allowance of relief from Dominion income tax in respect of the payment of United Kingdom income tax, then in assessing or charging income tax in the United Kingdom in respect of income assessed or charged to income tax in that Dominion a deduction shall be allowed in estimating for the purpose of United Kingdom income tax an amount equal to the difference between the amount of the Dominion income tax paid or payable in respect of the income and the total amount of relief granted from the United Kingdom income tax in respect of the Dominion income tax for the period on the income of which the assessment or charge to United Kingdom income tax is computed.

This proviso had the effect of reducing the United Kingdom tax assessed but, as it was dependent on a prior calculation of the Dominion Income Tax Relief available (which in turn depended on a prior assessment of United Kingdom tax assessed), it resulted in

¹²⁶ United Kingdom, *supra* note 18 at pp 16-17, paragraphs 74 to 76.

¹²⁷ United Kingdom, *supra* note 18 at p172, paragraph 35.

¹²⁸ The printer's copy of this circular with handwritten corrections and annotations is contained in the United Kingdom National Archives file IR 40/2560.

¹²⁹ For a discussion of these aspects of the practice of the United Kingdom Board of Inland Revenue see circular to H.M. Inspectors of Taxes United Kingdom titled *Finance Act, 1920 – Section 27; Relief In Respect Of Dominion Income Tax* was published in December 1920. The printer's copy of this circular is contained in the United Kingdom National Archives file IR 40/2560.

complexities in administration which could only be dealt with by extra statutory concessions.¹³⁰

4 THE ADOPTION OF DOMINION INCOME TAX RELIEF BY THE COMMONWEALTH OF AUSTRALIA

The initial response of the Commissioner of Taxation to the details of the proposed scheme for Dominion Income Tax Relief was positive. Ewing, clearly having read the relevant portion of the Report of the Royal Commission on Income Tax and a set of examples of the intended operation of the scheme provided by Harrison to Knibbs on 21st January 1920,¹³¹ wrote to Collins on 17th March 1920. Ewing outlined the scheme proposed by the Royal Commission and noted that Commonwealth Government now had three schemes before it for the prevention of double taxation within the Empire. These were: (1) the Government's proposal that residence country taxation be limited to the excess residence tax, if any, over the source tax; (2) the Royal Commission scheme; and (3) Ewing's own scheme as set out in his letter to Collins of 17th July 1919. Ewing pointed out that the Commonwealth Government's scheme had been rejected by the imperial authorities owing to the heavy loss of revenue that it would involve for the Imperial Exchequer. Ewing noted that his own scheme had not been presented to the Sub-Committee of the Royal Commission. Ewing considered that of the schemes presented to the Sub-Committee the one which most closely approximated his own scheme was Harrison's initial scheme and noted that Knibbs had rejected this scheme at the London Conference.¹³²

Ewing considered that the scheme proposed by the Royal Commission was:

a much more liberal one at the present time to the Commonwealth than my scheme. It is of course considerably less liberal than scheme (1) proposed by the Commonwealth Government but is the most liberal scheme which the Imperial authorities are prepared to recommend.¹³³

The comment, 'at the present time', is significant. Ewing pointed out that under the Royal Commission scheme a subsequent increase in Australian rates with United Kingdom rates remaining stationary would result in greater loss of revenue for Australia while the reverse be true under Ewing's scheme.¹³⁴ Nonetheless Ewing's overall recommendation was that the Commonwealth Government accept the scheme proposed by the United Kingdom Royal Commission but pointed out that it would be necessary to obtain 'the adhesion' of the State Governments to the scheme as otherwise double

¹³⁰ For a contemporary discussion of problems associated with this provision see R Staples, *Dominion Income Tax Relief: Law and Practice*, London, GEE & Co, 1925 at pp 68 to 70 and R L Renfrew, *The Practice Of Dominion Income Tax Relief*, London, The Solicitors' Law Stationary Service Ltd., 1934 at pp 15 to 21.

¹³¹ G H Knibbs, Memorandum to The Secretary of the Treasury, Melbourne (undated) and E R Harrison to G H Knibbs, 21st January 1920 are both contained in R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 199 to 202. The letter from Harrison contains examples illustrating Harrison's interpretation of the operation of the proposed scheme. A note by Knibbs on the Harrison letter strongly implies that Knibbs to Collins letter was dated 26th January 1920.

¹³² R Ewing to The Secretary to the Treasury (Collins), Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 177 to 179.

¹³³ R Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁴ Ewing to Collins, 17th March 1920, *supra* note 132.

taxation between the States and the Commonwealth would continue.¹³⁵ Ewing's letter then indicates that he was attaching 8 schedules illustrating the operation of the Royal Commission scheme in a variety of hypothetical circumstances. Unfortunately, copies of these schedules are not currently contained in the relevant Australian Taxation Office file located in the National Archives of Australia. Ewing anticipated that, for the Board of Inland Revenue, in particular, but also to some extent for the Dominions, significant complexities would be involved in the application of the scheme to companies. Ewing anticipated that further complications might arise in the case of companies due to:

the differences between the bases of assessment in the United Kingdom and Australia. The United Kingdom taxes on profits which means net gain and involves deduction of many items which are not deductible in Australia. This feature will be the main difficulty to be overcome in isolating the actual amount of income which is being doubly taxed. It is not an insuperable difficulty.¹³⁶

Interestingly Ewing wrote again to Collins on 13th July 1920 indicating that in his view the corollary of removal of double taxation within the Empire was the taxation of all residents of Australia on a residence rather than a source basis. In Ewing's view the policy of only taxing Australian source income was now no longer necessary and that a switch to a residence basis would mean that Australia was receiving some income in circumstances where it was currently receiving nothing and, due to the existence of relief from international double taxation, Australian residents with foreign source income would be paying less foreign tax to the Imperial or other Dominion governments.¹³⁷

Apparently Ewing envisaged that Australia would, as a residence country, adopt a mirror image of the United Kingdom Dominion Income Tax Relief scheme under which the Australian credit for foreign tax would not exceed one half of the Australian rate with the Imperial Government or the relevant Dominion providing any further credit necessary to ensure that the total rate applicable did not exceed the largest of the rates applicable in the relevant jurisdictions. Despite Ewing's suggestion, Australia continued to tax exclusively on a source basis until 1930 when it moved to a nominal global basis but exempted foreign source income which had been subject to tax at source.

The next correspondence relating to Dominion Income Tax Relief that the author has been able to locate in either the United Kingdom National Archives or the National Archives of Australia is a cable from Ewing to Collins dated 11th November 1920. At the time Collins was in London and Ewing asks whether statements made in Australia to the effect that the limit to the rebate allowed by the United Kingdom would be 4/3d in the £ or whether the limit would be half of the British rate as stated by the Chancellor of the Exchequer in the budget speech.¹³⁸ Collins' reply was that that s27 of the *Finance Act 1920* provided for relief from double income tax at the rate of: (a) Dominion tax; or

¹³⁵ Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁶ Ewing to Collins, 17th March 1920, *supra* note 132.

¹³⁷ R Ewing to The Secretary to the Treasury, Melbourne, 17th July 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II.

¹³⁸ R Ewing, Proposed Telegram to Mr J R Collins at Australia House, London, 11th November 1920, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.204. It appears from a note on the copy in the file that the original telegram was sent to Collins by the Australian Treasury.

(b) half taxpayer's appropriate rate of United Kingdom tax, whichever was the less. Collins advised that, while the minimum United Kingdom rate was 3/- in the £, the maximum rate approached 12/- in the £ which would mean that the maximum rebate would be 6/- or the Dominion rate if that were higher. Collins was 'at a loss' to understand the reference to a maximum United Kingdom rate being 4/3d in the £ and asked Ewing to advise him if the position was not now clear to him.¹³⁹ Ewing advised the Acting Secretary for the Treasury by letter on 2nd December 1920 that the position was now clear.

On 17th November 1920, the Secretary of State for the Colonies cabled the Governors General of the Dominions asking, inter alia, what action the Dominion Governments were taking in relation to the proposals made by the Royal Commission for relief of double taxation within the Empire.¹⁴⁰ The Australian Government replied through the Australian Governor General on 8th December 1920 that the United Kingdom proposals had been submitted to the Australian Royal Commission (the 'Warren Kerr Commission') enquiring into Commonwealth Taxation.¹⁴¹

On 11th August 1921 Collins wrote to Ewing advising that, given that the United Kingdom had enacted partial relief from double income taxation, the Treasurer was considering whether the Commonwealth should also enact relief so that double income taxation could be entirely eliminated. Collins asked Ewing to prepare a statement showing how relief from double taxation could be implemented by Australia and the amount of revenue that would be lost by the implementation.¹⁴²

Ewing replied, by letter dated 18th August 1921, in terms which corresponded to the recommendation that he had made to the Warren Kerr Commission.¹⁴³ Ewing considered that it was difficult to estimate what the loss of revenue would be if the Australian *Income Tax Assessment Act* 1915 were to be amended to provide reciprocal relief. The matter had been examined between Ewing and Knibbs and they agreed that there was a possibility of a loss of revenue of £45,000 per year under the then present conditions. While there would be a loss of revenue, Ewing referred Collins back to Ewing's representation of 13th July 1920 that Australia should switch to taxing on a residence basis and that to do so would mitigate the revenue loss associated with providing reciprocal relief from international double taxation.

¹³⁹ Acting Secretary for the Treasury to Commissioner of Taxation, 26th November 1920, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p. 205 quotes the telegram received from Collins in reply to the telegram of 11th November 1920.

¹⁴⁰ Cable, Secretary of State for the Colonies to Governor General of the Commonwealth of Australia, 17th November 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁴¹ Cable, Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 7th December 1920, Cable Secretary Australian Prime Minister's Department to The Official Secretary to the Governor General Commonwealth of Australia 8th December 1920. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁴² J R Collins, Secretary to the Treasury to Commissioner of Taxation, 11th August 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p. 221.

¹⁴³ R Ewing, Commissioner of Taxation to Secretary to the Treasury, Melbourne, 18th August 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.223. A handwritten note by Ewing on Collins to Ewing, *supra* note 142, indicates that Ewing's reply was in terms of the recommendation that he had made to the Royal Commission.

Winston Churchill, as Secretary of State for the Colonies, sent a despatch to the Australian Governor General on 30th June 1921 enclosing a draft clause that the United Kingdom Government suggested be inserted in legislation of the ‘colony’ to give effect to reciprocal relief from international double taxation of income. Churchill also sent the memorandum referred to above on Dominion Income Tax Relief issued to the public by the Board of Inland Revenue.¹⁴⁴ Churchill’s despatch stressed that as the United Kingdom system was based on a comparison of the rates of United Kingdom tax and Dominion taxes and not on the amounts it was desirable that the rates of United Kingdom and Dominion taxes should be determined in the same way for the purposes of relief in the ‘colonies’ as they were determined for the purposes of relief in the United Kingdom. Having said this Churchill’s despatch then points out that for the purposes of United Kingdom relief the method for determining the rate of United Kingdom tax differed from the method applied for determining the rate of Dominion tax. The calculation of the United Kingdom rate was determined by dividing tax payable by the taxpayer’s income less deduction of any abatement while the rate of Dominion tax was determined by dividing the amount tax payable by the taxpayer’s income without allowing for any abatement. The rate of United Kingdom Super Tax payable was taken into account in determining the appropriate rate of United Kingdom tax and was determined by dividing the amount of Super Tax payable by the income which was subject to Super Tax. The despatch also indicated that to avoid complications that would be involved in defining ‘the appropriate rate of United Kingdom tax’ the United Kingdom revenue authorities would issue certificates in the attached form indicating what the appropriate rate of United Kingdom tax was. The despatch went on to point out that, as the principle underpinning the system was that the lower of the two rates of tax should be eliminated, it followed that in assessing United Kingdom or Dominion tax as the case may be no deduction should be allowed for the other tax. In modern parlance the foreign income should be ‘grossed up’ for any foreign tax payable in calculating domestic tax payable. The despatch concluded by advising that certificates as to the appropriate rate of United Kingdom tax would be restricted to cases where a ‘colony’ made provision for reciprocal relief. Accordingly, Churchill asked to be informed immediately that such as provision was made and of the date when it was to first operate.

The Australian Treasury forwarded Churchill’s despatch to Ewing on 26th September 1921 without asking for comment at that point.¹⁴⁵ The Governor General, presumably on the advice of the Australian Government and prior to release of the first report of the Warren Kerr Commission, replied to Churchill by cable dated 30th September 1921 stating that the scheme recommended by the United Kingdom Royal Commission would be adopted so far as the Commonwealth Income Tax was concerned but that relief from State tax would be left to State Governments.¹⁴⁶ Churchill replied to the Governor

¹⁴⁴ Winston S Churchill to The Officer Administering the Government of, 30 June 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 226 and 228. The despatch was a standard printed form letter which commences at p.228 of the Australian Taxation Office file. A typed copy of the letter is also contained in the Australian Taxation Office file commencing at p.226. Churchill was Secretary of State for the Colonies from 1921 until he lost his seat in the general election of 1922.

¹⁴⁵ Ross, for Secretary to the Treasury to Commissioner of Taxation, 26th September 1921, R Ewing to The Secretary to the Treasury, Melbourne, 17th March 1920, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.229.

¹⁴⁶ Extract from cablegram from His Excellency, the Governor General to the Secretary of State for the Colonies, 30th September 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.230.

General by cable on 15th October 1921.¹⁴⁷ The cable noted that the Board of Inland Revenue regarded United Kingdom law relating to Double Income Tax as very complicated and reiterated the points made in Churchill's despatch of 26th September 1921 regarding the method for determining the rate of United Kingdom tax and Dominion tax and made the following suggestions on administrative procedures:

It will be necessary also before or as soon as Commonwealth provisions operate to make arrangements as regards certificate of United Kingdom rate(s) of relief to be furnished to taxpayer claiming complementary relief in Commonwealth also Commonwealth and United Kingdom taxation years corresponding for purpose of relief. Board feel that in intricate matter mutual co-operation from the first would minimise administrative difficulties and friction with taxpayers. Suggest that Board should be supplied in advance with proposed Commonwealth provisions or if there is representative of Commonwealth Government in this country conversant with question he should discuss with Board in order that liaison should exist from the first. Should be glad to know whether Ministers agree.¹⁴⁸

The Australian Treasury passed Churchill's cable on to Ewing for comment on 21st October 1921.¹⁴⁹ Ewing did not reply until 22nd November after the release of the first report (discussed below) of the Warren Kerr Commission. As will be seen a majority of the Warren Kerr Commission recommended that both the Commonwealth and the States grant reciprocal relief as part of the Dominion Income Tax Relief system. The Governor General's cable to Churchill dated 30th September 1921 would indicate, however, that a decision to grant reciprocal relief had been made at the Commonwealth Government level prior release of the first report of the Warren Kerr Commission. Ewing's reply of 22nd November 1921 simply stated that the necessary amendment to the *Income Tax Assessment Act* 1915 was being considered and would be submitted shortly.¹⁵⁰ As will now be discussed this action was consistent with the recommendations in the first report of the Warren Kerr Commission.

The first report of the Warren Kerr Commission was released on 2nd November 1921. The Warren Kerr Commission noted the submission by the Australian Federal Commissioner of Taxation that if Australia entered into the arrangement by the United Kingdom Royal Commission then it should thereafter tax its residents on their worldwide income.¹⁵¹ A majority of the Warren Kerr Commission considered that there was no essential relationship between the adoption of the United Kingdom Royal

¹⁴⁷ Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.231.

¹⁴⁸ Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.231

¹⁴⁹ Ross, for Secretary to the Treasury to Commissioner of Taxation, 21st October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.232.

¹⁵⁰ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, 22nd November 1921, Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.233

¹⁵¹ Australian, *supra* note 104 at p32 paragraph 169.

Commission's recommendation and the taxation of ex-Australian incomes.¹⁵² After noting the loss of revenue to Australia that would result for adopting the proposal, the Warren Kerr Commission stressed that several witnesses had testified to it that double income taxation acted as a distinct deterrent upon the investment of British capital in Australia.¹⁵³ The Warren Kerr Commission also regarded the concession which the proposal asked Australia to make as one which could rightly be regarded as a practical expression of the spirit of reciprocity which, as far as possible, should govern inter Empire transactions.¹⁵⁴ The Warren Kerr Commission pointed out that the theory of the British arrangements was that:

the Empire should for certain important purposes be regarded as a unit, and that while each self-governing portion retains its full right of imposing taxation at its own rates and within the limits which itself fixes, from the point of view of membership of such an Empire no taxpayer can consider himself aggrieved if his total taxation, where he is taxed by more than one authority, does not exceed the higher of the two taxes.¹⁵⁵

Although they each imposed income taxes in this period, the Governments of the individual Australian States had not been represented at the 1919 London meetings with the Sub-Committee of the United Kingdom Royal Commission. On 19th August 1921 the Warren Kerr Commission sought advice from the United Kingdom Board of Inland Revenue as to whether, in computing relief under the British scheme, account would be taken of both Commonwealth and State income taxes or of Commonwealth taxes only.¹⁵⁶ The Board of Inland Revenue replied via the Australian High Commissioner in London on 26th August 1921 that both Commonwealth and State Income Tax were taken into account under the British proposal.¹⁵⁷ In its first report the Warren Kerr Commission while noting that the States had not been represented at the British Conference, pointed out that given that the British scheme took into account both Commonwealth and State taxation:

It is therefore, very desirable that if the Commonwealth joins in the reciprocal arrangement, each of the State Governments should give early attention to the subject with a view of defining its position, as evidently the question must arise in a practical form so soon as the Commonwealth gives effect to the proposal. The fact that the States levy different rates will not create any practical difficulty, for it is recognised that such differences will exist, and it will be merely a question of arriving at the proportionate contributions to be made by the Commonwealth and a State or States respectively, where the

¹⁵² Australia, *supra* note 104 at p32 paragraph 170. One member of the Royal Commission, M B Duffy, dissented from this recommendation. His reservation is set out at p40 of the Royal Commission's first report.

¹⁵³ Australia, *supra* note 104 at pp 32 to 33 paragraph 171.

¹⁵⁴ Australia, *supra* note 104 at p33 paragraph 172.

¹⁵⁵ Australia, *supra* note 104 at p33 paragraph 173.

¹⁵⁶ Cable, Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 17th August 1921, Cable Secretary Australian Prime Minister's Department to Australian High Commissioner's Office, London, 18th August 1921. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

¹⁵⁷ Cables, Australian High Commissioner's Office, London, to Australian Prime Minister's Department, 26th August 1921 and 31st August 1921. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

deduction made in Great Britain is not sufficient to provide complete relief against Double Taxation.¹⁵⁸

The Warren Kerr Commission endorsed the views of the United Kingdom Royal Commission at paragraph 69 of its report (quoted above) and went on to recommend:

1. That in respect of incomes taxed both in the United Kingdom and the Commonwealth, in all cases where the deduction at present allowed from the United Kingdom tax is not in itself sufficient to insure the payment only of an amount equivalent to the higher of the two taxes, the Commonwealth Government should grant such further relief to the taxpayer as will effect that end.
2. That consequent upon the adoption of this recommendation, the Commonwealth and State Governments should mutually agree on the question of proportional deductions from their respective taxes in all cases where complete relief from Double Taxation is not entirely secured by the deductions under the British law.¹⁵⁹

The Australian Government accepted this recommendation but the means for implementing it were left for the Federal Commissioner of Taxation to determine. The relevant provisions were inserted in the *Income Tax Assessment Act* 1915-1918 as s12A by Act No.31 of 1921 which received the Royal Assent on 17th December 1921. Ewing wrote to Deputy Commissioners of Taxation on 6th February 1922¹⁶⁰ enclosing a copy of Churchill's cable of 15th October 1921 and a draft of his reply which quoted s12A.¹⁶¹ Ewing asked the Deputy Commissioners to consider his proposals immediately by conference with senior officials and to report without delay on them, with any suggestions for improvement. Following responses from Deputy Commissioners¹⁶², Ewing on 22nd February 1922 sent a revised advice to Collins¹⁶³ containing a draft reply to Churchill's cable of 15th October 1921.

The Australian Governor General wrote to the Secretary of State for the Colonies on 2nd May 1922 setting out the Australian legislation and providing details of what Australian administrative practice would be for providing rebates. The Governor General's letter was based on a draft prepared in the Prime Minister's Department which in turn was based on a draft from Treasury which itself was based on Ewing's draft of 22nd February

¹⁵⁸ Australia, *supra* note 104 at p 33 paragraph 175.

¹⁵⁹ Australia, *supra* note 104 at p33 paragraph 177.

¹⁶⁰ Commissioner of Taxation to Deputy Commissioners, All States (Except Darwin N.T.) 6th February 1922, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.253.

¹⁶¹ The draft is addressed to The Secretary of the Treasury and is dated 6th February 1922 and is Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 247 to 251.

¹⁶² Responses were received from Deputy Commissioners in all States and are contained in Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.255 to 262.

¹⁶³ R Ewing, Commissioner of Taxation to The Secretary to the Treasury, Melbourne, 22nd February 1922, Cablegram received by His Excellency, the Governor General from the Secretary of State for the Colonies, 15th October 1921, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.265 to 269.

1922.¹⁶⁴ After noting that no State Government had yet indicated its intention to be a party to the arrangement the letter indicated that the intent of the Australian legislation was to eliminate double taxation as between the United Kingdom and the Commonwealth of Australia to the extent that would be required if the States were parties to an arrangement for the elimination of treble income tax as recommended by the Warren Kerr Commission. Under s12A, where only Australian Commonwealth tax and United Kingdom tax was payable, Australia granted a rebate of tax where the Australian rate was greater than one half of the British rate. The amount of the rebate varied according to whether or not the Australian rate was greater than the British rate. Where the Australian rate was greater than the British rate then the Australian rebate was one half of the British rate. Where the Australian rate was not greater than the British rate the Australian rebate was the excess of the Australian rate over one half of the British rate. The Australian legislation would apply from the financial year commencing on 1 July 1921. As was standard Australian practice at the time assessments for that year would be based on income derived in the year ending 30 June 1921.

The letter envisaged several possible problems that might arise in the application of the system. First, although tax years between the Commonwealth and the Australian States were the same the United Kingdom applied a different tax year. Here, the letter indicated, the Australian Taxation Office would require the taxpayer to demonstrate that the amount of income included in the United Kingdom assessment was also included in the Australian Commonwealth assessment. Secondly, great administrative difficulties were envisaged in dealing with the United Kingdom system of averaging of incomes in determining taxable income for a year. On this question the Australian Taxation Office would assume, at least for the present, that the actual amount of Australian income taken into account by the United Kingdom authorities in determining the average income to be taxed for that year was the income that would otherwise be doubly or trebly taxed that year even though the United Kingdom averaging system might increase or decrease the actual amount. Thirdly the letter noted that the business income tax bases in the United Kingdom and Australia differed because the United Kingdom taxed net profits of the business whereas in Australia taxable income was determined by deducting from assessable income only such deductions as the *Income Tax Assessment Act 1915-1918 (Cth)* allowed (a point that Ewing had made to Collins in his letter of 21st January 1920 discussed above). The letter pointed out that ‘it would appear to be necessary for both the United Kingdom and Commonwealth Taxing Authorities to require the taxpayer concerned to produce evidence to each authority from the other authority showing certain definite particulars as to income which has been assessed by the authority in a particular period and the rate at which tax has been levied by the authority’.

The letter pointed out that differences in the progressive rate scales adopted by the two countries should not produce difficulties as the rate used for calculating the rebate in both countries would be the average rate determined by dividing the tax payable by the income on which tax was charged. No difficulties were anticipated in dealing expeditiously with claims for rebates by companies given that Australia taxed companies at a flat rate on their undistributed profits and at a lower flat rate on payments

¹⁶⁴ Governor General Commonwealth of Australia to Secretary of State for the Colonies, 2nd May 1922. The Governor General’s letter and the drafts by the Prime Minister’s Department and by Treasury dated 26th April 1922 and 22nd April 1922 are contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

to absentees (non-residents in modern parlance) while the United Kingdom taxed companies at a flat rate. It was anticipated that difficulties might arise in the case of businesses owned by individuals or partnerships as the applicable rates would vary according to the amounts of taxable income assessed to the individual owner or the respective members of the partnership.

The letter set out in some detail the procedures that the Australian Taxation Office would follow in implementing the system in the case of an Australian branch of a United Kingdom business. These envisaged an itemised dissection of the income of the taxpayer showing the income that had been subject to Australian or United Kingdom taxation and the income that had been exempt from Australian tax with certification of these amounts by the Australian and United Kingdom taxation authorities at differing stages of the rebate process.

The procedure set out in the letter was bound to be cumbersome and clearly took a more detailed itemised approach to differing tax years and differences in tax bases than the approach that was proposed to be used in the United Kingdom. Correspondence between the revenue authorities in the two countries continued but, as is discussed in more detail below, despite this the two countries took significantly different approaches in operationalizing Dominion Income Tax Relief.

5 THE SUBSEQUENT OPERATION OF THE DOMINION INCOME TAX RELIEF SYSTEM BETWEEN THE UNITED KINGDOM AND AUSTRALIA; ASSESSMENT OF THE EFFECTIVENESS OF THE AUSTRALIAN REPRESENTATIVE AT THE 1919 – 1920 CONFERENCE

As between the United Kingdom and Australia, the Dominion Income Tax Relief system continued to operate in this form until the entry into force of the Australia – United Kingdom Double Taxation Agreement in 1947.

As it happened none of the Australian States ever agreed to grant reciprocal relief. Throughout the period the States unanimously held the view that, as they only taxed income sourced within their jurisdictions, it was inequitable to ask them to provide relief from double income taxation which they regarded as attributable solely to the United Kingdom taxing residents on a worldwide basis.¹⁶⁵ The consequence was that Australia was treated as a non-participating Dominion for purposes of proviso (b) to subsection 4 of s27 of the *Finance Act 1920 (UK)* referred to above. The effect of this treatment was that, while the United Kingdom tax assessed on Australian sourced income was lower than it would otherwise have been, additional complications arose in the calculation of United Kingdom tax and greater reliance was placed by the United Kingdom tax authorities on formulae aimed at achieving approximately correct results.¹⁶⁶ The United Kingdom treatment of Australian Commonwealth taxation does

¹⁶⁵ Examples of the views of State Governments can be seen in Premier of Victoria to Prime Minister of Australia 17th October 1933 with attached memorandum by Victorian Commissioner of Taxation and in Premier of South Australia to Prime Minister of Australia 5th February 1934 with attached memorandum by South Australian Commissioner of Taxation. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁶⁶ See the discussion in R Staples, *supra* note 130 at pp37 to 39 for a discussion of the method of calculating relief depending on whether or not the Dominion was participating and in R L Renfrew, *supra* note 130 at p15 for a discussion of problems associated with calculations where the Dominion was not participating and at p53 for a list of participating Dominions. Australia, Canada and the Union of South

not appear to have changed following the practical disappearance of State income taxes as part of the Uniform Tax Scheme of 1942¹⁶⁷ and the first Uniform Tax Case.¹⁶⁸

Remarkably Australia and the United Kingdom appear to have used different approaches throughout the period for calculating the relevant tax rates for purposes of determining the amount of rebate allowed. Australia continued to dissect accounts to determine whether income was within the Australian tax base a procedure which the United Kingdom regarded as unnecessary and refused to follow. Notwithstanding the difference in methods of calculation adopted, for the purpose of calculating rebates Australia accepted certificates issued by the United Kingdom Inland Revenue authorities showing the rate of United Kingdom tax paid on what Australia had characterised as Australian source income.¹⁶⁹

The procedures adopted in the implementation of the system, particularly those adopted by the Australian Taxation Office, were extremely cumbersome requiring certification by both taxing authorities before relief could be granted by the United Kingdom and requiring further certification by Australia before it granted relief. While difficulties associated with the practical implementation of the system were discussed by correspondence, one wonders if a more workable means of administering it might have been devised if the Australian representative at the 1919 conference with the Sub-Committee of the United Kingdom Royal Commission had been someone like Garran or Ewing with intimate knowledge of the income tax laws rather than a ‘strong man’ like Knibbs, or if follow up meetings had been held between officials actually involved in the implementation of the system.

Having said this, the issues associated with the implementation of the Dominion Income Tax Relief system in Australia were not unique to that system at least as it was interpreted by Australia. Any foreign tax credit system based on a measured approach to relief has to have some rules for determining which income is being distributed and credited, to whom it is being credited, and for adjusting for differences in tax base between jurisdictions. There continues to be no standard practice on the first issue while generally the last is dealt with by adjustments made by the residence jurisdiction which itself often proves to be a cumbersome process. Difficulties associated with credit mismatches arising through the interaction of different systems of corporate-shareholder taxation continue and can be regarded as contributing to the demise of dividend deduction and dividend imputation systems. The United Kingdom approach to the system, however, was one of notional relief under which some of these issues were

Africa were treated as non-participating Dominions as, although relief was granted at the Federal level, it was not granted at the Provincial level in any of these cases.

¹⁶⁷ The scheme was implemented through four Acts: *Income Tax Act 1942 (Cth)*; *Income Tax Assessment Act 1942(Cth)*; *State Grants (Income Tax Reimbursement) Act 1942 (Cth)*; and *Income Tax (War-Time Arrangements) Act 1942 (Cth)*.

¹⁶⁸ *South Australia v The Commonwealth* (1942) 65 CLR 373.

¹⁶⁹ The differences in approach are highlighted in Note, dated October 1922 by the Board of Inland Revenue on dispatch of 2nd May 1922 from the Governor General of the Commonwealth of Australia on the subject of double income tax; Letter from Governor General of the Commonwealth of Australia to the Secretary of State for the Colonies dated 2nd April 1924 forwarding statement by Commonwealth Commissioner of Taxation dated 29th January 1924; and Note by Board of Inland Revenue on dispatch of 2nd April 1924, from the Governor General of the Commonwealth of Australia, forwarding a statement by the Commonwealth Commissioner of Taxation on the subject of Double Income Tax dated 29th January 1924.. The first two documents are contained in Australian National Archives, Series A11804, Control Symbol 1926/317. The third document is contained in Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

not relevant. It is possible though that, if Ewing had been present at the meetings of the Sub-Committee of the United Kingdom Royal Commission, he may have been persuaded of the virtues of a notional as distinct from a measured approach to relief.¹⁷⁰

Despite Knibbs' fears in 1919 and 1920 that the United Kingdom would get a considerable balance of tax (due to the application of its progressive rate scale to worldwide incomes), in fact, Australia by the 1930s regarded the system as working well.¹⁷¹ By contrast in the 1930s the United Kingdom made intermittent efforts to reform the system as its high rates of taxation and a credit limit being one half of its applicable rate meant that it was bearing the major portion of relief that was granted. United Kingdom efforts in 1930 to amend the system so that the Dominions exempted some classes income (principally, fixed interest securities) from taxation on a source basis while the United Kingdom and the Dominions bore equal shares of relief on the remaining classes of income¹⁷² received a frosty reception from the Dominions with Australia again leading the dissent.¹⁷³ Neville Chamberlain as United Kingdom Chancellor of the Exchequer subsequently made desultory efforts to revive the 1930 proposal¹⁷⁴ but when he failed to follow up on a request for a response to his proposal Australia simply decided not to reply at all.¹⁷⁵ The concession Knibbs obtained in late 1919 and early 1920, that the United Kingdom relief would take into account the entire graduated scale of Dominion tax, had proved to be critical in allowing the Dominions to increase their tax rates while ensuring that the major portion of Dominion income tax relief rebates were borne by the United Kingdom. By the 1930s this feature of the

¹⁷⁰ For a discussion of the distinction between measured and notional approaches to relief from international double taxation and a discussion of advantages of a notional approach to relief see C John Taylor, 'Twilight Of The Neanderthals, Or Are Bi-Lateral Double Taxation Treaty Networks Sustainable?' (2010) 34 *Melbourne University Law Review* 240 to 279.

¹⁷¹ Numerous Australian Government internal documents and correspondence in this period reflect this view. See for example: Earle Page (Australian Treasurer) to S M Bruce (Australian Prime Minister) 25th August 1928; S M Bruce (Australian Prime Minister) to Secretary of State for Dominion Affairs 30th August 1928; L S Jackson (Acting Australian Commissioner of Taxation) to Secretary Prime Minister's Department, Canberra, 5th September 1934; Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷² The proposals made at the 1930 Imperial Conference are summarised in Imperial Conference 1932 – Note On Double Taxation Within The Empire enclosed in N Chamberlain to S M Bruce (Australian High Commissioner in London) dated 24th July 1933. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷³ The attitude of the Australian representative to the proposal is clearly set out in the Memorandum from Collins (Australian representative) to Secretary Prime Minister's Department Canberra 22nd December 1930. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁴ Chamberlain intended to raise the issue at the 1932 Imperial Conference in Ottawa but pressure of other business prevented this. Chamberlain wrote to S M Bruce as Australian High Commissioner in London on 24th July 1933 asking him to request the Australian Government to take the issue into consideration with a view to a possible conference of financial experts. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁵ See L S Jackson (Acting Australian Commissioner of Taxation) to Secretary Prime Minister's Department, Canberra, 5th September 1934; Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department, 27th March 1935; Cable, Bruce (Australian High Commissioner, London) to Prime Minister's Department, Canberra, 18th June 1935; Secretary to the Australian Treasury to Secretary Australian Prime Minister's Department 25th September 1935; Cable, J A Lyons (Australian Prime Minister) to S M Bruce (Australian High Commissioner, London) undated; Memorandum from Secretary to the Australian Treasury to Secretary Prime Minister's Department Canberra 21st April 1936; Cable, Lyons (Australian Prime Minister) to High Commissioner, London 22nd April 1936; Cable, Bruce (Australian High Commissioner, London) to Australian Treasurer and Treasury 30th April 1936. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part I.

system meant that the Dominions wanted it to continue but the United Kingdom wanted it modified.¹⁷⁶

Prior to Australia's abandonment of its dividend deduction system in favour of an imputation system in 1923, notwithstanding the prior discussion in the report of the Sub-Committee of the United Kingdom Royal Commission, difficulties were experienced in determining whether the company or the shareholder was entitled to the relevant rebate under Dominion Income Tax Relief. The Commissioner of Taxation received correspondence from tax practitioners and businesses on this issue and the Australian Taxation Office view was that Australian shareholders were entitled to any Australian rebate but was unwilling to rule on whether the shareholder or the company should make the application to the United Kingdom for any applicable rebate of United Kingdom tax. In the case of non-resident shareholders the Australian Taxation Office view was that where the shareholder was separately assessed on the dividend the shareholder should apply for any Australian rebate but where this was not the case (that is where the company elected to withhold tax at source) the company should be the applicant.¹⁷⁷

Prior to 1923 the Australian system principally provided relief from economic double taxation of dividends by relief at the company level. The system was that the company paid tax on its undistributed profits and received a deduction for distributions. Companies had the discretion to either pay tax at lower rate in respect of distributions to non-residents or to withhold tax from the distributions. Both resident and non-resident shareholders were taxed on an assessment basis and were entitled to a rebate on distributions of previously taxed income at the lower of the corporate rate or the shareholder's rate on income from property thus making the rebate non-refundable. Non-resident shareholders in companies which chose to pay tax on distributions to them were entitled to deduct tax paid by the company on the distribution from the tax payable by the shareholder.¹⁷⁸

At the time the United Kingdom system of corporate-shareholder taxation, although itself a form of integration system, principally provided relief at the shareholder rather than at the company level. Under United Kingdom legislation companies paid tax at the standard rate and dividends were assumed to be paid out of taxed profits and to have had tax at the standard rate deducted from them. This meant that only those natural person shareholders with a surtax liability were subject to any further tax on the dividend. Withholding tax was not applied to dividends paid to non-residents and

¹⁷⁶ N Chamberlain (United Kingdom Chancellor of the Exchequer) to S M Bruce (Australian High Commissioner, London) 24th July 1933. Australian National Archives, Series A461/8, Control Symbol D344/3/3 Part II.

¹⁷⁷ For example H W Buckley to The Federal Commissioner of Taxation, 4th August 1922, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, p.326. The Australian Taxation Office response to this inquiry is set out in Commissioner of Taxation, Minute Paper, Double Income Tax, Letter from Mr H W Buckley, National Archives of Australia Series A 7072/21 Control Symbol J245/2, Part II, pp. 344 to 346.

¹⁷⁸ The account in the text is based on the discussions of the Australian system of corporate-shareholder taxation at this time in C John Taylor, 'Development of and Prospects for Corporate-Shareholder Taxation in Australia' (2003)57 *Bulletin For International Fiscal Documentation*, pp. 346 to 357 (hereafter, 'Taylor, Development Of And Prospects For') at pp. 346 to 347, C John Taylor, 'The Negotiation and Drafting of the UK-Australia Double Taxation Treaty of 1946' [2009] *British Tax Review* pp. 201 to 241 (hereafter 'Taylor, Negotiation and Drafting 1946 Treaty') at pp. 202 to 204; and C John Taylor, 'I suppose I must have more discussion on this dreary subject': The Negotiation and Drafting of the UK – Australia Double Taxation Treaty of 1946' in J Tiley, ed., *Studies In The History Of Tax Law*, Volume 4, Hart Publishing, Oxford and Portland Oregon, 2010, pp. 213 to 266 (hereafter 'Taylor, Dreary Subject') at pp.215 to 217.

practical difficulties were associated with collecting surtax from non-residents. The availability of various reliefs to residents could mean that, in some circumstances, a natural person resident shareholder could be entitled to a refund of tax in respect of dividends received. In effect resident shareholders were being given credit for United Kingdom corporate tax paid.¹⁷⁹

Difficulties associated with the interaction of the two systems of corporate-shareholder taxation within the system of Dominion Income Tax Relief appear to have subsided when Australia in 1923, for reasons associated with Federal – State co-operation in income tax collection, abandoned its dividend deduction system for an imputation system in which shareholders received rebates (which eventually were to be non-refundable), the effect of which in most cases was that no tax on dividends was payable at the shareholder level.¹⁸⁰ As mentioned above, throughout the 1930s successive Australian governments viewed the system as working well.

Dominion Income Tax Relief survived Australia's move to a nominal global system in 1930. After its adoption of a global system in 1930 Australia exempted foreign source income that had been subject any foreign income tax so the change to a nominal global system did not have a substantive effect on the Australian tax effects of most outbound investments. Exempting most foreign source income meant that Australia did not have to develop a credit based mirror image of the United Kingdom system of Dominion Income Tax Relief in the manner that had been envisaged by Ewing in his letter to Collins of 30th July 1920 discussed above.

In 1946 J B Chifley (as Australian Prime Minister and Treasurer) noted that while the Dominion Income Tax Relief system had been cumbersome in application and had resulted in long delays it had granted a reasonable measure of relief until changes to Australian taxation laws in 1939 made the relief inadequate.¹⁸¹ Although J B Chifley did not specify what changes to Australian tax law in 1939 made the relief inadequate it is likely that he was referring to the 1939 abolition of inter-corporate dividend rebates for non-resident holding companies. The effect of this measure was to increase the effective rate of Australian tax on dividends paid to non-resident holding companies. Further problems developed when, in 1940-1941, Australia changed its corporate-shareholder taxation system to a classical system.¹⁸² Following this change it appears that the United Kingdom, for the purpose of calculating Dominion Income Tax Relief, grossed up the dividends for Australian shareholder tax but not for Australian corporate tax. In calculating any reciprocal relief that it was obliged to provide, Australia only took account of Australian shareholder tax. The end result of the combined operation of these practices was that the effective rate of tax on dividends derived by United

¹⁷⁹ This account is based on the discussion of the United Kingdom system in Taylor, *Negotiation And Drafting 1946 Treaty*, *supra* note 178, at p.204 and Taylor, *Dreary Subject*, *supra* note 178, at pp. 217 to 218. See also the discussion in J F Avery-Jones, 'The History of the United Kingdom's First Comprehensive Double Taxation Agreement' [2007] *British Tax Review* 211 to 254 (hereafter, 'Avery-Jones, First UK Treaty') at pp. 222-223.

¹⁸⁰ See the discussion of the Australian imputation system in this period in Taylor, *Development Of And Prospects For*, *supra* note 178 at pp. 347 to 349.

¹⁸¹ Memorandum by J B Chifley for Cabinet dated 3rd June 1946. Australian National Archives, Series Number A2700 Control Symbol 1172 Barcode 3264124

¹⁸² For a discussion of the process by which the Australian imputation system of the 1930s was transformed into a classical system see Taylor, *Development Of And Prospects For*, *supra* note 178 at pp. 349 to 350.

Kingdom parent companies on dividends paid by wholly owned Australian subsidiaries approached 67.5%.¹⁸³

While Dominion Income Tax Relief was operating within the British Empire, the League of Nations was working on the problem of international juridical double taxation. At the same time the United States was refining the foreign tax credit system that it had introduced in 1918. Moreover, Double Tax Agreements that can be seen as the progenitors of the current OECD Model Double Taxation Convention had been entered into by some States. Importantly these included agreements between States, such as Sweden, with a schedular system of taxation and States, most notably the United States, which used a global system. Each of these developments have been the subject of detailed discussion elsewhere.¹⁸⁴ For the purposes of this paper three important points can be noted from these developments.

First, none of the reports of the League of Nations committees regarded the system of Dominion Income Tax Relief as optimal largely because of the administrative difficulties associated with it but also because it was not suited to eliminating international double taxation where one State was using a schedular system while the other was using a global system. Secondly, a consensus developed through actual treaties and the work of the League of Nations committees that involved a different approach to sharing the burden of relieving international juridical double taxation to that taken in the Dominion Income Tax Relief system. The international consensus came to be that source countries would reduce their taxes on investment income (such as interest, dividends and royalties) and that the residence country would have the primary right to tax this income subject to giving relief through a foreign tax credit. In the case of business profits the consensus that developed was that the source country would have the primary right to tax with the residence country having a residual right to tax provided it granted a foreign tax credit. The consensus was based on paradigms, adopting different treatments for different categories of income and treating the corporate tax as distinct from the shareholder tax, which reflected in different ways, paradigms of the schedular and classical tax systems of the countries that dominated the League of Nations committees and early treaty negotiations. Thirdly, in this period, the United States developed the practice of only limiting its foreign tax credit by reference to the United States tax otherwise payable on the relevant foreign source income. Tax planning subsequently led the United States to develop other limitations but none of the limitations prevented a foreign jurisdiction from increasing its tax rates to the level of United States rates to take advantage of the United States foreign tax credit. The end result of these developments was that by the end of World War II international practice, and particularly United States practice, had begun to settle on limiting the source country's right to tax investment income, giving the source country the major right to tax business profits and requiring the residence country to relieve double taxation by

¹⁸³ For a detailed discussion of the approaches of both Australia and the United Kingdom to dividends under the system of Dominion Income Tax Relief following Australia's adoption of a classical system see Taylor, Negotiation And Drafting 1946 Treaty, *supra* note 178, pp. 205 to 206 and Taylor, Dreary Subject, *supra* note 178, pp. 218 to 220..

¹⁸⁴ See S Picciotto, *International Business Taxation*, Weidenfeld and Nicholson, London, 1992 at pp 12 to 14; M J Graetz and M M O'Hear, 'The 'Original Intent' Of U.S. International Taxation' (1997) 46 *Duke Law Journal* 1021; P Verloren van Themaat, 'The Anglo American Group of Taxconventions, concluded since 1939, compared with the pre-war treaties' 3 *Cahiers De Droit Fiscal International* pp 1 to 21; M B Carroll, 'Double Taxation Conventions Concluded By The United States Since 1939' 5 *Cahiers De Droit Fiscal International* pp 25 to 78.

providing a foreign tax credit up to the amount of residence country tax otherwise payable.

Hence, when the United States and the United Kingdom began negotiations for a Double Taxation Agreement in 1944 the United States already had a highly developed negotiating position that reflected both its treaty practice to that time and the emerging international consensus. The United Kingdom by contrast, used the Dominion Income Tax Relief system within the Empire but otherwise had only a simple treaty with the Irish Free State and a series of agreements with other States on specific topics such as agency profits. The Double Tax Convention of 1945 between the United Kingdom and the United States that emerged from a fairly lengthy set of negotiations was consistent with the emerging international consensus and hence differed significantly from the Dominion Income Tax Relief system.¹⁸⁵ To fulfil its treaty obligations the United Kingdom introduced a foreign tax credit as part of its domestic law.¹⁸⁶

Following the negotiation of the Double Taxation Convention with the United States the United Kingdom Secretary of State for the Dominions began negotiations with each of the Dominion Governments offering to enter into Double Taxation Conventions with them on terms which were decidedly less favourable to the Dominions than those that the United Kingdom had agreed to in its Convention with the United States.¹⁸⁷ Given that the Convention with the United States provided greater relief to a United Kingdom resident with United States taxed income than that provided by the Dominion Income Tax Relief system the days of the latter system were numbered so far as the Dominions were concerned. Eventually all of the Dominions entered into Double Taxation Conventions with the United Kingdom and as they did so the system of Dominion Income Tax Relief ceased to apply to them.¹⁸⁸ As might have been expected given the history of negotiations in 1919 and the 1920s, the most difficult negotiations proved to be with Australia which clung tenaciously to its policy of maximizing its taxation of Australian sourced income.¹⁸⁹

¹⁸⁵ See Avery-Jones, First UK Treaty, *supra* note 1789 at pp. 222 to 225.

¹⁸⁶ *Finance Act (No2) 1945 (United Kingdom)* s51(4) and Sch VII.

¹⁸⁷ Details of the negotiations with Australia are contained in the following files in the United Kingdom (UK) National Archives, IR 40/13740 and DO 35/1157.

¹⁸⁸ *Finance Act (No2) 1945 (United Kingdom)* ss51(1) and (2).

¹⁸⁹ The initial steps in negotiating the Australia – UK Double Taxation Agreement of 1946 can be traced to a letter from the Australian High Commissioner, S M Bruce, to Viscount Cranbourne on 9th March 1945. Negotiations at official level eventually broke down and agreement was only eventually reached through ministerial negotiations. The Australia – UK Double Taxation Agreement was not signed until 29th October 1946, long after agreements had been concluded by the UK with other Dominions. Details of the negotiations with Australia are contained in the following files in the UK National Archives, IR 40/13740 and DO 35/1157. For a discussion of the negotiation and drafting of this treaty see Taylor, Negotiation And Drafting 1946 Treaty, *supra* note 178 and Taylor, Dreary Subject, *supra* note 178.

The Tiley trilogy and US anti-avoidance law

Erik M. Jensen*

Abstract

This article considers an influential set of pieces, written by Professor John Tiley in the mid-to-late 1980s, about US anti-avoidance doctrines. The trilogy of articles was written for a British audience, as part of Tiley's efforts to resist importation of those US doctrines ('bleeding chunks of alien doctrine', as he put it) into the UK, but his ideas remain relevant to tax theorists in all countries. The article also examines the work of the Aaronson Committee, of which Tiley was a member, which in 2011 successfully recommended that the UK adopt a general anti-avoidance rule (GAAR). Did Tiley's resistance to anti-avoidance doctrines lessen over the decades, or did the recommendations of the Aaronson Committee avoid the problems that Tiley had seen in the US doctrines? This article concludes, probably not surprisingly, that the latter was the case.

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1 INTRODUCTION

John Tiley first came to Cleveland, Ohio, and Case Western Reserve University for the 1985-1986 academic year. He came with a specific project in mind. The House of Lords had recently decided *Furniss v. Dawson*,¹ which, to some commentators, looked like a significant step toward importing US substance-over-form concepts into the relatively formalistic British tax system.² John wanted to study the American ideas—to get a better idea of what his countrymen and -women might be getting themselves into. He read voraciously, he sat in on tax courses (as well as teaching his own) at the School of Law, and he established contact, in that era before e-mail, with tax professionals across the US.³

John's study led to three important articles in the *British Tax Review*,⁴ a trilogy of articles demonstrating that John had a better grasp of key US tax concepts than most US tax professionals do (the Tiley trilogy). John came away from his study with what, to us colonials, seemed to be a heretical conclusion: the US judicial anti-avoidance doctrines, unless they were quite limited in scope, should stay in the US.

Most US lawyers take the importance of substance for granted. Why (we think) would anyone want to run the risk of being called a formalist, rather than being seen as a keen observer of reality?⁵ As John sarcastically put it in criticizing the 'insidiously attractive' substance-over-form doctrine: 'What could be more attractive than to be freed from the task of living in an unreal world?'⁶

John not only questioned the merits of many judicially imposed US substance-over-form principles; he summarily rejected them for the UK: '[I]mporting bleeding chunks of alien doctrine could prove extremely dangerous.'⁷ If the UK courts do not constrain the scope of any imported doctrines, John wrote, 'they are heading for a quagmire of unprincipled decision making'.⁸ Vivid images indeed.⁹

Particularly interesting to this observer is that the UK has now, by Act of Parliament, adopted a general anti-avoidance rule (GAAR), and the recommendation to do so came

¹ [1984] AC 474.

² *Furniss v Dawson* was not entirely novel. It expanded the so-called 'Ramsay principle,' deriving its name from a case decided two years earlier. See *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300.

³ John already knew many US tax academics, of course, all of whom adored him. The level of adoration increased dramatically during that year.

⁴ See John Tiley, 'Judicial anti-avoidance doctrines: the US alternatives' (1987) *British Tax Review* 180; and 'Judicial anti-avoidance doctrines: the US alternatives—part II' (1987) *British Tax Review* 220 (with a couple of corrections, one quite amusing, noted at 433) [Tiley I]; 'Judicial anti-avoidance doctrines: some problem areas' (1988) *British Tax Review* 63 [Tiley II]; 'Judicial anti-avoidance doctrines: corporations and conclusions' (1988) *British Tax Review* 108 [Tiley III]. See also John Tiley & Erik M Jensen, 'The control of avoidance: the US alternative' (1998) *British Tax Review* 161 (further reflections on US doctrine).

⁵ The substance-over-form doctrine is ordinarily something the government, not taxpayers, may invoke. But see *Zenz v Quinlivan* 213 F2d 914 (6th Cir 1954) (holding that it does not matter whether, if the steps are part of an integrated transaction, a corporate shareholder first sells shares and then has other shares redeemed, or the steps are reversed). *Zenz* gave its name to the bootstrap transaction at issue in the case—'zenzing out'—and taxpayers are as entitled to rely on the substance-over-form result in *Zenz* as is the Internal Revenue Service. See Rev Rul 75-447 1975 2 CB 113 (accepting *Zenz*). See also Tiley I, note 4, 231-34 (critically discussing *Zenz*); Tiley III, note 4, 123-24 (also discussing *Zenz*).

⁶ Tiley I, note 4, 226 (footnote omitted).

⁷ *Ibid* 181.

⁸ *Ibid* 244.

⁹ Phrases like 'bleeding chunks of alien doctrine' do not commonly appear in US tax journals.

out of the Aaronson Committee (named for its chair, Graham Aaronson), of which John Tiley was a member.¹⁰ Did John change his mind over the years, or was the committee's proposal for a new GAAR substantially different from 'the bleeding chunks of alien doctrine' he had condemned a quarter century earlier?

This article reexamines the Tiley trilogy of articles published after his year in the US. The goals are several: to bring John Tiley's learning about key US doctrines to a new generation of tax professionals; to reevaluate the merits of the Tiley analysis; and to consider whether subsequent developments, including the Aaronson report, require modifying that analysis.

This article first provides a brief summary of the Tiley trilogy. Part II discusses the defects John saw in the US judicial doctrines, and Part III considers the differences between the US and British systems that might justify different methods to attack avoidance behaviour. Finally, Part IV considers the Aaronson Report in light of John Tiley's aversion to US anti-avoidance doctrines, and briefly describes the recent US codification of an anti-avoidance doctrine.

2 THE FORM (AND SUBSTANCE) OF THE TILEY TRILOGY

In the first instalment of the trilogy, published in two parts, John Tiley set out the circumstances that led to his US research; pondered some of the differences between the US and UK legal systems that might reasonably lead to differences in tax jurisprudence;¹¹ described different levels of reasoning that can be involved in resolving a tax dispute (the more ethereal of which, he argued, ought to be avoided by judges);¹² and then comprehensively explained, in often unflattering terms, several of the US judicial anti-avoidance doctrines.

In the second instalment, John considered a number of specific problem areas involving application of the US doctrines outside the corporate tax context. In the final instalment, he extended the discussion to the problem areas in US corporate tax law. At the very end of that last instalment, John reiterated—and embellished—his reservations about the US doctrines.

To say that John had 'reservations' is putting it mildly. To be sure, on the very first page of the trilogy, John had written in measured terms: 'It will be suggested that United Kingdom judges should be extremely wary of importing United States doctrines, since both the intellectual structure of the United States tax system and the administrative structure that underpins it are very different from ours.'¹³ That use of the passive voice has the sound of the typically restrained academic article. The final instalment of the trilogy ends with some passages that have a similar tone, once again urging UK courts to be 'extremely wary' of the US doctrines.¹⁴ But on the second page of the first instalment, there is the reference to 'bleeding chunks of alien doctrine', and examples of similarly biting language can be found throughout the articles. Restrained though the

¹⁰ Report by Graham Aaronson QC, 'GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system' (11 November 2011), available at http://webarchive.nationalarchives.gov.uk/20130321041222/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf [the Aaronson Report].

¹¹ See Part III.

¹² See notes 33-38 and accompanying text.

¹³ Tiley I, note 4, 180.

¹⁴ Tiley III, note 4, 142.

trilogy might have been in some respects, this was not an exercise in dispassionate analysis.¹⁵ This was a subject about which John Tiley had very strong views.

The details of US tax law have of course changed since the trilogy was written, and the trilogy is therefore not a trustworthy guide to today's US black-letter law. Some of the legal doctrine John described has changed dramatically. For example, as John was studying and writing, Congress was interring what had been a key principle of American corporate tax law, the *General Utilities* doctrine.¹⁶ Furthermore, most dividends from corporations are now taxed to individuals at preferential rates, another important change that affects the specifics discussed in the trilogy.¹⁷

The details may have changed, but what John wrote about US anti-avoidance doctrines remains as relevant today as it was back then. This is not to say that John was right in everything he wrote, but the issues he raised are (and always will be) important ones. The trilogy is still a worthwhile, and often wonderful, read.

3 WHAT'S WRONG WITH THE US DOCTRINES?

John Tiley condemned US judges' use of judicially created anti-avoidance doctrines for many reasons. For one thing, he said that US judges underestimate the value of form. Deference to form makes tax law more predictable and administrable (with, to be sure, some losses of revenue). 'If it is objected that tax law must live in the 'real world,' John wrote, one response 'is that the need for certainty is part of the real world.'¹⁸ Relying on form also arguably leads to fairness, with results less dependent on the vagaries of fact-finding.¹⁹ And, as John regularly noted, many statutes, even in the US, intentionally create formalistic rules. According to John an 'indiscriminate adoration of substance' would be totally inappropriate in interpreting and applying such a statute.²⁰ It would be stupid, that is, to interpret a formalistic statute in a non-formalistic way.

A related point is that particular transactions are sometimes clearly governed by a particular set of rules. In that case, John wrote, where:

the court is asked to recharacterise facts which fall clearly within one rule . . . , the court has stumbled into quicksand. . . . The price of uncertainty, although capable of exaggeration, is too great since there is no discernible limit to the areas which are rendered uncertain.²¹

According to John, professing to search for the substance of a transaction can lead to judicial laziness and to the production of opinions that provide little or no legal guidance. John concluded, based on his research, that the typical US judge seemed to think that,

¹⁵ One biting reference that hit this reader particularly hard was about 'basis fixation. United States tax lawyers are obsessed with the problem of determining the basis for assets.' Tiley I, note 4, 190. I regularly tell my students that basis is the most critical concept in the income tax, and that they should be fixated on it.

¹⁶ See *General Utilities & Operating Co v Helvering* 296 US 200 (1935), under which distributions of property from corporations to shareholders were considered non-taxable events at the corporate level. With one limited exception, the *General Utilities* doctrine is no longer the law. See IRC §§ 311(b), 336 (making distributions of appreciated property taxable to the distributing corporation).

¹⁷ 'Qualified dividends' are taxed at the same maximum rates applicable to most long-term capital gain. See IRC § 1(h)(11).

¹⁸ Tiley III, note 4, 143.

¹⁹ What facts are relevant may well depend on whether the 'substance' of a transaction must be determined. See notes 37-38 and accompanying text.

²⁰ Tiley I, note 4, 234.

²¹ Tiley III, note 4, 143.

by citing an anti-avoidance doctrine, he could avoid the hard work of analysis—as John put it, ‘an invocation of doctrines as if they determined the case without explaining how’.²² It is easier, that is, to say that the substance of a transaction is *X*, and that the tax results should follow from that characterisation, than to have to interpret difficult revenue statutes (and, for that matter, to explain *why* the substance is *X* and not *Y*). John quoted the legendary Judge Learned Hand,²³ who in 1932 described judicial recourse to concepts like ‘form’ and ‘substance’ as ‘anodynes for the pains of reasoning’.²⁴ John added:

It is all too clear from the American authorities that a simple invocation of this doctrine as if it answered the problems presented is an easy a [sic] trap to fall into and frequently deprives a decision of any doctrinal value.²⁵

And it is not as though the US anti-avoidance doctrines are models of clarity: ‘if they operated in isolation, they would produce extreme uncertainty but, worst of all, they can be extremely difficult to grasp and at times lack intellectual credibility.’²⁶ The relationship among the various doctrines is also a source of uncertainty. Are the ‘doctrines’ of a step transaction, a sham transaction, and economic substance distinct from substance-over-form, or do they merely reflect the application of that general doctrine in particular contexts?²⁷ After all, the step transaction doctrine—setting out the circumstances under which a number of formally separate transactions should be collapsed and analysed as a single transaction for purposes of determining the tax consequences—seems to do nothing but disregard form in favor of a newfound substance. If that is so, is anything gained by giving a name to another ‘doctrine’? Similarly, John seemed to think (at times anyway) that the so-called sham transaction doctrine, under which a transaction will be disregarded for tax purposes if its only purpose is tax avoidance, had no independent significance. That doctrine, derived from the 1960 Supreme Court decision in *Knetsch v United States*,²⁸ can also be understood as an application of substance-over-form principles.²⁹

The invocation of judicially created rules would lead to uncertainty under any circumstances, but the uncertainty is compounded by the complex US judicial system. A federal tax dispute can begin its judicial travels in any one of three different sets of trial courts—the Tax Court, the Court of Federal Claims, or a federal district court—at the taxpayer’s option.³⁰ Those courts are not necessarily in doctrinal agreement. Appeals

²² Tiley I, note 4, 188. See also Tiley II, note 4, 103 (noting that his survey of non-corporate cases ‘has been designed to highlight the necessity for clear and intellectually sustainable rules of law and the dangers of vague invocations of ‘substance’ and ‘reality’’).

²³ Hand has often been described as the most important jurist never to have sat on the US Supreme Court.

²⁴ *Commissioner v. Sansome* 60 F2d 931, 933 (2d Cir 1932).

²⁵ Tiley I, note 4, 226-27 (footnote omitted).

²⁶ *Ibid* 180.

²⁷ For that matter, John concluded that judges sometimes used hyperbolic substance-over-form language when all they were doing was reasoning by analogy: see Tiley I, note 4, 228.

²⁸ 364 US 360 (1960).

²⁹ See, eg, Tiley I, note 4, 196-97 (‘It is extraordinarily difficult to work out what a United States lawyer means by a sham transaction. . . . When the United States lawyer concludes that a transaction is a sham he usually means that the form of the transaction is to be disregarded because it is a sham as compared with the underlying substance; the use of the term in this way seems to be nothing more than a rhetorical device of disapprobation to support a conclusion reached on other grounds—usually one of the general doctrines.’). But see 220 (stating that the *Knetsch* approach is ‘intellectually sustainable’).

³⁰ Different jurisdictional rules apply. For example, the Tax Court is available only if the taxpayer does not first pay the contested tax; the taxpayer then petitions to challenge the asserted efficiency. Entrance to the

are heard in twelve different courts spread across the country, and here too doctrinal disagreement is not uncommon. The Supreme Court in theory can impose consistency, but it hears few tax cases (and those only grudgingly).³¹ As a result, a single ‘doctrine’ can take different forms in different fora. As John noted, the step transaction doctrine, described above, had (and probably still has) at least three different formulations in US courts.³²

Perhaps John’s biggest problem with the US judicial doctrines is that he believed they reflected types of thought that are, and should remain, foreign to UK judges. John posited nine levels of reasoning in tax disputes, ranging from the purest questions of fact (level 1) to the most cosmic. One of his goals in the trilogy was to encourage UK judges to continue to avoid levels 8 and 9 and to reach level 7 only on occasion. (Level 7 reasoning arises ‘when the court, having determined the relevant facts and interpreted the relevant legislation, considers invoking some general principle of tax law.’³³)

John classified US anti-avoidance doctrines as level 8 reasoning:

general doctrines which are not of universal application and which are applied spasmodically rather than being constant influences. . . . It is clear that while these doctrines are pervasive they are also unpredictable; they are, or take the form of, rules, but potential rather than actual. They thus resemble comets rather than stars or planets. . . . [I]t is much easier to state such a basic doctrine than to define its limits. . . . [O]nce a doctrine is loose in the law it is extremely difficult to get rid of.³⁴

That sounds bad enough, and level 9 is even worse: ‘At level 9 we move beyond formal legal reasoning into an area in which broad principles float about in the legal ether. These principles are, as much as anything else, gut feelings about what the law should be’,³⁵ and the ‘principles’ at this level inevitably conflict.³⁶

The US doctrines fell within the higher, more suspect levels of reasoning, but John argued that they muddled the waters even at the lowest level, that of basic fact-finding. The world is full of facts, after all, almost all of which should be irrelevant to any particular legal dispute. But if, should a controversy develop, a transaction might be re-characterised into something other than what is suggested by the form, the universe of potentially relevant facts expands exponentially. In short, one needs to know what the law is in order to determine what the salient facts are, and ‘in no area of tax law is this

other two courts requires paying first and then suing for a refund. But it is within the control of the taxpayer as to which court to use, and one important factor in the choice of forum is the relevant precedents in each court.

³¹ For example, Justice William Brennan’s reported ‘normal reaction’ in reviewing petitions for a writ of certiorari was to write ‘This is a tax case. Deny.’ See Bob Woodward & Scott Armstrong, *The Brethren: Inside the Supreme Court* 362 (1980). It is true, however, that, if circuit courts disagree on an issue, the circuit split increases the likelihood that the Supreme Court will agree to hear a case involving that issue, even if it involves taxation.

³² Tiley I, note 4, 235-41. Although John did not discuss this, the economic substance doctrine, under which a transaction may be disregarded for tax purposes if it lacks economic substance, was applied quite differently across the country as well—a defect that was cured only in 2010, and then only prospectively, by legislation. See notes 73-77 and accompanying text.

³³ Tiley I, note 4, 193.

³⁴ Ibid 194 (footnotes omitted).

³⁵ Ibid. For an amusing mistake, see ibid 220 (where ‘level 9 reasoning’ came out, perhaps because of a dictation error, as ‘Lord Freasonine’).

³⁶ Ibid 195.

more difficult than in that of general anti-avoidance doctrine.’³⁷ Such a doctrine potentially leaves all ‘facts’ at the risk of being re-characterised.³⁸

4 FUNDAMENTAL DIFFERENCES BETWEEN THE US AND UK TAX REGIMES

Although John Tiley had many uncomplimentary things to say about US doctrines and practices—he really did not like the anti-avoidance doctrines as they operated on US soil—he conceded that the development of the doctrines was understandable in the US. It was understandable because the US governmental and legal systems are very different from their UK counterparts. While that helped to explain the US developments, it also made fighting their transfer to the UK all the more important.

The creaky system of often divided government in the US (it is not the norm for one political party simultaneously to control the presidency and both Houses of Congress) makes quick reaction to tax abuses difficult. Congressional tax enactments generally are of unlimited duration; they become part of the continuing Internal Revenue Code. Unless provision is made for an expiration date, those enactments remain indefinitely on the books for tax professionals to plan around. Congress has the power to amend or repeal provisions that become problematic, of course, but Congress works slowly and inefficiently.³⁹

Under the circumstances, with Congress (and administrators as well) unable to react quickly to the spread of abusive transactions, it may have been necessary for US courts to send the signal, through anti-avoidance doctrines, that claimed tax results which seem too good to be true probably are.⁴⁰ In contrast, the UK parliamentary system, with its strong party discipline, is better suited to quick legislative fixes. If UK taxpayers are behaving badly in a particular way, the party in power is likely to be able to get targeted legislation through Parliament in a clean and quick way. As John wrote,

With the House of Commons . . . little more than a rubber stamp as the annual Finance Bill passes on its stately way, and with the opportunity of an annual Finance Bill for the Revenue to put things right it is suggested that the United Kingdom courts do not need to develop doctrines to protect the Revenue beyond those such as Lord Brightman’s step transaction and possibly a business purpose approach; moreover to develop such a doctrine along the lines of substance over form will be to imperil the Revenue just as much to protect it.⁴¹

In the US we do not have the luxury of fast-acting government.

The US federal system, with the separate state governments operating within the national system, introduces other complications not found in the UK. Legal rules in many areas, including property law, are almost entirely created by state governments; the national tax laws must then classify the transactions carried out pursuant to those substantive rules, which can vary substantially across the fifty states. In the UK, in contrast,

³⁷ Ibid 191.

³⁸ Ibid.

³⁹ That statement is meant to be a description rather than an editorial comment. Many would say that the US Constitution was intended to create a creaky system, so as to protect the populace from a potentially abusive government.

⁴⁰ US legislative and regulatory responses to tax avoidance are discussed in Erik M Jensen, ‘The US legislative and regulatory approach to tax avoidance,’ in *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley* 99 (2008).

⁴¹ Tiley III, note 4, 144-45.

Parliament establishes both the substantive rules and the governing tax doctrine.⁴² That reduces doctrinal complexity and lessens the need for judicial development of anti-avoidance doctrines.

The form that tax legislation takes in the two countries provides another reason for judicial participation in the US lawmaking process in a way frowned upon in the UK. In John's words, in the US, '[t]he legislation which the courts have to apply contains many provisions of a complexity equal to the worst of the United Kingdom legislation but it is much more prone to introduce relatively woolly concepts and leave matters to the courts to resolve'.⁴³ It was because of these 'woolly concepts' that US judges were forced to develop 'level 7 reasoning'⁴⁴ (and sometimes much worse): 'Level 7 reasoning comes much more naturally to United States lawyers than to their United Kingdom colleagues not least because they recognise that their statute provides a framework for the judges to develop doctrine, a premise which United Kingdom lawyers do not share.'⁴⁵

John may have exaggerated some of the differences he saw between the US and the UK, however. US judges think it necessary to determine the reality, the substance, underlying behaviour, but John argued that there are profound differences

between the real world of the United States and the real world of the United Kingdom. The United States is content to live in an atmosphere of *in terrorem* provisions and considerable uncertainty because of the system of quasi-law which underpins the state. This quasi-law consists of Regulations . . . and Letter Rulings. . . . The result of all this is that the taxpayer has a reasonable awareness of when he will be straying into dangerous territory and when not and that such information is reasonably accessible.⁴⁶

In this passage John seemed to be suggesting both that those in the US are willing to deal with 'considerable uncertainty' and that, because of this 'quasi-law', there is really not much uncertainty at all, particularly if a taxpayer stays away from the borders of 'dangerous territory'. Doctrines with somewhat fuzzy boundaries may be regarded as '*in terrorem* provisions', but the terrified are only going to be those who engage in aggressive tax planning. And, despite the disparaging reference to 'quasi-law', no US tax lawyer thinks of Treasury regulations, which do indeed help in providing certainty, as anything but *real* law. They are generally promulgated pursuant to elaborate rules of administrative law and are subject to potentially rigorous public comment during the promulgation process.⁴⁷

⁴² Tiley I, note 4, 186.

⁴³ Ibid 187. John conceded that Americans do occasionally act like Her Majesty's subjects: 'Where subsequent legislation has been meticulous in its detail the United States courts have indicated a willingness to approach the problems of construction in a thoroughly English way and to reject arguments based on form and substance' Tiley III, note 4, 144.

⁴⁴ See text accompanying note 34.

⁴⁵ Tiley II, note 4, 64.

⁴⁶ Tiley III, note 4, 143.

⁴⁷ On this point it is impossible for those in the US to imagine the practice of tax law without the extremely comprehensive body of regulations that flesh out statutory language and provide examples of the operation of the statute. (To the extent a regulation conflicts with a congressional enactment, the regulation must fall, but that is a relatively unusual situation.) The status of private letter rulings is different in that, for most purposes, they are not to be treated as precedent. Nevertheless, although they might be 'quasi-law', it is invaluable to know what sorts of transactions the Internal Revenue Service is blessing. And the letter rulings are publicly available, with identifying information redacted.

John may also have overstated the extent to which the US Constitution, which imposes limitations on the national taxing power, contributes to the enactment of fuzzy statutes that invite, or even demand, judicial intervention. In particular, John emphasised the significance of the Sixteenth Amendment to the Constitution, ratified in 1913. Without the Amendment, a tax that reached income from property would (the Supreme Court had held in 1895⁴⁸) be a direct tax that would have to be apportioned among the States on the basis of population.⁴⁹ Apportionment would have made the income tax absurd.⁵⁰ By exempting ‘taxes on incomes’ from the apportionment requirement, the Amendment made the modern income tax possible—but only insofar as the tax is really on ‘incomes’. Hence the uncertainty, or so John argued.

US courts, John wrote, have to construe legislation

not only in terms of what Congress intended but also in terms of what the Sixteenth Amendment allowed. The legislation in the early years was broad and many of those broad principles have remained in place. Broad legislation is sensibly construed in a broad way. Issues of form and substance first emerged in this era and the preference for substance over form, being concerned with fact classification rather than re-characterisation, is a natural and correct way to determine the facts of the case.⁵¹

It is true that Supreme Court cases from the 1920s and 1930s regularly contained discussions as to whether a particular item constituted ‘income’ within the meaning of the Sixteenth Amendment.⁵² But such discussions have almost completely disappeared from modern jurisprudence. The old cases may help explain the origins of anti-avoidance doctrines, I suppose, but they cannot explain their continued importance in the US system. Modern US courts give almost no consideration to constitutional limitations on the national taxing power.⁵³

Some of what John Tiley wrote about the differences between the systems of the US and the UK may thus be questioned, but he certainly provided a lot to think about.

5 THE AARONSON REPORT AND THE US CODIFICATION OF THE ECONOMIC SUBSTANCE DOCTRINE

As noted earlier, it was a surprise to many US observers that John Tiley, eminent sceptic about anti-avoidance doctrines, particularly of the US variety, was a member of the Aaronson Committee that recommended a general anti-avoidance rule (GAAR) for the

⁴⁸ See *Pollock v Farmers' Loan & Trust Co* 157 US 429, 158 US 601 (1895).

⁴⁹ See US Constitution, Art I, § 2 and Art I, § 9, cl 4 (both requiring that direct taxes be apportioned).

⁵⁰ Suppose two states have identical populations, but the average income in state A is twice that in state B. If an income tax is a direct tax that has to be apportioned, the amount of income tax to be paid by the two states would have to be the same, presumably meaning that the tax rates in state B, the poorer state, would have to be twice as high as those in state A. The mechanics of that system could be made to work, but the result would be preposterous. No self-respecting Congress would ever enact such a tax.

⁵¹ Tiley III, note 4, 144.

⁵² See, eg, *Eisner v Macomber* 252 US 189 (1920) (holding that the receipt of a totally proportionate stock dividend, one that did not change the recipient's proportionate interest in the corporation's assets and earnings, was not income within the meaning of the Sixteenth Amendment).

⁵³ But see *National Federation of Independent Business v Sebelius* 132 S Ct 2566 (2012) (holding that a ‘penalty’ for failure to acquire suitable health insurance under the so-called ‘Obamacare’ legislation is really a tax authorised by the Taxing Clause in the Constitution and that the penalty would not be affected by the Sixteenth Amendment).

UK.⁵⁴ But the Report issued by Graham Aaronson contains little that the author of the Tiley trilogy might have objected to. The recommendations were quite limited in their scope, and intentionally so. The Committee did not recommend anything like the importation of US substance-over-form doctrines, and, in any event, the Committee recommended *legislative*, not judicial, action. (Doing this legislatively was characterised in the report as being consistent with the rule of law.⁵⁵)

The GAAR recommended by the Aaronson Committee was to apply only to transactions of a clearly abusive sort. The goal was to have ‘a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements’.⁵⁶ The Report posited two main requirements for an acceptable GAAR: ‘The first is that the GAAR applies only to abnormal arrangements’, and ‘[t]he second is that the GAAR will operate only if the arrangement cannot reasonably be regarded as a reasonable exercise of choices of conduct afforded by the legislation.’⁵⁷

Determining whether an arrangement is ‘abnormal’ is not necessarily easy, of course, but the difficulty is lessened if the category is limited to those transactions that might otherwise seem to lead to preposterously good results.⁵⁸ If there is a colourable claim that a transaction, as structured, achieves the desired results, the GAAR is not to apply. When there is doubt about whether ‘an arrangement can be regarded as a reasonable exercise of choices made available by the tax rules[,] the appropriate principle is to give the taxpayer the benefit of the doubt.’⁵⁹ And the Report recommended that there be ‘an automatic exclusion from the operation of the GAAR for any arrangement which is entered into entirely for non-tax reasons.’⁶⁰

Furthermore, the Aaronson Report emphasised that, unlike the case with other GAARs, there should be no negative presumption merely because one of the objects of the arrangement is a tax advantage:

I do not consider this to be the right approach for a GAAR that is suitable for the UK tax regime. The insuperable problem is that the UK tax rules offer, and indeed in many instances positively encourage, the opportunity for taxpayers to reduce their tax liability. Taking advantage of this can be described as a form of tax avoidance, but clearly it is not something to be criticised and therefore it should not be counteracted by a GAAR.⁶¹

Limited though it was, the recommended GAAR was not to be a paper tiger. It could be invoked to strike down the desired tax consequences in transactions that otherwise seemed to meet statutory requirements:

[I]t should be made clear that the GAAR is not to be regarded as a rule of construction, or interpretation, of statutory language. Rather, it operates on the hypothesis that the particular tax rules engaged by the arrangement would, on

⁵⁴ See Aaronson Report, note 10.

⁵⁵ Ibid 15.

⁵⁶ Ibid 4.

⁵⁷ Ibid 40.

⁵⁸ See ibid 32 (‘I have reached the conclusion that the better approach is to identify what it is that makes the centre ground of responsible tax planning unobjectionable, and to use this as the way to exclude from the shortlist of abnormal transactions those which come within that centre ground.’).

⁵⁹ Ibid 33.

⁶⁰ Ibid 35.

⁶¹ Ibid 30-31.

conventional purposive interpretation, succeed in achieving the advantageous tax result which it set out to obtain. The GAAR then provides an overriding statutory principle to which other tax legislation is subject.⁶²

The GAAR would help avoid the ‘fiscal chess game’—laws are enacted, taxpayers work around those laws, and then new laws are enacted to deal with the changed behaviour.⁶³ And it would make it unnecessary for judges and administrators to ‘stretch’ the interpretation of a statute to come to the right result in a case involving an abnormal arrangement.⁶⁴ No stretching would be necessary; the GAAR would provide the authority to disallow the claimed tax benefits.

The ultimate goal was ‘to avoid the application of [the substantive tax] rules, or exploit their application, in a way that Parliament could not rationally have contemplated.’⁶⁵ This seems to require something like a ‘too good to be true’ standard—that is, if the tax results, although they seem to be justified by statutory provisions, purposively interpreted, are too good to be true—the GAAR may be applicable.⁶⁶

Graham Aaronson recognised the danger of ‘mission creep’—that a GAAR could be pushed over time by Her Majesty’s Revenue and Customs (HMRC) into something far different from what was originally intended⁶⁷—and the Committee’s proposal had built into it a protection against mission creep: the creation of an Advisory Panel not made up only of HMRC personnel. The Advisory Panel would, among other things, regularly review the application of the GAAR; make sure that an independent person who has expertise about the transaction under review be involved;⁶⁸ publish decisions in redacted form, so that systemisation would develop;⁶⁹ and guard against HMRC’s discretionary powers by having the Advisory Panel do periodic updating of guidance about the types of cases to which the GAAR should apply.⁷⁰

The Aaronson Report is full of other goodies as well, but those are many of the highlights. It is understandable that John Tiley could have supported such a GAAR, even though those redacted documents might contain the seeds of ‘quasi-law’.⁷¹

It is worth noting that the US has recently had its own codification, in a limited way, of an anti-avoidance doctrine that had been judicially created. (If the US action had not taken place in 2010, slightly before the enactment of the UK GAAR, I might have suggested that a ‘bleeding chunk of alien doctrine’ must have crossed the Atlantic from east to west.)

⁶² Ibid 28.

⁶³ Ibid 15.

⁶⁴ Ibid 5.

⁶⁵ Ibid.

⁶⁶ This is like a standard suggested by Professor Alan Gunn to interpret a US anti-abuse rule in a regulation promulgated under the partnership tax regime. A transaction is abusive even if it seems to satisfy all statutory requirements if one concludes that, had Congress thought about the transaction, Congress would have deemed the transaction objectionable: Alan Gunn, ‘The use and misuse of anti-abuse rules: lessons from the partnership antiabuse regulations’ (2001) 54 SMU Law Review 159, 174.

⁶⁷ See Aaronson Report, note 10, 24 (‘Without exception the representative bodies were concerned about the possibility that some HMRC officials would use a GAAR in cases for which it was not designed.’).

⁶⁸ Ibid 26.

⁶⁹ Ibid.

⁷⁰ Ibid 29 (‘provide for an authoritative source of guidance as to the sort of cases to which the GAAR should apply’).

⁷¹ See notes 46–47 and accompanying text.

The US for years had resisted codification of any general anti-avoidance rule. Although the Internal Revenue Code includes many provisions that contain authority for application of substance-over-form principles, those provisions are targeted at specific transactions.⁷² The George W Bush administration did not support codification of a general anti-avoidance rule largely on the ground that doing so would fossilise doctrines that need to be fluid, to be able to adjust quickly to the never-ending imagination of tax planners.

Nevertheless, as part of the healthcare legislation enacted in 2010, popularly and unpopularly known as ‘Obamacare’, Congress did codify an economic substance doctrine (or what the statute characterised as a ‘clarification’ of that doctrine),⁷³ with consequences that we are not yet in a position to understand.⁷⁴ In brief, that doctrine would honour a transaction for tax purposes only if it has economic substance. One of the salutary results of the new statute, by almost everyone’s standards, was clarifying the relationship in application of the test between an objective criterion (to what extent did a transaction in fact have possibly beneficial tax consequences apart from the tax effects?) and a subjective criterion (to what extent did a taxpayer participating in a transaction need to have non-tax motivations for that participation?). US courts had taken inconsistent positions as to whether a transaction, to be honoured, had to satisfy both criteria, or only one, effectively leading to the doctrine’s being applied in different ways in different parts of the country. As a result of codification, it is now clear (for transactions subject to the codified doctrine) that a transaction will be treated as having economic substance only if it satisfies both tests.⁷⁵

I do not know for sure, of course, but I suspect that this US ‘clarification’ is a change that John Tiley would accept, and maybe even endorse. It was done legislatively; it eliminated inconsistencies that existed in judicial doctrines; and it was not meant to apply to all aspects of tax law. It was not a bad first effort by the US.

The ‘clarification’ did not, however, make the judicial anti-avoidance doctrines irrelevant; indeed, the statute defines the ‘economic substance doctrine’ in terms of the

⁷² For example, a Code provision sets out the standards governing when a contribution of property to a partnership (generally a non-taxable event) followed by a distribution of cash to the contributing partner (distributions also generally being non-taxable) will be treated as a disguised sale of the property: see IRC § 707(a)(2)(B).

⁷³ See IRC § 7701(o). Congress also provided for a strict-liability penalty to enforce the ‘clarification’: 40 percent of the understatement of tax attributable to any ‘nondisclosed noneconomic substance transaction’: IRC § 6662(b)(6) (i). A penalty of that magnitude should be enough to get the attention of most aggressive tax planners.

⁷⁴ The codification of the economic substance doctrine had nothing to do with the healthcare legislation, except that codification was scored as a revenue raiser and the Obama administration and Congress were looking everywhere for revenue to support the legislation. Disallowing hoped for tax benefits on the ground that a transaction lacked economic substance, coupled with a strict liability penalty, see note 73, was expected to raise \$4.2 billion in 2016—a pittance by US budgetary standards, but something.

⁷⁵ The application of the ‘clarification’ has lots of other ambiguities. For example, one must determine whether a transaction is one to which the economic substance doctrine is relevant, and that determination is to be made ‘in the same manner as if this subsection had never been enacted’: IRC § 7701(o)(5)(C). Pretend, that is, that what you in fact know happened did not. See Erik M Jensen, ‘Legislative and regulatory responses to tax avoidance: explicating and evaluating the alternatives’ (2012) 57 *St Louis University Law Journal* 26-37 (discussing codification of economic substance doctrine).

‘common law doctrine’.⁷⁶ On that front, John’s criticisms of US judicial anti-avoidance doctrines are as timely today as they were in the 1980s.

6 CONCLUSION

Twenty-six years ago, John Tiley concluded that, even though he did not like the US anti-avoidance doctrines, he was not averse to importing a couple of limited, ‘alien’ principles into the UK:

Of these a version of the step transaction doctrine . . . , combining a preordained series of transactions with an absence of a business purpose, can be seen to be intellectually sustainable and reasonably workable. The same is true of the business purpose doctrine in the sense that where the taxpayer invokes a particular provision it is open to the courts to hold that the particular provision is not a mechanical rule but requires a particular purpose other than the saving of tax to be shown by the taxpayer; such a doctrine would have the advantage of being inapplicable whenever the relevant purpose can be shown. Such a test would be predictable . . . and reasonably workable.⁷⁷

John Tiley’s scepticism about broader US judicial anti-avoidance doctrines was intended as a warning to his countrymen and –women; the trilogy was written for a largely UK audience. But for those not part of the primary audience, in particular those of us across the Atlantic, the trilogy was worth reading when it first appeared, and it is worth reading now. The US can be very provincial in matters of tax policy. Most US tax professionals do not study the tax law of other countries, even though there is much that could dramatically improve our laws. John’s work suggests another reason that the US should broaden its horizons: the Tiley trilogy was an extraordinary effort to question the merits of doctrines that most in the US take for granted. As we continue evaluating anti-avoidance doctrines, a never-ending process, the Tiley trilogy should be must reading in the US and elsewhere.

Indeed, everything John Tiley wrote is worth reading and rereading. It is a matter of great sadness that this wonderful man has left us. We have lost the pleasure of his presence—his ready smile, his quick wit, his graciousness—but at least his written work, his intellectual legacy, will be with us forever. For that we can be thankful.

⁷⁶ See IRC § 7701(o)(5)(A). In addition, the judicial doctrine remains in full force to analyse transactions consummated before the effective date of the ‘clarification’.

⁷⁷ Tiley III, note 4, 142.

Locke, Hume, Johnson and the continuing relevance of tax history

Jane Frecknall-Hughes¹

Abstract

This paper examines the relevance of the tax theories of John Locke and David Hume in the context of a new country (say, an independent Scotland) being faced with a change of tax system. It shows that events of the past have a continuing resonance in a modern context in respect of establishing a sound theoretical underpinning for a tax system, which then provides a broad, over-arching framework for the development of taxes which align with it. This is then demonstrated by showing how Samuel Johnson used Locke's theory to defend keeping the American colonies as part of Great Britain.

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1 INTRODUCTION

The study of history is often lambasted for being of no use. Henry Ford² famously said that it is ‘more or less bunk’, while the philosopher Hegel (1830) was of the view that mankind learned nothing from it. Perhaps this is because we can only see similarities between events with the clarity of hindsight: when they occur, they often appear unique to those experiencing them because they have not lived through anything similar. Even if something has occurred before, for example, a war, it may arise in a guise such that, at the time, the similarities with past events are not obvious. All this is likewise true of tax history as a specific type of history. Do we, for example, when contemplating changes to a taxes or a tax system, look back to consider the history or effect of past changes? The record would suggest not. Would a government fully conversant with the deep unpopularity of poll taxes in the past in England ever have considered introducing another one?³ Yet this is exactly what happened with the introduction in 1980 of the Community Charge, which was a poll tax. The Community Charge fulfilled all the requirements and characteristics of a ‘good’ tax apart from one – fairness/equity (see James, 2012) – in that it did not differentiate between the personal circumstances of taxpayers (vertical equity). It gave rise to such a level of civil dissension, however, that it was rapidly replaced by another form of taxation.

Over time, many newly independent or newly established sovereign states have been confronted by the need to set up a tax system, either ‘from scratch’, as in the case of Eastern European countries, following the break-up of the Soviet bloc in the 1990s, or by adopting a legacy system bequeathed by a colonial power (see Stewart, 2002, p. 9, citing Thirsk, 1997). In the UK, Scotland faces potentially the same kind of issues if the outcome of the 2014 referendum is in favour of independence, many of which would be similar under further devolution. However, this is not the first time that the UK has faced this kind of separation. It did so when the Irish Free State (now Republic of Ireland) was established as a separate state in 1921, and when former colonies became independent states, though the process was often quite long in legal terms, with countries being, for example, British Dominions for a time, though this was not always so, as in the case of America. Equally, Britain has faced integration with other sovereign states, notably in the case of Scotland, in 1707. Potential Scottish independence focuses attention again on tax and tax systems and what might be appropriate if there is a greater degree of separation or independence from a larger entity. In this context, the vying for dominance between the political theory of John Locke (as utilised by Samuel Johnson) and David Hume can shed light on the continuing relevance of tax history.⁴

For the characteristics of a ‘good’ tax, it is usual to refer to the concepts (or canons) of equity/proportionality, certainty, convenience and efficiency put forward by Adam Smith in Book 5 of his work, *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776. Later theorists have added neutrality, correction/control/influencing of behaviour, flexibility, simplicity, fairness, accountability and acceptability (in respect of behaviour of governments and

²See the entry under ‘Henry Ford’ (p. 289) in *The Oxford Dictionary of Quotations* (1996).

³The 1377–1380 poll taxes were famously responsible for the Peasants’ Revolt, but ‘poll taxes continued to be imposed by English governments strapped for cash throughout the fifteenth, sixteenth and seventeenth centuries’ and remained ‘deeply unpopular’ (Sims, 2010, p. 121).

⁴The ideas developed in this paper were first outlined in a review of the development and spread of tax ideology in Frecknall-Hughes, J. (2007), ‘The Concept of Taxation and the Age of Enlightenment’, in J. Tiley (ed.), *Studies in the History of Tax Law II*, Hart Publishing, Oxford and Portland, Oregon, pp. 253–286.

individuals) (see Myddelton, 1994; Daunton, 2001). The most recent review of the UK tax system, the *Mirrlees Review* (Mirrlees, 2010, 2011) accepted Smith's canons as commanding 'near-universal support' but felt that 'they are not comprehensive' (Mirrlees, 2011, p. 22). Considerable amounts of thought have been expended by theorists in considering the principles which should ideally underpin a tax system – and taxes generally – but not all thinkers would necessarily concur with the characteristics detailed above. The American Institute of Certified Public Accountants (AICPA), for instance, produced in 2001 a document which outlined ten guiding principles for good taxes, which includes some of the above, but not all. The Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) in its 1999 produced a similar discussion document (*Towards a Better Tax System*), which commented that the UK tax system was 'far too complex', 'full of anomalies', 'caught in a culture of never-ending change' and 'lacking in democratic control' (p. 3). This document (pp. 4–5) also suggested ten principles for a better tax system: taxes should be statutory (that is, enacted by primary, and not delegated, legislation), certain, simple, easy to collect and calculate, properly targeted, constant, subject to proper consultation, regularly reviewed, fair and reasonable, and competitive.

Richard Murphy, in his 2007 *A Code of Conduct for Taxation* (a voluntary code of behaviour based on the United Nations' *Universal Declaration of Human Rights*) has also been critical of Smith's canons, which he deems 'outmoded' (p. 8), because they (p. 9):

fail to recognise the obligation of the State to the citizen with regard to the provision of public goods, and relate primarily to the practice of taxation rather than the principles that underpin it.

On pp. 9–10, Murphy sets out a series of principles, derived from articles within the *Universal Declaration of Human Rights* (although the *Declaration* itself makes no reference to taxation), which are that the State should: protect its citizens; provide public goods; not discriminate in protection/provision; democratically determine its provision; be unconstrained by the action of another state; and levy taxation, which must respect the right to hold private property; must be imposed by law; must not be arbitrary; and must apply to all citizens. Citizens must pay the tax due by them, but can appeal against it, although they must disclose all relevant data to the State. Citizens do have the right to leave, in which case they lose their right to State protection and provision, but would not be obliged to contribute to its maintenance.

The issue of principles as opposed to practice is a dominant theme when considering tax theory as propounded by Locke and Hume and as put into practice by Johnson (the focus of this paper), and have considerable resonance in a modern context. The development of tax ideology is not often examined in academic accounting, law or business journals, though there is now work looking at the historical development of taxation, in its own right (for example, Frecknall-Hughes and Oats, 2004; Frecknall-Hughes, 2010) and its relationship with accounting regulation, practices and accountability (Hoskin and Macve 1986; Freedman and Power, 1992; Picciotto, 1992; Lamb, 1996; Bryer, 2000; and Hopwood and Miller, 2000). However, Lamb (2001, p. 295) comments that '...we need a better understanding of how tax law, rules and procedures have emerged and have been applied in practice'. One way of meeting this need is by considering how men's thoughts on taxation have led to the development of such law, rules and procedures. This necessitates delving into the distant past, when ideas of what government should and should not do were being debated – and this forms

the justification for this paper. This is not a new debate, but one which has, quite literally, raged for centuries.

The rest of the paper is structured as follows. Section 2 examines John Locke's theory of taxation in detail, followed by a consideration of David Hume's and Samuel Johnson's views in Sections 3 and 4 respectively. Section 5 offers the paper's conclusions.

2 JOHN LOCKE'S THEORY OF TAXATION

Locke (1632–1704) was a leading English figure at the forefront of the phenomenon which came to be known as the Enlightenment (c1688–1800), also referred to as the 'long' eighteenth century. This period was characterised by radical shifts in thinking, typically moving away from unswerving obedience to religious beliefs towards rationalism and the supremacy of things or facts that could be scientifically proved, with ideas increasingly committed to writing. Some scholars do not accept the Enlightenment as a separately identifiable phenomenon, seeing it rather as a development in the history of ideas (see Israel, 2002, p. 24, and 2006; and Porter, p. 3). Locke, for example, knew well the scientists Robert Boyle, Robert Hooke and Isaac Newton – and was himself heavily involved in the political movement which saw James II ultimately replaced by William and Mary in the 'Glorious Revolution' of 1688. All this, following personal experience of a period which saw the English Civil War, the execution of Charles I, the Cromwellian Protectorate (with the abolition of the House of Lords and the Anglican Church), the demise of the Protectorate and the restoration of Charles II, meant that for Locke, thinking from first principles was the usual thing to do. In *An Essay Concerning Human Understanding, Epistle to the Reader* (1690a, pp. 9–10), he saw himself as 'clearing the ground a little, and removing some of the rubbish that lies in the way to knowledge', and starting with a blank slate (*tabula rasa*), in everything from the generation of ideas to the development of political systems. This extended to his thinking about taxation. However, one cannot explore Locke's approach to taxation without first considering his views on private property and government.

In *The Second Treatise of Government* (1690b, II.2.26), Locke develops a theory of private property, basing this on the development of man from a state of nature to civil society, where natural law principles mean that man has a right to own the product of his own labours, including land which he has worked. There are, however, many different interpretations of Locke's theory of property (see, for example, Tully, 1980, 1993a, 1993b, 1994, 1995; Arneil, 1996; Buckle, 2001). His basic idea is that there was enough for everyone, but this was altered by greed and the introduction of money, enabling possession and exchange of goods which men might otherwise have acquired by labour (Locke, 1690b, II.5.48). This distorted economic proportions and created frictions, which were made worse by an increase in the population. Government then became necessary to ensure that people could live together harmoniously.

Men being, as has been said, by nature free, equal, and independent, no one can be put out of this estate and subjected to the political power of another without his own consent, which is done by agreeing with other men, to join and unite into a community for their comfortable, safe and peaceable living, one amongst another, in a secure enjoyment of their properties, and a greater security against any that are not of it. This any number of men may do, because it injures not the freedom of the rest; they are left, as they were, in the liberty of the state of Nature. When any number of men have so consented to

make one community or government, they are thereby presently incorporated, and make one body politic, wherein the majority have a right to act and conclude the rest.

Locke, 1690b, II.8.95

Political power, then, I take to be a right of making laws with penalties of death, and consequently all less penalties, for the regulating and preserving of property, and of employing the force of the community, in the execution of such laws, and in defence of the common-wealth from foreign injury; and all this only for the public good.

Locke, 1690b, II.1.3

Elsewhere in *The Second Treatise of Government* (1690b, II.8.99), Locke reinforces the idea that uniting into a community means that individuals surrender power to the will of the majority. Individuals agree to abide by a majority decision, in return for the benefits obtained by living as a member of the community – protection of life, health, liberty and property. This is Locke's form of social contract theory. However, individuals must be prepared to pay for these benefits by paying taxes.

It is true that governments cannot be supported without great charge, and it is fit every one who enjoys his share of the protection should pay out of his estate his proportion for the maintenance of it. But still it must be with his own consent – i.e., the consent of the majority, giving it either by themselves or their representatives chosen by them; for if any one shall claim a power to lay and levy taxes on the people by his own authority, and without such consent of the people, he thereby invades the fundamental law of property, and subverts the end of government. For what property have I in that which another may by right take when he pleases himself?

Locke, 1690b, II.11.140

Therefore an individual living in a community has, by his decision to live in that community, given consent to paying tax to pay for the benefits he derives. Locke is keen to stress that it is only a legitimate government which can impose taxes and can take part of a man's 'estate' in payment. Any other sort of taking away of property, even by a government, is wrong. Protection of property and assets was very much the order of the day. O'Brien and Hunt (1993, p. 170) comment, for example, that the fiscal system established after the 'Glorious Revolution' actually was such that it provided funds to protect not only Britain, but also her 'hegemony over the international economic order'.

...the supreme power cannot take from any man any part of his property without his own consent. For the preservation of property being the end of government, and that for which men enter into society, it necessarily supposes and requires that the people should have property, without which they must be supposed to lose that by entering into society which was the end for which they entered into it; too gross an absurdity for any man to own....For I truly have no property in that which another can by right take from me when he pleases against my consent. Hence it is a mistake to think that the supreme or legislative power of any common-wealth can do what it will, and dispose of the estates of the subject arbitrarily, or take any part of them at pleasure.

Locke, 1690b, II.11.138

There is inherent contradiction in the idea that a government's primary function is the protection of property while at the same time it has the right to take it away, the citizen's agreement to which, by a voluntary alienation of rights, is at odds with his right to private property. Locke's predecessor, Thomas Hobbes, also felt that levying taxes was justifiable as the price of protection (see Jackson, 1973, pp. 176–177). However, the implicit tension in these concepts is something that remains with us to this day. The renowned thinker, Richard Epstein, in his examination of the US tax system from a Lockean viewpoint, also comments on this fundamental contradiction. Taxation is (1986, p. 49):

...the power to coerce other individuals to surrender their property *without* their consent. In a world – a Lockean world – in which liberty is regarded as good and coercion an evil, then taxation authorizes the sovereign to commit acts of aggression against the very citizens it is supposed to protect.

No government can exist without taxation – but taxation is 'institutionalized coercion'. The dilemma is 'how to preserve the power of taxation while curbing its abuse' (Epstein, 1986, p. 50). Locke, when read in context, was aware of this dilemma, hence his stress on the need to adhere to a majority decision, although this could mean that a sizeable minority might disagree. However, as Locke explicitly says (1690b, II.11.138, cited earlier), a legislative power cannot act wilfully or arbitrarily, so the power to tax must be regarded as limited. Taxation is justified as the means to provide benefits in return for surrender of individual rights.

Locke's comments in *The Second Treatise of Government* (1690b, II.11.140) are the only direct comments he makes about taxation, and, needless to say, have been the subject of much debate as to their exact meaning. What, for example, does he mean by 'estate'? The word is capable of several different interpretations, from the concept of what a person might own generally through to specific amounts of land – meanings which it still has today. This has led some to suggest that only landowners were envisaged by Locke as having to pay tax, rather than everyone, as the possession of land at this time conferred the right to vote (see Cohen, 1986, p. 301). However, in his pamphlet, *Some Consideration of the Consequences of the Lowering of Interest, and Raising the Value of Money* (1691), Locke does suggest that the 'publick charge' of government must be borne by landholders as merchants and labourers will not and cannot bear it (cited by Dome, 2004, p. 12, Note 6). Similarly, the use of the words 'proportion for the maintenance of it' ('it' being 'protection', by reference to the earlier part of the sentence) has caused debate. The use of 'proportion' inherently suggests some form of equity or fairness, which may or may not translate to progressive or proportionate taxes (in the modern sense of these terms – see Byrne, 1999), but the linking of the concept to the 'maintenance' of protection leaves the way open for debate on whether tax should be paid in relation to income/assets or on some consumption basis. At this remove in time, if Locke had precise intentions, we shall probably never be able to tie them down. However, it may be the case that he used words that would allow for the development of a tax system along one of several possible lines, and was doing no more than establishing a broad framework, with a philosophical underpinning, which would encompass this. As a political activist, Locke was aware of the innate power of words and did not acknowledge his authorship of *The Second Treatise of Government* during his lifetime, thinking it too dangerous to do so. It is not

unreasonable to suggest that the inherent potential for different interpretations of his words is therefore deliberate.

3 DAVID HUME AND THE DESTRUCTION OF SOCIAL CONTRACT THEORY

Not all theorists have accepted the concept of the social contract as the basis for civil government, even in theory. The destruction of ‘the Lockean concept of social contract theory’ (Werner, 1972, p. 439) is widely attributed to David Hume (1711–1776), another key Enlightenment thinker. Not all scholars accept social contract theory as a validation for the development of government, even as a useful theoretical device.

Governments have existed throughout recorded history, and all primitive societies today display at least a judicial system enforcing a customary law. Since, in known history, government of some sort has always existed, social contracts cannot have created governments and thus rights. In fact...the causal relation probably runs the other way: rulers themselves (legislatures, executives, judges) have generated property rights, hoping to encourage efficiency, and doubtless, also, to increase tax income.

Riker and Sened, 1991, p. 952

This opinion reflects David Hume’s, and subsequently Jeremy Bentham’s, rejection of social contract theory. Bentham (1748–1832) particularly rejected the idea of natural rights, the state of nature, and the social contract. His view was that men had always lived in society, so there could be no such thing as natural rights or a state of nature, such as Locke advocated, and so, no social contract. Such an idea would entail freedom from restraint, and from all legal restraint. As a natural right would have to come before any law, it could not be limited by law. For meaningful rights to exist implies that no one else can interfere with them, so they must be enforceable, which is the domain of the law (Molivas, 1999).⁵ The law protects the interest of the individual – and, by extension, his economic interest and his personal goods and property.

Hume spent some time (1734–1737) in France, and was for a time a friend of the social contract theorist, Jean Jacques Rousseau, for whom he provided sanctuary in England in 1766, although Rousseau accused Hume of conspiring to ruin his character (see Zaretsky and Scott, 2009). Hume’s world was different in many ways from Locke’s, especially in financial terms. Scotland had been involved in the disastrous Darien schemes, to set up colonies in the late 1690s on the Isthmus of Panama, which had lessened resistance to its formal political union with England in 1707, though there was still protest against this; there were the various Jacobite rebellions (1689–1692, 1715, 1719 and 1745); the South Sea Bubble had burst in 1720; the Bank of England had been established (1694) and the National Debt to fund Britain’s wars, notably the War of the Spanish Succession (1702–1713) and the War of the Austrian Succession (1740–1748) (see Dome, 2004, p. 1). This ‘Financial Revolution’⁶ was an alternative to raising money by taxes, but nonetheless required tax money to fund interest payments, which Hume felt was a burden on the populace. He wrote about this and the threats posed by public debt, including the possibility of public bankruptcy in his essay *Of Public Credit* (1742). Hume wrote extensively on moral and political philosophy, but it is very

⁵Bentham’s view was that tax could only be imposed by law (Bentham, 1793, 1794, 1795, 1798 and c. 1798: Bentham’s thoughts on the subject are spread across a number of different works (see Steintrager, 1977; and Dome, 1999)).

⁶This term is usually attributed to Dickson (1967).

difficult to unravel the sequence of his works and the development of his ideas, as he re-wrote and re-published major works under different titles and his thoughts on a particular subject may not be confined to a given work.

In his essay *Of the Original Contract* (1748), Hume argues that governments are founded by violence,⁷ not contractual agreement, rejecting Locke's theory of tacit consent. His essay considers the philosophical differences between the Tories and the Whigs on the origin of government and concurs with the Tory thinking that political power derives from divine right: the Whigs adopted Lockean theory. In the essay *Of the First Principles of Government* (1741), he suggests that protection of the public interest and of the rights to power and property are the basic reasons for the establishment of government, arguing in *Of the Origin of Government* (1777)⁸ that the objective of government is to maintain justice (see Kelly, 2003, p. 211).

There is thus in Hume's thinking no underpinning social contract theory to validate the imposition of taxes. What then can be the basis for the legitimate imposition of taxes? This presents a considerable theoretical and philosophical dilemma, not directly addressed by Hume. Dome (2004, p. 3) suggests that Hume, despite his concern about public debt, 'did not put forward an efficient system of taxation which could avoid national bankruptcy' and (p. 5) 'left to future generations the problem of how to establish a system of public finance compatible with liberal and commercial society'. There are some indications of his thinking, however, running through various works. From Book 3 of the *Treatise of Human Nature* (1739–1740) and from *An Inquiry Concerning the Principles of Morals* (1751), he contends that justice is an artificially derived concept aimed at protecting the ownership of property and the performance of promises, which it requires the authority of a government to enforce. Rules are invented to promote a peaceful society. Paying taxes thus may be seen as a civil duty in support of the type of society that is desirable.

However, *An Inquiry Concerning Human Understanding* (1748) might provide another basis. Although in this work Hume is concerned in part with how senses receive impressions and how ideas in accordance with these impressions link to a causal principle, he posits that there is no reality underlying these impressions. Werner (1972, p. 440) comments:

Reality can be found only in a continuously changing aggregate of feelings bound together by a psychological or social force known as custom. Custom thus replaces *a priori* reason as the subjective basis of beliefs about causation in external and human nature.

If one cannot develop a theory from first principles, as Locke does in *The Second Treatise of Government*, then one may be forced to accept things which exist (including taxation) because they have been come about as a result of custom – though this can be changed. Hume makes this clear in *Of the Original Contract* (1748, pp. 275–276).

When a new government is established, by whatever means, the people are commonly dissatisfied with it, and pay obedience more from fear and necessity, than from any idea of allegiance or of moral...Time, by degrees, removes all these difficulties, and accustoms the nation to regard, as their

⁷Because, for example, there was not enough of everything to go round.

⁸This work is generally dated 1777, which is after Hume's death, so it would appear to have been published posthumously.

lawful or native princes, that family, which, at first, they considered as usurpers or foreign conquerors.

He is aware, however, that not all customs are good ones, especially in regard to taxation.

The greatest abuses, which arise in France, the most perfect model of pure monarchy, proceed not from the number or weight of taxes, beyond what are to be met with in free countries; but from the expensive, unequal, arbitrary, and intricate method of levying them, by which the industry of the poor, especially of peasants and farmers, is, in great measure, discouraged, and agriculture rendered as beggarly and slavish employment.

Hume, *Of Civil Liberty*, 1741, p. 54

The ‘method of levying’ is clearly addressed by Smith’s four canons. Hume comments that the nobility too suffer as a result of this: estates are ruined, tenants beggared and only financiers gain.

If a prince or minister, therefore, should arise, endowed with sufficient discernment to know his own and the public interest, and with sufficient force of mind to break through ancient customs, we might expect to see these abuses remedied.

Hume, *Of Civil Liberty*, 1741, p. 54

Hume’s approach is strongly practical in many things, despite his standing as a philosopher. For example, in the essay *Of Taxes* (1752), he discusses how increased taxes may be dealt with by workers by increasing their labours, rather than by receiving higher wages, drawing a comparison with working in countries with harsh climates: workers must labour harder to overcome such a natural disadvantage. While Hume does not discuss taxation theory here, he does concede, however, that it is preferable to tax the consumption of luxury items, rather than the necessities of life, as people often have a choice about whether or not to buy luxury items. He disliked arbitrary taxes, in which class he put land taxes, disagreeing with Locke that all taxes would finally fall on land (see Dome, 2004, pp. 2–4).

4 SAMUEL JOHNSON

Samuel Johnson (1709–1784) is best remembered for his *Dictionary* (1755) (see Drabble, 1998, pp. 512–513), his *Lives of the English Poets*, James Boswell’s biography of him, and for his significant position as a man of letters in his own time. However, he wrote a number of other works, including four political pamphlets in the 1770s, of which two directly related to taxation, namely, *The Patriot* (1774) and *Taxation No Tyranny* (1775). These both concerned the vexed question of the day – American taxation and representation.

Johnson was a contemporary of Hume and lived through a period when Lockean social contract theory vied for dominance with Hume’s newer ideas, although social contract theory seemed to be on the wane. Intriguingly, Adam Smith when writing *An Inquiry into the Nature and Causes of the Wealth of Nations*, published in 1776, the year Hume died, uses the language of social contract theory to express his now famous four canons of taxation – despite being an acknowledged disciple of Hume. His use of language is

sufficiently careful, however, so that any allegation of utilising social contract theory could be refuted. Johnson had an option as to which ideas about taxation to follow: Locke or Hume. Despite the ideas of Hume, Locke's writings remained immensely influential – and Johnson utilises Locke's theory to defend England's right to impose tax on the American colonies.⁹ The significance of Johnson's use of Locke's theory is that he applies it to an actual situation.

That man, therefore, is no patriot, who justifies the ridiculous claims of American usurpation; who endeavours to deprive the nation of lawful authority over its own colonies, which were settled under English protection; were constituted by an English charter; and have been defended by English arms.

To suppose, that by sending out a colony, the nation established an independent power; that when, by indulgence and favour, emigrants are become rich, they shall not contribute to their own defence, but at their pleasure; and that they shall not be included, like millions of their fellow subjects, in the general system of representation; involves such an accumulations of absurdity, as nothing but the show of patriotism could palliate.

He that accepts protection stipulates obedience. We have always protected the Americans; we may, therefore, subject them to government.

Johnson, *The Patriot*, 1774, pp. 8–9

The idea of taxation being the price paid for state protection is explicitly stated, and thus the link to Locke's ideas could not be clearer. Johnson returns to the same theme in *Taxation No Tyranny*.

...[T]hey who flourish under the protection of our government, should contribute something towards its expense.

Johnson, *Taxation No Tyranny*, 1775, p. 2

A tax is a payment, exacted by authority, from part of the community, for the benefit of the whole. From whom, and in what proportion such payment shall be required, and to what uses it shall be applied, those only are to judge to whom government is intrusted. In the British dominions taxes are apportioned, levied and appropriated by the states assembled in parliament.

Of every empire, all the subordinate communities are liable to taxation, because they all share the benefits of government, and, therefore ought all to furnish their proportion of the expense.

Johnson, *Taxation No Tyranny*, 1775, p. 4

Johnson is applying the broad, over-arching framework outlined by Locke. For Johnson, the colonies are part of Britain, as an arm or leg is a part of a body and the

⁹Johnson was heavily influenced by Locke. For example, his *Dictionary* is influenced by Locke's *Essay Concerning Human Understanding* (see McLaverty, 1986). He derives the third meaning he gives under the word 'property' from Locke, though he does not attribute it to any specific work.

potential independence of America would be like (he says) Cornwall setting itself up as an independent country: unthinkable.

In *Taxation No Tyranny* (1775, p. 7) Johnson specifically refers to the Americans enjoying ‘security of property’, by the grace of English law. If the Americans accept law, they must accept all of it: they cannot pick and choose the laws they want and reject the ones they do not want – and ‘by a chain which cannot be broken’ must accept ‘the unwelcome necessity of submitting to taxation’ (*ibidem*, p. 9). Colonists were always ruled by the terms of the original charter: they were not in a ‘state of nature’ (*ibidem*, p. 9¹⁰) as were the native inhabitants. While they cannot vote for representatives in an English parliament, this has been their choice.

As man can be but in one place, at once, he cannot have the advantages of multiplied residence. He that will enjoy the brightness of sunshine, must quit the coolness of shade. He who goes voluntarily to America, cannot complain of losing what he leaves in Europe. He, perhaps, had a right to vote for a knight or burgess; by crossing the Atlantick, he has not nullified his right; but he has made its exertion no longer possible. By his own choice he has left a country, where he had a vote and little property, for another, where he has great property, but no vote.

Johnson, *Taxation No Tyranny*, 1775, p. 10

They have not, by abandoning their part of one legislature, obtained the power of constituting another, exclusive and independent, any more than the multitudes, who are now debarred from voting, have a right to erect a separate parliament for themselves.

Johnson, *Taxation No Tyranny*, 1775, p. 11

Although Johnson does not add anything new in terms of ideas about taxation, he does show how a practical, real taxation issue can be addressed in Lockean terms. This is a very rare example of theory of this kind being applied in practice. The root question, really, is the point at which a colony becomes an independent state.

5 CONCLUSION

In examining the tax ideology of Locke and Hume, we see two different sets of ideas coming into play. The theoretical underpinning of Locke’s social contract theory provided a broad, over-arching framework fundamental to the imposition of taxes, which the American jurist, Oliver Wendell Holmes,¹¹ succinctly summed up as the price we pay for ‘civilized society’. This idea permeates modern society as well, in the notion that people should be prepared to pay taxes to fund society’s provision of benefits, whether they be law and order for the protection of property, as in Locke’s day, or modern day social services to support the less advantaged members of society. The over-arching theoretical framework also allowed Johnson to argue rationally for the retention of the American colonies under British rule: Britain protected them, *ergo* the colonies should pay tax and Britain had the right to impose it. There is a twofold wider resonance for today, first in the particular consideration of the fiscal elements a potential

¹⁰ A direct reference to Locke’s *Second Treatise of Government*, in which Locke refers a number of times to America and its native peoples as illustrative examples of the points he makes (see Lebovics, 1986).

¹¹ *Compania General De Tabacos De Filipinas v. Collector of Internal Revenue*, 275 US 87, 1904.

breakaway state might retain from being part of a larger political body, which is currently relevant to Scotland, whether starting or not ‘from scratch’. It might even be argued that there would be a reversion to a ‘state of nature’, in that the country would be recreated by descendants (in part, at least) of its original inhabitants. The second resonance is in the concentration on underlying tax principles, which is found in more modern documents critical of current taxes and the tax system (see especially Murphy, 2007, p. 9), rather than on several tenets ‘which relate primarily to the practice of taxation rather than the principles that underpin it’. The debate of principles over practice has regained dominance in recent years in discussions about whether the UK should have a general anti-avoidance (or anti-abuse) rule and is reflected in the calls to eschew avoidance schemes.

However, one cannot ignore practical matters. If individuals adopt the principle that they should pay tax, they also need to know how much to pay, so idealism needs to be tempered by practicality. While Hume was critical of the taxes of his day and of social contract theory, he did not propose any particular reforms or an ideology. It would have been impossible for Johnson to have defended Britain keeping the American colonies on the basis of any of Hume’s ideals, as there was no coherent underpinning theory. Hume lived at a time when England and Scotland were dealing with the practical difficulties of melding together the English and Scottish fiscal systems after the Union in 1707. It may be no coincidence that four of the leading political economists of the Enlightenment (Hume, Adam Smith, Sir James Steuart and Lord Kames¹²) were also Scottish. For Hume, it would, perhaps, have been difficult to imagine starting from first principles in order to bind together two systems, which had developed with varying degrees of complexity since the political ‘re-start’ of 1688: one had to live with what existed, and change it if one could. This situation resonates today. The UK tax system has become still more complex since the seventeenth and eighteenth centuries, and its tax legislation is one of the most voluminous in the world. We would not lightly contemplate sweeping away completely the existing taxation structure and replacing it with something entirely new. Innovation remains possible but, because of existing complexities, is better introduced by gradual implementation in accordance with an underlying policy or principle.

¹²Considerations of space preclude consideration here of Steuart’s and Kames’s writing about tax, but these would have been known to Hume and would have influenced him.

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Taxation in Australia up until 1914: the warp and weft of protectionism

Caroline Dick*

Abstract

This article offers an account of the taxing policies in Australia from 1788 up until the beginning of World War I, when the exigencies of the First World War forced the Australian government to reassess its tax policies. During the period from 1788 until 1914, Australia transitioned from being a collection of provincial colonies with their own economic objectives and taxing policies to a Federation with a centrally-directed taxing authority. Whilst this political transition was taking place there was also a transition occurring in government policy concerning the function of taxation in Australia.

Government no longer used taxation just for revenue-raising but began to use it more as an intrusive tool to modify the private behaviour of Australians to reflect its own economic policy of protectionism. As a result, a strong symbiotic relationship developed between taxation and protectionism and, by the end of the first decade after Federation, Australia had become almost uniformly Protectionist.

This article argues that at the same time taxation was taking on this decidedly protectionist character, the Federal government's policy of imposing high tariffs on apparel began, especially in the first three decades after Federation, to markedly resemble what Alan Hunt calls "a project" of sumptuary regulation. This meant that the Government, in effect, controlled what type and quality of clothing certain classes of people could wear.

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1 INTRODUCTION

The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to the natural man. It is not only the power to destroy, but the power to keep alive.¹

This article offers an account of the taxing policies in Australia from 1788 up until the beginning of World War I, when the exigencies of the First World War forced the Australian government to reassess its tax policies. During the period from 1788 until 1914, Australia transitioned from being a collection of provincial colonies with their own economic objectives and taxing policies to a Federation with centrally-directed taxing authority. Whilst this political transition was taking place there was also a transition occurring in government policy concerning the function of taxation in Australia. Government no longer used taxation just for revenue-raising but began to use it more as an intrusive tool to modify the private behaviour of Australians to reflect its own economic policy of protectionism. As a result, a strong symbiotic relationship developed between taxation and protectionism and, by the end of the first decade after Federation, Australia had become almost uniformly Protectionist.

This article argues that at the same time taxation was taking on this decidedly protectionist character, the Federal government's policy of imposing high tariffs on apparel began to markedly resemble what Alan Hunt calls 'a project'² of sumptuary regulation. This meant that the Australian Government, in effect, controlled what type and quality of clothing that certain classes of people could wear.

Following on from the introduction in Part 1 the second part of the article looks at the main source of taxation in the early Australian colonies. It also argues that at the time of the first white settlement there were some commonalities between these early colonial taxes and sumptuary regulation. Part 3 begins by providing some background to the taxation regime which came to be introduced at Federation. This part also suggests that the form of protectionism which developed in the first three decades after Federation had its roots in the colonial taxing policies implemented in the first three decades of white colonial settlement in Australia.

Part 4 describes the move from an Imperial-administered colonial taxing regime to one where the colonial governor was in a position to impose local customs duties. It shows that it was not until each colony had its own representative government that it was in the position to implement its own taxation policy. Part 5 briefly explores how the original revenue-raising role of taxation in the colonies morphed into a combined fiscal and protective device which was then used by colonial governments to promote their social and economic objectives. Further, this part will also show that protectionist duties provoked a spirit of provincialism in the colonies which eventually became one of the main motivating factors behind the move towards Federation, which, it was hoped, would solve inter-colonial trade disputes.³

Part 6 deals with the shift of taxing powers from the colonies to the Federal Government. It details the emergence of a centrally-directed taxing regime which sought to provide

¹ Quoted by Isaacs J, in *The King v Barger*, (1908) 6 CLR 41.

² Alan Hunt, *Governance of the Consuming Passions: A History of Sumptuary Law* (MacMillan Press Ltd, 1996).

³ A J Reitsma, *Trade Protection in Australia* (University of Queensland University Press, 1960) 11.

funds to the States and to provide for the costs of the Federal Government. This part also illustrates that although most of the revenue collected during the first two decades after Federation came from customs and excise, these same duties had also quickly become highly protectionist in character. Part 7 examines the second Deakin government's attempt to attract labour supporters to its protectionist ideology by linking protection with the provision of 'fair and reasonable wages' for workers. Part 8 attempts to proffer some explanations why, by the end of the first decade after Federation, Australian politicians began to take on a more uniform approach to protectionism. This part also provides a brief sketch of the political discourse which was not only preoccupied with the potential effects of protection, but which also had adopted a more pro-protectionist advocacy and fervour. Part 9 briefly describes how government continued to increase tariffs on clothing after the failure of the 'New Protection' to link protection with 'fair and reasonable wages'. It also provides an overview of the functions of the Inter-State Commission which the Federal government established as part of its continued experimentation with trade protection.

2 THE NATURE OF EARLY COLONIAL TAXES-A FAINT SUMPTUARY PATTERN

This was the state of things in England at the time of the first settlement in Australia.⁴

Australia's earliest⁵ colonial taxes on spirits, wine and beers,⁶ were 'indirect' consumption taxes and took the form of customs⁷ and excise duties. The fact that taxation took this form in the Australian colonies was not an unusual phenomenon. By the time of white colonization in Australia, most countries and colonies had taxation which tended to be indirect.⁸ In 1925, when Mills published his iconic *Taxation in Australia*, these types of indirect taxes⁹ were continuing to provide the largest single item of revenue for the Commonwealth of Australia.¹⁰ Mills argues that the introduction of this type of 'impost'¹¹ during the early stages in the history of maritime countries such as Australia is '*a priori* probable'¹² because it was commonly the first form of taxation levied by a young community. This type of taxation historically also often reflected the need for royal or State protection in light of the real risks from piracy¹³

⁴ Stephen Mills, *Taxation in Australia* (MacMillan and Co., Limited, 1925) 11.

⁵ Mills, above, n 4, 24. Mills states that in 1791 Governor Phillip suggested the imposition of a duty on spirits; which the King afterwards imposed.

⁶ Mills, above n 4, 22.

⁷ Mills, above n 4, 4-6. Although Customs (*portoria*) existed at the time of ancient kings of Rome, it was during the reign of Augustus and his successors when the trade in riches and exotic merchandise from Syracuse, Carthage, Macedonia and Asia increased enormously, that customs and excise duties were then imposed on every kind of imported and exported goods. These same types of taxes were maintained in the British Isles after the Romans departed. It was commonplace for the English sovereign to impose import duties on luxuries including textiles such as lace, silk and scarlet and other dyed cloth, as well as export duties on items such as wool and leather.

⁸ Woellner, Barkoczy, Murphy, Evans and Pinto, *2012 Australian Taxation Law* (CCH, 22nd ed, 2012) 1-040. It is suggested by the authors that by 1755 such taxes provided 82% of total English revenue. It is also suggested that the reason why there was the lack of any real broad-based system of taxation was the lack of the administrative infrastructure and expertise necessary for the efficient control of this type of tax system.

⁹ Mills, above n 4, 3. Mills suggests these types of taxes had their roots in Roman and Medieval English taxing policy.

¹⁰ Mills, above n 4, 3.

¹¹ Mills, above n 4, 5.

¹² Mills, above n 4, 5.

¹³ Mills, above n 4, 5.

which importers and merchants faced with the transit of precious and rare merchandise, such as wine, wax and cloth.¹⁴ This explanation hints at an interesting parallel between these early types of taxes¹⁵ in Australia and early or pre-industrial sumptuary laws which prescribed how individuals and classes of people could spend their income, particularly on food consumption and extravagant and ‘unnecessary’ fashionable clothing. Both types of legislation depended to a large extent on the economic control and security of maritime spaces and territorial borders. This meant that it was often necessary, when protecting local industry, to regulate the ingress and egress of foreign domestic necessities and luxuries.¹⁶

There are a number of other commonalities between these early Australian colonial customs duties and sumptuary laws. Both were consumption-based and involved restrictions on the expenditure on dress, food and other items of consumption. They were also both based on a plethora of *ad hoc* and often inconsistent legislation and regulations.

At the time of the first white settlement in Australia, not only was the management and collection of customs revenue subjected to ‘incredible abuses’¹⁷ but ‘[t]he Statute Book was crammed with innumerable Acts relating to the Customs, overlapping, chaotic, unintelligible.’¹⁸ Mills suggests that it was this jungle of legislation, concerning the imposition and collection of Customs duties, which formed the basis of the tax system applicable at this time in Australia.¹⁹

3 COLONIAL TAXING POLICY, 1788-1819 - THERE WAS LITTLE NEED FOR TAXATION

Isolation begat provincialism, provincialism begat protection, and protection begat colonial envy, bitterness, and strife.²⁰

For many decades, the colonies’ taxing policies were motivated by the need to raise revenue to supplement those often meagre funds which were provided by England to establish and maintain both a penal colony and a free settlement in a land which was not only isolated by vast distance from ‘the homeland’ but which also lacked any of those comforts and industries found at the time in England.²¹ During this period, the British government provided food and clothing for most of the convicts, their guards, some civilians and Aborigines.²² Some taxes, in the form of customs (tariffs) and excise duties, were also raised by the colony’s administrators to ostensibly supplement the official stipend which was aimed at mere subsistence husbandry.²³ It was expected that this stipend would continue to be provided by the British Government until such a time that each colony, with its cheap prison labour, could ‘keep itself’.²⁴ In fact, until 1824,

¹⁴ Mills, above n 4, 5.

¹⁵ Mills, above n 4, 8. Customs duties were at various times called ‘Aliens Duty’.

¹⁶ Mills, above n 4, 8.

¹⁷ Mills, above n 4, 10.

¹⁸ Mills, above n 4, 10. According to Mills there were 1300 laws of Customs passed between the first and fifty-third years of the reign of George III.

¹⁹ Mills, above n 4, 10.

²⁰ C D Allin, *A History of the Tariff Relations of the Australian Colonies* (Bulletin of the University of Minnesota, 1918)171.

²¹ Margaret Maynard, *Fashioned from Penury: Dress as Cultural Practice in Colonial Australia* (Cambridge University Press, 1994) 28.

²² Maynard, above n 21, 27.

²³ W K Hancock, *Australia* (Ernest Benn Limited, 1930) 11.

²⁴ Hancock, above n 23, 11.

public expenses for the Colony of New South Wales consisted chiefly of expenditure connected with the support and management of British convicts²⁵ and were borne almost entirely by the 'Imperial Government.'²⁶

This form of financial assistance helped to shore up both Britain's need to establish and maintain colonies in which it could relocate surplus convicts²⁷ or 'human riffraff'. It also allowed her to continue to carve out colonial outposts where resources, both human and natural, could be regulated and turned to an advantage in building up the expanding Imperial Empire.²⁸ Britain not only 'owned' the new colonies and all their natural resources, but the Imperial government deemed itself to be in the best position to minutely regulate and guide the activities of all British colonial subjects. At the same time, it maintained public order and established a clearly defined hierarchical social order. During the transportation period, for instance, the British government regulated what clothing which most inhabitants could wear.²⁹ Early convicts were in most part identifiable by a uniform which was made distinctive by a coloured stripe.³⁰

This form of paternalism,³¹ where the Imperial Government was the universal provider, also created a widespread dependency which discouraged local enterprise and eventually fostered strong reliance on cheap ready-made imported clothing and accessories, particularly those of British origin.³² The flood of ready-made clothing into the colonies not only became a boon to British manufacturing, but also provided colonial governments with an opportunity to alleviate economic insecurity by raising substantial revenue on such imported clothing.³³ These social and economic bonds and associations with Britain and the indefatigable crossing and recrossing of the oceans from one hemisphere to another in the transportation of convicts, government officials, free settlers and merchandise continued to ensure that there was a constant flow of goods which would attract customs and excise duties; particularly imported clothing and exported materials such as wool.³⁴ After the 1790s, there was also a vigorous private trade in fabric, leather, sewing accessories and low-cost readymade clothing for men and women³⁵ with British colonies, including India.³⁶ Not only did these goods supplement the supply of British made clothing but it also meant more money for the colonies' coffers.

However, the collection practices and value of these taxes were nothing more than an *ad hoc* exercise during a period when the Colonies' administrators had to deal with

²⁵ Mills, above n 4, 26.

²⁶ Mills, above n 4, 26.

²⁷ Mills, above n 4, 20.

²⁸ Maynard, above n 21, 10.

²⁹ Maynard, above n 21, 10.

³⁰ Maynard, above n 21, 14.

³¹ Maynard, above n 21, 27; Commonwealth, *Parliamentary Debates*, House of Representatives, 30 May 1901, 0015, (Mr McColl). It is interesting to note that whilst Maynard refers to this type of economic protectiveness as a male-gendered 'paternalism', the connection between Britain and the Australian colonies and later the Federation of Australia was always discussed in nostalgic maternal language such as 'the Mother Country' or 'the Motherland'. Germans on the other hand refer to their homeland as 'the Fatherland'.

³² Mills, above n 4, 26-27.

³³ Maynard, above n 21, 27.

³⁴ Reitsma, above n 3, 2. For example, there was, according to Governor King (who initiated the tariff system in New South Wales) a 5% duty on 'all wares and merchandise brought from any port to the east-west of the Cape'.

³⁵ Maynard, above n 21, 27.

³⁶ Maynard, above n 21, 27.

many exigencies: an uncertain economy, a disinterested British government, unrest and dissatisfaction of prisoners and settlers, the irregularity of shipments and the lack of local industries and businesses.³⁷ Harris suggests that the Colonies ‘did not have a great need for revenue during the first half of the 19th Century’.³⁸ Whilst most of the costs of transportations and the establishment and running of the penal settlements were borne during this period by the Imperial Governments, through the raising of funds from the London markets and the sale of public land to free settlers, local tax collection in the colonies was still significant. Not only did the added revenue help fill some of the gaps not covered by these fiscal procedures but it could be argued that this type of taxation became the foundation stone upon which the colonial tax regime and later the early Federal tax systems were built.

4 COLONIAL TAXING POLICY, 1819-1859 - A MOVE TOWARDS THE FORMALISATION OF TAXATION POLICY IN THE AUSTRALIAN COLONIES

In 1819 the affairs of New South Wales received more than the usual amount of attention and publicity in England.³⁹

In 1819, the British Parliament legalised⁴⁰ the collection of duties. The New South Wales Governor was thus authorised to impose customs duties of 10 shillings per gallon upon British spirits or British West Indian rum shipped from Britain; of 15 shillings upon foreign spirits; of 4 shillings per pound on tobacco and 15 per centum *ad valorem* duties upon non-British manufactures and upon the importation of all goods, wares and merchandise not being the growth, produce, or manufacture of the United Kingdom.⁴¹ The first steps in establishing representative government were made with the passing of a British Act⁴² in 1823, and whilst the legislators envisaged a colonial constitution and court system for New South Wales and Van Diemen’s Land, they did not consider expanding the colonial taxing powers.⁴³

The colonial parliaments could only levy taxes or duties ‘as it may be necessary to levy for local purposes.’⁴⁴ Notwithstanding, these limited colonial taxes and duties, which were mostly on imports of alcohol and luxuries,⁴⁵ became very profitable and the revenue raised by import duties increased from £28,763 in 1824 to £195,080 in 1840.⁴⁶ By 1850, the European population in the colonies was less than half a million⁴⁷ and most of the tradeable goods were connected with primary production, whilst most manufactured articles, including clothing, were imported mainly from Britain.⁴⁸ By 1858-1859 the population in the colonies had increased to one million⁴⁹ and there was a very noticeable growth in the market for imported clothing and other domestic goods

³⁷ Maynard, above n 21, 27-32.

³⁸ Peter Harris, *Metamorphosis of the Australian Income Tax: 1866 to 1922* (Australian Research Foundation, Research Study No. 37, 2002) 201.

³⁹ Mills, above n 4, 29.

⁴⁰ Act 59 Geo. III., c.114.

⁴¹ Mills, above n 4, 29.

⁴² Act 4 Geo. IV., c. 96.

⁴³ Mills, above n 4, 29.

⁴⁴ Mills, above n 4, 31.

⁴⁵ K Anderson and R Garnaut, *Australian Protectionism: Extent, Causes and Effects* (Allen & Unwin, 1987) 40-41.

⁴⁶ Anderson and Garnaut, above n 45, 41.

⁴⁷ Anderson and Garnaut, above n 45, 40.

⁴⁸ Anderson and Garnaut, above n 45, 40-41.

⁴⁹ Commonwealth, *Australian Bureau of Statistics Yearbook Australia*, 2001, 2.

and luxuries.⁵⁰ This growth in imported items reflected the period of rising trade and the increase in economic prosperity of the colonies and the spending capacity of their populations. In New South Wales, for instance, the total amount of imported British-made clothing more than quadrupled between 1848 and 1853⁵¹ and much of the colony's prosperity was generated by the rapid growth in exports of primary-produced tradeable goods.⁵² There was also an enormous spike in the demand for imported clothing during the gold-rush period when 'a rising population of prosperous consumers'⁵³ spent their newly found wealth on all sorts of imported luxurious and superior ready-made fashion apparel, even though these goods attracted high customs duties.⁵⁴ This rapid growth in exports and the dramatic increase in disposable income in this period also soon resulted in a rapid expansion of banking and commerce.⁵⁵

Colonial tariff policies continued to be controlled by 'the Mother Country' until self-government was granted to five of the six Australian colonies between 1855 and 1859.⁵⁶ From then on, and in a relatively short period, these colonies, albeit in different degrees, began to achieve some economic and political independence. In 1850 the *Australian Colonies Government Act, 1850* (Imp)⁵⁷ was passed and provided for the formation of government in New South Wales, Van Diemen's Land, South Australia, and to Victoria as a colony separate from New South Wales. The Act also provided for future application to Western Australia.⁵⁸ New South Wales and Victoria subsequently achieved responsible government in 1855; Tasmania in 1856; and Queensland, which separated from New South Wales, in 1859. It was not until 1890 that Western Australia achieved responsible government.⁵⁹

There was a high degree of economic and political tension and competition⁶⁰ between these newly formed colonies and their governments and Allin suggests that the history of the tariff relations between them can be read as 'a sorry record of inter-colonial jealousy and strife.'⁶¹ One of the burning political issues in the colonies before Federation was centred on the fact that each of the colonies raised their revenue by not only imposing taxes on overseas imports but also on inter-colonial traded goods,⁶² it

⁵⁰ Maynard, above n 21, 122.

⁵¹ Maynard, above n 21, 122. According to the Australian Bureau of Statistics the population increased to two million in 1877.

⁵² Anderson and Garnaut, above n 45, 40. The Australian Bureau of Statistics (2009-10 Yearbook) states that the value of gold exports surpassed wool exports as Australia's major export during the 1850's and 1860's.

⁵³ Maynard, above n 21, 122.

⁵⁴ Maynard, above n 21, 122.

⁵⁵ Commonwealth, Australian Bureau of Statistics, *Year Book Australia, 2009-10*, 1.

⁵⁶ Anderson and Garnaut, above n 45, 40.

⁵⁷ Act 13 & 14 Vict. Cap 59.

⁵⁸ Reitsma, above n 3, 5.

⁵⁹ Reitsma, above n 3, 5. For each separate colony the English Parliament passed a 'constitution' act which gave each colony some measure of independence and self-government. However, the Colonial Office in London retained control over foreign affairs, defence and international shipping. Sections 2 and 3 of the *Colonial Law Validity Act, 1865* (Imp) defined the relationship between the 'colonial' and 'imperial' legislation and gave the colonies the right to amend their own constitutions and the opportunity for them to enact legislation without necessarily applying English domestic law, provided that no English statute directly applied to the colony in question.

⁶⁰ Allin, above n 20, 1.

⁶¹ Allin, above n 20, 1.

⁶² Allin, above n 20, 1.

was their most 'elastic and most important source of revenue.'⁶³ The colonies, with their pre-federation rivalries had 'scattered Customs houses along their land frontiers.'⁶⁴ However, the great difficulty in the fifteen years prior to Federation was 'in working out exactly what would be the fair way(sic) and sustainable way'⁶⁵ to return revenue to the States once a future federal government acquired the sole power to impose customs and excise duties. Despite the passing of the *Australian Colonies Government Act 1850* (Imp), the colonies were slow in taking on national status. Not only were they 'small, isolated communities in the pioneer stage of social and political organization'⁶⁶ but each colony was oblivious to what was going on in 'the contiguous but far distant communities.'⁶⁷ Each colony was only focused on the development of its own resources and to the furtherance of their own immediate political and economic interests.⁶⁸ Their efforts were without the support of the British Parliament, which only took a spasmodic interest in the affairs of the distant colonies. Besides, the colonial office was 'to ill-informed to be able to supervise the policy of administration of the struggling settlements.'⁶⁹

As the colonies became more economically self-reliant and idiosyncratic in their economic ideologies they also began to develop even more divergent social, political and economic policies and rivalries. For instance, the two major colonies, Victoria and New South Wales, had, for various reasons,⁷⁰ adopted radically different commercial and revenue policies. New South Wales had a steadfast adherence to Free Trade which was largely supported by the sale of public land,⁷¹ whilst Victoria exhibited a 'doctrinal fervour'⁷² for the theory of Protection.⁷³ Whereas New South Wales' consistent adherence to Free Trade policy was largely motivated by Sir Henry Parkes, who was 'for a long period was the most striking figure'⁷⁴ in Australia's political life, Victoria's obsessive stance on Protection, which resulted in very high tariffs, was fuelled by 'the

⁶³ Sir George Turner, Commonwealth Treasurer, *First Commonwealth Budget*. Parl. Debates, 1901, 5 673 et seq.

⁶⁴ Hancock, above n 23, 76.

⁶⁵ J Smith and N Warren, *Plucking the goose: a history of taxation in Australia*. ABC Rear Vision on ABC Radio National, 17 June, 2007, 2.

⁶⁶ Allin, above n 20, 1.

⁶⁷ Allin, above n 20, 1.

⁶⁸ Mills, above n 4, 20-199.

⁶⁹ Allin, above n 20, 5.

⁷⁰ F S Alford, *The Greater Illusion: A Critical Review of Australia's Fiscal Policy* (Marchant & Co. Ltd, 1934) 23.

Alford suggests that the reasons why Victoria turned shapely towards Protection after 1860 were that there was sharp decline in the output of gold which fell by one-half between 1856 and 1866; unemployment grew to a disturbing extent and the outlook for the Colony became grave. At the time David Syme (The Age) entered into a powerful advocacy of the adoption of a protective policy to enable industries to provide employment.

⁷¹ Harris, above n 38, 166.

⁷² Mills, above n 4, 201.

⁷³ Fred Perry, 'The Australian Tariff Experiment', *The Quarterly Journal of Economics*, 3, No 1 (October 1888) 92. Perry states that the number employed in woollen industry in Victoria (1886-1888) was considerably larger than in New South Wales. However, Victoria had not at that stage made the manufacture of woollens profitable. The Victorian industry was protected by duties ranging from 7.5% to 30%, whilst New South Wales woollen industry had no protection at this time. The manufacture of boots and shoes was also protected in Victoria.

⁷⁴ Mills, above n 4, 202. Mills argues that the 'phenomenon of Free Trade in one Colony among six, five of which had adopted Protection as their fiscal policy...is not readily explained.' He asserts that one cause of this phenomenon was that 'the spirit of Free trade was incarnate in the person of Sir Henry Parkes.'

continuous and passionate advocacy⁷⁵ of David Syme.⁷⁶ As the proprietor⁷⁷ of the Melbourne morning journal (*The Age*), he exercised powerful influence over local politics.⁷⁸ All these factors prompted, as between the colonies, the creation of contrary self-referential interests and conflicting fiscal legislation.⁷⁹ Each colony framed its taxing legislation with an aim to foster its own particular economic and social needs, with little regard to the interests of the other colonies.⁸⁰ This meant that each colony adopted ‘the easiest and readiest means of taxation without regard to economic principles.’⁸¹ Consequently, this individualistic type of economic and financial policy throughout the colonies laid the groundwork for economic discrimination in the form of a variety of inter-colonial differential and preferential tariffs.

5 COLONIAL TAXING POLICY, 1860-1900 - THE BEGINNING OF ‘A STRONG SYMBIOTIC RELATIONSHIP’ BETWEEN TAXATION AND PROTECTIONISM⁸²

It is true that a considerable number of Customs duties aim openly at revenue, but there is also an unmeasured and a very large return to the Treasury from duties which are intentionally, though clumsily, Protectionist.⁸³

Before the 1860s, colonial duties were ‘nearly always mainly for purposes of revenue’⁸⁴ and whilst protective motives were not always absent, Reitsma argues that it would go too far to say that the infant colonies had established any commercial policy at all at that stage, particularly in relation to a preference for free trade or a structured tariff regime.⁸⁵ By the latter part of the 1800s this position had obviously changed substantially, for in 1883, Richard Twopeny,⁸⁶ whilst visiting the various colonies, makes the observation that ‘[p]rotectionist duties and heavy freights form an effectual sumptuary tax’ resulting in ‘first-class articles’ being ‘heavily handicapped’ and ‘a premium put upon the importation of shoddy.’^{87, 88}

⁷⁵ Mills, above n 4, 202.

⁷⁶ David H Plowman, ‘Industrial Relations and the Legacy of New Protection’ (1992) 34 *Journal of Industrial Relations*, 50. Plowman suggests that Syme was Deakin’s mentor and saw the state as an instrument of social change.

⁷⁷ Mills, above n 4. Mills says that Syme was ‘a man of strongly marked personality’.

⁷⁸ Mills, above n 4, 202; Alford, above n 73, 24. It is interesting that Syme, in his argument for a high enough tariff to enable Victorian manufacturers to pay workers a ‘fair, living wage’, foreshadowed the introduction of ‘New Protection’ and Justice Higgins’ basic wage determinations which are both discussed later in this article.

⁷⁹ Allin, above n 20, 5.

⁸⁰ Allin, above n 20, 5.

⁸¹ Allin, above n 20, 5.

⁸² This heading is a play on Hunt’s statement. He says that since 14th century ‘sumptuary regulation had existed in a close symbiotic relationship with protectionism’. See Hunt, above n 2, 324.

⁸³ Hancock, above n 23, 90.

⁸⁴ Reitsma, above n 3, 1.

⁸⁵ Reitsma, above n 3, 5-6. Reitsma argues that until the middle of the eighteen-sixties the various tariffs in the colonies were all free-trade tariffs. The local merchants favoured a simple revenue tariff because of its administrative advantages. Protection was not an issue for these merchants because they relied on imported goods rather than locally produced goods.

⁸⁶ R Twopeny, *Town Life in Australia* (Penguin Colonial Facsimiles, 1983) 110. Twopeny was the son of a South Australian archdeacon and was the editor of his own journal, the *Pastoral Review*. It seems that Twopeny wrote a number of letters for publication in an English periodical. His book *Town Life in Australia* is the unauthorised collection of these letters.

⁸⁷ Poor quality items; often where wool is adulterated with cheap cotton materials.

⁸⁸ Twopeny, above n 86, 110.

Just as sumptuary regulation from its earliest inception in the fourteenth century had existed in a ‘close symbiotic relationship with protectionism’,⁸⁹ in Twopeny’s remark we see the same development of a close symbiotic relationship in Australia between taxation tariffs and protectionism. And just as the discourse of ‘sumptuarism’⁹⁰ later became integrated within, and then submerged within the discourse of protectionism we can see the same integration and submersion of tariff discourse within the discourse of protectionism. It is also at this time that we begin to see within these protective policies the threads of the sumptuary impulse which were woven into the protective economic blanket which the Federal Government wrapped around clothing manufacturing industries in the 1920s.

From the 1880s Australian manufacturers and primary producers faced heavy competition from the massive increase in all forms of imported goods from Britain and Europe.⁹¹ The first ostensible protectionist tariff introduced⁹² in the colonies was presented to the Victorian Assembly in 1865 with the objective⁹³ of protecting new industries and overcoming the problem of expensive, but poorly made imported goods⁹⁴ being ‘dumped’⁹⁵ on the Victorian market.⁹⁶ Reitsma suggests that the relentless force behind protectionism, particularly in Victoria, was the ‘newspaper dictator’ and ardent Protectionist, David Syme.⁹⁷ Even though protection had a popular following in Victoria, colonies such as New South Wales continued to embrace free trade which ‘fitted in with pastoral and financial opinion’⁹⁸ in the colony. These diverging policies contributed significantly to ‘the inter-colonial custom troubles that characterized the period’⁹⁹ and the often difficult debates plaguing the introduction of Federation.

⁸⁹ Hunt, above n 2, 324.

⁹⁰ Hunt, above n 2, 325. This is Hunt’s term.

⁹¹ See Maynard, above n 21, 122. This competition continued well into the 1930s.

⁹² Dorothy P. Clarke, ‘The colonial office and the constitutional crises in Victoria, 1865-68’, *Historical Studies: Australia and New Zealand* 5:18, 160-171. The *Tariff Bill* was attached to the annual *Appropriation Bill*. This mixed Bill was rejected by the Legislative Council (by ‘laying it aside’) on the basis that the Bill for raising revenue should not be ‘tacked’ onto the Bill for the appropriation of this revenue. This issue caused an enormous amount of controversy about the legality and constitutionality of this practice of tacking.

⁹³ Perry, above n 73, 86. Perry argues that ‘[t]he protective system is intended specially to diminish importation, and is also expected to prevent money from going out of the country.’ These objectives are inherently sumptuary in nature.

⁹⁴ E O Shann, *An Economic History of Australia* (Cambridge University Press, 1948) 266. Shann states that such goods included apparel, textiles, boots, saddler and earthenware.

⁹⁵ Geoffrey Sawer, *Australian Federal Politics and Law 1901-1921* (Melbourne University Press, 1956) 42. Sawer says that manufacturers were constantly lobbying Parliament about the practice of ‘dumping’ goods on the Australian market to the detriment of Australian-produced goods. In response, the *Australian Industries Preservation Act 1906* (Cth) was enacted to penalise those who engaged in this practice. Often the ‘dumped’ goods were poorly made clothing lines (sometimes called shoddy) which were being produced in other countries, particularly Britain and Japan, at cost far less than Australian manufacturers could achieve.

⁹⁶ Reitsma, above n 3, 9. At the general election held in the colony of Victoria in November 1864, the McCulloch ministry was returned to power. On his campaign platform he had pledged a policy of protection to native industry.

⁹⁷ Reitsma, above n 3, 7. Reitsma even goes so far as to call him the ‘father of protectionism’. He continued to exercise his political power through his newspaper, ‘The Age’ for the remainder of the century and until his death in 1908.

⁹⁸ Reitsma, above n 3, 9. Much of the impetus for the protective tariff in the colony of Victoria came from Syme, who argued that the ‘naked competition’ of free trade meant that manufacturer were prevented from making a beginning ‘of opening up new sources of industry’ in Victoria. See Shann, above n 312, 265.

⁹⁹ Reitsma, above n 3, 10.

By the end of the nineteenth century each of the six colonies had distinct tax systems which were almost entirely reliant on customs and excise duties.¹⁰⁰ Not only did Customs duties or tariffs underpin the newly emerging colonial economies, but they also acted as effective barriers against overseas imported goods and trade barriers between the colonies.¹⁰¹ Reinhardt and Steel¹⁰² suggests that one of the ‘significant results of Federation in 1901’ was the removal of all duties on goods traded between Australia states.¹⁰³ Federation was to be used as an effective apparatus of economic intervention to relieve the colonial governments’ intense rivalry and provincialism whilst at the same time providing a new paradigm of power relationships between the colonies.

Although, as previously mentioned, each colony initially framed their tariffs primarily for revenue purposes, gradually protective characteristics became more pronounced.¹⁰⁴ Despite enormous protests from their ‘sister colonies’ about the ‘growing evil of inter-colonial duties’¹⁰⁵ and the passing of hostile, retaliating or ‘tit-for-tat’ legislation, each colony went on its merry way in exacting, often complicated inter-colonial duties as a ‘necessary’ measure for the protection of their local industries. For instance, even though South Australia was mainly dependant on primary industry and strongly in favour of inter-colonial free trade, the colony still remained protective of its clothing and woollen industries.¹⁰⁶ The result was this ‘strange melange of tariff anomalies’ which completely ignored the ‘general welfare of the Australian group and the empire.’¹⁰⁷ It would be many decades, and much political lobbying and vitriolic debates before Federation finally settled the question of inter-colonial tariffs.

It has also been argued¹⁰⁸ that the very isolation of the colonies engendered the spirit of provincialism. Not only were the colonies cut off from the outside world by ‘both time and space’, they had no external relations and no more than a passive interest in what was happening in Europe for they ‘lived in a little world of their own, a world with a distinct set of interests and problems from those of Europe or America.’¹⁰⁹ Even their relationships with other colonies were strained and far from intimate;¹¹⁰ the Australian land mass was huge and there was great distance between settlements, with few interconnecting transport systems. The tariff, more than any other issue had ‘aroused the latent spirit of provincialism in all the colonies...’ ‘[i]t was ‘the lion in the path’ of all federal measures.’¹¹¹ It was the major cause contributing to the failure of imperial and colonial governments in their attempts to improve the political and economic relationships of the colonies.

This provincialism meant that there was no unity of taxing policy between the various colonies until Federation when the Federal Parliament occupied the dominant position in Australian politics. Taxation policy had always been at the centre of the pre-

¹⁰⁰ Perry, above n 73, 87. Perry states that ‘[e]ach colony is entirely satisfied with its own fiscal system.’

¹⁰¹ S Reinhardt and L Steel, *A brief history of Australia’s tax system* (paper presented to 22nd APEC Finance Ministers’ Technical Working Group, Vietnam, 2006) 2.

¹⁰² Reinhardt and Steele, above n 101, 2.

¹⁰³ See Section 92 of the Constitution. This section refers to free trade between states.

¹⁰⁴ Allin, above n 20, 10.

¹⁰⁵ Allin, above n 20, 11.

¹⁰⁶ Reitsma, above n 3, 10.

¹⁰⁷ Allin, above n 20, 13.

¹⁰⁸ Allin, above n 20, 167.

¹⁰⁹ Allin, above n 20, 167.

¹¹⁰ Mills, above n 4, 201.

¹¹¹ Allin, above n 20, 170.

Federation debates¹¹² because the colonies were concerned that Federation would mean they would lose their major tax base when they were no longer able to impose tariffs on imported goods. The Constitution was designed to give the Federal Government the sole authority to impose customs and excise duties. However, the colonies were placated to some extent by drafters of the Constitution, who would allow the newly formed States to maintain their taxing powers in relation to other taxes such as income tax.¹¹³ Finally, on 8 October 1901 the first Federal tariff was introduced¹¹⁴ by the first Federal Parliament¹¹⁵ and effectively ended inter-colonial tariff wars.¹¹⁶ It was a compromise between the revenue tariff of NSW and the protectionist tariffs of Victoria¹¹⁷ and was mildly protectionist by comparison with the level of protection existing twenty years later.¹¹⁸

6 FEDERATION - THE FIRST REMARKABLE MOMENT IN AUSTRALIA'S TAXATION HISTORY¹¹⁹

But the day of small things was passing away. A new Spirit of Australian nationalism was beginning to find lodgement in the hearts of the younger generation. New imperial problems come upon the scene. The political and economic life of the colonies gradually loses its purely local significance and begins to take on a true national character.¹²⁰

To understand how the tariff grew so rapidly both outwards and upwards, one must first look at the sources of the Commonwealth's taxing power. This taxing power is contained mainly in s51 (ii) of the Australian Constitution;¹²¹ it gives the Federal Government a general and unlimited power to raise taxes for the peace, order and good Government of the Commonwealth. Section 55¹²² provides that laws imposing taxation shall deal only with the imposition of taxation. Section 90 not only removed certain taxing powers from the colonies but it provided the Federal government with the exclusive power to set and impose Customs and Excise duties.¹²³ This provision was to

¹¹² Julie Smith, *Taxing Popularity: The Story of Taxation in Australia* (Federalism Research Centre, Canberra 1993) 40.

¹¹³ Julie Smith, above n 112, 40-41. Smith says that the states viewed 'the infant federal government as their child. And like most parents they expected to exercise reasonable control over their offspring.'

¹¹⁴ It became known as the *Customs Tariff Act 1902 (No 14 of 1902)* (Cth).

¹¹⁵ There were three parties in the new Parliament: the Free Trade Party, which drew much of its strength from New South Wales, the Protection Party and the Labor Party (which had no settled policy on protection), see Anderson and Garnaut, above n 45, 43.

¹¹⁶ Athukorala, Prema-chandra and Satish Chand, 'Tariff-Growth Nexus in the Australian Economy, 1870-2002: Is there a Paradox?' July 2007, *Working Papers in Trade and Development*, Working Paper No. 2007/08, Division of Economics, Research School of Pacific and Asian Studies, ANU College of Asia and the Pacific.

¹¹⁷ J Pincus, 'Evolution and Political Economy of Australian Trade Policies', in *Australia's Trade Policies*, Pomfret, Richard (Ed) (Oxford University Press, 1995) 60. Pincus said they were 'weakly' protective duties ranging from 5-25%.

¹¹⁸ Alford, above n 70, 29.

¹¹⁹ Smith and Warren, above n 65, 2.

¹²⁰ Allin, above n 20, 171.

¹²¹ According to s 51(ii), the [Commonwealth] Parliament shall... 'have power to make laws with respect to...

(ii) taxation; but not so as to discriminate between States or parts of States.'

¹²² Woellner, above n 8, 45. Section 55 limits laws imposing taxation to dealing only with the imposition of taxation and only one subject of taxation. Laws imposing duties of customs and excise must deal only with duties of customs or excise respectively.

¹²³ COMMONWEALTH OF AUSTRALIA CONSTITUTION ACT - SECT 90

Exclusive power over customs, excise, and bounties

have a significant impact on the taxing powers of the colonies; at the time of Federation, approximately 75% of colonial revenues came from Customs and Excise duties.¹²⁴ After Federation tariffs would only apply in the case of imports to Australia, and inter-State trade was thus free of tariffs, pursuant to s 92 of the Constitution.

At first, the scheme of Commonwealth finance was almost wholly based on the revenues to be derived from Customs and Excise duties.¹²⁵ To give support for this objective, s 88 of the Constitution required that ‘uniform duties shall be imposed within two years after the establishment of the Commonwealth.’ It was proposed¹²⁶ that stimulants and narcotics would raise the most revenue (£1,959,306) and they attracted the highest rate of duty (145.21%). It was expected that apparel and textiles would raise £1,441,863 with an average rate of 17.73% duty.¹²⁷ Jewellery and fancy goods were expected to raise £120,580 at an average rate of 21.03% duty.¹²⁸

Section 86 of the Constitution gave the Commonwealth, as central government for the emerging nation state, the power to take control of the collection and administration of these duties.¹²⁹ For at least ten years after Federation the Commonwealth had to return to the States ‘three-fourths of the net revenue from Customs and Excise; one-fourth¹³⁰ only being available for Commonwealth expenditure’ (The Braddon Clause).¹³¹ Not only was ‘the paramount object of Federation’¹³² inter-State free trade with a uniform Tariff in the importation of overseas goods but the preparation of a ‘uniform’ Tariff became the ‘most urgent task of the new Commonwealth Government.’¹³³ The use of customs and excise duties, as the Commonwealth’s main source of revenue, proved to be a very lucrative means¹³⁴ of raising revenue and these taxes fitted in neatly with the growing nationalism¹³⁵ which spread throughout the colonies and later the Commonwealth.¹³⁶ These taxes were easy to exact. They could also be readily utilised to protect the interests of those local manufacturers, industrialists and farmers who were

On the imposition of uniform duties of customs the power of the Parliament to impose duties of customs and of excise, and to grant bounties on the production or export of goods, shall become exclusive.

On the imposition of uniform duties of customs all laws of the several States imposing duties of customs or of excise, or offering bounties on the production or export of goods, shall cease to have effect, but any grant of or agreement for any such bounty lawfully made by or under the authority of the Government of any State shall be taken to be good if made before the thirtieth day of June, one thousand eight hundred and ninety-eight, and not otherwise.

¹²⁴ Julie Smith, above n 112, 60. Most of this revenue came from customs duty. The remaining revenue generally came from Crown land sales, income tax, death duties, sale of gold and land tax.

¹²⁵ Mills, above n 4, 200.

¹²⁶ By C C Kingston who was the Minister of Trade and Customs.

¹²⁷ Mills, above n 4, 220. The rate of duty on apparel and attire ranged from 25% on wool and silk apparel down to 15% on cotton and linen goods.

¹²⁸ Mills, above n 4, 209. These estimates are set out in a table issued by Mr C.C. Kingston who was the Minister of Trade and Customs. The table can be seen in Mills’ book.

¹²⁹ Mills, above n 4, 200. Mills contends that the State tariffs remained temporarily in operation until the Commonwealth Government had established a uniform tariff. However, I was loss to find evidence to support this contention, except what is said in s 88 about uniform duties been imposed within 2 years.

¹³⁰ This was in accordance with s 87. This practice was reversed after the expiration of Clause 87 (Braddon Clause) on 31 December 1910.

¹³¹ This was known as ‘the Braddon Clause’, named after its author, Sir Edward Braddon, the Premier of Tasmania.

¹³² Mills, above n 4, 201.

¹³³ Mills, above n 4, 201.

¹³⁴ In 1901-1902 the Commonwealth’s total revenue £18 million was derived from Customs and Excise Duties.

¹³⁵ Allin, above n 20, 171.

¹³⁶ Hancock, above n 23, 89.

worried that their wealth and reputation would be endangered by the proliferation of cheap imported goods. They were also concerned about the ‘dumping’¹³⁷ of ‘end of season’¹³⁸ clothing by an ‘outside world which struggled for profit and cared nothing for Australia’s adventurous quest for justice.’¹³⁹

Protection had gained popularity as an economic policy because it promised to be a policy of plenty.¹⁴⁰ The very word appealed to ordinary Australians because they believed ‘in their hearts that both their enjoyments and their existence need[ed] to be protected against extraordinary dangers.’¹⁴¹ During the 1890s there had emerged a number of ‘extraordinary’ factors which had adversely affected the lives of most Australians and were subsequently instrumental in creating a general economic climate which favoured protectionist tariff policies. Labour turmoils, falling prices for agricultural and pastoral commodities such as wheat and wool, the failure of a number of banks and a decline in consumer spending all contributed to a widespread economic depression.¹⁴² At the same time, the new labour movement began to seek a high wage economy. This would particularly affect those thousands of agricultural workers severely affected by ‘the worst and widest drought the white man had seen’.¹⁴³ These workers had been moving to the cities in large numbers in search of employment, in newly emerging manufacturing industries.¹⁴⁴ In the early years after Federation, trade unionists, who had at first held the balance between Free Traders and Protectionists, began playing what Hancock calls ‘the profitable game of ‘support in return for concessions.’¹⁴⁵ The unionists finally started to drift towards the Protectionist side which pandered to their fears that ‘the competitive strength of frugal Orientals’¹⁴⁶ might result in lower wages and conditions for Australian workers.

So, whilst it seemed inevitable that the 1902 Australian Tariff would be of the Protectionist type¹⁴⁷ questions remained about how much money was needed to support local industry and how it was proposed to raise it. The Treasurer, Sir George Turner,¹⁴⁸ argued in the first Commonwealth Budget speech, that ‘neither the Free trader nor the Protectionist can have his own way entirely. *The Tariff is a compromise Tariff.*’¹⁴⁹ The objects of the first Federal Tariff were manifold. Policy makers such as Turner argued that the Tariff should be framed to raise revenue to fund Commonwealth obligations to the States so they could maintain their solvency, as well as to cover Federal expenditure. They also argued that the Tariff was meant to keep faith with the States by providing ‘for moderate protection, particularly avoiding unnecessary destruction of existing industries whose magnitude and suitability rendered them worthy of fiscal

¹³⁷ Hancock, above n 23, 83; *Parliamentary Debates* (In Committee of Ways and Means) 17 November, 1910.

¹³⁸ This term was sometimes referred to as the ‘fag end of season’. See *Parliamentary Debates* 17 November, 1910.

¹³⁹ Hancock, above n 23, 83.

¹⁴⁰ Hancock, above n 23, 89.

¹⁴¹ Hancock, above n 23, 89.

¹⁴² Shann, above n 94, 328-348.

¹⁴³ Shann, above n 94, 386.

¹⁴⁴ Shann, above n 94, 328-348.

¹⁴⁵ Hancock, above n 23, 83.

¹⁴⁶ Hancock, above n 23, 83.

¹⁴⁷ Mills, above n 4, 201.

¹⁴⁸ He was a member of the Protectionist Party.

¹⁴⁹ Commonwealth, *Parliamentary Debates*: Budget Speech 8 October 1901; Editorial, *The Advertiser*, 9 October 1901. Emphasis added.

protection.¹⁵⁰ So whilst this first object of this early Federal tariff was revenue-raising, it is very clear that protection, at least for existing manufacturing industry, was also of high importance in the government's plan for the new nation.¹⁵¹

However, this 'compromise tariff' failed to please all stakeholders, mainly because it was not a compromise between those who supported Free Trade and those on the Protectionist side. Rather, it was only a compromise between what Mills calls 'the high' and 'moderate'¹⁵² Protectionists. In addition, there was no 'Compromise Cabinet', because there were no 'free traders' in the Ministry.¹⁵³ The Commonwealth taxation policy, from the beginning of Federation, had 'been unmistakably Protectionist, and every subsequent dealing with the Tariff ... affirmed that policy, with a deeper emphasis each time.'¹⁵⁴ Some¹⁵⁵ believed the tariff was neither a compromise nor a moderate Tariff because 'the aggregate of taxation on the working man'¹⁵⁶ on his items of apparel, such as hats, woollens and boots, was 'enormous'.¹⁵⁷

In the first year after Federation, the Commonwealth raised £8.9 million from customs and excise out of a total of £11.3 million and, in accordance with s 87 of the *Constitution*, £7.6 million was paid out to the States.¹⁵⁸ Under this 1902 tariff, duties were imposed on luxury items, such as furs, and necessities, such as blankets. However, it soon became apparent¹⁵⁹ that there were many anomalies and inequalities 'that bristled in the old Tariff'¹⁶⁰; for example, for some time there was a lower rate of duty on furs¹⁶¹ than on blankets.¹⁶²

Some politicians¹⁶³ considered that protection meant the protection of the privileged class, as it did not advance the wages 'of the great industrial classes of the community one farthing.'¹⁶⁴ They considered protectionism socially distasteful. They likened it to the harsh interventionist sumptuary laws of the Middle Ages which authorised 'men in parts of London to cut the ruffle from women's dresses when they exceeded a certain length, and which also regulated the style of boots to be worn.' Some parliamentarians, particularly the Free Traders,¹⁶⁵ considered tariff taxation to be an overt method of regulating the affairs of the lower classes by 'depriving the poor man or woman of practically everything, except proved necessities.'¹⁶⁶ They questioned whether clothing

¹⁵⁰ Commonwealth, *Parliamentary Debates*, Budget Speech, 8 October 1901, (Sir George Turner).

¹⁵¹ Commonwealth, *Parliamentary Debates*, 8 October 1901, 5699.

¹⁵² Mills, above n 4, 210.

¹⁵³ Mills, above n 4, 210.

¹⁵⁴ Mills, above n 4, 221.

¹⁵⁵ Commonwealth, *Parliamentary Debates*, House of Representatives, 1 October 1901, 0016 (Mr Winter Cooke).

¹⁵⁶ Commonwealth, *Parliamentary Debates*, above n 153, at 0016.

¹⁵⁷ Commonwealth, *Parliamentary Debates*, above n 153, 0016.

¹⁵⁸ Stuart Macintyre, *The Oxford History of Australia, Volume 4, 1901-1942, The Succeeding Age*, (Oxford University Press, 1986) 81.

¹⁵⁹ Commonwealth, *Parliamentary Debates*, House of Representatives, 5 December 1901, 0082 (Mr Kingston—he was the Minister of Trade and Commerce).

¹⁶⁰ Commonwealth, *Parliamentary Debates*, Senate, 19 February 1908, 0027 (Senator Clemons).

¹⁶¹ For furs valued at £4 000 or £5 000 only £39 or £40 in duties were collected.

¹⁶² Blankets, as manufactured items, attracted a protective duty of 25%.

¹⁶³ Commonwealth, *Parliamentary Debates*, House of Representatives, 7 March 1902, 0006 (Mr Conroy). Mr Conroy was the Member for Werriwa in House of Representatives.

¹⁶⁴ Commonwealth, *Parliamentary Debates*, House of Representatives, 7 March 1902, 0006 (Mr Conroy).

¹⁶⁵ Mr Conroy was one of these Free Traders.

¹⁶⁶ Commonwealth, *Parliamentary Debates*, above n 158 (Senator Clemons).

and accessories were still necessities of life for the poorer classes.¹⁶⁷ High protective duties had even made socks¹⁶⁸ and hat pins¹⁶⁹ luxury items.

On the other hand, there were some ‘Protectionist’ members of Parliament who took a vastly different view as to the economic effect of these old laws.¹⁷⁰ They strenuously argued in favour of the value of the English protective sumptuary laws, which had compelled the wearing of English goods and prohibited the exportation of raw materials. They contended such laws were at the heart of England’s success in world trade and commerce under Queen Elizabeth I.¹⁷¹ They argued that the imposition of a protective tariff along with rigorous navigation laws, which prevented free trade in shipping and compelled English colonies to trade in English ships, had made England ‘the great workshop of the world.’¹⁷² Protectionists, such as McColl MP, argued that just as England was ‘built up under protection’, Australia’s manufacturing industries could prosper in the same way under ‘moderate, reasonable, and discriminating protection.’¹⁷³ Yet, they continued to object to any high protective duties which were ‘unreasonable and unwise’¹⁷⁴ because they would tend to discredit protection and could diminish the revenues of the States.¹⁷⁵

Still, there continued to be some resistance¹⁷⁶ against protection, generally by those¹⁷⁷ in the Liberal or Labor¹⁷⁸ sides who advocated a free trade policy. There was also an ongoing contentious dialogue between various stakeholders about the issue of granting preferential tariffs to Great Britain.¹⁷⁹ Preferential treatment had been afforded to English trade by various Australian colonies prior to 1850 in accordance with the principles of imperial monopoly whereby colonial trade was directed and monopolised by England.¹⁸⁰ However, the *Australian Colonies Government Act* 1850 (Imp) abolished all preferences, even to Britain.¹⁸¹

It would not be until August 1906 that Sir William Lyne, then Minister for Trade and Customs, proposed a Tariff resolution in the House of Representatives¹⁸² concerning approximately thirty British products,¹⁸³ with a view to giving Great Britain or ‘the

¹⁶⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 29 October 1907, 0092, (Mr Liddell); *Parliamentary Debates*, Senate, 20 February 1908, 0100 (Senator Millen).

¹⁶⁸ Commonwealth, *Parliamentary Debates*, Senate, 19 February, 1907, 0027 (Senator Findley).

¹⁶⁹ Commonwealth, *Parliamentary Debates*, House of Representatives, 28 February, 1902, 0032 (Mr Wilks). Mr Wilks pointed out that ‘[h]onorable members’ seem to run away with the idea that because jewellery is an ornament it is necessarily a luxury; but I am of the opinion that the daughters of the people have as much right to be adorned as their luckier sisters who can afford to buy high-class jewellery.’

¹⁷⁰ Commonwealth, *Parliamentary Debates*, House of Representatives, 30 May 1901, 0015 (Mr McColl).

¹⁷¹ Commonwealth, *Parliamentary Debates*, above, n 168, at 0015 (Mr McColl).

¹⁷² Commonwealth, *Parliamentary Debates*, above n 168, 0015 (Mr McColl).

¹⁷³ Commonwealth, *Parliamentary Debates*, above n 168, 0015 (McColl).

¹⁷⁴ Commonwealth, *Parliamentary Debates*, above n 168, 0015 (Mr McColl).

¹⁷⁵ Commonwealth, *Parliamentary Debates*, above n 168, 0015 (Mr McColl).

¹⁷⁶ Mills, above n 4, 210.

¹⁷⁷ Mills, above n 4, 210. G.H Reid, for example. He was the leader of the Federal Opposition at the time. He became Prime Minister in August, 1904, and held office until July, 1905 (only in combination with a leading Protectionist, Allan McLean, who Mills says was, ‘equal in all things’ with the Prime Minister).

¹⁷⁸ This word was spelled ‘Labour’ before 1912. For consistency and to avoid confusion I have used the spelling ‘Labor’ throughout this article.

¹⁷⁹ Mills, above n 4, 211.

¹⁸⁰ Reitsma, above n 3, 3 & 44.

¹⁸¹ Act 13 & 14 Vict. Cap. 59. Section XXXI.

¹⁸² *The Brisbane Courier*, 31 August 1906.

¹⁸³ The items included ammunition, guns, bicycles, boots and shoes (sizes 30 and 40). For the proposed duties for British goods and for foreign goods;- a full list can be seen in *The Advertiser* 31 August 1906, 7.

Mother Country'¹⁸⁴ favourable or preferential treatment, as against similar products from other parts of the world.¹⁸⁵ The proposal was to leave the tariff untouched for these British goods and to increase, by ten per cent, the duties against all other countries. Such favourable treatment was conditional upon the goods being produced or manufactured solely in the United Kingdom and being imported direct to Australia in British ships.¹⁸⁶ As a result of hostile criticism from the Free Traders and the problems relating to the demand for amendment to the tariff bill by those who wanted the Bill to contain even stricter racially-based conditions¹⁸⁷ to be placed on these favourably-treated British goods, the British Preference was postponed.

7 THE NEW PROTECTION, 1905-1908—AN ATTEMPT TO LINK PROTECTION WITH 'FAIR AND REASONABLE WAGES' FOR WORKERS

The old protection contented itself with making good wages possible. The new protection seeks to make them actual.¹⁸⁸

Between 1905 and 1908¹⁸⁹ 'The New Protection' permeated Commonwealth legislation.¹⁹⁰ Acts of Parliament,¹⁹¹ such as the *Customs Tariff Act 1906* (Cth) and the *Excise Tariff Act 1906* (Cth)¹⁹² encouraged and protected certain industries 'contingent upon fair and reasonable wages being paid.'¹⁹³ Deakin, an ardent protectionist, actively promoted¹⁹⁴ 'New Protection' by linking tariff protection to workingmen's wages¹⁹⁵ via providing assistance to the manufacturer to 'that degree of exemption from unfair outside competition which will enable him to pay fair and reasonable wages without impairing the maintenance and extension of his industry, or its capacity to supply the local market.'¹⁹⁶ The concept of 'New Protection' thus envisaged was that protection would walk 'hand-in-hand' with employers in protected industries. To avail themselves

For boots and shoes the proposed duty for British goods was to remain at the current duty of 25% and for other foreign goods the proposed duty was to increase to 35%.

¹⁸⁴ Britain was sometimes also referred to as 'the old country'.

¹⁸⁵ Mills, above n 4, 212.

¹⁸⁶ Mills, above n 4, 212.

¹⁸⁷ Mills, above n 4, 214. Mills suggests that that most of these sought that the British ships bringing in the imported goods should be 'manned exclusively by British seaman', 'manned by 80 per cent white seamen', 'manned exclusively by white seamen' or the goods 'must be manufactured by white labour'.

¹⁸⁸ Deakin's government's policy declaration contained in Memorandum on 'New Protection', *Commonwealth Parliamentary Papers*, 1906, Vol 11, 1887.

¹⁸⁹ This period was the term of the second Deakin Ministry.

¹⁹⁰ Plowman, above n 76, 48. Plowman suggests that New Protection dominated much of the legislative work of the newly formed Commonwealth Parliament till 1912. He says that '[i]n essence it was major plank of that Parliament's social engineering platform. In common with other newly formed countries, the Commonwealth of Australia sought to determine the type of society it wished to be and to implement policies towards that end. The society envisioned was that of an affluent, white society.'

¹⁹¹ These acts related to bounties, customs excise and manufacture.

¹⁹² However, this legislation was challenged as being unconstitutional. The High Court declared the *Excise Tariff Act 1906* (Cth) to be invalid. See *Ex parte H.V. McKay (1907) 2 CAR 1* (Harvester Case) (Higgins J was President in this decision) and *R v Barger (1908) 6 CLR 41*.

¹⁹³ Reitsma, above n 3, 18.

¹⁹⁴ Plowman, above n 76, 48. Plowman says that this doctrine was articulated by Deakin in the Victorian Parliament as early as 1895. He also suggests that Syme used his newspaper (The Age) to popularise the term and notion of New Protection.

¹⁹⁵ Reitsma, above n 3, 16.

¹⁹⁶ Commonwealth, 'Explanatory Memorandum' in regard to New Protection, *Commonwealth Parliamentary Papers* 1907-1908, Vol. II, 1887-1889.

of the enormous benefits of protection policies, these employers had to provide superior conditions of employment, including higher wages to their employees.¹⁹⁷

What were ‘fair and reasonable wages’ was to be decided by a Board of Trade¹⁹⁸ and once done, the Board would then be in position to determine, with some degree of precision, the question whether the measure of protection given to a particular industry was sufficient to pay those wages.¹⁹⁹ The government declared its intention to also protect the consumer against the charging of unduly high prices.²⁰⁰ At the same time that this new centralised form of tariff and wage board were being proposed, Justice Higgins,²⁰¹ also began considering in the Arbitration Court, what was ‘fair and reasonable remuneration’²⁰² for ‘the normal needs of the average employee, as a human being living in a civilised community.’²⁰³ In developing his principle of a basic ‘living wage’, which was to be based on frugal and reasonable comfort, he took into account the average worker’s needs²⁰⁴ for basic commodities such as food, shelter and clothing.²⁰⁵

Reitsma suggests that this ‘New Protection’ was an attractive wage policy because it ‘caused the complete conversion of Labor to trade protection.’²⁰⁶ The Labor Party’s newly found belief in the popular policy of protection, coincided with the basis of its co-operation with the Deakinites in passing the 1907-1908 tariffs²⁰⁷ which projected increases in duty far in excess of the 1902 tariff. The increases were the result of recommendations of a Parliamentary Tariff Commission which took nearly two years to complete its reports.²⁰⁸ This new tariff, known as the Lyne Tariff,²⁰⁹ proposed that over 440 articles attract duties which very nearly double those fixed in 1902.²¹⁰ For instance, the rate on wool and silk ‘apparel and attire’ was set at 45% compared to 25% in the 1902 tariff.²¹¹ The new Tariff schedules also contained much higher duties on woollen-piece goods.²¹² The 1907 Tariff was to be ‘the first really protectionist tariff’²¹³

¹⁹⁷ Anderson and Garnaut, above n 45, 46.

¹⁹⁸ The Board does not seem to have been established.

¹⁹⁹ Reitsma, above n 3, 17.

²⁰⁰ Reitsma, above n 3, 17.

²⁰¹ Reitsma, above n 3, 18. It seems that it was as a direct result of the ‘New Protection’ policy.

²⁰² *Ex parte H.V. McKay* (1907) 2 CAR 1. It has been suggested that this activity was a direct result of the ‘New Protection’ policy.

²⁰³ *Ex parte H.V. McKay*, above n 202.

²⁰⁴ Plowman, above n 76, 52. Plowman says that Higgins’ own criterion was ‘what was necessary to satisfy’ ‘the normal needs of the average employee regarded as a human being living in a civilised community.’ His established a rate of seven shillings per working day or forty-two shillings per week for unskilled male workers.

²⁰⁵ Reitsma, above n 3, 18. See also *Ex parte H.V. McKay* (1907) 2 CAR 1.

²⁰⁶ Reitsma, above n 3, 17-18. This conversion helps to explain Labor’s strong stance on protection during the Tariff Board’s Apparel Hearings in 1925.

²⁰⁷ This tariff called the Lyne-tariff included over 440 articles with rates nearly double those fixed in 1902.

²⁰⁸ Mills, above n 4, 220. Mills says that the Commission was composed of equal numbers of Protectionists and Free Traders and in fact there were 2 reports as there irreconcilable differences of opinion between them on the mode of dealing with Tariff items. The Government treated the Protectionist section of the report at the report of the Commission, but in fixing duties the Government went beyond the rates recommended by the Commission in respect of many items.

²⁰⁹ The Tariff was named after Sir John William Lyne, Minister for Trade and Customs. Duties were imposed on nearly 1000 items.

²¹⁰ Reitsma, above n 3, 18.

²¹¹ Mills, above n 4, 220.

²¹² At 35% compared to 15% under the 1902 tariff.

²¹³ Reitsma, above n 3, 18.

which sought to protect certain industries from ‘unfair outside competition.’²¹⁴ It was also the first Federal tariff which provided for preferential treatment for the United Kingdom.²¹⁵ However, its glory was short lived: the *Excise Tariff Act* 1906 was challenged as being unconstitutional and the High Court declared it to be invalid.²¹⁶

However, there was, a positive legacy for workers arising from this failed New Protection paradigm.²¹⁷ In the Arbitration Court, Justice Higgins²¹⁸ continued to develop and consolidate his rules relating to arbitration and wage determination. So whilst the new Protection failed to successfully link protection with the workingman’s wage, Higgins’ principles and methods for determining what was a ‘fair and reasonable remuneration’, with margins for skill,²¹⁹ became the bedrock for future legislation²²⁰ and arbitration practices linking the minimum wage with the cost of living. This meant that protection, albeit without any statutory nexus, became a basis for Australian living standards.²²¹

8 AUSTRALIA’S CONVERSION TO UNIFORM PROTECTIONISM-FINDING MORE SUMPTUARY THREADS

Consumers have always been a weak countervailing force against protection because of the free rider problem of collective action.²²²

By the end of the first decade after Federation Australian politicians began to take a more uniform approach to protectionism²²³ and contemporary political discourse,²²⁴ which was not only preoccupied about the potential effects of protection had also adopted a more pro-protectionist advocacy and fervour.²²⁵ At the same time protectionist rhetoric had also begun to take on a more noticeable semiotic engagement with the language and concerns of sumptuary regulation.

²¹⁴ Reitsma, above n 3, 16.

²¹⁵ Reitsma, above n 3, 16.

²¹⁶ *R v Barger* (1908) 6 CLR 41. The High Court comprising of Griffith CJ, Barton, O’Connor, Isaacs and Higgins JJ had the task of deciding whether the *Excise Tariff Act* 1906 (Cth), which attempted to indirectly regulate the working conditions of workers, was a valid exercise of the legislative powers of the Commonwealth Parliament. The majority (Isaacs and Higgins dissenting) held that the Act was not in substance an exercise of the power of taxation conferred upon the Commonwealth Parliament by the Constitution; that the Act was invalid as being in contravention of S 55 (taxation laws only to deal with taxation) and even if the term ‘taxation’, uncontrolled by any context, were capable of including the indirect regulation of the internal affairs of a State by means of taxation, its meaning in the Constitution is limited by the implied prohibition against direct interference with matters reserved exclusively to the States.

²¹⁷ Reitsma, above n 3, 18.

²¹⁸ See *Ex parte H. V. McKay*, above n 202.

²¹⁹ This meant that an extra amount was added to the wage if the tradesman was skilled.

²²⁰ MacIntyre, above n 158, 104. Within a few years three States had legislated for the judicial determination of a basic wage; Plowman, above n 76, 52. Plowman suggests that the complementary operations of tariff and wage tribunals resulted in the *de facto* operation of a New Protection wages policy.

²²¹ MacIntyre, above n 158, 104.

²²² Anderson and Garnaut, above n 45, 117.

²²³ Reitsma, above n 3, 13-14.

²²⁴ Hancock, above n 23, 89.

²²⁵ Mills, above n 4, 201. Deakin did much to convince Labor that it should support protection when he argued that there could be a direct link between tariff protection and workingmen’s wages. This contention proved to be unsuccessful in the New Protection legislation, particularly the *Excise Act 1906(Cth)* which was ruled to be invalid.

The preoccupation with protectionism can be explained to some extent by the national response to the sudden large increases²²⁶ in import penetration²²⁷ following the end of the ‘Great Drought’²²⁸ when consumers displayed a greater demand and capacity to pay for imported goods. There is the suggestion that such increases in imports are generally more likely to trigger a protectionist response than gradual increases.²²⁹ This triggering of a protectionist response is also historically often more likely if the domestic industry has a well-established lobbying organisation;²³⁰ this was the case in Australia where various protectionist groups propagated the tariff, not merely as moral or ethical issue but also as a question of ‘business expediency’.²³¹ By the end of the first decade after Federation the Free Trade Party had given up on its anti-protectionist commercial policy²³² ‘of cheap goods, cheap money and the handling and not making of goods.’²³³ The Party went on to align itself with the Protection Party in an anti-Labor coalition²³⁴ which then adopted a pro-protection stance.²³⁵ Anderson and Garnaut suggest that this consensus towards protectionism ‘allowed protectionism to be strengthened or at least maintained for half a century.’²³⁶ Members of the Labor Party continued to support protectionism well into the 1920s because they believed that protection of Australian industries was intimately tied to increased wages and improved working conditions for workers.²³⁷

There are four main reasons why, after Federation, Australia became uniformly Protectionist.²³⁸ First, the strong legacy of protection in Victoria, and less populated states such as South Australia and Tasmania, had created numerous vested interests who sought to maintain the protection which they had enjoyed up until Federation.²³⁹ These interest groups, comprising of pastoralists and industrialists²⁴⁰ as well as various Chambers of Commerce²⁴¹ wanted to avoid the type of free trade policies which New South Wales espoused and to ensure this they vamped up their demand for a continuation of this protection.²⁴² The voices of those who argued that the Tariff was only an artifice to ‘protect and coddle the local producer’²⁴³ by placing the burden ‘on the shoulders of the consumer,’²⁴⁴ were drowned out by the fervent rhetoric of

²²⁶ See Hancock, above n 23, 89.

²²⁷ Anderson and Garnaut above n 45, 117.

²²⁸ Shann, above n 94, 388. Whilst Shann says the drought occurred between 1894 and 1902 there are others who suggest that it did not break until 1905.

²²⁹ Anderson and Garnaut above n 45, 117.

²³⁰ Anderson and Garnaut, above n 45, 117. See also Reitsma, above n 3, 18.

²³¹ Commonwealth, *Parliamentary Debates*, House of Representative, 30 May 1901, 0015 (Mr McColl).

²³² Sawyer, above n 95, 50-52.

²³³ Commonwealth, *Parliamentary Debates*, House of Representatives, 30 May 1901, 0015 (Mr McColl).

²³⁴ Anderson and Garnaut, above n 45, 43.

²³⁵ Anderson and Garnaut, above n 45, 43.

²³⁶ Anderson and Garnaut, above n 45, 44.

²³⁷ Anderson and Garnaut, above n 45, 44.

²³⁸ Anderson and Garnaut, above n 45, 47.

²³⁹ Anderson and Garnaut, above n 45, 45.

²⁴⁰ Anderson and Garnaut, above n 45, 47.

²⁴¹ Commonwealth, *Parliamentary Debates*, House of Representatives, 11 October, 1901, 0016 (Mr Winter Cooke). There was a concern that the protective Tariff would bring into existence, or keep in existence, throughout Australia a number of vested interests as well as the ‘very evil which has grown up in Washington—a profession of lobbyists, men whose time is spent in interviewing Members of Parliament, and influencing them when a Tariff is proposed to be touched.’

²⁴² Anderson and Garnaut, above n 45, 45.

²⁴³ Commonwealth, *Parliamentary Debates*, House of Representatives, 27 Jun 1906, 0057 (Mr Bruce Smith).

²⁴⁴ Commonwealth, *Parliamentary Debates*, above n 240, 0057.

protectionists.²⁴⁵ The latter sincerely promised that a protective policy would provide a system which could regulate social conditions and was absolutely necessary to build up industries and ‘benefit equally every class of the community.’²⁴⁶ The widespread political and media²⁴⁷ support for protection, the diminution in support for the Free Trade Party and the successful lobbying of various interest groups all ensured that protection became more than a policy: it became ‘a faith and dogma.’²⁴⁸

Secondly, the Braddon Clause²⁴⁹ meant that three quarters of federal revenue, raised by the imposition of customs and excise duties, would have to be returned to the States. To this extent the imposition of high import duties made it easy to introduce incidental protective effects into the current tariff regime.²⁵⁰ The third consideration,²⁵¹ which also helps explain why protection became a widespread dogma, is that the exercise of ‘nation-building’ required economic and political compromise between the States.²⁵² The compromise, which was eventually nipped out between the States lay between the high level of protection provided in Victoria and the free trade policies followed in New South Wales.²⁵³ When New Protection legislation was passed in 1906, the Free Trade Party had lost most of its appeal and was defeated decisively in the elections that year.²⁵⁴

Anderson and Garnaut argue that it was the fourth consideration which was decisive in the victory for protectionism.²⁵⁵ Those who led the protectionist movement in Victoria turned out to be very skilful in ‘wooing’ the support of the Labor Party with the promise of a share in the material benefits and ‘happiness’.²⁵⁶ This alliance proved to be an ingenious tool to align Labor with protection.²⁵⁷ Until 1906, when New Protection was given legislative force,²⁵⁸ Labor Party members in New South Wales and other states such as Queensland and Western Australia²⁵⁹ repeatedly claimed that protection was only favourable to manufacturers in increasing their profits and that the burden of protection fell disproportionately on workers whose expenditure was in the main concentrated on mass consumption goods.²⁶⁰ Labor also believed the only way workers could have improved working conditions and higher wages, which were needed by these workers and their families to face a significantly higher cost of living, was for the Federal Government to implement budgetary measures to effect a means of financial

²⁴⁵ Hancock, above n 23, 89. Hancock argues that behind this national fervour ‘there is the pressure of particular interests. These interests have to some extent created the fervour and to some extent exploited it.’

²⁴⁶ Commonwealth, *Parliamentary Debates*, House of Representatives, 13 October 1907, 0027 (Mr Mathews).

²⁴⁷ C M H Clark, *A History of Australia, Vol V: The People Make Laws*, (Melbourne University Press, 1981) 281.

²⁴⁸ Hancock, above n 23, 89.

²⁴⁹ See above, note 130.

²⁵⁰ Anderson and Garnaut, above n 45, 45-46.

²⁵¹ Anderson and Garnaut, above n 45, 46.

²⁵² Anderson and Garnaut, above n 45, 46.

²⁵³ Anderson and Garnaut, above n 45, 46.

²⁵⁴ Anderson and Garnaut, above n 45, 47.

²⁵⁵ Anderson and Garnaut, above n 45, 47.

²⁵⁶ C M H Clark, above n 247, 285.

²⁵⁷ Anderson and Garnaut, above n 45, 46.

²⁵⁸ Part of the ‘New Protection’ was subsequently ruled by the High court to be invalid. See *R v McKay* above n 202.

²⁵⁹ Anderson and Gaunaut, above n 45, 45. Anderson and Garnaut suggest that Victoria, South Australia and Tasmania were pro-Protectionist and had created ‘many vested interests which wanted continued protection after federation.’

²⁶⁰ Anderson and Garnaut, above n 45, 46.

redistribution.²⁶¹ The promise of higher wages and better working conditions for workers in protected industries dispelled the concerns of the Labor members, and the Labor Party then effectively resolved its own divided position to become more united behind protection.²⁶² These government promises not only highlighted the rise in the relative importance of manufacturing in Australia since the 1890s but also reflected a direct correlation with rise of the Labor Party and its aim for a high wage economy.

During this period of socio-economic development, when protectionists were ‘wooing’ the working classes, protectionist rhetoric also began to take on an even more noticeable semiotic engagement with the language of sumptuary regulation. Politicians such as Millen²⁶³ and Lynch directly spoke of a natural relationship between the Australian protective tariff and sumptuary regulation. For instance, during a debate on the protective duties imposed on floorcoverings, Senator Lynch suggested that this form of duty was ‘a sort of sumptuary tax.’²⁶⁴ There were also numerous articles²⁶⁵ in the press, either highlighting the similarities between the rise of protection and sumptuary regulation²⁶⁶ or facetiously alluding to sumptuary law as a potential means to control extravagance and appearance.²⁶⁷ Even advertisements²⁶⁸ used sumptuary discourse glibly, and sometimes even perversely, to promote imported luxurious women’s apparel.²⁶⁹

During this period of intense tariff debate we begin to see more tension about the dichotomous relationship between the rich and poor and their respective consumption practices.²⁷⁰ The language of tariff and ‘luxury’ were frequently coupled in Parliamentary debates²⁷¹ and in the press.²⁷² Often, the polemic was whether high tariffs, even in a prosperous period,²⁷³ should impinge on the rights of the poorer classes to be able to enjoy the same luxuries as the rich, especially if these luxuries were now regarded by the poor as their ‘new necessities’.²⁷⁴ Senator Clemons, in arguing against protection, stated that he ‘should like to bring some of the luxuries of rich... within easy

²⁶¹ Anderson and Garnaut, above n 45, 46.

²⁶² Anderson and Garnaut, above n 45, 47.

²⁶³ Commonwealth, *Parliamentary Debates*, Senate, 20 February 1908, 8262 (Senator Millen).

²⁶⁴ Commonwealth, *Parliamentary Debates*, Senate, 20 February 1908, 0100 (Senator Lynch).

²⁶⁵ *The Register*, 9 August 1904, 4; *Western Mail*, 27 April 1907, 40-41.

²⁶⁶ Commonwealth, *Parliamentary Debates*, above n 174 & n 175.

²⁶⁷ ‘J S Mill on Dress’, *Barrier Mail*, 4 February 1908, 1.

²⁶⁸ *Sydney Morning Herald* 22 March 1907 (furs); *Sydney Morning Herald* 22 August 1907 (veils); *Sydney Morning Herald* 18 August 1907 (silks); *Sydney Morning Herald* 29 February 1908 (damask).

²⁶⁹ This is the text of an advertisement in SMH 22 March 1907:

Furs probably rank next to jewels in the affections of the gentler sex, and the pages of history indicate that ‘it was ever thus.’ Anne of Brittany, when married to Charles V 111. of France appeared in a robe ornamented with 160 sable skins. In those days sumptuary laws prevented the ‘masses’ from gratifying their taste for furs, to say nothing of the prohibitive cost. But to such perfection has the dyeing and preparation of furs been brought that for rich or poor, tile few or the millions, there are cosy AND BECOMING; FURS AT MODÉRATE PRICES.
FARMER’S FAR-FAMED FÜRS.

²⁷⁰ Commonwealth, *Parliamentary Debates*, Senate, 19 February 1908, 0027 (Senator Clemons).

²⁷¹ Commonwealth, *Parliamentary Debates*, Senate, 19 February 1908, 0027 (Senator Clemons).

²⁷² Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0029 (Mr Reid).

²⁷³ Commonwealth, *Parliamentary Debates*, House of Representatives, 13 October 1907, 0027 (Mr Mathews).

²⁷⁴ Commonwealth, *Parliamentary Debates*, Senate, 20 February 1908, 0100 (Senator Millen); House of Representatives, 29 October 1907, 0092 (Mr Liddell).

grasp of the poorer classes of the community.²⁷⁵ Further, it was claimed that under a policy of indirect taxation most of the revenue was provided by the poor;²⁷⁶ for 'it is the poor who have to pay the Customs duty.'²⁷⁷ Others tried to placate these concerns by arguing that protection, although not 'a panacea for all the ills of humanity,'²⁷⁸ was absolutely necessary because it was linked to desirable labour conditions and had flow through benefits for the consumer.²⁷⁹

During this period there was also much moralising rhetoric²⁸⁰ about the 'evil' of imported fashion apparel and women's extravagance of dress,²⁸¹ fickleness in women's fashion²⁸² and women's desire and demand for 'ever-changing fashion' fabrics.²⁸³ Some even argued that 'the old [sumptuary] laws' needed to be revived to address these issues.²⁸⁴ The implementation of the 'old laws' was not necessary as the protective tariff was having the same effect as sumptuary regulation; but only for the poorer classes. Poorer women had to depend upon cheap imported apparel, including corsetry, because they could not pay for the locally-made item.²⁸⁵ Yet, cheap apparel was denied to them²⁸⁶ and they had few, if any, alternatives.²⁸⁷ A working girl employed in a factory at a wage of 10s a week could not afford the luxury of a locally made pair of corsets, at prices which ranged from four guineas to thirteen guineas, with an additional charge of 6d for suspenders.²⁸⁸ This was especially because of the strain of her work, which was so great that the corsets had no more than three months life. There was no relief for 'the great masses of people'²⁸⁹ who had a 'natural craving for cheap articles.'²⁹⁰ Tariff schedules specifically targeted many items of 'lower end' female apparel and accessories with high rates of duty, whilst 'high end' goods, such as velvets, silks, furs

²⁷⁵ Commonwealth, *Parliamentary Debates*, Senate, 19 February 1908, 0027 (Senator Clemons).

²⁷⁶ Commonwealth, *Parliamentary Debates*, House of Representatives, 9 July 1907, 0028 (Mr Thomas).

²⁷⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 9 July 1907, 0028 (Mr Thomas).

²⁷⁸ Commonwealth, *Parliamentary Debates*, House of Representatives, 13 October 1907, 0027 (Mr Mathews).

²⁷⁹ Commonwealth, *Parliamentary Debates*, House of Representatives, 13 October 1907, 0027 (Mr Mathews).

²⁸⁰ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0075 (Mr Wilks). Mr Wilks suggested that a 'thumping big duty' should be imposed on imported ostrich feathers. He says '[i]t is interesting to observe that whilst a duty of 40 per cent has been imposed upon apparel and attire-an item of great concern to the masses of the community-the honourable member for Fawkner considers that ostrich feathers used for the personal adornment of those who could afford to pay a high duty should come in free, because there is a feather-dressing industry in his constituency.'

²⁸¹ 'In Fashions Realm: What to wear; Hints for Women', *Western Mail*, 27 April 1907, 40-41.

²⁸² 'The Coming of the Mammoth Hat', *Albury Banner and Wodonga Express*, 16 August 1907.

²⁸³ Commonwealth, *Parliamentary Debates*, House of Representatives, 12 November 1907, 0059 (Mr Edward).

²⁸⁴ 'In Fashions Realm: What to wear; Hints for Women', *Western Mail* 27 April 1907, 40-41.

²⁸⁵ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0050 (Mr Maloney).

²⁸⁶ Commonwealth, *Parliamentary Debates*, House of Representatives, 24 March 1908, 0150 (Mr Thomas).

²⁸⁷ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0029, (Mr Reid). Mr Reid suggested that with high tariffs on cheap articles of clothing, the poor could only choose between 'shoddy and nothing at all.'

²⁸⁸ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0050 (Mr Maloney).

²⁸⁹ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November 1907, 0029 (Mr Reid).

²⁹⁰ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 November, 1907, 0029 (Mr Reid).

and gloves, which were usually purchased by wealthier women, attracted lower duties.²⁹¹

During this period of high protectionism, not only was there a widespread obsession with luxury and extravagance in women's dress, but other sumptuary signifiers also became evident. There was an increased hostility to the importation of alien products²⁹² and a preoccupation with the placing of a metaphorical 'ring fence around Australia',²⁹³ that was to later become more pronounced, especially during the war years.

9 THE ESTABLISHMENT OF THE INTER-STATE COMMISSION-THE NEW SCIENTIFIC APPROACH TOWARDS PROTECTIONISM

There shall be an Inter-State Commission with such powers of adjudication and administration as the Parliament deems necessary for the execution and maintenance of this constitution relating to trade and commerce and of all laws made thereunder.²⁹⁴

The Tariff was further amended in 1910, 1911 and 1914. Most of the 124 amendments in 1911 were to remove anomalies, assist in interpretation and remove difficulties of classification.²⁹⁵ However, there would be no further general revision of the Tariff until 1920-21; although the schedules of rates, particularly in relation to preferences,²⁹⁶ were varied regularly before then. The 1911 and 1914 tariff increases specifically targeted clothing.²⁹⁷ The duty on felt hats (per dozen) in 1911, for instance, was increased to 16s (12s as British preferential rate) and in 1914, duties these hats were further increased to 20s per dozen (15s preferential rate).²⁹⁸ The 1914 the tariff increases reflected the recommendations made by the Inter-State Commission which was established pursuant to s101 of the Constitution.²⁹⁹

It seems that the authors of federation feared that the exercise of its powers over trade and commerce would be so overwhelming and difficult that parliament would 'need an organ of adaptation to unforeseen changes, a board whose rulings might be more flexible than the decisions and precedents of the law-courts.'³⁰⁰ By August 1913, the Inter-State Commission was appointed with functions which were similar to those later attached to the Tariff Board pursuant to the *Tariff Board Act* 1921. The only difference was that the Commission's recommendations were based on pre-war 'normal' circumstances, and these considerations became largely irrelevant in the greatly changed post-war situation.³⁰¹

²⁹¹ Commonwealth, *Parliamentary Debates*, House of Representatives, 28 August 1907, 0025 (Mr Hughes).

²⁹² Commonwealth, *Parliamentary Debates*, House of Representatives, 13 October 1907, 0027, (Mr Mathews).

²⁹³ Commonwealth, *Parliamentary Debates*, House of Representatives, 27 June 1906, 0057 (Mr Bruce Smith).

²⁹⁴ Section 101 *Commonwealth of Australian Constitution Act (The Constitution)*.

²⁹⁵ F.G Tutor (Treasurer) *Parl Debates* lxxxii., 3 489

²⁹⁶ Mills, above n 4, 225. During 1908-11 period there were, for instance, 237 tariff items which had preference of 5% whilst in 1914 there were 303 such items.

²⁹⁷ Reitsma, above n 3, 19.

²⁹⁸ Mills, above n 4, 226.

²⁹⁹ Shann, above n 94, 409.

³⁰⁰ Shann, above n 94, 409.

³⁰¹ Reitsma, above n 3, 19.

The Cook government set up this Commission and authorised it to formally investigate claims for increased tariff protection.³⁰² Not only did the Commission have the power to investigate any industries in urgent need of tariff assistance but it also had the power, which it did not ever exercise, to scrutinize the 'lessening, where consistent with the general policy of the Tariff Acts, of the cost of the ordinary necessities of life, without injury to the workers engaged in any useful industry.'³⁰³ Shann suggests³⁰⁴ that the instigation of this Commission resulted from the natural anxiety of a government, having committed itself to protection, that industry would then take advantage of the consumer and that the lack of competition would result in inefficiencies.³⁰⁵

The Commission's 'scientific' investigations proved that this anxiety was not without foundation.³⁰⁶ The Commission found that the 1908-1911 Tariff prompted, amongst manufacturers, a widespread neglect of accurate costing, and a lack of attention to what their rivals in other countries were doing.³⁰⁷ The Commission suggested that there was a waste of power, a waste of by-products, and a lack of applied science which could enhance the cost of manufacturing.³⁰⁸ It considered that the failure to use efficient modern standards in manufacturing meant that higher duties were sought by inefficient industries and these duties were then being passed onto the consumer.³⁰⁹ The Commission recommended that the greatest assistance be given to those industries which used the greatest amount of skilled labour.³¹⁰

In formulating their recommendations to government, the Commissioners took a practical and reasoned approach about the need for increased protection.³¹¹ Not only did they venture to remind Parliament that every burden of trade is paid for by someone, but they also predicted that it may be an economic advantage to withdraw Tariff encouragement from certain subordinate³¹² industries because such encouragement might become more of a hindrance than an aid to the whole scheme of industrial development.³¹³ Despite that fact that the Commission's term was short-lived³¹⁴ it appears that the Commissioners worked extremely hard³¹⁵ and took their role seriously³¹⁶ in determining the efficacy of increased protection for local industries. At

³⁰² Sawyer, above n 95, 128. Three Commissioners were appointed: Mr A.B. Piddington, K.C (legal member), Mr G Swinburne and Mr N Lockyer.

³⁰³ Reitsma, above n 3, 19.

³⁰⁴ Shann, above n 94, 409.

³⁰⁵ Reitsma, above n 3, 27. Reitsma argues that this Commission exerted little influence on tariff making.

³⁰⁶ Shann, above n 94, 413.

³⁰⁷ Shann, above n 94, 413.

³⁰⁸ Shann, above n 94, 413.

³⁰⁹ Shann, above n 94, 43.

³¹⁰ Reitsma, above n 3, 20.

³¹¹ Shann, above n 94, 414.

³¹² Shann, above n 94, 415. Shann suggests that manufacturing industries were subordinate, 'in the sense that their prices must consort with such costs in the primary industries as enable the latter to make headway against their rivals.'

³¹³ Shann, above n 94, 414.

³¹⁴ It only continued into existence until 1920 when the Commissioners' terms expired, the Commission lapsed and no other Commissioners were appointed. There was much legal and political controversy about the Commissioners' terms of appointment and their role.

³¹⁵ We see the same dedication and hard work exercised by the members of the Tariff Board after its establishment in 1921.

³¹⁶ Reitsma, above n 3, 19. In 1916, a total of 663 applications were dealt with, resulting in 73 tariff reports and 70 appendices. Evidence was taken both in public and in private.

the same time they appeared to be fully cognisant of the possible repercussions of this new, more formalised method of ‘scientific protection.’³¹⁷

10 CONCLUSION

This article argued that echoes of sumptuary regulation were evident in Australian taxes from the earliest colonial taxes through to the restrictive and onerous protective tariffs of the first two decades after Federation. The article began by showing that the early Australian colonial taxing regime had much in common with the sumptuary paradigm. Not only were they both consumption-based but they were, to a large extent, also both dependent on regulating the ingress and egress of foreign luxuries. Both legislative regimes were also based on a plethora of *ad hoc* and often inconsistent legislation.

The article also provides an overview of the move towards a more formalised colonial taxation policy, which was then followed by a shift of taxing powers from the colonies to the Federal Government. In the course of the transition to this centrally-directed taxing regime, there was an increased growth in the ‘strong symbiotic relationship’ between taxation and protectionism. This article also shows how Australia’s tariff policies after Federation became more uniformly protectionist. Not only did numerous vested interests seek to maintain the strong legacy of protection, existing in Victoria and other less populated states, but those who led the protectionist movement in Victoria proved skilful in ‘wooing’ the support of the Labor Party for their protectionist policies, by the promise of increased wages and better working conditions for workers. In addition, massive surges in imported cheap apparel triggered an increased protectionist response from the Australian government.

Whilst the government’s rationale for this response was the need to protect local manufacturers and the nation’s economy, this article illustrates how this protectionist response also placed an unfair burden on poorer consumers. Correspondingly throughout this period, protectionist and taxation discourse also began to take on an increased semiotic engagement with the language and objectives of sumptuary regulation. As a result, sumptuary threads began to be woven even more tightly into the fabric of taxation and protectionism.

³¹⁷ Reitsma, above n 3, 20.

Exploring innovations in tax administration: a Foucauldian perspective on the history of the Australian Taxation Office's compliance model

Robert B Whait¹

Abstract

At the turn of the century, the Australian Taxation Office (ATO) adopted the cooperative compliance model (CCM). This was regarded as a paradigm shift in tax administration and therefore a historically significant event, although its history has received little attention to date. Previous research has discussed the role of administrative equity and administrative efficiency in its history. This article reconsiders those themes in the light the theoretical work of Michel Foucault and further sources. Such an analysis focuses attention on the ATO's realisation that a more strategic use of its power could achieve greater long-term compliance. It also focuses attention on the ATO's realisation that the observation of taxpayers alone can improve compliance. These conclusions have implications regarding the use of probability of detection, risk assessment and data gathering procedures to improve compliance which are discussed. Also discussed are implications for serious noncompliance.

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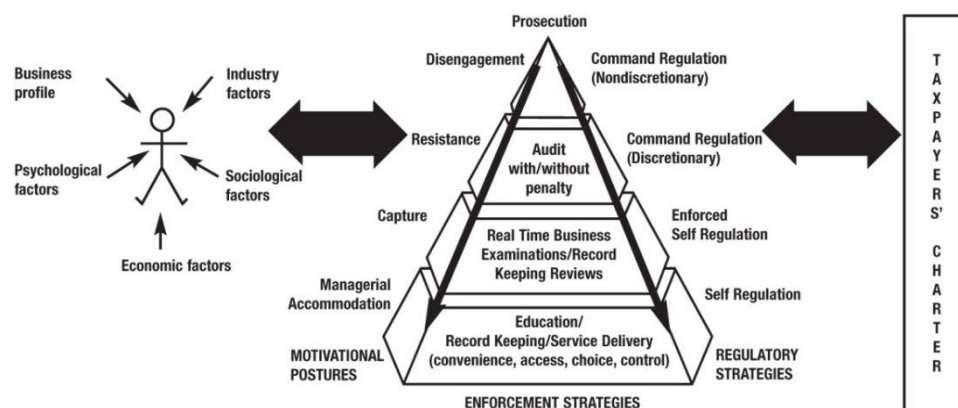
An earlier manuscript was presented at the 7th *Accounting History* International Conference, Seville, Spain, 26 September 2013.

1 INTRODUCTION

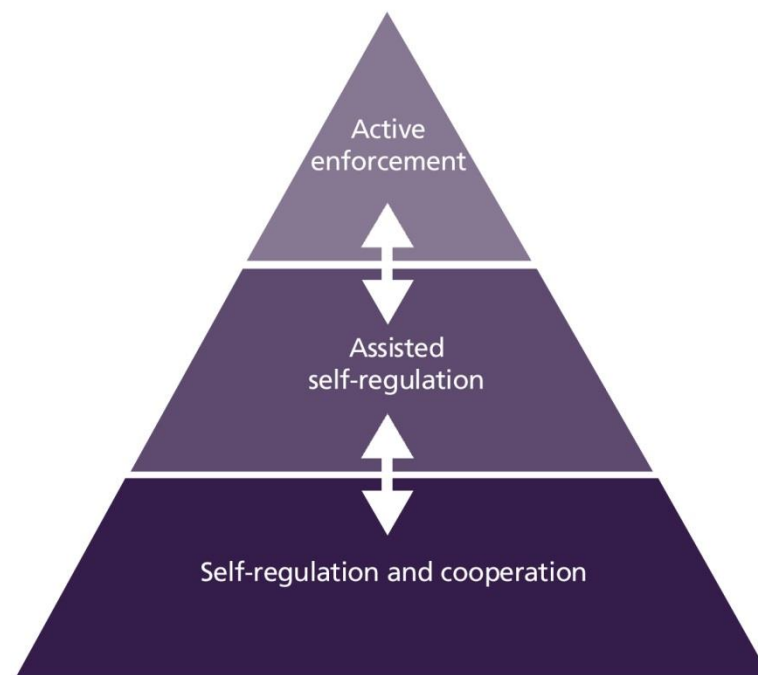
Taxation plays an important role in economic management and in the provision of public goods and services (Allan 1971). Consequently, improving voluntary compliance with tax systems is a goal of many governments and revenue authorities (OECD 1998; Tanzi 2000; D'Ascenzo 2010; Commonwealth of Australia 2010). Compliance has been traditionally achieved through deterrence methods such as the fear of audit and associated penalties based on the assumption that taxpayers will comply only when forced (Becker 1968; Allingham & Sandmo 1972; Braithwaite, V 2002a). In more contemporary times many revenue authorities have sought other approaches to improving voluntary compliance by taxpayers.

The Australian Taxation Office (ATO) adopted the cooperative compliance model (CCM; refer to Figure 2) in 2000 to improve voluntary compliance in its Large Business and International segment (Commonwealth of Australia 2000). This was adapted from Figure 1 which was developed for the cash economy by the Cash Economy Task Force (Commonwealth of Australia 1998). Since Figures 1 and 2 rely on the same underlying concepts and operate in a similar manner; this article will refer to both as the CCM. The BISEP (Business, Industry, Sociological, Economic and Psychological) model lies to the left in Figure 1. This model informs the pyramid's operation by capturing various environmental data that may impact on a taxpayer's compliance. While Figure 2 contains no BISEP equivalent, these factors are still important to its operation in Large Business and International (Commonwealth of Australia 2000). Consequently, the BISEP model is also regarded as part of the CCM. The *Taxpayers' Charter* situated to the right in Figure 1 is not part of the CCM. Figure 1 merely illustrates its relationship to the CCM.

Figure 1: The CCM for the cash economy



(Commonwealth of Australia 1998, p. 58)

Figure 2: The CCM for LBI

(Commonwealth of Australia 2000, p. 5)

The pyramid applies two regulation theories (responsive regulation and motivational posturing) with the aim of assisting the ATO to determine an appropriate response to the taxpayer's compliance or noncompliance. As its name suggests, a motivational posture attempts to combine a taxpayer's compliance attitude and behaviour into a single descriptor. There are four possible motivational postures: *commitment* (labelled as *managerial accommodation* in Figure 1), *capitulation* (labelled as *capture* in Figure 1), *resistant* and *disengaged* (Commonwealth of Australia 1998; Braithwaite, V 2002a).

The CCM assumes that most taxpayers have a commitment posture. The pyramid determines that the appropriate response to these taxpayers is self-regulation aided by education and service or any appropriate means to help them to comply. Taxpayers who capitulate are those who have some small motivation toward noncompliance. The ATO meets this posture with assisted or enforced self-regulation that is designed to persuade taxpayers to comply without resorting to penalties through the fair treatment and procedural justice that the taxpayer experiences (Braithwaite, V 2002a; Murphy 2004). The last two motivational postures are met with traditional deterrence strategies differing only in their intensity in the hope of enforcing compliance (Braithwaite & Braithwaite 2001; Braithwaite, V 2002a). Indeed, even for compliant postures, the threat of audit and penalties is ever present. Despite the unlikely event of achieving compliance from a disengaged taxpayer, it is recommended that all regulatory encounters begin with compliance strategies from the base of the pyramid with deterrence strategies used only once the compliance strategies have failed (Braithwaite & Braithwaite 2001).

This article builds on the prior work of Whait (2012) which showed that administrative equity and administrative efficiency were key drivers in the development and adoption

of the CCM. This article's objective is to use more sources to consolidate these drivers in the development and adoption of the CCM and interpret them through the critical theoretical work of Michel Foucault. Such research may not only help to inform future tax compliance approaches and policy directions, but it may also help improve the understanding of taxpayer compliance behaviour, a phenomenon which is poorly understood (Richardson & Sawyer 2001; McKerchar 2001; Niemiowski, Baldwin & Wearing 2001; McKerchar, Bloomquist & Pope 2012; Pope & McKerchar 2012). A theoretical perspective will also further the debate regarding responsive regulation and also help peer through tax's technical façade so that its social dimension can be understood (Haines 1997; Boden et al. 2010). A theory of power is used to inform this article since tax compliance has been regarded as a power struggle between the taxpayer and the revenue authority (Braithwaite, V 2002a).

The outline of this article is as follows: the next section (section 2) will briefly discuss the literature regarding the history of the CCM. It will then discuss the methodology in section 3 followed by a description of the theoretical framework in section 4. The article then discusses its findings and implications in section 5 after which it concludes briefly in section 6.

2 LITERATURE REVIEW

There are no formal histories of the CCM apart from the aforementioned article by Whait (2012). While other literature may describe the CCM and explain its mechanism of operation, details as to the process of its development and adoption are generally only mentioned in passing or by way of introduction.

The origins of the CCM are generally attributed to John Braithwaite's (1985) book, *To Punish or Persuade: Enforcement of Coal Mine Safety* or Ian Ayres and John Braithwaite's (1992) book, *Responsive Regulation: Transcending the Deregulation Debate* (Braithwaite 2011). These volumes attempted to work through the *punish versus persuade* debate by suggesting that regulation could be improved by using an appropriate mix of punishment and persuasion rather than using either alone. They are concerned with forging a more cooperative way of improving compliance through responsive regulation where the regulator would respond and act in accordance with the context of the situation (Ayres & Braithwaite 1992; Braithwaite 2011). Responsive regulation's development was a collective effort, but was initially influenced by the 'master practitioners of escalated enforcement of the late 1970s and early 1980s in the pharmaceutical industry' such as Bud Lofus and the 'practitioners of coal mine safety enforcement such as Ron Schell of the (then) Mine Safety and Health Administration' (Braithwaite 2011, p. 477).

By 1998, the CCM was developed by the Cash Economy Task Force which 'urged' (Braithwaite, V 2002a, p. 2) the ATO to better understand taxpayers using a BISEP perspective (see also Commonwealth of Australia 1998; Braithwaite & Job 2003). The ATO was also persuaded to adopt the pyramid that the Cash Economy Task Force developed but how, why or when that took place is not disclosed (Braithwaite & Braithwaite 2001). Interestingly, the CCM was adopted by the ATO without comprehensive empirical testing (Braithwaite 2011). After the Cash Economy Task Force made its recommendation, the CCM was adapted for Large Business and International but there was skepticism as to whether it could be successfully applied there due to it being based on research in other regulatory areas such as nursing homes (Braithwaite & Braithwaite 2001; Braithwaite, J 2002; Braithwaite, V 2002a;

Commonwealth of Australia 2000). Thus its application across the ATO was an intuitive leap of faith by senior ATO management (Braithwaite, V 2002a).

The late 1990s saw a number of contextual developments that are regarded as having some influence in the CCM's development and adoption. These include the level of aggressive tax planning by high wealth individuals, the introduction of the Goods and Services Tax as part of *A New Tax System* and concerns about the cash economy (Braithwaite 2007). The late 1990s also saw the adoption of the *Taxpayers' Charter* to communicate the public's rights and obligations with respect to tax compliance and administration (McLennan 2003; Commonwealth of Australia 2004). As Figure 1 suggests, the CCM was adopted, in part, to complement it (Commonwealth of Australia 1998; Braithwaite, V 2002a).

Despite these details, the following questions remain unanswered:

- What were the key change factors that prompted and shaped the emerging discourse regarding new approaches to compliance?
- What was the nature of the transition from the previous deterrence approach to the CCM?
- What influences shaped the emergence of the officially promulgated model?

This article addresses these questions through the methodology discussed in section 3. The lack of empirical testing of the CCM's effects on compliance before its adoption by the ATO is notable since taxpaying behaviour was poorly understood and in need of continued research at the time the CCM was adopted (Andreoni, Erard & Feinstein 1998; McKerchar 2001; Richardson & Sawyer 2001). By the late 1990s only the morality of the taxpayer, the probability of detection of noncompliance, penalties and the type of income (whether it is subject to a withholding tax or not) were regarded as having a definite positive influence on taxpayer compliance (Fischer, Wartick & Mark 1992; Andreoni, Erard & Feinstein 1998; Richardson & Sawyer 2001; McKerchar 2001). Despite this agreement, some remained unconvinced of the positive effect of probability of detection and associated penalties on compliance and these variables consequently had fallen out of favour with those hoping to develop new methods of improving compliance (Bardsley 1994; Braithwaite & Braithwaite 2001).

The article by Whait (2012) partly addresses the above questions by arguing that a desire to administer the taxation system equitably and efficiently led to the development and adoption of the CCM. The Cash Economy Task Force was established in the hope of levelling the playing field with respect to the cash economy, but those in the Cash Economy Task Force believed that it was important that the taxpayer's circumstances be taken into account by the ATO when it responds to noncompliance. Furthermore, the ATO realised that it needed to operate efficiently by focusing its limited resources on noncompliant taxpayers only. This led to the ATO developing many compliance improvement techniques that later found their way into the CCM. This article will interpret those findings, and others made through the analysis of more sources, with the aid of the theoretical work of Michel Foucault.

3 METHODOLOGY

Except for the application of a critical theoretical lens, this article has applied a similar methodology to Whait (2012) encompassing the assembly, organisation and analysis of evidence from a variety of written and oral sources. The written sources were searched and selected with reference to the above research questions as a guide (Miles & Huberman 1994). The selection process also included classifying the sources in terms of time and place and origin, primary or secondary characteristics, content and aim (Previts, Parker & Coffman 1990a). Some interviewees also provided written sources, particularly tax administration conference papers, submissions to government reviews and internal ATO presentations. Academic literature that was not written with the express purpose of providing a history of the CCM was also regarded as a source. Consequently, this research considered the following primary and secondary sources from the 1970s to 2000.

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

Semi-structured interviews were also employed using a combination of open and closed questions that guided the interview as well as probing questions to draw out more information. Interviews represent a purposive rather than probabilistic data gathering technique being conducted until saturation is reached (Strauss & Corbin 1990 as cited in Bowen 2008; Morse 1995; Guest, Bunce & Johnson 2006; Glesne 2006; Marginson 2008). Here, saturation was reached after approximately 22 interviews; nevertheless 25 were conducted among the following three categories:

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

Table 1 provides details as to the numbers interviewed.

Table 1: Interviewee categories

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

Interviewees were chosen on the basis of their direct involvement in the development and adoption of the CCM and/or their experience with respect to the ATO's compliance approaches. Many interviewees, particularly within the ATO, held senior or middle management positions. Many of the interviewees had broad experience thus could be placed in more than one category. For example, an interviewee who was interviewed for their academic or professional experience may have also been previously employed by the ATO at some stage. Table 2 provides details of the richness of experience among the interviewees.

Table 2: Range of interviewee experience

Type of Experience	Number interviewed with such experience
ATO employee (former and current)	13
Academics	9
Cash Economy Task Force members	9
Interviewees with professional tax industry experience (ie non-academic and non-ATO experience)	6

Since the Enlightenment, historical scholarship has been influenced by three broad trends: historicism, social science and postmodernism (Appleby, Hunt & Jacob; Evans 1997; Budd 2009). This article regards the sources with the utmost importance since it is the mastery of the sources that is the hallmark of historical scholarship (Fleischman, Mills & Tyson 1996; Evans 1997; Tosh 2010). Therefore, in common with the historicists, this article seeks to produce an objective history where the sources are the keys to recounting the past (Evans 1997, Parker 1997; Budd 2009). This article also recognises the evolution in historiography since historicism and the weaknesses in that approach regarding a focus on political history and a consequent inability to consider broader ethical and moral issues surrounding historical events (Appleby, Hunt & Jacob 1994). Therefore this article is also influenced by social history and its associated utilisation of social science methods and theory in producing history (Appleby, Hunt & Jacob 1994; Parker 1999; Budd 2009). Finally, this article is influenced by postmodernism, which recognises the impact of the historian in producing the history (Appleby, Hunt & Jacob 1994; Evans 1997; Tosh 2010). This article, however, seeks to avoid the extremes of postmodernism, such as nihilism (Appleby, Hunt & Jacob 1994; Tosh 2010). Despite the influences of social science and the recognition of the historian's influence in producing history, sources remain vitally important since 'history is about evidence. It is also about other things: hunches, imagination, interpretation, guesswork. First and foremost, though, comes evidence: no evidence, no history' (Vincent 1995, p. 1).

Historical analysis involves making sense of the evidence through an ordering or reconstruction of it using a creative mental effort (Elton 1967; Stanford 1986). This may include using analytical techniques to organise and describe qualitative data, identify patterns among the data, create explanations, develop theories and linking stories to others (Fleishman, Mills & Tyson 1996; Glesne 2006). This research used thematic analysis for this purpose (Glesne 2006; Neuman 2011). In broad terms this involved coding the data among categories that were determined through the researcher reading and re-reading the texts and transcriptions and through inductive reasoning (Neuman 2011).

Writing the history is an essential part of the process of conducting historical research as well as being essential in communicating its reconstruction (Stanford 1986; Marius & Page 2005). There are many different types of history that can be produced ranging from narrative to interpretive histories, but even narratives employ some form of explanation (Stanford 1986; Previts, Parker & Coffman 1990a, b; Parker 1997). Since this research aims to explain the existence of the CCM, it has adopted an interpretive approach. To aid in the interpretation, the data was analysed through a critical the theoretical lens provided by Michel Foucault. The following section describes this lens.

4 THEORETICAL FRAMEWORK

As introduced above, this article is informed by the theoretical work of Michel Foucault. He wrote extensively about power and his theory regarding it became particularly developed in *Discipline and Punish: The Birth of the Prison* (1977; 'Discipline and Punish'), in *The History of Sexuality* (1978) and in his writings on governmentality (Foucault 1977, 1978, 1991; Rouse 1994; Smart 2002; Mills 2003; Gutting 2005).

4.1 From brutal to gentle punishments

Discipline and Punish may be regarded as a case study in how the operation of power evolved from the mid 18th Century. Prior to the French Revolution, punishment took the form of public torture followed by executions which had the purpose of deterring crime and restoring power to the sovereign. A criminal act was interpreted as an offence directly against the sovereign since his or her laws were an extension of his or her body. Therefore punishments were a political ritual where the sovereign took vengeance for the crime in addition to the judicial purpose of the punishment (Foucault 1977; Schwan & Shapiro 2011). There were some unintended consequences of these brutal punishments which undermined its purpose. The lower socioeconomic classes believed that they were being unjustly targeted for punishment compared to the wealthier classes leading to uprisings and rebellions that accompanied some executions. This led to the criminal becoming a folk hero among his or her social class. The punishment was generally considered so disproportionate to the crime that it was losing its effect. Consequently, the harsh punishments effectively transferred power from the sovereign to the people (Foucault 1977).

As the French Revolution gave way to the Industrial Revolution, the Enlightenment reformers believed that the best approach was not to punish more but to punish better with the aim of rehabilitating criminals to become contributing members in society in terms of producing economic output (Foucault 1977; Rouse 1994; Delanty 2003; Gutting 2005; Schwan & Shapiro 2011). The reformers regarded executions as a waste of the human body, therefore a new form of punishment that instilled a liking of work into the criminal needed to be developed (Foucault 1977; Schwan & Shapiro 2011). It was believed that the right amount of punishment must be used to deter crime and the punishment must diminish as it produces the desired effect. While it was recognised that similar crimes should be punished in similar ways, it was also recognised that the same punishment does not necessarily have the same effect on everyone (Foucault 1977; Schwan & Shapiro 2011). Therefore, characteristics of the criminal and the crime were taken into account in determining punishment with the aid of experts providing advice to the judiciary. Such broad input made it difficult to determine who was responsible for the punishment. Prisons also meant that punishments were meted out in private making it more abstract in the minds of the public unless leading to exaggeration in society's imagination thereby creating a stronger deterrent (Foucault 1977; Schwan & Shapiro 2011). These various abstractions of punishment, plus its focus on rehabilitation, resulted in it shifting focus away from the body to the soul (Foucault 1977; Schwan & Shapiro 2011).

One of Foucault's key arguments is that a change in punishment is indicative of a change in the operation of power and in power relationships (Foucault 1977). Thus the nature of power changed from *sovereign power* to *disciplinary power* as prisons replaced executions as the predominant form of punishment after the French Revolution. Foucault's theory of power is unique since he regards it not as something that is manifested within one entity to be held, used and controlled at that entity's discretion, but rather it is dispersed across the whole of society and is enacted through discursive systems (Foucault 1977; Rouse 1994; Delanty 2003). Therefore power is strategic in nature (Foucault 1977; Rouse 1994; Delanty 2003; Mills 2003). Even though Foucault used the prison system to explain his theory, he argued that disciplinary power had spread through the whole of society to be used in schools, hospitals and factories. Consequently, society has become a disciplinary society where punishment became a

way of enacting power with the goal of producing behaviour instead of oppressing it (Foucault 1977, 1978; Mills 2003). Society also became a confessing society offering up information for institutions to use for behavioural control (Foucault 1978; Rouse 1994).

Another of Foucault's key arguments is that the rise of the social sciences is commensurate with disciplinary power since it relies on the knowledge gained through the use of social science methods and theories in order to understand and control the behaviour of individuals and populations (Foucault 1977, 1978; O'Farrell 2005; Schwan & Shapiro 2011). Foucault uses the French word *savoir* to refer to 'empirical, quantitative, rule- or skill-based' knowledge used by institutions to control behaviour (Schwan & Shapiro 2011, p. 47). For Foucault, power and knowledge are inseparable and this is why his theory of power is often referred to as *power/knowledge* (Mills 2003; Rouse 1994). Also characteristic of Foucault's theory is that power and resistance to power are similarly inseparable (Smart 2002; Mills 2003). This line of argument continued in *The History of Sexuality* as sexual behaviour was studied and categorised by experts so that an appropriate punishment may be meted out for delinquency with the aim of changing the behaviour to a more appropriate one (Foucault 1978; Gutting 2005). Universities and government agencies that conduct social science research would be regarded as institutions within the ambit of Foucault's theory since they produce knowledge, or *savoir*. Through the disciplinary process, the individual becomes an object of knowledge and power (O'Farrell 2005). Power is necessarily linked to surveillance due to power being created through the knowledge gained through surveillance (Delanty 2003). Power therefore operates through and with the aid of social interaction, discourse and knowledge (Foucault 1977; Rouse 1994; Delanty 2003; Mills 2003).

The CCM was also preceded by similar discontent that salary and wage and small business taxpayers were singled out for the ATO's attention while large business and the wealthy were not. The CCM also has a desire to punish better by selecting it with reference to the circumstances of noncompliance for rehabilitation. These similarities suggest that the CCM utilises a more strategic form of power (disciplinary power) as it tries to improve the compliance behaviour of taxpayers with the aid of the social sciences providing the necessary knowledge. The next section will describe the operation of disciplinary power.

4.2 Operation of disciplinary power

According to Foucault, disciplinary power rehabilitates through the creation of *docile bodies* which are defined as bodies that 'may be subjected, used, transformed and improved' (Foucault 1977, p. 138). He described various techniques of discipline that act to create docile bodies through controlling prisoners in terms of space and time. The first of these is the *enclosure*, a place or a space where people are physically confined (Foucault 1977; O'Farrell 2005; Schwan & Shapiro 2011). Schools, factories and hospitals are examples of enclosures in addition to prisons (Foucault 1977; O'Farrell 2005; Schwan & Shapiro 2011). Enclosures are further divided into *partitions*, such as prison cells, classrooms and the like (Foucault 1977; O'Farrell 2005; Schwan & Shapiro 2011). Enclosures and partitions had the purpose of controlling the movement of individuals, aiding observation and preventing rebellion (O'Farrell 2005; Schwan & Shapiro 2011).

Enclosures and partitions are supported by *functional sites*: multi-purpose architectural forms within prisons, schools, factories or hospitals (Foucault 1977; O'Farrell 2005). These are also designed to aid in observation but also to help make the individual produce output efficiently (Schwan & Shapiro 2011). Numerous sites exist within a factory since many small processes are carried on as part of the production of a complete product (Schwan & Shapiro 2011). Within these sites, individuals are classified and *ranked* according to various attributes (Foucault 1977; O'Farrell 2005). The rankings allowed for further partitioning so that each individual may be treated differently in accordance with his or her rank (Foucault 1977; Gutting 2005).

A key tool that emerged to control the distribution of individuals is the *table*. Foucault described this as a diagrammatic representation of the distributions of prisoners in space including the rankings (Foucault 1977; Schwan & Shapiro 2011). Indeed, Foucault (1977, p. 148) describes tables as a 'technique of power and a procedure of knowledge. It was a question of organizing [*sic*] the multiple, of providing oneself with an instrument to cover it, to master it; it was a question of imposing on it an "order"'. Individuals and their behaviour can therefore be ordered and understood through the drawing of a table to classify and impose order on observations.

It is possible to observe similar elements with respect to tax administration via the CCM. Taxpayers may not be able to be divided into specific physical spaces as Foucault suggested, instead the ATO organises taxpayers into notional spaces such as market segments. The CCM also ranks taxpayers in accordance with their motivational posture and thus are classified and ordered into a tabular like structure. These similarities suggest that the CCM incorporates disciplinary power.

Discipline also involves the control of the individual's activity in time with respect to when a task is done and how long it takes using strict time-tables (Foucault 1977; O'Farrell 2005; Schwan & Shapiro 2011). To control how long a task takes, activities were organised into specific steps or movements and given timeframes to complete the movements, like soldiers marching to a beat. The body was trained to move in an efficient manner with respect to itself and also with respect to any particular object that it uses, for example, a rifle or a pen (Foucault 1977; O'Farrell 2005; Schwan & Shapiro 2011). Such discipline trains the body to act like an efficient machine (Foucault 1977; Schwan & Shapiro 2011). It was also considered important that the body improves or develops over time (Foucault 1977; Schwan & Shapiro 2011). These various techniques serve to achieve discipline's aim of producing desirable behaviour rather than suppressing undesirable behaviour. All desirable behaviour must be performed as efficiently as possible with continuous improvement (Foucault 1977; Mills 2003; Schwan & Shapiro 2011).

In addition to the techniques of discipline, a mechanism of generalised surveillance is required to support discipline. This consists of three 'simple instruments', namely, hierarchical observation, the normalising gaze or judgement and the examination (Foucault 1977, p. 170; Gutting 2005; O'Farrell 2005; Schwan & Shapiro 2011). The examination is a combination of the other two (Foucault 1977; O'Farrell 2005). Each instrument will now be briefly discussed in turn.

4.2.1 Hierarchical observation

Hierarchical observation is a single gaze that is able to see everything constantly (Foucault 1977; Gutting 2005; Schwan & Shapiro 2011). Since it is not possible to observe a prisoner or other individual constantly, intermittent observation is used instead with the prisoner being unaware as to when they are being observed and when they are not. Thus intermittent observation creates a behaviour equivalent to being constantly observed since individuals subject to it must assume that they are being observed at all times (Gutting 2005). Hierarchical observation thus induces, 'in the inmate a state of consciousness and permanent visibility that assures the automatic functioning of power' (Foucault 1977, p. 201).

4.2.2 Normalising judgement or gaze

Normalising judgement, as might be expected, involves the use of norms to judge the behaviour of those being observed. Norms define what behaviour is abnormal and the threat of being considered abnormal steers or coerces individuals into behaving normally (Foucault 1977, 1978; Gutting 2005; Schwan & Shapiro 2011). The norms are internalised within the individual such that once it becomes clear to an individual that he or she strays from the norm, he or she will spontaneously take corrective action, or self-regulate, to comply with it (Foucault 1977, 1978; Gutting 2005; Schwan & Shapiro 2011). Many aspects of behaviour can be normalised once knowledge about that behaviour has been collected, usually in quantitative form (Foucault 1977, 1978; Schwan & Shapiro 2011). This means that disciplinary power has the ability to target areas not directly specified in the law (Foucault 1977; Gutting 2005; Schwan & Shapiro 2011). It also means that disciplinary power can make an inability to carry out a task an offense in itself (Foucault 1977, 1978; Mills 2003; Schwan & Shapiro 2011). When Foucault became concerned with the governing of populations in western neo-liberal democracies and in doing so formed his theory of governmentality, he believed that he had overemphasised the role of disciplinary power as a form of domination (Smart 2002; Delanty 2003; McKinlay et al. 2010). Consequently, he began to focus on the role of self-regulation in the governing of populations. Thus in governmentality, disciplinary power combines with sovereign power to align the behaviour of individuals within that population with the socio-economic goals of government, such as reduced crime, in a cost effective manner (Rose & Miller 1992; McKinlay et al. 2010). Governments use various technologies to achieve alignment, including the techniques of discipline and the mechanisms of generalised surveillance discussed herein.

4.2.3 The examination

Hierarchical observation and normalising judgment are combined in the examination (Foucault 1977; O'Farrell 2005). Examination brings observation and judgment down to the individual level so that each individual becomes a *case* with various characteristics being measured and compared against other cases (Gutting 2005; O'Farrell 2005). This occurs through three methods, the observation itself, documentation of the observations and the apparatus of writing that enables the documentation to be recorded (Foucault 1977; Schwan & Shapiro 2011).

At first instance, it is possible to see the mechanisms of generalised surveillance present in the CCM with its observation or surveillance of taxpayers and use of knowledge gained by application of BISEP to determine the appropriate response to noncompliance. In the process, taxpayers are regarded as cases to be examined for their

potential noncompliance with reference to norms and standards determined through the use of knowledge of a similar nature to BISEP. With Foucault's theoretical framework and its potential relevance to tax administration under the CCM outlined, the article will now discuss the history of the CCM with respect to administrative equity and administrative efficiency through a Foucauldian lens.

5 DISCUSSION

5.1 Perceptions of unfair treatment and harsh punishments

As discussed in Whait (2012), one of the drivers of the development and adoption of the CCM was a desire to create a more administratively equitable tax system. Further evidence can be produced to illustrate how a desire to achieve this was influential. This evidence revealed that the ATO was often inequitable in numerous ways when it came to audit conduct, collection of tax debts and in the manner that it applied penalties. Generally, the perception of certain taxpayers, some in the tax profession, those conducting inquiries into the ATO and the Commonwealth Ombudsman throughout the period under study was that some within ATO favoured the wealthy over the poor with the latter being subject to undue attention or unfavourable treatment. It must be noted that such practices were the result of only a small minority (Commonwealth of Australia 1993; Senate Economics References Committee 2000). Enough was made of these practices, however, that the ATO had to change. This section illustrates how this occurred, how this may be regarded as an inappropriate and ineffective use of power and how it led to the development and adoption of the CCM.

In 1992 the Senate Estimates References Committee, at which senior ATO officers including Commissioner Carmody were present, discussed instances of alleged poor treatment of taxpayers through auditor misconduct (Senate Estimates Committee 1992, p. 305). While the Committee did not believe that audit misconduct was a widespread problem, it recommended that the ATO do more to curb it (Senate Estimates Committee 1992, p. 305). The discussion continued in the Joint Committee of Public Accounts report *An Assessment of Tax* (Commonwealth of Australia 1993; McLennan 2003). This report was a result of the first major inquiry into the administration of Australia's tax system. Perceptions of inequitable treatment were also investigated by the Senate Economics References Committee during its extensive inquiry into the operation of Australia's tax system at the end of the 1990s (Senate Economics References Committee 2000). The latter inquiry concluded that the ATO 'treats small taxpayers unfairly and inequitably while it goes soft on the "big end of town"' (Senate Economics References Committee 2000, p. ix). With respect to audit conduct, the Senate Economics References Committee referred to instances of heavy-handed behaviour on the part of some ATO officers or sections. The Senate Economics References Committee also referred to a statement made by the accounting firm Arthur Anderson who believed that a minority of ATO officers appeared to view taxpayers 'almost by definition [as] [sic] dishonest cheats' (Senate Economics References Committee 2000, p. 21). Such poor conduct tended to manifest itself with respect to the application of tax penalties and the recovery of tax debts.

With respect to debt collection, the Commonwealth Ombudsman was critical of the ATO's wealth bias in his 1994/95 annual report and accused it of treating taxpayer's who owed it large sums of money differently compared to those who owed it small amounts (Lampe 1995). 'The big fish appear to be treated with kid gloves while the small ones are hit with a sledgehammer' (Lampe 1995). The Ombudsman also raised

concerns over mechanical treatment given to small debtors while the Joint Committee of Public Accounts and some in the profession commented that ATO audit officers at times placed too much emphasis on following procedure rather than achieving the appropriate outcome (Commonwealth of Australia 1993; Lampe 1995; Williams 1996). Criticisms of the ATO's treatment of debtors were raised at the Senate Economics References Committee a few years later (Senate Economics References Committee 2000). The criticism toward the ATO arising from its treatment of vulnerable people illustrates the political risks associated with taking unjustifiable action against them.

[if] we [are] perceived to prosecute little old ladies that were doing the wrong thing, we are in big trouble (ATO employee).

With respect to the ATO's power to penalise, some were of the view that the ATO applied penalties in an inflexible manner without consideration of the circumstances of the taxpayer (Wallschutzky & Gibson 1993 cited in Bird 1994; Oats 1996; Williams 1996). A new penalty regime adopted from the year ended 30 June 1993 expected taxpayers to take reasonable care with respect to their tax affairs and were penalised when they did not, but there was confusion regarding what constituted taking reasonable care leading to difficulties regarding the application of penalties (Coleman & Freeman 1994; Nethercott 1994; Pearson 1994). This confusion often led to penalties being automatically applied without reference to the circumstances of the taxpayer.

The administration of the provisions will likely lead to most taxpayers being subject to a 'standard' 25% penalty, whether they exercised reasonable care or not – because it is not worth the effort of finding out, and they are probably unaware of their rights to do so (Pearson 1994).

Similar concerns were also raised at the Senate Economics References Committee in the late 1990s which concluded that the unfairness of the ATO's penalty system was 'the most common issue of aggravation for taxpayers' which was poorly understood and inconsistently applied' (Senate Economics References Committee 2000, p. x).

The application of penalties by the ATO bears some resemblance to events just prior to the French Revolution (Foucault 1977) where not only did the lower social classes perceive that they were being singled out for punishment, but that the penalties applied were considered to be disproportionate to the offence. The Joint Committee of Public Accounts, the Senate Economics References Committee and the Commonwealth Ombudsman revealed the public's dissatisfaction with the treatment. As power was transferred to the lower social classes by extreme punishments just prior to the French Revolution (Foucault 1977; Schwan & Shapiro 2011), the ATO's penalties also transferred power to salary and wage and small business taxpayers. While these taxpayers did not engage in uprisings, they were able to respond via the Joint Committee of Public Accounts, the Senate Economics References Committee, the Commonwealth Ombudsman and associated discourse. Such events illustrate the political risks evident in some aspects of the ATO's administration of the tax system and that the nature of power and punishment needed to change. Indeed, the inquiries were largely concerned with how the ATO used its powers. To reduce the political risk and transfer power back to itself, the ATO needed to adopt a different, gentler, more strategic form of punishment.

The Joint Committee of Public Accounts noted that the ATO had been given 'exceptional powers' to administer the system and emphasised the importance of

‘establishing an administration which is fair, equitable and sufficiently flexible to manage the individuality of taxpayers’ (Commonwealth of Australia 1993, p. vii). The Joint Committee of Public Accounts sought to restore balance to the ATO’s administration that had ‘grown to ignore the people that it serves’ (Commonwealth of Australia 1993, p. vii). Thus the Joint Committee of Public Accounts emphasised the importance of an equitable tax administration and that the ATO had to improve its performance in that regard by using its powers more appropriately (Williams 1996; McLennan 2003). Similar concerns were raised at the Senate Economics References Committee (2000) that government agencies invested with wide powers ought to discharge those powers properly and fairly. Therefore the political risk for the ATO lay in the potential loss of power yet having to perform the same duties and achieve the same, or better, outcomes. This was implicit in the Joint Committee of Public Accounts report *An Assessment of Tax* (Commonwealth of Australia 1993).

There is a veiled threat in the attention drawn both to the ‘exceptional powers’ given to the ATO for its collection of tax and to the people who are ignored by the ATO. The inference is that it is open to parliament to curtail those ‘exceptional powers’ if they are used with an arrogant disregard or unless there is reform to redress the balance of power between the agency and taxpayers (McLennan 2003, p. 23 commenting on the Joint Committee of Public Accounts report).

It was never suggested in the inquiries that the whole of the ATO was using its power inappropriately. As the Senate Economics References Committee (2000, p. x) noted, however, ‘it only takes a minority of officers to act prejudicially and improperly for the organisation’s public reputation to be marred’. It also noted that:

Most ATO staff have succeeded in managing the challenge of balancing the interests of the revenue with interests of individuals. However, the evidence shows that some individual officers and local work areas have concentrated solely on the goal of revenue collection, contravening clear ATO corporate guidelines (Senate Economics References Committee 2000, p. x).

Thus two contrasting views of the ATO developed. One view regarded the ATO as a progressive organisation devoted to service improvement and professional conduct. Another view regarded the ATO as a harsh and inflexible organisation driven by procedure (Senate Economics References Committee 2000). The ATO needed to change the latter perception so that the majority saw the ATO as the former. The challenge for the ATO therefore lay in utilising its powers in a more effective and appropriate manner to maintain its legitimacy over tax administration. The Senate Economics References Committee’s comments show that many in the ATO were doing this, but the activities and approach of these ATO officers needed to become more widespread. The next section will discuss how the ATO saw the CCM as a means to change the nature of punishment and in doing so alter the power relations in order to reduce the political risks described above. The key to this change was in recognising that power is strategic in nature rather than a possession to be used at will.

5.2 The ATO’s response to its criticisms

Foucault informed this research, in part, by suggesting that the ATO’s response to the perceived inequity would entail a gentler form of punishment that would ‘achieve greater effectivity, regularity, constancy and detail’ (Smart 2002, p. 83). With respect

to the introduction of the prison system, such a punishment was determined with the aim of rehabilitating the criminal. Similar observations can be made in the development and adoption of the CCM. The first response that the ATO made in response to the above criticisms was essentially forced upon it by the Joint Committee of Public Accounts.

The Joint Committee of Public Accounts argued that ensuring proper conduct was the ATO's responsibility on an organisational level (Commonwealth of Australia 1993; Williams 1996). Therefore it recommended that the ATO adopt a *Taxpayers' Charter* to redress the balance of power between it and taxpayers (Commonwealth of Australia 1993; McLennan 2003). It was important for the tax system to be fair and seen to be fair and the *Taxpayers' Charter* was to help achieve that (Bentley 1995). Upon releasing the draft *Taxpayers' Charter* on 30 October 1995, Commissioner Carmody acknowledged that the ATO had wide-ranging powers and that a sense of balance between these and the rights of people in the community was required (Australian Taxation Office media release 95/46 as cited in Williams 1996; Edmonds 2010). After its adoption on 1 July 1997, the *Taxpayers' Charter* appeared not to gain widespread acceptance within the ATO, a development that Commissioner Carmody was disappointed about (Burgess 1995; Williams 1996; Senate Economics References Committee 2000; McLennan 2003; Commonwealth of Australia 2004).

He had been upset at the time that Taxpayers' Charter, a lot of work had gone into and it ... and it was like 'yeah beauty' and everyone just stuck it on their shelf. No one was using it or thinking about it or bringing it to life, and that concerned him, because that's about our obligations towards each other, us to the taxpayer, taxpayer to the ATO (ATO employee).

The Senate Economics References Committee blamed the lack of improvement with respect to the inequities discussed above on its lack of acceptance within the ATO.

Pockets remain among ATO staff that are resistant to the spirit and approach exemplified in the *Taxpayers' Charter* (Senate Economics References Committee 2000, p. x).

The CCM was specifically developed with the *Taxpayers' Charter* in mind to give it effect.

So then I used the Taxpayer [sic] Charter man and stuck that in the middle, and again if you look at the first report and you look at the Taxpayers' Charter you will see that there was a Charter man and that had been introduced one year before. So I put him in the middle of the BISEP, so this is what we were trying to understand and this is like the two way street that we're working with. The Commissioner took one look at it and he said, 'I love it – this is the way of bringing the Taxpayers' Charter to life' (ATO employee).

In November 1996, just prior to the adoption of the *Taxpayers' Charter*, Commissioner Carmody established a Cash Economy Task Force in an attempt to deal with increasing concerns about the cash economy (Australia, House of Representatives, *Questions Without Notice*, 1997, p. 4661). Some members of the Cash Economy Task Force expressed the view that penalties did not achieve compliance but only resulted in a taxpayer exiting the system altogether. The CCM gave the ATO a framework to become more flexible with respect to how it meted out penalties and this was a key reason why

the CCM became popular within the ATO (Commonwealth of Australia 1998). Applying penalties to taxpayers who genuinely found it difficult to comply was regarded as inequitable in the eyes of the Cash Economy Task Force members.

So if you knew your industry was really struggling and you're meeting with resistance you wouldn't go 'you bastard we'd give you a huge fine' you'd go 'look I know you're struggling I know this is happening and that's happening I've talked to others' so that you can actually show your understanding of the situation and then you say to them 'you're breaking the law we need to find some way of working this out we need to get this problem sorted' (Former Cash Economy Task Force member).

The CCM therefore allowed the ATO to move away from a one-size-fits-all approach to tax administration (Australian Taxation Office 1999). This was consistent with the principles of responsive regulation and made a clear distinction between those who were noncompliant due to various mitigating circumstances versus those who made a deliberate decision to be noncompliant. The Cash Economy Task Force, and those within the ATO behind the development of the CCM, were of the view that those two groups of taxpayers ought to be treated very differently. Through BISEP, the CCM thus took into account the social causes of noncompliance in a similar manner to which criminologists were advocating during that period (Brown 1990). The CCM allowed for a hierarchy of punishments based on compliance behaviour and attitude but also attempted to tailor any punishment to the circumstances of the taxpayer and his or her noncompliance. Foucault (1977) argued that some criminal behaviour became regarded as less serious after the French Revolution and a similar phenomenon occurred with respect to inadvertent noncompliance. He also argued (Foucault 1977; 1978) that different degrees of guilt ought to have different levels of punishment, although this ought to be influenced by whether the criminal ought to have been aware of the wrongness of his or her actions and the associated circumstances of those actions. As discussed above, the same punishment does not necessarily have the same effect on everyone; therefore it needs to be tailored to the circumstances of the criminal and the crime. Furthermore, punishment ought to diminish as it achieves its effect. Foucault also observed that experts advised the judiciary regarding the appropriate punishment (Foucault 1977; Schwan & Shapiro 2011). In a similar manner, criminologists and psychologists act as experts advising on the appropriate punishment for tax noncompliance via the compliance pyramid after gaining knowledge through the application of BISEP and its associated social sciences.

The ATO responded to concerns about inconsistent application of penalties raised at the Senate Economics References Committee by promising to update its information technology systems to track a taxpayer's past compliance behaviour and to support new approaches which allow for greater individualised treatment of taxpayers (Senate Economics References Committee 2000). The new approach adopted to achieve this was the CCM (Commonwealth of Australia 1998; Senate Economics References Committee 2000). The CCM was regarded as a tool to assist administration of the penalty regime.

And I think probably the compliance model was developed as a tool to assist, a genuine tool to administer, to help administer the penalty regime because they recognised under self-assessment that the onus ... is on taxpayers to get it right (Academic).

Foucault argued that the method of choosing the punishment advocated by the reformers had the advantage of diluting responsibility of the punishment making it difficult to determine who decided it. The CCM works in a similar manner since the ATO could deflect criticism of its approach by appealing to the CCM and its balanced method of dealing with taxpayers. The experiences of previous Commissioners of Taxation may have influenced a desire to adopt an apparently balanced approach to tax administration to deflect criticism.

And I think that was a context where ... Michael Carmody had seen Bill O'Reilly vilified for sitting on his hands and not being tough enough [on tax avoidance and bottom of the harbor schemes] and then he saw Bill O'Reilly's successor [Commissioner Boucher] being vilified for enforcement excess in Bronwyn Bishop's [MP] eyes at least and so how do we just not do this see saw back and forth (Academic).

Foucault (1977) argued that the changing nature of punishment reflected a shift in power relationships, specifically a shift from sovereign power to disciplinary power. This change was to bring about a more effective and strategic use of power. Therefore, the change in the nature of punishment that the CCM facilitated may also be interpreted as a change in power relationships between the ATO and taxpayers through the use of disciplinary power, although the CCM allows for sovereign power to be used if required in a manner consistent with Foucault's theory of governmentality (Foucault 1991). The ATO could then avoid the type of criticism that it had been subject to during the 1990s, reduce its exposure to political risk, take power back from taxpayers and continue to carry out its responsibilities. The CCM was adopted since it supported the *Taxpayers' Charter* and since stronger enforcement action is justifiable once cooperative measures have been trialled but failed (Commonwealth of Australia 1998). Throughout the development and adoption of the CCM, questions were being raised regarding the efficacy and appropriateness of compliance enforcement measures.

Is prosecution the best hammer we've got? (ATO employee).

I think the Task Force was also echoing some of that, you know, appropriate use of power can mean also you know – and also smart use of your powers and being clever about how you do your job, you know? (ATO employee).

It was also necessary that the new form of punishment and power be efficient (Foucault 1977; Smart 2002). The rest of this article will illustrate how the need for efficiency influenced the ATO to adopt disciplinary power within the CCM.

5.3 Disciplinary Power

As discussed in Whait (2012) the need for an efficient tax administration was one key driver that led to the development and adoption of the CCM. These pressures are likely to have come from New Public Management, a type of management that swept the world's public sector agencies from the 1970s onwards (Hood 1991, 1995; Wanna, Forster & Graham 1996; Olson, Guthrie & Humphrey 1998). New Public Management created an impetus for public sector agencies to become 'more efficient, more effective, more accountable, performance driven, orientated toward quality, best practice, client responsive, and commercially focused' (Wanna, Forster & Graham 1996, p. 1; see also Boucher 1996). Briefly, the ATO was expected to improve its performance and outcomes over time with progressively fewer resources. Self-assessment and risk

management were important steps toward that aim as they allowed the ATO to focus its resources on the risks to the revenue (Wickerson 1994a, 1995, 1996). Project Based Auditing was developed to support risk management by performing the initial risk assessment of taxpayers and ranking them in accordance with their risk to the revenue (Donoghue & Barry 1993). The broad influence of New Public Management can be seen in the ATO's expression of its primary goal of collecting the tax due at the least cost (Grabosky & Braithwaite 1986; Sutton 1992; Donoghue & Barry 1993; Saavé-Fairley & Sharma 1993; Wickerson 1994b). As alluded to above, disciplinary power was developed in the post Revolution period to enact an efficient form of punishment aimed at rehabilitation (Foucault 1977; Rouse 1994; Smart 2002). Such an interest in efficiency remained present in governmentality (Rose & Miller 1992). Therefore, on face value, there are a number of similarities between the post Revolution era and the 1990s tax administration in Australia which led to the ATO adopting disciplinary power within the CCM. It will be shown that this was a relatively slow process taking almost a decade to complete.

5.3.1 *Techniques of discipline*

When Public Based Auditing was adopted in 1989, the ATO realised that 'solutions to noncompliance are often not audit based' (Donoghue & Barry 1993, p. 16). Instead, education, service and cooperation were regarded as tools that could achieve long-term compliance (Sutton 1992, 1995; Sutton & Donohoe 1993; Donoghue & Barry 1993; Bird 1994; Wickerson 1993, 1994b, 1995). To facilitate the provision of services and education in an efficient manner, from 1991 the ATO sought to apply market segmentation principles by dividing taxpayers into segments based on size and type, for example, 'non-business individuals' and 'large/medium business' (Sutton 1992; Boucher 1993). The ATO's operations were streamlined into those segments over the next few years so that it could develop 'an appropriate service, enforcement, systems and collection mix for each of these markets' (Boucher 1993, p. 231). In the small and medium business segment, where Public Based Auditing was most utilised, taxpayers were further divided into 350 to 370 industries (Wickerson 1994b; Goss 1995). Industries in which Public Based Auditing was conducted were ranked in accordance with their risk to the revenue on a scale from the highest to lowest with taxpayers in the highest three risk categories becoming subject to further attention (Donoghue & Barry 1993).

Market segmentation was part of the ATO's risk management strategy since it recognised that different taxpayers posed different risks that ought to be treated with different levels of service and education (Sutton 1992; Sutton & Donohoe 1993; Bird 1994). It was also regarded as an efficient strategy since the ATO believed that future compliance was more likely to be forthcoming without ATO intervention if it could help taxpayers to comply through education and service allowing resources to be allocated elsewhere (Sutton 1992; Sutton & Donohoe 1993; Bird 1994).

In order to continuously improve, the ATO refined this approach throughout the early to mid 1990s by seeking to achieve a greater understanding of taxpayers' needs for the purpose of providing more tailored education, service and enforcement and to also allocate resources more efficiently (Sutton 1992, Baldry 1993; Saavé-Fairly & Sharma 1993; Sutton & Donohoe 1993; Bird 1994; Wickerson 1994b). The provision of service and education to help taxpayers comply is essentially identical to what the CCM advocates at its base.

The ATO's compliance strategy as described above appears to arrange taxpayers in space, albeit notional, and time in accordance with the techniques of discipline (Foucault 1977). As Foucault described in *Discipline and Punish*, the enclosure was described as a clearly defined space such as a prison or a hospital where the group being regulated is clearly defined as prisoners or patients. Although the ATO pays more attention to some taxpayers than others, it nevertheless regulates all taxpayers and thus the entire taxpaying population may be regarded as the enclosure. The ATO has no jurisdictional authority over citizens who are not taxpayers in a similar fashion to prison guards having no authority over free citizens. The market segments just described may represent partitions within the enclosure. Within these partitions, the ATO further divides taxpayers into functional sites that comprise the industries or occupations of each taxpayer. These may be further divided based on the taxpayer's location. These industries and occupations are ranked by their risk to the revenue. Through these processes the taxpayer became a case in the Foucauldian sense so that the ATO could assess the taxpayer's risk to the revenue and develop a treatment for noncompliance if required. Later, the BISEP model was also used to rank taxpayers in accordance with their propensity toward noncompliance and the compliance pyramid was used to determine the appropriate response to that propensity. Thus, rather than using tables to order and understand those being regulated as Foucault describes, the ATO instead uses information technology, statistical and financial analysis and the CCM to assess and control taxpaying behaviour (Donoghue & Barry 1993; Wickerson 1994b; Braithwaite & Braithwaite 2001; Braithwaite, V 2002a). Foucault argues that the techniques of discipline are established for the purposes of observation and control; therefore it is arguable that the CCM is performing the same function since it appears to use many techniques of discipline.

Discipline also controls a taxpayer's behaviour in time with the aim of making the taxpayer more efficient (Foucault 1977). As the Joint Committee of Public Accounts noted, the ATO 'plays a vitally important role in the efficiency of the Australian Economy' (Commonwealth of Australia 1993, p. vii) and its method of administration may have a substantial effect on it. A more cooperative approach is likely to increase productivity in business due to it not having to undergo intrusive and costly audits. It has been discussed above how the ATO sought to provide customer service to taxpayers with the reasoning that if taxpayers have their queries dealt with efficiently then the ATO also becomes more efficient (Sutton 1992; Sutton & Donohoe 1993; Bird 1994). Taxpayer compliance costs may therefore be regarded as a proxy for ATO efficiency (Gibson & Wallschutzsky 1993; Bird 1994; Richter 1995). For example, both the ATO and the taxpayer will benefit if the time taken to finalise a dispute is reduced (Bird 1994). Another important aspect of controlling a taxpayer's time efficiency was with respect to deadlines for various lodgements and other responsibilities such as information requests. These were regarded as a measure of compliance in addition to the payment of the appropriate amount of tax and the ATO regards failure to lodge or provide other materials on time as a potential indicator of more serious noncompliance.

Thus the CCM can be interpreted from the Foucauldian perspective as a means to control taxpayer behaviour through disciplinary power rather than sovereign power, although sovereign power remains an option for those determined to not comply. Since Foucault's view of power seeks to encourage behaviour rather than oppress it, the CCM can be regarded as a positive means of controlling behaviour rather than a negative one. Consequently, Foucault's theory of power/knowledge may be regarded as a carrot rather

than a stick where the carrot is used to encourage taxpayers to comply in contrast to the stick which is used to punish or oppress undesirable behaviour.

For Foucault, knowledge, or *savoir*, and power are inseparable (Foucault 1977; Schwan & Shapiro 2011). This suggests that the ATO relies on knowledge to give it power. The next section will show how the ATO gains that knowledge through surveillance and in doing so was able to gain more power of a disciplinary kind and gradually shift the emphasis away from sole reliance on sovereign power that it had traditionally used.

5.3.2 Mechanisms of generalised surveillance

The techniques of discipline are supported by a mechanism of general surveillance encompassing hierarchical observation, the normalising gaze and the examination (Foucault 1977; Schwan & Shapiro 2011). The ATO developed methods to achieve surveillance in a number of ways in a progressive fashion after adopting self-assessment. These included data matching (Jungwirth 1995) and financial ratio analysis (Donoghue & Barry 1993). The ATO implemented these methods as part of its risk management system to locate the risks to the revenue but over time it realised these techniques could be used to alter compliance behaviour when the taxpayer became aware of the observation.

A desire to deal with compliance issues in the small business segment was influential in the ATO adapting its approach and undertaking more active and public surveillance of taxpayers. Studies indicated that the small business segment was the least compliant and that small business did not engage with the education and services provided by the ATO due to having more pressing business concerns (McKerchar 1993; Bird 1994; Mitchell 1995). Furthermore, the small business segment was quite diverse making the tailoring of solutions difficult to develop (Mitchell 1995; Hite 1997). The ATO believed that the answer to this issue was to gain a deeper understanding of the various small business segments (Bird 1994). One segment that became a focus was the cash economy (Commonwealth of Australia 1998). The ATO specifically sought to understand why the community considered it acceptable to not pay tax on cash income (Australian Taxation Office 1997). Up to this point, in 1997, the ATO had developed numerous responses to noncompliance that were later to become part of the CCM. Such techniques included using letters to publicise the results of Project Based Auditing among the relevant industries (Donoghue & Barry 1993). Another technique that was not apparently practiced widely until after the CCM was adopted, was to gain cooperation of the relevant industry body that was regarded as a risk. This occurred with respect to the taxi industry where the ATO was able to gain special knowledge through such cooperation and use it to improve compliance (Findlay & Steele 1995). For example, since taxi drivers kept very good records of the kilometres they travelled for their tyre warranty, the ATO was able to calculate how many kilometres a taxi travelled per year. The ATO learned from the taxi industry what a taxi ought to earn per kilometre travelled.

And we went along to this big conference in Canberra and I presented this whole thing and when we actually gave out to everybody, all our research on the taxi industry and the next tax year everyone's compliance went up dramatically. I forget the exact numbers, but it was over 20 million dollars in additional revenue above what we expected, from just publicising and taking that information out (ATO employee).

Similar types of data was used in the paint industry and the fish and chip shop industry with respect to the amount of paint required to paint a room or the amount of fish required for a serve of fish and chips. This knowledge was used to assess the likely noncompliance of the taxpayer in those industries. These examples illustrate how society became a confessing society in accordance with Foucauldian theory.

Some techniques were newly developed during the Cash Economy Task Force. One technique was the real time review (Commonwealth of Australia 1998). These reviews differed from an audit since they simply involved observation of the business. In a similar fashion to what occurred in the taxi industry, a business was chosen on the basis of its deviation from an industry norm where businesses, say restaurants, in the same location were compared to each other. Instead of auditing all the outliers, the ATO decided to visit one explaining that a review would be preferable to an invasive and costly audit. Thus the ATO achieved a certain level of cooperation immediately. Through the review, the ATO proceeded to check various details such as the wages paid compared to turnover or the number of staff present, or the number of tablecloths washed compared to the laundry bill. Such checks helped tackle the cash economy since some employees were being paid cash and were not officially on the books. The real time reviews were successful in achieving the long-term compliance with respect to a number of measures such as the number of on-time lodgments and taxes paid.

... and what we ended up was creating something called a real-time review which is basically an opportunity to visit a business, explain what we are doing and almost give an option to, 'look we have got reasons to suspect that we might need to do an audit, that is going to be quite intrusive and costly. You would have to get an accountant, or you can just agree for us to drop in unannounced over the next few months, just once or twice or three times over that period and we will just do a few things like check your wages book and see how things are going.' And lo and behold, it was amazing. I think on average there was an 8 percent increase in the number of employees, there was like a 15 percent increase in the turnover of visited businesses and you think well that's interesting isn't it? Just the presence, just the watch, just the attention is having this effect; and I guess that was a shock to some of the auditors who didn't want to be just turning up to make sure all the employees on the premises are in the wages book ... (ATO employee).

For the aforementioned strategies under the CCM to be successful, the ATO had to demonstrate to taxpayers that it possessed relevant knowledge and that it was prepared to act on it if required. Such knowledge could arise from normative ratio analysis, data matching, or from its interaction with taxpayers to show that the taxpayer was a potential risk to the revenue. The ATO could therefore demonstrate that its audits were not random but targeted. Constant observation was not required, since, for example, the ATO could drop in at any time unannounced during the review. Such attention from the ATO would send ripples through the industry such that if one taxpayer had a visit from an ATO officer, others within the industry may wonder if they would be next to be visited and change their behaviour in preparation for it. A Foucauldian perspective suggests that there may also have been some abstraction of the punishment in the minds of taxpayers yet to be reviewed which might have also influenced them to comply. Overall, the new approach to compliance generally produced the desired behaviour, namely, increased voluntary compliance, at least in the short-term.

While many approaches to improve compliance discussed above were being used by the ATO before the CCM was adopted, they all became formalised in the hierarchical pyramidal structure of the CCM. Education and service to make it easy for taxpayers to comply can be found at the base of the CCM whereas more persuasive techniques such as real time reviews and utilisation of information gained through risk assessment are within the ambit of the CCM's second level. The next two levels of the CCM consist of traditional deterrence strategies. Foucault informs this history by highlighting how the CCM may be regarded as a formalised system of disciplinary power. This is because the CCM appears to contain many of the techniques of discipline and methods of generalised surveillance encompassing hierarchical observation and a normalising judgment combined together in some form of examination such as a real time review. This interpretation appears to be particularly valid when it is considered that the goal of the CCM is to produce compliant behaviour rather than suppress noncompliant behaviour. Only Foucault's view of power has such a productive quality (Foucault 1977, 1978; Mills 2003; Schwan & Shapiro 2011). The relationship between power and knowledge is particularly evident from the ATO's use of knowledge to encourage compliance. Consequently, the CCM may be considered, at least with respect to the bottom two levels, as a form of disciplinary power. Foucault (1977) argued that disciplinary power had dispersed throughout society and was not simply a domain of the prison system. It is perhaps not surprising to see that the ATO uses it in addition to schools, hospitals and the military.

5.4 Implications

There are a few of implications that can be gained from the history presented herein. The Foucauldian lens applied reveals the powerful ability of the probability of detection to positively influence compliance behaviour providing that taxpayers are aware of such a probability. This is because under the CCM, audits are not random, but targeted based on knowledge or *savoir*. Furthermore, the above discussion illustrates the use of probability of detection within a compliance or cooperative setting rather than its traditional deterrence setting. Thus probability of detection may be regarded as a technique of persuasion meaning that the distinction between deterrence and compliance methods or variables may be artificial. Indeed, Foucauldian thought re-establishes the influence of probability of detection on voluntary compliance after a period where it was somewhat discredited (Bardsley 1994; Braithwaite & Braithwaite 2001). Since it can be used in a deterrence or compliance setting, it is a potentially powerful factor in improving compliance over which the ATO has a great deal of control.

Related to this implication is that risk management strategies themselves are an effective method of achieving compliance since they may increase the probability of detection. Consequently, improving methods of determining the risks to the revenue have a dual effect in guiding the allocation of scarce resources as well as improving compliance. Continuing to refine these techniques is therefore paramount to the success of future compliance activity. Qualitative information is generally more difficult to analyse than quantitative. While the BISEP model tries to include more qualitative information than has been traditionally used, it is likely that quantitative information takes precedence in any analysis. If this is the case, then intelligent solutions to collect, manage and interpret qualitative information ought to be developed especially since a great deal of information used today is in qualitative form. Foucault regarded the knowledge, or *savoir*, on which disciplinary power relies as knowledge that is officiated by institutions

and emerges from them (Foucault 1977). This implies that *savoir* goes through a process within each institution before it is used. The ATO will need to be careful that whatever process it uses to officiate its knowledge does not lead to its corruption and that there are no bias in its selection.

While the CCM takes into account and attempts to deal with the social causes of noncompliance, it continues to use deterrence measures for those who are determined to remain noncompliant. The noncompliance of these taxpayers may not be due to his or her circumstances, but rather due to some attribute within him or herself themselves that creates a desire to be noncompliant. This means that any BISEP analysis and associated response may be ineffective against taxpayers that are determined not to comply. Such a possibility was raised in an interview with Michel Foucault where the interviewee noted that:

In discourses about crime, the straightforward condemnation of the nineteenth century: “He steals because he is evil”, has given way to explanation: “He steals because he is poor”, and also to the attitude that it is worse to steal when one is rich than when one is poor (Gordon 1980, p. 44).

As this article has shown, such a change in view took place during the development and adoption of the CCM and in the preceding decade. Foucault agreed with the interviewer’s comment, but added (Gordon 1980, p. 44):

If that were all, perhaps one could feel confident and hopeful. But along with that, isn’t there any explanatory discourse that involves a number of dangers? He steals because he is poor, certainly, but we all know that all poor people don’t steal. So for this individual to steal there has to be something wrong with him, and this is his character, his psyche, his upbringing, his unconsciousness, his desires.

Foucault (1967) had previously made the connection between the penal system and medicine in *Madness and Civilisation* where psychiatry was used to treat criminality as if it were a disease. Therefore, there appears to be two prevailing views regarding criminality; that it is due to social causes and/or due to the criminal’s psyche. The ethics and morals of the taxpayer have been shown to be important in tax compliance but determining what influences a taxpayer’s ethics and morals has been problematic (McKerchar, Bloomquist & Pope 2012; Pope & McKerchar 2012).

So far, tax administration has been considered from economic and psychological viewpoint. Foucault (1967) illustrated the link between delinquent behaviour and medicine, but perhaps it is time to consider whether the disciplines of ethics and philosophy can contribute. Insights from the field of neuroscience have begun to inform research in finance decision-making giving rise to the new discipline of neuroeconomics which may also prove fruitful with respect to understanding tax compliance decision-making (Camerer, Loewenstein & Prelec 2005; Peterson 2007; Bossaerts 2009; Howard 2012). Therefore, further engagement with academic discourse in that discipline may be required if further improvements in tax compliance are to be made.

6 CONCLUSION

This research has considered the role of the ATO’s desire to understand taxpayer compliance behaviour in the development and adoption of the CCM. In order for the ATO to administer the tax system in an administrative equitable and efficient manner,

it had to learn about taxpayer behaviour to detect noncompliance and to respond to it. Through this process, the ATO realised that a subtler use of power would improve compliance. It also realised that observation and surveillance combined with appropriate knowledge and communication of it could improve compliance. From a Foucauldian perspective, it is arguable that the CCM utilises many techniques of discipline and the mechanisms of generalised surveillance that are characteristic of disciplinary power. This perspective produced some implications that have been discussed above.

This research has considered the history of the CCM from a Foucauldian perspective, but it has not revealed how the responses to noncompliance came to be formed within the hierarchical structure of the CCM, nor has it discussed how motivational posturing theory came to be combined with responsive regulation theory in the CCM. Neither has it discussed how the BISEP model was developed. Future research will address these aspects of the CCM's history. It is suggested that Foucault's theory of discourse will be useful for this purpose due to the ability of discourse to produce knowledge.

Also not explored in depth in this research are the difficulties raised by Smart (2002) and Mills (2003) regarding the relationship between power and resistance. These scholars discussed the gap in Foucault's writings regarding how resistance and power operate and why some choose to acquiesce while others resist. The data on which this article is based as well as more contemporary data may be used to further understand the relationship between power and resistance more completely. Understanding why some resist and others acquiesce may be vitally important in improving voluntary compliance.

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Taxing Jamaica: the Stamp Act of 1760 & Tacky's rebellion

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Abstract

In 1760 the colonial assembly in Jamaica passed an act imposing stamp duties on the island colony as a response to increased costs in the wake of a slave rebellion. This article examines the conditions in Jamaica which led to the introduction of the 1760 stamp act, and discusses the provisions of the Jamaican act along with the reasons for its failure. This episode in eighteenth century taxation serves as a reminder of the importance of both the social context and political expediency in the introduction of new forms of taxation.

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1 INTRODUCTION

In December 1760, effective 1 March 1761, the colonial assembly in Jamaica passed an act imposing stamp duties on the island colony. By its own provisions, the act was due to expire on 31 December 1761, but it was in fact extended until 1763.⁴ There had been a stamp act in existence in England since 1712⁵, and the colonial legislatures of Massachusetts and New York passed acts similar to the English one in 1755 and 1756 respectively.⁶ One of the principal reasons for the introduction of all these stamp acts was the necessity of raising funds in a time of war. The Jamaican act was no exception as the island struggled to cover the costs associated with a slave rebellion in 1760, known as 'Tacky's Rebellion' or 'Tacky's War', and to deal with the financial difficulties posed by the ongoing Seven Years War.⁷

The purpose of this article is to examine in detail the 1760 Jamaican stamp act, about which little has thus far been written,⁸ and explore the contextual background to its introduction. Previous references to the Jamaican stamp act have been en passant; within examinations of the 1765 stamp act imposed by Britain on the colonies in mainland America and the West Indies. This 1765 Imperial stamp act, and the resultant 'Stamp Act Crisis', was a precursor to the American Revolutionary War. Under the heading 'The Influence of Jamaica's Local Stamp Law', Lane gives some details of the 1760 colonial act, and charts a comparison of the rates between the 1760 Jamaican act and the 1765 Imperial act.⁹ He then lists 'Items taxed under Jamaica's Stamp Law but excluded under Parliament's'.¹⁰ The references in Spindel and O'Shaughnessy are much briefer, and all three mention it only to contrast the reaction to the 1765 Imperial stamp act in Jamaica with the reaction in the other colonies affected by that act, the reaction in Jamaica being comparatively benign. In contrast to these earlier references, the focus of this article is squarely on the Jamaican stamp act.

A close examination of this episode in colonial history allows for an exploration of wider issues relating to the imposition of taxes at times of emergency and adds to our understanding of eighteenth century taxation more broadly. The analysis in this article draws on various primary source documents located in the UK National Archives¹¹ and the British Library¹², including the Jamaican Stamp Act, various minutes of Jamaican Assembly meetings and testimony from witnesses to the Stamp Act Committee. Scholarship dealing specifically with the events described in this article is

⁴ British Museum (hereafter BM) Add. Mss. 33030 f78. Testimony of James Carr, Merchant.

⁵ Lynne Oats and Pauline Sadler, 'This Great Crisis in the Republic of Letters', (2002) 4 *British Tax Review*, 353-66.

⁶ See Lynne Oats and Pauline Sadler, 'Variations on a Theme: Stamp Duty in the Eighteenth Century', in John Tiley (Ed.), *Studies in History of Tax Law, Volume 5*, (Hart Publishing, 2010), 67-75.

⁷ The Seven Years War began in 1756 and concluded with the Treaty of Paris in 1763.

⁸ For the most comprehensive reference to the act see Carl Lane, "The Roots of Jamaican Loyalism 1760-1766", (1978) D Phil Thesis, City University of New York, USA, 305-314. For other (brief) references see Donna Spindel, 'The Stamp Act Crisis in the British West Indies' (1977) 11:2 *American Studies* 203, 210; Andrew O'Shaughnessy, 'The Stamp Act Crisis in the British Caribbean' (1994) 5:2 *The William and Mary Quarterly* (3rd Ser), 203, 221.

⁹ Lane above n 8, 308-09.

¹⁰ Lane, above n 8, 310-11.

¹¹ Documents contained in the National Archives are categorized by department and identified by a departmental acronym (for example T for Treasury, CO for Colonial Office) a file number and folio numbers within the file.

¹² The British Library now holds documents and papers formerly held at the British Museum (BM). Documents are identified as BM Add MS followed by a number.

rare. The article draws on a variety of work, and in particular, on a contemporaneous account of the history of Jamaica written by Edward Long in 1774.¹³ In the spirit of new fiscal sociology¹⁴, this article emphasizes the importance of contextual background in understanding the processes by which particular forms of tax come into being and are put into practice.

The article proceeds as follows. The first part examines the conditions in Jamaica which led to introduction of the stamp act. This includes a discussion of the Jamaican economy and the impact of the Seven Years War, and slave rebellions, in particular 'Tacky's Rebellion', one of the worst of the eighteenth century slave rebellions in Jamaica. The second part is an examination of the provisions of the Jamaican stamp act with details of the items taxed, the administrative provisions, penalties, content of the general provisions and the duration of the act. This is followed by a brief analysis of the problematic aspects of implementation.

2 CONDITIONS IN JAMAICA LEADING TO THE STAMP ACT

The emergence of the Jamaican stamp duty in 1760 is puzzling, not because of its timing since many innovative taxes are introduced at times of social and economic upheaval, but primarily because of its form. As will be demonstrated later, the act was extremely detailed, more so than similar acts, and clearly carefully crafted to accommodate the peculiarities of the Jamaican environment. In order to understand its emergence and form, it is important to pay due regard to the prevailing conditions leading up to its emergence. There are four key contextual features that are important, specifically:

1. the Jamaican economy and the reasons for it being a valued colony making it worthwhile for the British crown to protect and maintain its stability;
2. the engagement of Britain in the Seven Years War, which reduced its capacity to attend to local matters in the colonies;
3. the history of slave rebellions in Jamaica since the English occupation in 1655 culminating with the Tacky Rebellion, delineating those conditions which predisposed Jamaica to these revolts. Rebellions and uprisings were costly events making it necessary for the assemblies throughout the period to seek creative ways to raise revenues to either fund the wars or make the colonies safer or more secure; and
4. the sources of taxation revenue in Jamaica prior to the introduction of the stamp act.

These four contextual features are dealt with in turn in this section.

¹³ Edward Long, *The History of Jamaica or, General Survey of the Antient and Modern State of that Island*, (Library of Princeton University, 1774).

¹⁴ Isaac Martin, Ajay Mehrota, and Monica Prasad, (Eds.) *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*, (Cambridge University Press, 2011).

2.1 The Jamaican economy

The trade between Britain and the West Indies in the period leading up to 1760 made the West Indies the 'most prized' part of the British Empire, although the potential of the North American colonies was by then beginning to make inroads into this status.¹⁵

Jamaica's trading partners up to 1760, included Spanish colonies in the Western Hemisphere, India, Africa, North American colonies, and of course the motherland, Britain. Items traded were many and varied of which the slave cargo accounted for a significant portion of the gains made. All profits from the Jamaican trade were repatriated to Britain, making the island an esteemed colony worth protecting. The West Indies', including Jamaica, main items of export were sugar, molasses, rum and cotton, all of which were destined for Britain, either for use in Britain or, in the case of sugar and its byproducts, for profitable re-export to northern Europe. In return Jamaica and the islands imported manufactured goods some of which were sent to the Spanish colonies in the area.¹⁶

In Long's *History of Jamaica*, a full analysis of Jamaican trade, starting with the slave trade, is given.¹⁷ In 1703 slave numbers in Jamaica were approximately 45000, but swelled to approximately 130,000 by 1753.¹⁸ Slaves were an important part of the trade items purchased by British merchants in Africa in exchange for a range of goods.¹⁹ In the case of an excess of slaves, the British merchants resold the slaves to other countries. Gold dust, elephants' teeth, dying woods and drugs were other items obtained in Africa. The British sold a wide range of manufactured items from various industries consequent on Britain's industrial boom to their African counterparts: fire-arms and ammunition, woolen goods, glass beads, linens, tallow, malt spirits, toys, cutlery, bars made from iron and copper, hardware items and tobacco pipes. All profits from these trading activities were eventually returned to Britain.

Jamaica's own trade with Britain was vibrant. This was fuelled by both the demand for items to be used on the plantations and by tradesmen, coupled by the demand by Britain for locally produced items. Additionally, the spinoff effects of the trade created the need for supporting commercial services such as shipping and insurance. Thus, the combination of the trade and commercial activities led to the generation of increased revenues to the Jamaican economy making the colony a place to be protected. The fieldworkers on the plantations required implements, for example hoes and axes, and the tradesmen required various tools which through continued use had to be replaced annually. But these items were insignificant compared to the equipment necessary for the sugar mills, such as the coppers and stills. All were imported from Britain plus numerous other goods.²⁰ In addition, goods exported out of Jamaica to

¹⁵ Ian Christie, *Wars and Revolutions: Britain 1760-1815*, (Harvard University Press, 1982), 17. Starting with Adam Smith in 1776, there is some debate with respect to whether or not the British colonies in the West Indies were in fact a drain on the British economy rather than providing an economic benefit. It is outside the scope of this article to analyse this debate in detail, but for a discussion see Roderick Floud and Deirdre McCloskey (Eds.), (1981) *The Economic History of Britain since 1700: Vol. 1*.

¹⁶ Christie, above n 15.

¹⁷ Long, above n 13, 491.

¹⁸ Orlando Patterson, "Slavery and Slave Revolts: A Socio-historical analysis of the First Maroon War: Jamaica, 1655-1740" (1970) 19:3 *Social and Economic Studies*, 289, 292.

¹⁹ Long, above n 13, 491.

²⁰ Including nails and bolts, materials for house building, furniture, fabrics, knives, scissors, ribbons, beads, buttons, foodstuffs (such as cheese, ham, bacon), beer, porter, ale, cider, flour and luxuries (such as chaises and coaches). Long, above n 13, 492.

Britain generated revenue for the British crown through payments made by Jamaicans for shipping and other associated charges.²¹

Jamaica was also a staging post to Britain from its neighbours in the Caribbean for various items, some of which were also produced in Jamaica. Long estimated that in 1751 there were about 15, 400 acres of cotton, 6, 000 acres of pimento, 4, 400 acres of ginger, breeding pens on 108, 000 acres, and polincks and provision places (market gardens) on 72, 000 acres. Although Long doesn't provide an exact count of the number of sugar works in Jamaica prior to and immediately following Tacky's Rebellion in 1760, his account of 651 sugar works involving 3, 000, 000 acres of sugar cultivation in 1768, suggests that Jamaica must have had large acres of sugar in cultivation up to the time of Tacky's Rebellion.²²

As an indication of the rapid growth in trade, the value of Jamaica's exports to Britain between 1729 and 1733 was rated in Jamaican currency at £539, 499 18s 3½d, in 1751 it was £692, 104 13s 6d, and from 1764 to 1765 at £1, 076, 155 1s 9d.²³ In 1756 21, 039 hogsheads of sugar and 4, 667 puncheons of rum were imported into the port of London from Jamaica; in 1760 it had risen to 44, 518 hogsheads of sugar and 5, 510 puncheons of rum.²⁴

It is clear that any disruptions caused by slave rebellions or war, resulting in the slowing down or halting of production and restriction of movement, would have a major impact on the economies of both Jamaica and Britain. The stamp act that is the focus of this paper was introduced while the Seven Years War was in progress, and so the war forms an important part of the backdrop to its adoption.

2.2 The Seven Years War (1756-1763)

The European powers during seventeenth and eighteenth centuries spent huge amounts of funds on military expenditure in a bid to secure their territories both on the continent and in the Western world including the Caribbean. Between 1680 and 1780 Britain fought five large wars, including the Seven Years War, and during that one hundred year period there was a threefold increase in the army and navy.²⁵ During the eighteenth century between 75 and 85 percent of public spending by the British government went on servicing the debts of previous wars or financing current wars. Brewer's chart of the 'Military spending as a percentage of total government expenditure, 1688-1783' shows total spending between 1756-63 to be £116, 664 (£000), with military spending being £82, 727 (£000), or 71%.²⁶ Bowen, however, put British government expenditure during the Seven Years War somewhat higher at over

²¹ Long, above n 13, 493. Sustic, or sustick, is a type of timber.

²² Long, above n 13, 539.

²³ Jamaica also exported to North America goods such as sugar, rum, molasses, coffee, pimento and mahogany. In return Jamaica imported from North America timber, flour and other items, but the cost of this trade was heavily in favour of North America by one third to two thirds. See Long, above n 13 494-99.

²⁴ Long, above n 13, 528.

²⁵ John Brewer, 1989, *The Sinews of Power: War, money and the English State 1688-178*, 29.

²⁶ Ibid, 40, citing *British Parliamentary Papers*, Vol. 35 (1868-9).

£160 million.²⁷ Between 1756 and 1763 the public debt rose from £74million to £133 million.²⁸

Christie describes the Seven Years War as being 'in effect two wars running concurrently'.²⁹ One was on the European mainland where Frederick the Great of Prussia, supported by Britain and Hanover, was fighting the Russian Empire, Austria and Sweden, and in the other war Britain was at war with France at sea, in North America and the Caribbean, in India and Westphalia.³⁰ Because of the number of countries involved, and the wide ranging dispersal of battle fronts, Winston Churchill is reported to have said that the Seven Years War should be seen as the 'first world war'.³¹

For the purposes of this paper, the account of the progression of the war is limited to the Caribbean in the period up to 1760. The war in the Caribbean involving Britain and France was driven by the economic importance of the sugar producing islands colonized by both countries. The French islands 'deprived by the selfishness of the Cognac interest in old France of any outlet for their molasses and rum' traded illegally with British colonies in North America. The 1733 Molasses Act had been an attempt, albeit unsuccessful, to destroy this illegal trade, which was hugely detrimental to British interests in the Caribbean.³² The British colonies in the West Indies lost out both ways in their trade with the North American colonies. The widespread availability of markets for the North American colonies kept the prices of their products high, while the duties imposed on the products exported by the British colonies in the West Indies made them more expensive than those emanating (illegally) from the French islands.³³

The strategy of the war in the Caribbean was to take full possession of enemy island colonies rather than simply destroying what made them valuable, such as the plantations. In January 1759 a British naval force was sent to capture Martinique, and when this attempt failed, the ships went on to Guadeloupe, successfully taking the capital Basseterre in April 1759 after a three month siege.³⁴

On a general level, the Seven Years War had an effect on the British colonies in the Caribbean. Britain was fighting a war across the globe meant that the attention of the centralist power was largely diverted away from the minutiae of politics and economics in the individual islands. As a result the islands had to resort to their own devices to manage internal difficulties, which would include, for example, quashing

²⁷ H.V. Bowen, *War and British Society, 1688-1815*, (Cambridge University Press, 1998), 22, citing Peter Dickson, *The Financial Revolution in England: a Study of the Development of Public Credit, 1688-1756*, (Melbourne, 1967) 10.

²⁸ Brewer, above n 25, 114.

²⁹ Christie above n 15, 45.

³⁰ Christie, above n 15, 45.

³¹ Bowen, H.V., *War and British Society, 1688-1815*, (1998), 7; citing P.M. Kennedy, *The Rise and Fall of British Naval Mastery* (1976), 98-107.

³² William Grant, 'Canada versus Guadeloupe, An Episode of the Seven Years' War' (1912) 17:4 *The American Historical Review*, 735, 738.

³³ Agnes Whitson, 'The Outlook of the Continental American Colonies on the British West Indies, 1760-1775' (1930) 45:1 *Political Science Quarterly* 56, 67.

³⁴ Edward Shaw, 'An Episode in the Seven Years' War: A Memoir of Jacques Cazotte concerning the capture of Guadeloupe by the English', (1948) 28:3 *The Hispanic American Historical Review*, 389, 389. As an aside, the British later gained Martinique in 1762 and in the course of the war took all the major French islands; these were traded in the Treaty of Paris at the end of the war for territories on the North American mainland: Christie, above n 15, 46-7.

slave rebellions and raising money to cover the cost arising from so doing. The next section considers the background to slave rebellions in Jamaica before focusing on Tacky's Rebellion in particular.

2.3 Slave rebellions in Jamaica

Jamaica has a history of slave resistance and rebellion throughout the seventeenth and eighteenth centuries, but there was a period of relative stability after 1739, when, at the end of a fifteen-year war, the colonial government entered into treaties with the Maroons.³⁵ The Maroons were slaves who had escaped and were living in the rugged Jamaican hinterland.³⁶ The geography of Jamaica is a factor that is constantly repeated in any discussion on the Maroons, slave revolts or colonial settlement. Running across the centre of Jamaica is range of mountains that is wild, rugged and inhospitable. The mountains have concealed valleys and inaccessible places into which runaways could disappear and from which they could make forays.³⁷

When the English captured the island in 1655 the Spanish slaves took the opportunity to escape into the interior to join other slaves who were already free. Between 1655 and the 1720s, by when their numbers may have been well into the thousands, these original Maroons were joined by escaped slaves who had well established settlements in the more remote areas.³⁸ The Maroons caused ongoing problems of varying severity for the English colonists. As more white settlers opened up new areas there was competition for land between them and the Maroons. The Maroons encouraged slaves to join them, and the Maroon's activities, including attacks on settlements, made some areas 'desolated' and travel dangerous. The expeditions that pursued the Maroons had little success because the Maroons had the advantage in the difficult terrain.³⁹ All this culminated in what is known as the first Maroon war which took place during the 1720s and 1730s. Craton suggests that 'the first war was fought as much to destroy the runaways' sanctuary as to remove the menace to settlements in outlying areas'.⁴⁰ In the treaties of 1739-1740 ending the war, Maroon societies were given formal recognition as being free from slavery, and formally granted tracts of land. In return the Maroons agreed to be peaceful and to serve the colonial government in the event of foreign invasion. They also agreed to help quell slave revolts and to track down and return future runaway slaves, for which they would be remunerated.⁴¹

The reasons postulated by various scholars for the slave revolts in the colonies in general, and Jamaica in particular, are complex and it is beyond the scope of this

³⁵ Richard Sheridan, 'The Jamaican Slave Insurrection Scare of 1776 and the American Revolution' (1976) 61:2 *The Journal of Negro History*, 290, 291-292; David Geggus, 'The Enigma of Jamaica in the 1790s: New Light on the Causes of Slave Rebellions' (1987) 44:2 *The William and Mary Quarterly* (3rd Ser) 274, 274.

³⁶ Their history goes back to the time when the island was colonized by the Spanish in 1509 bringing African slaves to the island for the first time. See generally Barbara Kopytoff, 'The Early Political Development of the Jamaican Maroon Societies' (1978) 35:2 *The William and Mary Quarterly*, (3rd Ser), 287.

³⁷ See for example; Monica Schuler, 'Ethnic Slave Rebellions in the Caribbean and the Guianas', (1970) 3:4 *Journal of Social History*, 374, 381; Patterson, above n 18, 321; Sheridan, above n 35, 291; Kopytoff, above n 36, 290.

³⁸ Michael Craton, *Testing the Chains: Resistance to Slavery in the British West Indies*, (Cornell University Press, 1982), 81; Kopytoff, above n 36, 288-89.

³⁹ Craton, above n 38, 78-81.

⁴⁰ Craton, above n 38, 228.

⁴¹ Sheridan, above n 35, 291-92; Kopytoff, above n 36, 306-07; Craton above n 38, 89-90.

article to examine this topic in depth.⁴² However there are some commonly accepted reasons that have especial relevance to the period leading up to the introduction of the Jamaican stamp act in 1760. While it would seem obvious that a desire for freedom would be a reason, or indeed the most compelling reason, there were usually other factors as well that led to open rebellion.⁴³

Schuler comments that 'some factors were more or less constant such as geography and the challenging existence of Maroon...settlements',⁴⁴ 'Maroon encampments were symbols of hope to slaves and a threat to slave discipline'.⁴⁵ This was certainly the case in Jamaica in 1760, only twenty or so years after the negotiation of the treaties which ended the first Maroon War.⁴⁶ Another reason was the ratio of slaves to settlers. Writing about the period from 1655-1740, Patterson comments that 'over a very short period of time, the slave group came to outnumber the ruling class by nearly ten to one', making it impossible to ensure the security of the colonial settlers.⁴⁷ Another commonly accepted reason for rebellion is the ethnic background of the slaves who rebelled. As Sheridan observes:

[A]lmost every one of the slave rebellions during the seventeenth and eighteenth centuries were instigated and carried out mainly by Coromantee or Akan slaves who came from the Gold Coast where the Ashanti Federation had a highly developed military regime which was skilled in jungle warfare.⁴⁸

The reference is to imported slaves, born in Africa, as distinguished from island born slaves who were known as 'creoles'.⁴⁹ By the middle of the eighteenth century over four-fifths of the Jamaican slaves had been born in Africa, perhaps more than half of these were Coromantee.⁵⁰ Tacky, the leader of the rebellion in 1760 that led to the Jamaican stamp act, was described by Edwards as 'a Koromantyn Negro ... who had been a Chief in Guiney', and the rebellion started on two plantations where there were upwards of 100 Gold Coast Negroes newly imported'.⁵¹ The conspiracy was grounded in such secrecy that it was known to most of the Coromantee slaves on the island without any suspicion on the part of the white settlers.⁵²

⁴² For an analysis of the reasons and analysis of the preceding authorities, see Michael Craton, *Sinews of Empire: a Short History of British Slavery* (1974) further refined in Craton, above n 38.

⁴³ Schuler above n 37, 380.

⁴⁴ Schuler, above n 37, 41.

⁴⁵ Schuler, above n 37, 376.

⁴⁶ Erin Mackie, 'Welcome the Outlaw: Pirates, Maroons, and Caribbean Countercultures' (2005) 59 *Cultural Critique* 24, 42-3.

⁴⁷ Patterson, above n 18, 318.

⁴⁸ Sheridan, above n 35, 293; Schuler, above n 37, 382; Patterson, above n 18, 319.

⁴⁹ Long, above n 13, 351.

⁵⁰ Patterson, above n 18, 319-321.

⁵¹ Bryan Edwards, *The History, Civil and Commercial of the British Colonies in the West Indies in Two Volumes, Vol II* (John Stockdale, 1793), 64. 'Coromantee' or 'Coromantin' are used in preference to 'Koromantyn' in the more recent authorities. The word(s) derive from the name 'Kormantine', a coastal trading post in Ghana: Schuler above n, 375. The name Tacky appears to be interchangeable with Tackey, but the former version is the most commonly used. In the context of a slave named Tackey who rebelled in Antigua in 1735, Craton comments (without citing a source), that Tackey is 'said to be the Akan word for "chief"': Craton, above n 38, 120.

⁵² Long, above n 13, 447.

A further reason, neglected by the literature on slave rebellions according to Geggus, was the movement of British troops and differing strengths in the local garrisons.⁵³ It was recognized by the colonial powers that the presence of garrisons would go some way to ensuring security where there was such an imbalance in the ratio of slaves to settlers.⁵⁴ Geggus says it is 'self evident' that slaves would have been aware of troop movements, and planned any revolt to coincide with reduced number of regular soldiers.⁵⁵ When referring to this aspect of slave rebellions, Geggus covers a broad sweep of the eighteenth and early nineteenth century, but mentions in particular Tacky's Rebellion, commenting that it 'followed by just over a year the dispatch of militia and military forces to occupy the French colony of Guadeloupe'.⁵⁶

It would also seem that many of the rebellions across the Caribbean in the eighteenth century began on estates where the proprietor was absent. Patterson refers to this as 'perhaps the most important [*feature*] ... conducive to revolt ...'.⁵⁷ The presence of the landlord kept in check gross mismanagement of the estate by attorneys and cruelty on the part of overseers, cruelty to the slaves being another motive for unrest. The problems caused by absentee landlords were of sufficient seriousness for the Jamaican Assembly in 1749 to record its anxiety on the matter in an address to the king.⁵⁸ In his account of Tacky's Rebellion in the second volume of *The History of Jamaica*, Long said:

As these insurrections and conspiracies had, for the most part, appeared upon estates belonging to persons resident in England, and the expences attending their suppression occasioned a very enormous sum to be levied in taxes, it was thought but equitable, that the proprietors, who, by their absence, had left their slaves in want of a due controul, and the personal influence of a master, and their estates to be defended by the personal services and hardships of other men, while they themselves were reposing in ease and affluence, beyond the reach of danger, ought to compensate for their non-residence by paying a larger share of the public charges, incurred in some measure through their means.⁵⁹

Tacky's Rebellion in 1760 happened at a most inopportune time for Britain because its focus and attention were elsewhere fighting to both maintain and gain supremacy paying little attention to its prized possession, the Jamaican colony. This lack of attention seemed to create a window of opportunity for the slaves to consolidate their positions. The naval war significantly increased the cost of imported provisions and the slaves were, according to Craton, "suffering from short rations and driven hard, [and] more than usually discontented and restless."⁶⁰

The capture of Guadeloupe had a direct connection to the Tacky's Rebellion. As mentioned earlier, in 1759 troops were sent from Jamaica to occupy Guadeloupe thus

⁵³ Geggus, above n 35, 293.

⁵⁴ Robin Blackburn, *The Making of New World Slavery: From the Baroque to the Modern 1492-1800*, (Verso, 1997), 344.

⁵⁵ Geggus, above n 35, 293. He makes a distinction between regular soldiers and the 'rash blundering and indiscipline of colonial militias', 292.

⁵⁶ Geggus, above n 35, 295.

⁵⁷ Patterson, above n 18, 321.

⁵⁸ Schuler, above n 37, 381; Sheridan, above n 35, 299.

⁵⁹ Long, above n 13, 388. Presumably the 'taxes' mentioned are those imposed by the 1760 Jamaican Stamp Act.

⁶⁰ Craton, above n 38, 126-27.

diminishing military strength on the island, a circumstance which would have been known to the slaves.⁶¹ In addition some slaves from Guadeloupe who had been involved in the fighting, and who were captured by the British and taken to Jamaica, were on one of the plantations where Tacky's Rebellion took place.⁶² Long describes them as 'the more dangerous, as they had been in arms in Guadeloupe, and seen something of military operations; in which they acquired so much skill ...'⁶³

Tacky's Rebellion started in the early hours of the morning on Monday 8 April 1760.⁶⁴ This happened to be Easter Monday, and it seems that slave revolts were often planned to coincide with holiday periods when the settlers were 'most vulnerable'.⁶⁵ The rebellion began in the parish of St. Mary where there were large numbers of slaves compared to the number of settlers, and where there was plenty of thick forests with good access to previously concealed supplies should retreat become necessary. The object of the rebellion was 'the entire extirpation of the white inhabitants; the enslaving of such Negroes as might refuse to join them; and the partition of the island into small principalities in the African mode; to be distributed among their leaders and head men'.⁶⁶

Slaves from two adjoining plantations, Frontier and Trinity, and from Heywood Hall, went to the fort at Port Maria (which was at the time without a garrison) where they killed the storekeeper and stole—a quantity of arms and ammunition. They then marched to Heywood Hall, where they set fire to sugar works and canes, and then on to Esher, murdering a white man on the way. At Esher they killed two white people, and 'mangled the doctor', who miraculously survived.⁶⁷ The rebels turned back to Heywood Hall and Ballard's Valley by which time their party, which now included some women, was around 400. A group of about 70 to 80 armed and mounted irregulars, led by Zachary Bayly from Trinity Estate, found the rebels resting in the forest off the road and during the ensuing fight several of the rebels were killed while the remainder retreated.⁶⁸

In the meanwhile two slaves from the Frontier Estate had taken horses and made their way quickly to Spanish Town which was 40 miles away, and alerted Governor Moore by one o'clock. Moore, who himself had an intimate knowledge of the terrain, declared martial law and quickly sent out two parties of regulars and two troops of horse militia. He also called upon the Maroons of Scott's Hall Town and the Leeward Maroons to advance on St Mary's parish from different directions.⁶⁹ Moore, a native of Jamaica with property on the island, had an intimate knowledge of the local conditions.⁷⁰ The strategy of confining the rebels in St Mary's parish was achieved in a week with the aid of more Maroons, and by closing down passes through the mountains, but the gains did not last long. The Maroons turned out to be uncooperative, and the regular soldiers, who were ill disciplined and inexperienced in this sort of fighting, found the terrain and weather difficult. The rebels took the

⁶¹ Geggus, above n 35, 295.

⁶² Craton, above n 38, 133.

⁶³ Long, above n 13, 452-53.

⁶⁴ Edwards, above n 51, 64; Craton, above n 38, 129.

⁶⁵ Sheridan, above n 35, 293.

⁶⁶ Long, above n 13, 447.

⁶⁷ Long, above n 13, 448-49 (the quote is at 449); Edwards, above n 51, 64-5.

⁶⁸ Long, above n 13, 449-50.

⁶⁹ Ibid 450-51.

⁷⁰ Ibid 462.

advantage by keeping on the move and traveling through the forest without staying in any one place for long. The rebels also had a psychological advantage because they believed that Tacky was invulnerable; his fame spread as he continued to escape all skirmishes without incident.⁷¹

News of the rebellion reached slaves in the more distant parishes, 'artfully misrepresented' according to Long so that they were given to believe that success for the rebels was close at hand.⁷² The uprising soon spread to other parts of the island. In May 1760 trouble broke out in the parish of Westmoreland when several whites were murdered on Captain Forrest's estate, where several of the slaves were from Guadeloupe, as discussed earlier. However, one slave from Forrest's estate acted as a faithful guide to the regulars and having shot one of the rebels was rewarded for his faithful services with an annuity for life, a silver badge and his freedom.⁷³ Again the militia failed to hold down the rebels, and was defeated after being ambushed. The rebels destroyed the equipment and crops on the Forrest estate, and killed slaves who refused to join them. After this, the number of rebels swelled until there were more than a thousand. There were also outbreaks in Clarendon, St Elizabeth and St James, and in June 1760 the Windward Maroons were sent to the parish of St Thomas-in-the-East to quell a plot at Manchionel.⁷⁴ Additionally, an act was passed in October 1760 ordering the payment of outstanding money to marooned negroes of Trelawny and Accompong Town in a bid to encourage Colonel Cudjoe and Captain Quaw to assist in the capture and destruction of those slaves who ran away or who were continuing the rebellion.⁷⁵ News of the rebellion also traveled to the mainland colonies in North America, with accounts appearing in the *Boston Gazette* on 28 July and 11 August 1760.⁷⁶

The rebellion in St Mary's parish continued until the death of Tacky in a battle with the Scott's Hall Maroons. After Tacky's death many of the St Mary's rebels committed suicide, while others negotiated for deportation and others returned to their plantations, claiming to have run away to escape the rebels.⁷⁷ In the west of Jamaica, however, the trouble continued. The Assembly was recalled in September 1760 so that Moore could 'explain the continuation of martial law, to persuade the members to tighten the militia and deficiency laws, and to authorize the payment of further bounties to the Leeward Maroons'.⁷⁸ It took a further thirteen months for Moore to announce in October 1761 that the rebellion was finally over.

According to Long⁷⁹ at least 1,000 people were killed in action, committed suicide, were executed or transported. He calculated the loss to the country, including damage to buildings, cane, cattle and slaves to be at least £100, 000. The final feature of the Jamaican social and economic landscape prior to the introduction of the Stamp Act is the range of taxes used in the colony, which is discussed in the next section.

⁷¹ Ibid 451-52.

⁷² Ibid 452.

⁷³ Minutes of the Journal of Assembly of Jamaica, December 10, 1760, p.238.

⁷⁴ Craton, above n 38, 132-33.

⁷⁵ Minutes of the Journal of Assembly of Jamaica, October 11, 1760, p.181.

⁷⁶ Whitson, above n 33, 66.

⁷⁷ Craton, above n 38, 137.

⁷⁸ Craton, above n 38, 137.

⁷⁹ Long, above n 13, 462.

2.4 Taxation in Jamaica

The fourth and final contextual feature relevant to understanding the emergence of the 1760 stamp duty is Jamaica's previous approach to taxation. Jamaica's taxation revenues during the eighteenth century were primarily from the deficiency tax supplemented by various other taxes (see below). The deficiency tax was designed to address the preponderance of negroes compared to whites in Jamaica that had existed prior to its being conquered by the English and was of sufficient concern in 1716 that legislative action was considered necessary. The Deficiency Act, reenacted annually, established a quota system whereby persons were required to employ white persons in proportion to the number of slaves, certain animals and vessels they maintained.⁸⁰ An example provided by Long⁸¹ is for hired or indentured white servants to be kept, in the following proportions:

One to every thirty slaves

One to every hundred and fifty head of cattle

One to every tavern or retail shop.

Fines were payable should the required white employment not be undertaken, and this levy formed the mainstay of Jamaican revenue raising for some years. The fine, or tax, varied from year to year, creating some uncertainty. The initial deficiency law was not a revenue raising measure, but instead an attempt to balance the population. Following the treaty with the Maroons, planters increasingly incurred deficiency fines, preferring to pay rather than bear the cost of employing white labour. This was particularly prevalent among the absentee landlords, whose profits from their land was diminished by commissions to managing agents in Jamaica, and therefore had incentive to keep costs as low as possible by not employing whites. Long describes an attempt to impose a heavier deficiency tax on absentee planters but this was vehemently opposed and blocked by the British Board of Trade. In one view, the absentees were negligent in not ensuring adequate white presence to protect against slave insurrections, which was detrimental to local society and therefore it was appropriate that they bear a higher contribution in the form of tax. The absentee counter argument was that they were paying fees to local agents (attorneys) to manage their plantations.

The early 1730s, prior to the entry into the treaty with the Maroons, regular British troops were needed to support the local militia and in 1733 and 34 a number of tax laws were passed to raise funds for, inter alia, the subsistence of troops⁸². These taxes included poll taxes on slaves, a tax on traders and rents from houses as well as a tax on specific officers. A 1734 law provided for a higher tax on slave and free coloured tradesmen, which Harris suggests⁸³ is evidence of the concern that the use of cheaper coloured tradesman would exacerbate the imbalance in population. Throughout the Seven Years War, Jamaica had continued to levy charges under the Deficiency Act, supplementing it with additional imposts. Harris⁸⁴ provides the example of the 1757 levy which followed the pattern of the 1733 Act and also included "a tax by the poll on trade super cargoes and masters of vessels in the out ports and on offices and rents

⁸⁰ Peter Harris, *Income Tax in Common Law Jurisdictions*, (Cambridge University Press, 2006), 249.

⁸¹ Long, above n 13, 381.

⁸² Ibid 249-50.

⁸³ Ibid 250.

⁸⁴ Ibid 267 by reference to NA CO 139/19, 20.

and applying the same to several uses". In 1758 a tax on carriages was added.⁸⁵ The West Indies were similar to the southern mainland American colonies in their heavy reliance on poll taxes as a revenue source, although with greater emphasis on slaves.⁸⁶

Although the Deficiency Act had evolved into a measure specifically to raise tax revenues, the Governor, attempted to use it as means of rewarding resident planters in Jamaica during Tacky's Rebellion in 1760 by giving a fifty percent discount on the tax. The British parliament considered that this constituted unequal taxing of resident and absentee planters thus did not give support for this measure. Absentee planters were not in favour of this either. This irked the governor who stated⁸⁷:

It appears by the agent⁸⁸, Mr. Stanhope's account that the gentlemen of the island who are in England, do for their little services they may render this country make a charge of their expenses for their meetings at taverns and coffee houses on many of the business of this island as they expect to be part for these trifling occasions, it cannot be deemed wrong that gentlemen, these should be paid for such extraordinary services.

This underscores the highly political nature of taxation and in particular the complex power plays associated with the introduction of new forms of tax. The paper now turns to the specifics of the 1760 Jamaican Stamp Act including its coverage and operation.

3 THE JAMAICAN STAMP ACT

The preceding discussion sets the scene for the introduction of the Jamaican Stamp Act which was passed on the 19 December 1760, effective 1 March 1761.⁸⁹ The act was entitled "An Act for raising Tax by a Duty on Vellum Parchment and Paper ascertained by Stamps and applying the same to Several Uses". The extra revenue was required to strengthen the militia, in response to Tacky's Rebellion.⁹⁰ The preamble to the act specifically acknowledges that previous attempts to raise revenue to support government were inadequate making reference to the 'present extraordinary Exigencies and Contingencies'.

The legislature in Jamaica at the time comprised three institutions. The governor was head, as the representative of the British crown. A Council, comprising twelve gentlemen appointed by the King, acted as an upper house. The lower house, the Assembly, comprised representatives elected by the freeholders of Jamaica. The tensions between the resident and absentee planters were evident in the discussion of the proposed bill in the Jamaican Assembly:

⁸⁵ Ibid 267 by reference to NA CO 139/19, 42.

⁸⁶ For a discussion of slave taxes in the American colonies, see Kevin Outterson, , 'Slave Taxes' in Tiley, J (Ed.) *Studies in the History of Tax Law*, Vol. 1, (Cambridge University Press, 2004), 263-282. See also Robin Einhorn, *American Taxation, American Slavery*, (University of Chicago Press, 2006).

⁸⁷ Minutes of Jamaica Council of Assembly held on December 18, 1760 at St Jago de la Vega, document 42.

⁸⁸ In the eighteenth century, each of the American and West Indian colonies was represented by an agent in London, acting as parliamentary lobbyists and reporting back to the respective Colonial governors.

⁸⁹ NA CO 139/21. The only version of the act the authors were able to obtain is extremely hard to decipher being closely hand written with no breaks or section numbers.

⁹⁰ Spindel, above n 8, 210.

We think it very extraordinary, that, upon the hearing before the lords of the trade, concerning our stamp bill, which passed the legislature unanimously, any gentlemen in England should, because they have properties here, take upon them to determine, that the bill was unnecessary; and assert, contrary to our experience that it would be ineffectual: Whatever those gentlemen may think of themselves, we do not by any means allow them to be competent judges of the expediency of laws that have passed the legislature; we therefore desire, that you will take no instructions from any gentleman in England, relative to the affairs of this island, unless you are directed by the committee to do so.⁹¹

The act stipulated an end date of 31 December 1761 but its operation was later extended for a further two years. There is, however, no evidence as to why it applied for such a short period of time, other than by implication due to the specific revenue needs for which it was introduced.⁹²

The act imposed stamp duty on a range of legal, court and commercial documents as well as military commissions. Governor Moore and members of the council and assembly were appointed as Commissioners able, *inter alia*, to empower the Receiver General to acquire and have stamped paper of varying sizes to cover the various types of dutiable instrument. The act was very specific in relation to the size of paper and the rates applicable to each sheet; the following is the wording of this section of the act, reproduced to demonstrate fully the extraordinary detail as to size and type of paper⁹³:

THE Sheet to be deemed a sheet and to Contain Forty Lines of Writing in each Sheet and each Line to be allowed as if Continued from one Edge of the Paper to the Contrary Edge and to Contain Twenty Eight Words in each Line and no more or on paper Commonly called or known by the names of Post Paper Pro Patria;

And Fools Cap Paper or any Paper Vellum or Parchment of the same Size one side of the sheet to be deemed a Sheet and to Contain twenty four lines in each sheet and each line to be allowed as continued from one Edge of the Paper to the Contrary Edge and to Contain twenty Words in each line and no more

Paper commonly called or known by the Names of Kings Arms Crown or Pott paper or any Paper Vellum or Parchment of the same or lesser size one side of the sheet to be deemed a sheet and to contain twenty lines of writing in a sheet and *

1	For stamping each and every sheet of paper called imperial or Royal Paper of the same size	Three Shillings and nine pence for stamping
2	For stamping Paper commony [sic] called medium or Demi Paper or any Paper Piece or Skin of Vellum or Parchment of the same Size	Two Shillings and Sixpence

⁹¹ Journal of Assembly of Jamaica, November 7, 1760, pp.199-200.

⁹² Oats and Sadler, above n 6, 67-75.

⁹³ As noted earlier, the only copy of the act the authors were able to obtain was difficult to decipher. The transcription here is that of the authors.

3	For Stamping each and every Sheet of Paper commonly called Post Paper Pro Patria or Fools Cap Paper or any Paper Piece of Skin of Vellum or Parchment of the same size	One Shilling and Ten pence half penny
4	For Stamping each and every Sheet of Paper Commonly Called Kings Arms Crown or Post Paper or any Paper Piece or Skin of Vellum or Parchment of the same Size	Seven pence * half penny

The dutiable documents and respective duty payable are detailed in the Appendix to the paper. The majority of dutiable items were legal documents including mortgages and court instruments, grants, and letters patent. Also dutiable were bills of lading, wine and spirit licences and certificates of naturalization.

Specifically exempted from duty were:

Any Act of the Council or Assembly, Proclamation, Acts of State, Votes or matters ordered to be printed by either Branch of the Legislature

Bills of Exchange accounts Bills of Fees or any Bills or notes not Sealed for Payment of Money nor to Charge the Probate of any Will or Letters of Administration of any Common Sailor or Soldier who shall be slain or die in His Majesty's Service the same appearing by a Certificate produced from the Captain under whom he served with the Duties charged by this Act.

The machinery for operating the stamp duty was particularly cumbersome. Commissioners were appointed, comprising the Governor and members of the legislative council and assembly, who were then empowered to appoint someone "to Execute and perform the Duties and Trusts hereafter required" The Receiver General was empowered to purchase quantities of paper of different sizes and sort and have the various forms printed and stamped and was accountable. The task of determining the relevant quantities of forms and arranging for their stamping was onerous, and this approach to making pre stamped forms available ran counter to the extant British stamp duty under which persons dealing in dutiable items purchased their own paper and arranged stamping at the Stamp Office.⁹⁴

⁹⁴ See Oats and Sadler, above n 6.

The act also contained an interesting array of penalties for non compliance⁹⁵:

	Breaches	Penalties
1	Receiver general not giving receipt or accountable for stamp papers bought	Five Hundred Pounds
2	Persons Engrossing on paper without being Stamped	
2A	If any Person shall Engross write or print or Cause to be Engrossed written or printed upon any Paper Vellum or parchment is hereby charged to pay any Duty before such time as the said Paper Parchment or Vellum shall be marked or Stamped or upon which there shall not be a Stamp or mark resembling the same or shall Engross Write or print or Cause to be Engrossed written or printed any matter or thing upon any paper Parchment or Vellum that shall be Stamped or marked for any lower Duty by this Act payable for what shall be Engrossed written or printed thereon such Persons	Forfeiture of ten pounds for each offence
2B	Any Officer Clerk or other person who in respect of any publick Office or Employment is intituled to make Ingross or write any Records Deeds Instruments or Writings by this Act charged to pay a Duty or shall Issue any such otherwise than by this Act prescribed and required or Commit and Fraud or practice whereby the Duties to arise or intended to arise by this Act shall be lessened impaired or lost	Legally Convicted and shall over and above the Penalties, forfeit his office place or Employment respectively
2C	Any Attorney, Solicitor or Proctor belonging to any Court shall be guilty of any fraud or practice (as mentioned in 2A) and convicted	Disabled for the future from practicing as an attorney, Solicitor or Proctor in any Court

⁹⁵ These were more comprehensive than the earlier colonial acts in Massachusetts and New York, see Oats, and Sadler above n 6, 67-75. The numbering in this list is the authors' own.

- | | | |
|---|--|--|
| 2D | If any Deed, Instrument or Writing or Copy thereof by this Act Charged with Payment of a Duty aforesaid shall Contrary to the true Intent and meaning thereof be written Ingrossed or printed by any Person or Persons whatever not being a known Clerk or Officer who in respect of any Publick Office or Employment is or shall be Intitled to the making, writing or Engrossing the same upon Paper Parchment or Vellum not marked or Stamped according to this Act or marked or Stamped for a lower Duty as aforesaid that then and in every such Case | Pay to the Receiver General the Sum of five Pounds over and above the duty |
| <p>3 Persons Counterfeiting the Stamp to be deed guilty of Felony</p> | | |
| 3A | If any Person or Persons whatsoever shall at any Time or Times hereafter Counterfeit or forge any Stamp or mark to resemble any stamp or mark which shall be provided or made in pursuance of this Act or shall Counterfeit or resemble the Impression of the same upon any Paper Parchment or Vellum thereby to Defraud the publick of any of the Duties hereby granted or shall utter Vend or sell any Paper Parchment or Vellum with such Counterfeit Mark or Impression thereupon knowing such mark or Impression to be Counterfeited | Convicted as felon and shall suffer death without the benefit of a clergy |
| 4 | Every Foreigner who shall be Naturalized in this Island shall be obliged to take or procure a certificate | Penalty of twenty pounds |

One particularly interesting and unique feature of the Jamaican stamp act is a set of provisions specifying how the money raised was to be expended. In addition to military purposes there 'were grants to various parishes for 'maintaining sick and poor persons'. There were also some rather curious grants, for example one of £118 15s 'to the person that shall win the race to be run on the Race Course of Saint Iago De La Vega ... to Encourage the Breed of good and Large Horses', and two £5 per annum annuities to specified individuals".⁹⁶

A tantalizing glimpse of the impact of the workings of the Jamaican stamp act and its impact can be found in the testimony of two witnesses before a British Parliamentary Committee (hereafter the Stamp Committee), established in 1766 to examine the

⁹⁶ Oats and Sadler, above n 6, 67-75: by reference to NA CO 139/21.

failure of the imperial stamp act of 1765⁹⁷. A summary of the oral evidence of the witnesses is contained in a document held at the British Library⁹⁸. The committee was chaired by Mr Fuller and on June 17, James Carr, a Jamaican merchant and attorney, gave evidence in relation to the Jamaican stamp act. James Carr confirmed that the tax had been introduced as a direct consequence of Tacky's rebellion and was questioned in relation to the workings of the act in terms of what documents it applied to and also the manner of its collection. Carr was adamant that the most problematic aspect related to it being 'unequal', by which he meant that it impacted most heavily on the poor, primarily as a consequence of its application to law suits, saying 'I have myself paid from 300 to 500 per annum for stamps on law suits'⁹⁹, and later stated that considerably more than half the revenue raised by the stamp act came from this source. Carr dismissed the suggestion that one possible benefit of the stamp duty on law suits was to check the 'litigious disposition', repeating that poverty was the problem, not any 'litigious disposition'.

Carr also alluded to the difficulties in administering the act in light of the geographical distances involved, which was also a problem with the Imperial stamp act imposed on the British colonies in both America and the West Indies in 1765¹⁰⁰.

There was some questioning by the Committee regarding the reasons for the repeal of the Jamaican Stamp Act, and despite the insistence of the questioner that the repeal would have been occasioned by the heavy tax on militia commissions and justices of the peace, Carr remained adamant that it was the 'oppression of the poor' that prompted its repeal. According to Carr, the Jamaican Stamp Act produced gross annual revenue of £18, 000, net from £11, 000 - £12, 000.

The second witness to the Stamp Committee was James Irwin, a planter, who was a Member of the Jamaican Assembly. Irwin supported Carr's testimony that the act was 'unequal and burthensome because the money was principally raised by law suits which fall on the poor'¹⁰¹. He also stated that the stamp act 'made the proceedings dilatory on account of mistakes and frauds'.¹⁰² The concern of the Stamp Committee was the potential problems for the Imperial stamp act, and the reason for the questioning of the two Jamaicans was to probe the problematic aspects of the Jamaican Act. Irwin observed that the Imperial act, being more complex with a wider range of provisions including forfeitures and penalties, would be even more difficult to enforce than the Jamaican act had been.

Irwin informed the Stamp Committee when questioned about the amount of duties on legal proceedings, that the only duty at the rate of £10 was that imposed on Commissioners. When asked whether this would be cause for complaint, he responded 'so far from it that they would consider as the getting them at a cheap rate'¹⁰³, although later conceding that there were complaints about the duty on commission subsequent to the discharge of the debt for which the stamp proceeds were required to fund.

⁹⁷ Lynne Oats, and Pauline Sadler, 'Accounting for the Stamp Act Crisis', (2008) 35:2, *Accounting Historians Journal*, 101-144.

⁹⁸ BM Add Ms 33030.

⁹⁹ BM Add Ms 33030 f182.

¹⁰⁰ Oats and Sadler, above n 97.

¹⁰¹ BM Add Ms 33030 f186

¹⁰² BM Add Ms 33030 f187

¹⁰³ BM Add Ms 33030 f187

Irwin was also questioned as to the reason for the eventual repeal of the Jamaican stamp act and said it was because of 'the extraordinary oppression to the poorer sort of people'¹⁰⁴. He further observed that the first year of operation, the act was tolerated due to lack of understanding, whereas the second and third years of operation was 'from necessity'.

Very little has been previously written about this peculiar tax. The drafting of the Act was unusual in its specificity, and the manner of its implementation was cumbersome to say the least. The choice of fiscal instrument almost certainly reflects political tensions, in particular around the impact of absentee landlords on the Jamaican social and economic environment.

4 CONCLUSION

Jamaica was one of the prized British colonies, making a substantial economic contribution to the British economy; important at a time of military engagement in the Seven Years War which threatened the contribution of Jamaica to the British purse. Tacky's Rebellion of 1760 threatened to ruin this status as a prized colony and the quashing of the rebellion was an expensive affair. To raise funds to cover the cost of the rebellion, the government passed the Jamaica Stamp Act which took effect from March 1761 and expired in 1763 allegedly raising gross annual revenue of £18,000.

The passing of the act was not without tensions between the local and absentee planters and seemed not to have received wide support of its operation. The act levied stamp duty on various legal, court, commercial documents and military commissions and carried thirteen denominations of stamps. Penalties for breaches not only contained monetary fines but also included losing one's employment, profession and even death without benefit of a clergy. The Jamaican stamp was curiously different from the New York and Massachusetts equivalents, which had been some years imposed earlier. This is indicative of the relative independence of the West Indian colonies from those in mainland America, although in other tax raising measures there were similarities, for example the poll tax on slaves.

The events described in this article illustrate three key features of eighteenth century taxation. The first is the relative willingness to accept new and arguably inappropriate forms of taxation when faced with extraordinary conditions such as war, or in this case, violent slave rebellion. The second relates to the importance of the social and cultural context within which taxes emerge and then survive, becoming embedded in the fabric of a country's revenue raising, or die as failed experiments. The third is the inevitable overlay of politics, as illustrated vividly by the following address by Governor Moore to the Jamaican Assembly on 24 November 1762¹⁰⁵:

I would not suffer the violent and factious measures of three or four among you, to prevent me from bringing this session to a conclusion in the manner I have; and I have now had the satisfaction to pass such bills as were necessary for the support of this majesty's government, and indeed all that have been presented to me; but I take this public occasion to declare, that, as I shall always despite the practices of any man who, under a false shew (sic) of zeal for the general good, shall seek, by aspersing me, to weaken the

¹⁰⁴ BM Add Ms 33030 f187.

¹⁰⁵ Journals of the Assembly of Jamaica, November 24, 1762, p. 384.

king's authority in my person, that he himself may maintain an undue influence in the community, destructive of the good order of his fellow citizens, so I shall willingly resign my office, the moment the king my master shall judge it to be conducive to his service; and that those who may with my removal, shall have no other motive to desire it, but the welfare of this island, I do with the advice of his majesty's council, in his majesty's name, prorogue this general assembly unto Tuesday, the 4th day of January next, and its prorogued accordingly.

APPENDIX

	Dutiable documents	Duty Payable
1	Grants or Letters patent / excepting of Kings Land for every Nomination therein under the Seal of this Island or of any Profit Advantage Honor Dignity Preferment or Promotion or Exemplification of the same	Five Pounds
2	Pardon of any Crime, Sum of Money or Forfeiture of any Warrants of Reprieves Relaxation from any Punishment or other Forfeitures	Five pounds
3	Order for Lands or any other Beneficial Order under the Sign Manual or Seal at Arms of * the Governor for any Sum exceeding twenty Pounds	Two Shillings and Sixpence
4	Grant Commission, Warrant or Appointment from the Governor for any Office or Employment of the Value of one hundred Pounds per annum or upwards	Five pounds
5	Benefice or Church Living	Ten pounds
6	Admittance of any Attorney Solicitor, Clerk, Advocate, Proctor or Notary or other Officer in any Court	Ten Pounds
7	Publick Attestation to any Appeal from the Court of Admiralty, the Court of Chancery or the Court of Errors or the Supreme Court of Judicature	Five pounds
8	Any paper skin, vellum or parchment on which Commission of General Officer of the Militia is written or printed	Ten Pounds
9	Any paper skin, vellum or parchment on which Commissions of Field Officer or of any Person who shall rank as such of the said Militia shall be written or printed	Five Pounds
10	Any paper skin, vellum or parchment on which Commission of Captain shall be written or printed	Two Pounds ten Shillings
11	Any paper skin, vellum or parchment Commission of Subaltern Officer of the said Militia shall be written or printed	One Pound five Shillings
12	Every piece or sheet of paper skin, vellum or parchment on which Recognizance shall be written	Five Shillings
13	Every piece or sheet of paper skin, vellum or parchment on which Special Bail shall be written	Five Shillings
14	Every piece or sheet of paper skin, vellum or parchment on which any Commission shall issue out the Court of Chancery/Commission of Rebellion upon Process excepted or out of the Supreme Court or any other Court of Judicature shall be written or printed	Ten Shillings
15	Affidavit or any Copy of an Affidavit that shall be filed and read in any Court. Affidavits taken before Officers of the Customs or before any Justice of the Peace Pursuant to any Act for laying Taxes or relating to the Execution of their Duty as Justices or to any Debt under Forty Shillings	Two Shillings and Sixpence
16	Notice, Citation, Petition, Protection Rule Order or Office Copy filed , read or granted in any Court	Two Shillings and sixpence

17	Deed, Conveyance, Reconveyance, Lease Release, Renunciation, Mortgage Surrender, Gift Grant or any other Deed	Two Shillings and sixpence
18	Attestation or Exemplifications that shall pass the seal of any Court	Twenty Shillings
19	Institution, Licence, Letters, Testamentary, Letters of Administration Letters of Guardianship, Dedimus Potestatem, Warrants of Appraisement or any other Instrument that shall pass under the Seal at Arms of the Governor and Commander in Chief as Ordinary or Duplicates in Offices of Record or Office Copies thereof or any Letter of Mart	Ten Shillings
20	Licence for selling Wine called Grand Licence	Ten Shillings
21	Petty Licence	Five Shillings
22	Declaration or copy Writ of Summons or Arrest signed by the respective Clerk of any Court	Seven pence halfpenny
23	Writ of Error, Certiorari Habeas Corpus, Capias Replevin Partition Dower Possession Scire Facias or Distringas	Two Shillings and sixpence
24	Writ issuing out of the Supreme Court or any Inferior Court of Judicature	Two Shillings and Sixpence
25	Charter Party, Policy of Insurance protest, Letter of Attorney or any other Notarial Act	Two Shillings and Sixpence
26	Bill of Loading or Receipts for Goods, Wares Merchandizes to be Exported	Seven pence halfpenny
27	Bond to be Executed between Party and Party	Five Shillings
28	Penal or Security Bond to His Majesty, his Heirs and Successors	Two Shillings
29	Certificate Permit or Cockett from the Receiver General Controulr, Secretary, Naval Officer, Collector or his or their Lawfull Deputy or Deputies or from any other officer of any Court of Judicature or public Office or from any Clerk of the Peace or Vestry of any Precinct or Parish excepting such as relate to Taxes or any Certificate of Marriage	One Shilling and three pence
30	Dockett Extract or Paragraph out of any public Office	Seven pence halfpenny
31	Demurrer, Pleas, Replications or Rejoinder filed in or Deposition or Interrogatory taken by Commission Issuing out of any Court	Two Shillings and Sixpence
32	Judgment by any officer belonging to any Court	Five Shillings
33	Platt or Return which shall be returned into any Court or Office or any Copy of any Platt out of any public Office	One Shilling and three pence
34	Probate of any Will	Ten Shillings
35	Precept from the Provost Marshall Required to issue and singly every Writt	Seven pence half penny
36	Passport or Lett, Pass for ships or Vessels departing the island	Two Shillings and sixpence
37	Passport or Lett pass of Vessells coasting about the Island	Five Shillings

38	Subpena Attachment or Dodimus Issuing out of the Court of Chancery	Ten Shillings
39	Subpena Issuing out * of the Supreme Court or any Inferior Court of Judicature	One Shilling and three pence
40	Copy of Toll signed by a Clerk of the Peace	Two Shillings and sixpence
41	Commission for a flag of Truce	Ten Pounds
42	Commission or Warrant of Brigade, Major Adjutant General adjutant muster master or Commissary	Five Pounds for every Commission
43	Masters of Vessels to give Security in the Secretary's Office not to Sign any Bills of Lading unless Stamped of Captain or Lieutenant of the Train	One pound five Shillings (security)
44	Masters of ships or Vessells trading to or from this island shall and they are obliged and required to give Security in the Secretary's Office that they or any person for them with their privity or consent shall not from and after the first Day of March next Sign any Bill of Loading or Receipt for any Goods, Wares or Merchandizes to be Exported other than such as are Stamped in the manner required by this Act and the Secretary of this Island is hereby impowered and required to take such Security by inserting the same in the Condition of the Bonds of Masters of Vessells giving Security in his Office	Ten Pounds (Security)
45	Certificate of Naturalization and	Ten Pounds
46	Contract of marriage among the Jews vulgarly called a Kettubah	Ten Shillings

Not argued from but prayed to. Who's afraid of legal principles?

Hans Gribnau*

Abstract

What is the use of legal principles in taxation? And do they have anything to do with morality? These are the main questions this article addresses - focusing on the theoretical and practical role of fundamental legal principles on the European continent. It is argued that principles indeed embody the dimension of morality (justice, fairness) – other than policies. These abstract principles are to be distinguished from rules, which contain more specific standards for behaviour.

Moreover, law-making and law-applying institutions are not the authors of legal principles, for they find the principles in the law. Because principles are external standards to law-makers, the body of rules established by law-makers should be in conformity to fundamental legal principles. Hence, legal principles - embodying the 'internal morality of law' – function as essential criteria of evaluation. Furthermore, these regulative ideals can be entrenched in a broader philosophy of law which accounts for some of their characteristics - such as inconclusiveness. Legal values and principles connect the legal system with the moral values and principles prevailing in society; the former function as a kind of filter. Thus, legal principles are vehicles in the movement back and forth between legal values and legal rules. Abstract principles in turn cannot be applied directly unless they are specified and elaborated in rules.

Next, this theory is put into practice. Some examples in the field of tax law are discussed in order to show the added value of the principle-based method of legal reasoning which can take account of varying circumstances. It will be shown that judges actually make use of principles, for example as the normative basis for rule-making. Moreover, it will appear that if it is not (yet) possible to establish a rule, priority principles may be developed to guide law-making. Thus, these examples show some aspects of principle-based reasoning in tax law. The practice of tax law reflects a theoretical approach which conceives of law as a system of rules based on coherent set of moral principles.

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1 INTRODUCTION AND OUTLINE

1.1 Introduction

Legal principles seem to be a source of confusion. John Tiley once wrote that principles in European law have ‘an aspirational aspect with words of such high abstraction that they are waiting to be not analysed but invoked, not argued from but prayed to.’¹ Also strange to common lawyers and especially tax lawyers is ‘the method by which the court states the principle and then works down to the facts.’² According to John Avery Jones the higher level of abstraction accounts for the principle being ‘something external to the rules which helps one to construe the rules.’³ So common law principles stay close to the ground in contradistinction with ‘European’ principles. Apparently such a higher level of abstraction causes common lawyers to change the terms of discourse - from legal reasoning to praying -, which is mildly surprising to some other lawyers, for example those from the European continent.

Xavier Groussot for example states, that principles ‘don’t fall from heaven, [they] are not invented from nowhere.’⁴ He refers to European Court of Justice case law where general principles are based on the law common to the member states of the European Union, international law and the consecutive treaties of the European Union (most recently, the Treaty of Europe, the Treaty on the Functioning of the European Union and the EU Charter of Fundamental Rights). In case law fundamental rights are recognized as general principles of European Union law. Elaborated in case law these general principles, the main tool of judicial development, offer a strong protection regarding individual rights. Thus, the judiciary gradually developed and elaborated these legal principles which as a result became less abstract - for their meaning is made clear in concrete cases.

In this article, I will not reflect on terms and concepts like ‘pray’ and ‘heaven’, being far outside my field of expertise. Neither, I’ll analyse the principles of European Union law – though I will now and then refer to views on features of these principles by way of examples. Instead, I’ll take a more theoretical approach. I will merely analyse the concept of a (fundamental) legal principle and the way a legal principle may function in a legal system – elaborating on Ronald Dworkin’s theory of principles. Though Dworkin was an American legal scholar, his theory of law definitely has the flavour of principle-based reasoning on the European continent.⁵ To that end I will look for a legal philosophy which enables me to entrench principles in the legal system. More specifically, there is need for a philosophy of law which accounts for the fundamental role of legal values in the legal order, a value-oriented philosophy of law, for principles appeal to moral values.

Moreover, I will address the issue of how to transpose principles into rules, for principles are indeed too abstract and unspecific to dictate outcomes in concrete cases

¹ J. Tiley, ‘The Law of Taxation in a European Environment’, *Cambridge Law Journal* 51(3) 1992, p. 451-473, at p. 467.

² Tiley 1992, p. 469.

³ J. Avery Jones, ‘Tax Law: Rules or Principles?’ *Fiscal Studies* August 1996 Vol. 17. Issue 3, p. 76.

⁴ X. Groussot, *General Principles of Community Law*, Europa Law Publishing: Groningen 2006, p. 10.

⁵ Robert Alexy has developed his own theory on the basis of Dworkin’s insights. For an application in the field of (European) tax law, see S. Douma, *Optimization of Tax Sovereignty and Free Movement*, Amsterdam: IBFD 2011. Here, I will mostly keep to the original, i.e. Dworkin’s theory, in order not to complicate matters further.

– a feature which John Tiley may have had in mind. Rules, however, contain less general, more specific standards for behaviour. As a result, both the abstract and the aspirational aspect of principles, elaborated in rules, may become manageable. Thus legal principles, themselves not in any way rigid standards of behaviour, but on the contrary, flexible standards, are fleshed out in rules in specific contexts and situations. All the more reason, not to be afraid of principles ‘in the European sense.’

The research question of this article, therefore, is formulated as: how to understand legal principles as regulative ideals in a broader philosophy of law which accounts for their relationship to rules? I will not elaborate on the common law conception of principles. Nonetheless, I will briefly deal with some common law authors to give the reader an impression so as to appreciate the radically different starting point of a value-based theory and the various features of principles as they are conceived by legal scholars on the European continent.

In passing I cannot but touch upon some aspects of legal positivism, not to give a complete picture of that theory. But pointing out striking contrasts may elucidate some features of principles and its background theory of law – which is value-related.

1.2 Outline

This article is structured as follows. I'll start with Dworkin's distinction between legal principles, policies and rules (§ 2). In his theory, legal principles embody a dimension of morality or fairness - other than policies. Principles state reasons which argue in a direction, they do not dictate an outcome, and they may collide with principles arguing in another direction. In the latter case their relative weight has to be determined to resolve the conflict. According to this substantive conception of law, (fundamental) legal principles connect law to the morality of a society and are therefore the normative basis of the body of rules; they are the underlying justification for the body of rules and therefore standards for evaluating these rules. In passing, I will point at two differences with H.L.A. Hart's view on legal principles, which shed more light on the aforementioned characteristics. In section 3, I will briefly deal with McCormick's theory which conceives of principles as standards constructed by the legislator and the courts to achieve rational coherence. Other than Dworkin, he does not make any reference to a necessary connection to morality. The same goes for his view on policies, which fits well into a 'coherent principle approach' to drafting legislation.

Next, I will argue that principles are standards preceding any law-making act, they are not something which law-makers construct (§ 4). The latter find principles in the law according to the Dutch legal scholar Scholten - they have to further develop these principles and elaborate them into rules. This accounts for a kind of 'empty place' of law-making power: principles do not originate in the will of some law-making institution. They are a kind of standards to assess the legitimacy of the body of legal rules, external to law-making power. Fundamental legal principles set boundaries to legislative policies and rule-making. The actual content of fundamental legal principles is the result of a dynamic collective debate by different legal and societal actors. Hence, the question as to what is considered legitimate power, and therefore, about the principles that limit this power is subject of a permanent debate. Moreover, legal principles never coincide with positive law; this feature accounts for their evaluative, critical function. Principles appeal to some moral value – which accounts for some of their characteristics. The next step will be to further entrench fundamental legal principles in the legal system by way of Radbruch's value-oriented philosophy of law

(§ 5). Law is oriented towards its supreme value: the idea of law. Law aims to realize justice. Radbruch maintains that law is not just a social fact, because it is value-oriented. Law is ultimately motivated by an understanding of a basic human good, viz. justice. Radbruch distinguishes three elements of justice that the law aims for: legal equality, purposiveness, and legal certainty. These fundamental values underlie the legal system. It will be argued that they are not mere abstractions but are elaborated and clarified in concrete situations. The value of purposiveness conceptualizes the external – e.g., societal and statal – input into the legal order which, however, has to pass the filter of equality and legal certainty.

In section 6 I will recapitulate some of the findings. Legal principles are concretizations of legal values in the legal system - at a lower level of abstraction. Legal values and principles connect the legal system with the moral values and principles prevailing in society; the former function as a kind of filter. Legal principles are vehicles in the movement back and forth between legal values and legal rules. Abstract principles cannot be applied directly unless they are specified and elaborated in concrete, often quite technical, rules. Legal principles function as essential criteria of evaluation, in the sense that law-makers are bound by legal principles. This is a conception of law where law is conceived of as based on a coherent set of principles, which express the moral dimension of law.

Then, I will discuss some examples in the field of tax law (§ 7). I will show the added value of the principle-based method of legal reasoning which can take account of varying circumstances.

First, I will show that notwithstanding the high level of abstraction of principles, principles can be elaborated into a theoretical model to assess the existing case law and predicts future developments in the case law. Here, I will make use of Douma's model which analyses the free movement case law of the European Court of Justice. A next demonstration of the relevance of legal principles for legal practice concerns the principle of equality. In the Netherlands, this principle restricts the legislative power to tax. In case law it is used to test tax legislation – thus functioning as a (limited) check on legislative power and protecting citizens against arbitrary interferences with their lives. Then, I will deal with the question how principles are elaborated into rules. Here, the case law of the Dutch Supreme Court serves – once more - as an example. On the one hand, the Court has developed principles of proper administrative behaviour and, on the other hand, it has elaborated these principles in so called priority rules. The last topic concerns retroactivity of tax legislation. Here, it will appear that it is not possible to translate the outcome of the collision of legal principles in (hard and fast) rules for lack of certain types of regularly occurring situations. However, it is still possible to develop standards which guide law-making. Pauwels has developed a principle-based framework for the tax legislator. He shows that when the relevant colliding principles are balanced, this balancing can result in lower level principles, which he calls 'priority principles.'

The final section consists of the conclusion.

2 DWORKIN'S THEORY OF LEGAL PRINCIPLES

2.1 Principles, policies and rules

Attacking legal positivism, Ronald Dworkin famously argued that when lawyers in hard cases reason about legal rights and obligations they make use of two kinds of standards. On the one hand they use rules, on the other hand 'standards that do not function as rules but operate differently as principles, policies and other sets of standards.'⁶ Before dealing with the difference between principle and rules, Dworkin distinguishes principles and policies - though he also uses the term 'principle' generically. He then defines a (legal) principle as a standard which is to be observed because it is 'a requirement of justice or fairness or some other dimension of morality.'⁷ A policy is that kind of standard that 'sets out a goal to be reached, generally an improvement in some economic, political, or social feature of the community.'⁸ The most striking difference is that, other than policies, principles express moral requirements. Thus, principles embody the dimension of morality which according to Dworkin is part and parcel of the law. My focus will mainly be on principles in this narrow sense.

Dworkin next distinguishes principles in the generic sense from rules. Principles differ from rules in a number of ways. First, he argues that the difference between the two kinds of standards is a 'logical distinction', for they differ in the character of the direction they give with regard to legal decisions. Rules are applicable in an 'all-or-nothing fashion.' If the conditions provided in the rule are met, the legal outcome follows automatically. If the facts a rule sets out are given, either the rule is valid, and the legal consequences it supplies must be accepted, or it is not. If the rule is not a valid rule, it must be renounced or rewritten, for it contributes nothing to the decision. Legal principles do not operate this way. They state a reason which argues in one direction, but does not compel to take a particular decision. Legal consequences do not follow automatically, for there may be other principles (or policies) arguing in another direction.⁹ A legal principle that does not prevail, still contributes to the decision, and may be decisive in the next case or situation to be decided. Thus, officials have to take a principle 'into account as a consideration inclining in one direction or another.'¹⁰

⁶ R. Dworkin, *Taking Rights Seriously*, London: Duckworth 1977, p. 22. Legal positivism, with its pyramidal structure of valid rules, holds that the morality or immorality of a law is a matter conceptually distinct from its validity. Contrary to legal positivism, Dworkin maintains that judges have no discretion when they run out of rules, i.e. when there are no applicable rules (hard cases), they are still bound by principles when they create new rules. The principles that figure in legal argument, are not identified by any broadly accepted master test of pedigree.

⁷ This dimension is also a feature of general principles of European Union Law. Cf. T. Tridimas, *The General Principles of EU Law*, Oxford: Oxford University Press 2006, p. 26: 'to be elevated to the status of a general principle, a proposition must enjoy a degree of wide acceptance, i.e. represent "conventional morality".'

⁸ Dworkin 1977, p. 22. Dworkin later restates the distinction in relation in terms of rights and (social or collective) goals. Dworkin 1977, p. 90: Principles are propositions that describe [individual or group] rights, policies are propositions that describe goals [of the community]. Here, I stay with the original distinction as a starting point in order to elaborate on the dimension of morality.

⁹ Cf. E. Burg, *The Model of Principles*, Amsterdam: Universiteit van Amsterdam 2000, p. 98ff: Principles are pure statements of something good one wants to achieve or an evil one wants to avert. Even though principles might seem to be stated as being absolute they do not function as being absolute within a normative legal system.

¹⁰ Dworkin 1977, p. 26.

According to Dworkin this first difference entails another. Other than rules, principles have a 'dimension of weight or importance.'¹¹ This implies that when principles (or policies) collide, their relative weight has to resolve the conflict. The establishing of the relative weight cannot be, of course, an exact measurement and the judgment that a particular principle has greater weight than another will often be a controversial one. With regard to the rules, however, it does not make sense to ask how important or how weighty it is. Rules are '*functionally* important or unimportant,' i.e., within in the system of rules.¹² So the conflict between two rules cannot be resolved by establishing which rule supersedes the other because of its greater weight.

The decision as to which rule is valid in case of a conflict between rules, 'must be made by appealing to considerations beyond the rules themselves.'¹³ A legal system may use different techniques to regulate this conflict. It may be regulated by other rules, for example, or the legal system may prefer the rule supported by the more important principles.

2.2 A community of principle

As shown above, for Dworkin principles in the narrow sense embody the dimension of morality which according to Dworkin is intrinsic to law. For him law and morality are necessarily, conceptually connected. His conception of law refers to a social and institutional practice that has a normative dimension. The normative dimension of the institutional practice of law does not only stem from the fact that it is regulated by rules, but that it rests on certain assumptions about what can acceptably count as law.¹⁴ In short, what counts as law is dependent on what people value in law, and that is a normative question.

Thus, Dworkin defends a substantive conception of the rule of law: fundamental legal principles or substantive moral values are the ultimate criteria of legal validity.¹⁵ A formal conception of the rule of law, however conceives of law as a neutral instrument.¹⁶ Joseph Raz, for example, disconnects the rule of law as means and the external end(s) it serves. Raz compares law to a knife. 'A good knife is, among other things, a sharp knife.' To his mind, like other instruments, 'the law has a specific virtue which is morally neutral in being neutral as to the end to which the instrument is put.'¹⁷ It is a purely instrumental,

¹¹ Dworkin 1977, p. 26. M.D. Bayles, 'Mid-level principles and Justification', in J.R. Pennock & J.W. Chapman, *Justification* (NOMOS XXVIII), New York: New York University Press 1986, p. 50-51 distinguishes between weight and importance. 'Importance has to do with effects on society's structure – its institutions and the relations among its members. Weight has to do with the force or stringency of a principle.'

¹² Dworkin 1977, p. 27. He adds 'that one legal rule may be more important than another because it has a greater or more important role in regulating behavior.'

¹³ Dworkin 1977, p. 27.

¹⁴ R. Dworkin, *Justice in Robes*, Cambridge (Mass.)/ London: Harvard University Press 2006, p. 2-10.

¹⁵ This is part of Dworkin's attack on Hart's legal positivism. However, H.L.A. Hart, 'Postscript', in H.L.A. Hart, *The Concept of Law* [1970], Second Edition Oxford: Clarendon Press 1994, p. 247 argues that Dworkin misrepresents his position because he states in his book (p. 71-72) that in some legal systems, as in the United States the ultimate criteria of legal validity might explicitly incorporate besides pedigree, principles of justice or substantive moral values and they may form the content of legal limitations on the exercise of legislative powers.

¹⁶ Cf. H. Gribnau, 'Legal Certainty: A Matter of Principle', in H. Gribnau & M. Pauwels (eds.), *Retroactivity of Tax Legislation*, Amsterdam, [IBFD] 2013, p. 72-80.

¹⁷ J. Raz, 'The Rule of Law and its Virtue' [1977], in J. Raz, *The Authority of Law*, Oxford: Oxford University Press 2009, p. 225-26. For a critique, see, for example, N. Simmonds, *Law as a Moral Idea*, Oxford: Oxford University Press 2007, p. 47ff who shows that the rule of law is a moral ideal because its

morally empty understanding of the rule of law. This version of the rule of law has no content requirement which, therefore, 'renders it open to a range of ends.'¹⁸

Dworkin's substantive conception of law, however, enables us to account for the role of principles as standards for evaluating existing law. It gives principles a place besides the legal rules and standards established by legal authorities. As will be shown, legal principles in the narrow sense have an existence of their own; they are not the product for example of the legislator. On the contrary, they set limits to legislative voluntarism. In this sense they are external to law-making institutions, though law-making institutions may develop principles by specifying them in rules and applying them to concrete situations.

Here, Dworkin elaborates on the distinction between principles and rules. He opposes the view that in a true associative community people assume that the content of the established legal rules exhausts their obligations. Members of a genuine political community view rules as negotiated out of commitment to underlying principles that are themselves a source of further obligation. They 'accept that they are governed by common principles, not just by rules hammered out in political compromise.'¹⁹ According to Dworkin, the rule of law is a discourse about values that have already deeply informed the community's understanding of itself as a community of principle. This community acts in a unified and principled manner. Rights and obligations in such a society of principle are not exhausted by 'the particular decisions the political institutions have reached but depend, more generally, on the scheme of principles those decisions presuppose and endorse.'²⁰ Before it is a set of particular rules, therefore, the rule of law is a set of values that shape and characterize the community in which people live. These principles are not necessarily themselves explicit, they are rather the underlying justification for the body of explicit rules. They can go beyond rules, they can resolve conflicts between the rules, and they offer guidance for the interpretation of rules. Dworkin applies this ideal of integrity, i.e., the requirement of principled consistency, to the legislature who should be guided by the principle of integrity in legislation. This form of integrity 'restricts what our legislators and other lawmakers may properly do in expanding or changing our public standards', such as legal rules.²¹ Laws entailing arbitrary distinctions which are the result of political compromise without minding the matters of principle at stake ('checkerboard statutes'), for example, violate the principle of integrity in legislation.²² Thus, according to Dworkin's substantive theory of law, there is a limit to the arbitrariness of the distinctions which the legislature may make in its pursuit of a collective goal.²³ To be sure, tax law should not be seen as an exception to the ideal of law as integrity, for the 'cases for legitimacy and integrity are at least as strong in tax's empire as they are in

characteristics are shaped and inter-related by one or more moral values (he focuses on one, the value of liberty). Cf. J. Simmonds, 'Reply: The Nature and Virtue of Law', *Jurisprudence* 1 (2010) 2, p. 285: 'The rule of law is 'a positive human good [...] of which we cannot form a clear conception except by reference to its realisation in law.'

¹⁸ B.Z. Tamanaha, *On the Rule of Law: History, Politics, Theory*, Cambridge: Cambridge University Press 2004, p. 94.

¹⁹ R. Dworkin, *Law's Empire*, Cambridge (Mass.) / London: Harvard University Press 1986, p. 211.

²⁰ Dworkin 1986, p. 211. Cf. P. Kahn, *The Reign of Law: Marbury v. Madison and the Construction of America*, New Haven and London: Yale University Press 1997, p. 45.

²¹ Dworkin 1986, p. 217.

²² D. Smith, 'The Many Faces of Political Integrity', in S. Herskovitz, *Exploring Law's Empire: The Jurisprudence of Ronald Dworkin*, Oxford: Oxford University Press 2006, p. 119-153 argues that Dworkin's discussion of checkerboard solutions provides only limited support for his claim that integrity offers a good fit with a community's political beliefs and practices.

²³ Dworkin 1977, p. 114.

law's'.²⁴ As John Tiley reminds us by quoting the American scholar Grove: 'Taxation is not simply a means of raising revenue. It is the most pervasive and privileged exercise of the police power.'²⁵

To conclude this section, legal principles constitute the moral core of the legal order - comparable to Fuller's 'internal morality of law'.²⁶ They embody the dimension of morality, but they are not purely moral standards, for legal principles serve legal values (see below § 6) – in contrast with moral principles which serve moral values. Indeed, law and morality are not identical. Legal principles are (moral) standards which are specific for the law, they are elaborated within the legal system. Though they are influenced by the moral values of a society, they are not purely moral principles.²⁷ Moral values and principles do not flow directly into the legal system, they are filtered by it. Hence, constituting the moral core of the legal order, legal principles connect law to the morality of a society.

2.3 Agreement and disagreement

After having explained Dworkin's conception of principles, it is apt to deal briefly with some legal scholars who conceptualize principles in a different way. Briefly contrasting their views with Dworkin's theory may shed more light on the moral dimension of principles in the latter's theory. First, I will briefly deal with the distinction between rules and principles which has been fiercely debated in legal literature. I will restrict myself to a few points which are of interest here. According to H.L.A. Hart, most scholars – legal positivists included – agree on two features which distinguish principles from rules. The first feature is a matter of degree: principles are broad, general, or unspecific.²⁸ This means that 'a number of distinct rules can be exhibited as the exemplifications or instantiations of a single principle.' Furthermore, principles appeal to some purpose, goal, entitlement or value. Therefore, they are regarded as not only providing 'an explanation or rationale of the rules which exemplify them, but as at least contributing to their justification.'²⁹ Here, the important point is the possible relationship between principles and values. According to Hart, within the legal system an appeal to some moral value by way of principles is possible. However, that does apparently not mean that he recognizes a necessary connection between law and morality. He therefore seems to disagree with Dworkin's conception of law where law - necessarily – is conceived of as based on a coherent set of principles, which express the moral dimension of law, appealing to moral values.³⁰

²⁴ E.J. McCaffery, 'Tax's Empire', *The Georgetown Law Journal* 85 (1996), p. 71–154, p. 107. Cf. R. Dworkin, 'Taxes and legitimacy', in R. Dworkin, *Is Democracy Possible Here?*, Princeton: Princeton University Press 2006, p. 90ff where he applies two principles of human dignity, the principle of the 'intrinsic value of human life' and the principle of 'personal responsibility', to tax policy.

²⁵ Tiley 1992, p. 452 quoting Groves, 1948 (1) *National Tax Journal* I, p. 23.

²⁶ L.L. Fuller, *The Morality of Law* [1964], New Haven/London: Yale University Press 1977, p. 200–224. For an in-depth discussion of Fuller's claim that a necessary connection between law and morality manifests in the principles that constitute this internal morality of law, see K. Rundle, *Forms Liberate: Reclaiming the Jurisprudence of Lon L Fuller*, Oxford: Hart Publishing 2012.

²⁷ Moral principles will (co-)determine the actual content of general legal principles. See H. Gribnau, 'General Introduction', in G.T.K. Meussen (ed.), *The Principle of Equality in European Taxation*, The Hague [etc.]: Kluwer Law International 1999, p. 22.

²⁸ Cf. J. Raz, 'Legal Principles and the Limits of Law', in M. Cohen (ed.), *Ronald Dworkin and Contemporary Jurisprudence*, London: Duckworth 1983, p. 75.

²⁹ Hart 1994, p. 260 (both quotes).

³⁰ Cf. R.S. Summers, *Instrumentalism and American Legal Theory*, Ithaca and London: Cornell University Press 1982, p. 41–42: 'Rules or other forms of law are not merely formal receptacles but have substantive

There is another point of disagreement explicitly mentioned by Hart himself on what he calls the 'non-conclusiveness' of principles. This regards Dworkin's view that rules necessitate particular legal consequences, dictating a result or outcome, whereas principles do not because they have a dimension of weight.³¹ Principles, therefore, do not conclusively determine a decision. Hart does not accept this sharp contrast between principles and rules. However, for Dworkin this is a crucial difference, for principles embody the dimension of morality, they appeal to moral values. The search for a legal philosophy of values to entrench principles (see § 5), therefore, probably will also shed light on the feature of 'non-conclusiveness.' If this will appear to be a crucial feature of values, the 'non-conclusiveness' of legal principles will be elucidated.

3 PRINCIPLES AND POLICIES: VARIATIONS

Now I will return to the difference between principles and policies. As shown above, according to Dworkin, the difference is that principles express moral requirements whereas policies do not. However, the distinction can be collapsed according to Dworkin. For example, a policy may be construed which states a principle - so as to realize 'a requirement of justice or fairness.' In this way, a policy incorporates a principle and consequently embodies a dimension of morality.³² More importantly, the use of principles intends to introduce the moral dimension of law, not as something accidental, but as a feature inherent to the very concept of law. So law does conceptually depend on moral considerations. This is a conception of law which many legal scholars (legal positivists) do not agree with. Moreover, Dworkin points at a second difference between principles and policies: the legislator states a policy and formulates a rule or a set of rules to achieve a policy goal. For Dworkin, however, this is not a feature of principles in the narrow sense, for they are not constructed by the legislator. 'The origin of [...] legal principles lies not in a particular decision of some legislator or court, but in a sense of appropriateness developed in the profession and the public over time.'³³ This specific origin accounts for a kind of 'empty place' which cannot be occupied by any law-making power (see below § 4). Here we see a striking difference with policies, which of course are formulated by government or one of the law-making institutions. Again, not all legal scholars will agree.

The legal theorist Neil MacCormick may serve as a nice illustration of this position. I will briefly deal with it in order to illuminate Dworkin's position. According to MacCormick legal rules tend to secure, or aim to secure, some desirable end. He explains the distinctive meaning of principles: 'to express the policy of achieving that end, or the desirability of that general mode of conduct, in a general normative statement, is, then to state "the principle of the law" underlying the rules' in question.³⁴ These general principles are the underlying reason specifying codes of conduct for a

content. When law is made and applied, its content is necessarily determined by values. These values are manifested in the reasons lawmakers, judges, and other officials give for what they do, and in the very formulations of the law itself. They necessarily figure in standards for evaluating the law.'

³¹ W. Twining & D. Miers, *How To Do Thing With Rules*, Cambridge: Cambridge University Press 2010, p. 83 argue that the 'all or nothingness' as a necessary element of the notion of a 'rule' obscures three separate ideas: 'the level of generality or particularity of a prescription, its precision or vagueness; and its status or force in dictating.'

³² Dworkin 1977, p. 22-23.

³³ Dworkin 1977, p. 40.

³⁴ N. MacCormick, *Legal Reasoning and Legal Theory*, Oxford: Clarendon Press 1978, p. 156.

whole body of rules in an Act. Moreover, these principles are capable of coming into conflict with each other.

Explicating general principles in this way, MacCormick creates the possibility of perceiving an Act of Parliament not just as a set of arbitrary commands but as a coherent set of rules directed at securing general ends, which the legislator conceived to be desirable. 'In this sense, to explicate the principles is to rationalize the rules.'³⁵ Coherence may also be achieved with regard to much of the detailed case-law. The use of principles thus supplies a rationalization of, and thus a justifying reason for case-law and statute-based rules. Note that this principled coherence does not necessarily imply any reference to the internal morality of law.

According to MacCormick, principles have explanatory and justificatory force in relation to particular decisions or rules, but, again, he does not attribute this force to a moral dimension inherent to principles. Evidently, Dworkin will disagree with MacCormick with regard to principles in the narrow sense. There is another point of disagreement. For Dworkin a policy sets out a social or collective goal (see § 2.1). However, MacCormick points out that the common usage of the term refers to a 'course of action' or 'course of interrelated actions' adopted by someone or some organisation.³⁶ A policy is a course of action aimed at securing some desirable state of affairs or achievement. Again, the spheres of principle and policy are not strictly separated, for the question whether a given policy is desirable or not, is raising a question of principle. To his mind, there is no distinction or opposition between arguments of principle and arguments of policy. They are 'irretrievably interlocking. [...] To articulate the desirability of some general policy-goal is to state a principle. To state a principle is to frame a possible policy-goal.'³⁷ This may seem to be in line with Dworkin's remark that the distinction can be collapsed. Actually, that is only the case when a policy is motivated by a principle so as to realize 'a requirement of justice or fairness.'

Apparently, however, there is no need for MacCormick to refer to 'a requirement of justice or fairness,' – to some moral value outside the power of lawmakers. On the contrary, as Judith Freedman explains, the principle is an expression of the scope that the legislature has decided to give to a legislative rule, 'a charging provision or relief and, since it leaves no room for judicial law-making, it does not invite judgments based on morality.'³⁸ Principles, therefore, are not some standards with an aspirational aspect external to the legislature, but the legislature's domain par excellence - a far cry from Dworkin's position with regard to principles in the narrow sense.

The use of principles without any reference to values such as fairness and justice which are external to legislation, is also an important feature of the 'coherent principle approach' to drafting legislation. This form of a principle is 'an operative legislative rule which specifies the outcome [...], and expresses the outcome at the highest possible

³⁵ MacCormick 1978, p. 157.

³⁶ MacCormick 1978, p. 263.

³⁷ MacCormick 1978, p. 263-264.

³⁸ J. Freedman, 'Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited', (2010) *BTR* 6, p. 730. This links in to the issue of trust and uncertainty related to law-making, cf. p. 721: 'If rules can be read subject to principles then, it is argued, this transfers power to the courts and administrators and creates a degree of uncertainty.' However, the thrust of my argument is that every law-making or law-applying institution are bound by legal principles apart from the question whether there is any external check on its power.

level rather than itemising a list of outcomes for every conceivable case.³⁹ A principle or a collection of principles implement the legislative purpose. They have to be structured logically so as to work together to achieve the legislative purpose. Thus, a framework of a specific piece of legislation results: a pyramid with one or more principles at the top 'and then carving out exceptions to the basic fall-back rule.'⁴⁰ When new situations emerge, a properly constructed principle provides a framework for working out how to deal with them. In short, here, a principle is not just a less specific rule, but it is a statement about the essence of the intended outcomes in a general field. Note that it is assumed that principles are something which the legislator constructs - not some standard preceding any legislative activity. Moreover, again no reference is made to any necessary connection to morality, viz. an appeal to values.

In the following I will tackle these two issues after which I will address the question of how to use principles to create hard and fast rules.

4 THE EMPTY SPACE OF LAW-MAKING POWER

Legal principles precede positive law. Therefore, they have an existence of their own – relatively independent law-making and law-applying institutions. They are not a product of the legislator's will, although the legislator determines – in interaction with other legal actors – the actual content of legal principles. The principle of equality, for example, cannot be abolished at will. Hence, principles set boundaries to government policies.

To gain more insight in this aspect of legal principles is worthwhile to turn to Paul Scholten (1875-1946), one of the most important legal theorists in the Netherlands. He has elaborated on the concept of legal principles. Scholten distinguishes a number of characteristics which enhance our understanding of legal principles – and the difference between principles and policies. Scholten precedes Dworkin in distinguishing between legal principles and legal rules. 'Direct application through subsuming a case under a principle is not possible.'⁴¹ Rules, however, can be applied directly because they have a more concrete content. Therefore, principles must be elaborated into rules. A principle only has use, when it is actualized in particular rules. Scholten points out that principles are very 'general conceptions'⁴² – they are more general or abstract than rules.⁴³ To his mind a principle offers guidance, but principles provide diverging reasons. Again, Scholten anticipates Dworkin's theory of principles. 'When forming such rules principles will clash: one will push in this direction, the other in that direction.'⁴⁴ Of course, this may also go for policies.

However, there are also marked differences between legal principles (in a narrow sense) and policies. According to Scholten, a legal principle is a 'statement, which is for us — people of a certain time living in a certain country with a certain system of law — immediately evident.'⁴⁵ He connects this feature with the moral dimension of principles

³⁹ G. Pinder, 'The Coherent Principle Approach to Tax Law Design', 2005, www.treasury.gov.au. See also Avery Jones 1996.

⁴⁰ R. Krever, 'Plain English drafting, Purposive drafting, Principle-based Drafting: Does Any of it Matter?', in J. Freedman (ed.), *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management*, Oxford: Oxford University Centre for Business Taxation 2008, p. 194

⁴¹ P. Scholten, 'General Part' [*Algemeen Deel*], 1931 <http://www.paulscholten.eu/downloads/>, no. 252.

⁴² Scholten 1931, no. 252.

⁴³ This is a point of general agreement; see § 2.3.

⁴⁴ Scholten 1931, no. 252.

⁴⁵ Scholten 1931, no. 251.

(again, in the narrow sense). Like Dworkin, he maintains that the principle regards the moral element in law, which marks a clear difference with policies. The legislator – or another lawmaker – is not the author of legal principles. When the legislator puts some principle into written law, this act in itself doesn't turn it into law. Scholten argues that principles do not become law simply *because* 'the authority has declared it.'⁴⁶ Why? Because principles are the moral *a priori* of the written law. Principles precede the body of rules. The legal principle is found *in* the law.⁴⁷ They are 'anonymous' standards for they exist in the law independently of their elaboration by law-makers. In the end it is possible that the legal principle is neither explicitly stated, nor derivable from specific provisions, but that it is the assumption of the regulation of a legal domain as a whole, or sometimes of the law as a whole.⁴⁸

Consequently, law-making and law-applying institutions may develop principles but they do not create them.⁴⁹ They find legal principles in the legal system. Law-making and law-applying institutions are bound by legal principles.⁵⁰ The legislator may claim to have laid down a principle in legislation, or to have turned principles into a rule, but a court may examine this claim and judge otherwise. Thus, legal principles are instruments to evaluate existing law and, therefore, a source of legal protection against the power of lawmakers.

Here, a comparison can be made with the idea, found in the work of French philosopher Claude Lefort, that in a (constitutional) democracy the locus of power is not embodied by anyone, but is 'an empty place, it cannot be occupied [...] and it cannot be represented.'⁵¹ Lefort argues that in the (French) monarchy of the Ancien Régime, the locus of power was embodied by the king. His power was legitimated by his mediating position between the transcendent authority of God and the people. However, with the beheading of the king at the end of the eighteenth century, the symbolic locus of power becomes and remains an empty place. The symbolic locus of power in a democracy never coincides with the actual exercise of power. Democratic rulers cannot identify themselves with the locus of power, for they only hold public offices on a temporary basis, subject to a regular political and electoral competition.⁵² The rulers wield temporarily power on the basis of their interpretation of the will of the people which itself transcends all actual interpretations.

Furthermore, the open-ended nature of the democratic decision-making process reflects the ineliminable gap between any actual interpretation of the common good and the

⁴⁶ Scholten 1931, no. 269. Cf. G. Zagrebelsky, 'Ronald Dworkin's principle based constitutionalism: An Italian point of view', (2003) 4 *International Journal of Constitutional Law*, p. 625: 'The law governing hard cases consists of legal principles that are placed "above" the norms proposed by the legislator, and it circumscribes the decisions of judges [...] by pointing them in a certain direction.'

⁴⁷ Cf. Tridimas 2006, p. 1-2: 'the process of discovery of a general principle is par excellence a creative exercise and may involve an inductive process.' He briefly deals with several types of general principles in the legal system.

⁴⁸ In the same vein: L.M. Friedmann, *The Republic of Choice. Law, Authority and Culture*, Harvard University Press: Cambridge (Mass.) 1994, p. 71. Principles may render a developing legal system with an incomplete character more coherent; Groussot 2006, p. 10.

⁴⁹ Cf. Tridimas 2006, p. 5: the general principles law in the European legal order are 'unwritten principles extrapolated by the [European] Court [of Justice] from the laws of the Member States by a process similar to that of the development of the common law by the English court.'

⁵⁰ Cf. Tridimas 2006, p. 8 and 44: The general principles bind not only the European Community institutions but also the member states, including central government, local and regional authorities where they implement Community law.

⁵¹ C. Lefort, *Democracy and Political Theory* (trans. David Macey), Cambridge: Polity 1988, p. 17.

⁵² Cf. S. Rummens, 'Deliberation Interrupted: Confronting Jürgen Habermas with Claude Lefort', *Philosophy & Social Criticism* May 2008 Vol. 34 no. 4, p. 384-385.

ideal of the common good. Consequently, on the one hand, no person or institution has absolute, exclusive authority to determine the actual content of the common good, and, on the other hand, every actual exercise of power, every actual interpretation of the common good should be debated on the basis of – conflicting views of – the ideal of the common good. The ideal of the common good is the ‘source’ of critique as to what is legitimate and what illegitimate exercise of power in modern societies. Thus, the ‘empty place’ may be seen as a metaphor for the (ongoing) debate about what is considered legitimate power, and therefore, about (legal) standards that limit this power, without ‘any guarantor.’⁵³ There is no sovereign author of these standards. They have their origin not in decisions by public authorities, for these authorities only wield temporarily power to give an interpretation of these standards - which moreover govern their own conduct.

The same idea applies to fundamental legal principles. As shown above, their origin lies not in the will of some law-making institution, but ‘in a sense of appropriateness developed in the profession and the public over time.’ (see § 3) They never coincide with positive law. Law-making institutions concretize these principles, but their interpretations never exhaust the principles nor the values underlying the principles. The actual meaning and content of legal principles are not fixed, they are indeterminate in the sense that they change over time as a result of the interaction of legal institutions and legal and societal actors.⁵⁴ Laws are legitimate when they comply with fundamental principles, but they do not coincide with these principles. Rules are elaborations of principles which do not exhaust the meaning of principles. By the way, this is somehow reminiscent of an anti-positivist tradition in legal theory in which judges are the guardians of the principles of the rule of law. Here, judges using the common law as the value-laden background against which legislation is to be interpreted, are not seen as ‘setting themselves against the people’s will because that background, no less than legislation, is the product of the people.’⁵⁵ Judges can mould this value-laden background somewhat but are not allowed to force it completely to their will.

Again, positive law does never coincide with fundamental legal principles. There is a gap between all factual exercise of law-making power, which provides for specific determinations of fundamental legal principles’ content, and the fundamental legal principles which transcend all actual and temporary concretizations. Here, the metaphor of ‘the empty place’ implies a permanent debate about what is legitimate law. This is a debate about the applicable standards, i.e., about legitimate interpretations and applications of fundamental legal principles. The locus of the power of legitimate law-making is empty in the sense that these ‘anonymous’ principles are not any lawmaker’s property. They are a kind of standards to assess the legitimacy of the body of legal rules, external to law-making power (though internal to the legal system). Principles often are unwritten law, but even when they are enacted in statutes, they are not exhausted by this codification. Lawmakers are collectively stewards of fundamental legal principles. They have to respect and operationalize the principles that explain and justify the existing

⁵³ See Lefort 1988, p. 39.

⁵⁴ See C. Lefort, *The Political Forms of Modern Society*, Cambridge: Polity 1986, p. 23.

⁵⁵ D. Dyzenhaus (ed.), ‘Recrafting the Rule of Law’, in D. Dyzenhaus (ed.), *Recrafting the Rule of Law: The Limits of Legal Order*, Oxford / Portland (Oregon): Hart Publishing 2000, p. 3. He refers to anti-positivists who, ‘following a tradition most famously articulated by Sir William Blackstone, argue that the common law is [...] the legal repository of the moral values of the people.’

legal practice and shows the law in its morally best light.⁵⁶ Every law-making or law-applying institution is bound by legal principles, even when an external (institutional) check on its power is lacking, it should respect them.

Thus, a critical function of legal principles is made possible because the lawmakers are not the author of legal principles. Of course, they may formulate legal principles and turn principles into rules, but principles as such precede law-making. They are already present in the legal system, sometimes waiting to be discovered. Law-making has to elaborate on these principles. This point of view also explains Scholten's conviction that legal science (jurisprudence) has a special responsibility to trace legal principles in positive law.⁵⁷ Legal principles are the moral foundation of the law and no law can be understood without these principles. The search for the principle by legal science is also a search for coherence and systematisation. Combining certain provisions, the legal scholars asks themselves if they stem from the same principle and therefore if the principle supports such a combination. Scholten stressed the importance of this moral dimension for jurisprudence: 'Each time we hark back to the legal principle.'⁵⁸ Thus, principles play an important role in guiding legal doctrine. They are regulative ideals that make morally sound positive law possible. Moreover, they are ends at which law-making should aim. These principles, conceived of as regulatory ideals, are 'in their realization dependent on what is factually possible and on the legal possibilities as defined by other principles.'⁵⁹

5 RADBRUCH'S LEGAL PHILOSOPHY OF VALUES

5.1 A philosophy of values

As shown above, according to Dworkin and Scholten fundamental principles necessarily appeal to some moral value. For Dworkin, the rule of law is a set of values that shape and characterize the community in which people live (see § 2.2). Thus, the relationship between principles and values being established, another question has to be addressed: is there a philosophy of law which accounts for the fundamental role of legal values in the legal order? In order to do justice to the role of (fundamental) principles in law, a conception of law is required which connects principles to values – explaining why they embody the moral dimension of law par excellence. Only then it can be explained how lawmakers can balance principles and creation of rules, by taking into account the relative weight of each principle involved.⁶⁰

The German lawyer and legal philosopher Gustav Radbruch provides a value-oriented theory of law which enables us to elucidate the importance of legal principles, their place in the body of law and to understand some crucial features of principles. Interestingly, Radbruch opposed the command theory of law of legal positivism which

⁵⁶ Dworkin 1986, p. 228-238 uses the idea of a chain novel written by a series of authors (judges) to illustrate this point. As the novel gets longer, the successive authors finds themselves more and more constrained by what has gone before. In the same vein, Kahn 1997, p. 92: 'Law's task is to maintain the past in the present and so to construct a future that is continuous with the past.'

⁵⁷ Scholten 1931, no. 253. Cf. no. 254: 'It could be that we find the legal principle by pointing out the common element in provisions which at first sight have nothing to do with each other.'

⁵⁸ Scholten no. 253.

⁵⁹ R. Alexy, 'Zum Begriff des Rechtsprinzips' [1979], in R. Alexy, *Recht, Vernunft, Diskurs*, Frankfurt am Main: Suhrkamp 1995, p. 205. See also R. Alexy, 'On the Structure of Legal Principles', *Ratio Juris* 13 (2000) 2, p. 294-304. As stated above, here I will not discuss the differences between Dworkin's theory and Alexy's optimization theory of principles.

⁶⁰ Principles firmly entrenched in the legal system may account for the testing of laws, and of administrative decisions, against principles, for example, the (fundamental, often constitutional) principle of legal equality.

in his wording 'held the law to be nothing but state caprice and the point of the law to be nothing but obedience.' He argues that the law should not be conceived of as the command of the state but primarily as a striving toward justice. We then must 'regard ourselves as called upon to collaborate in that effort and bring it to completion, called upon, then, not simply to serve the law but to serve justice within the framework of the law.'⁶¹ This quote makes clear that Radbruch refuses to stop at the law as it is posited, there is apparently more to law, i.e., the dimension of justice.

At the very core of Radbruch's legal theory is a philosophy of values, a clear reflection of the influence on Radbruch of – a branch of – neo-Kantian philosophy.⁶² The Heidelberg neo-Kantian school which influenced Radbruch followed Kant in distinguishing between 'is' and 'ought.' To their mind the strict distinction between reality and value translates into a division of labour between science and philosophy. They saw science as the examination of empirical realities and philosophy as the critical examination of values. Values imply an 'ought', the 'evaluative' stance.⁶³ Logic, ethics, aesthetics, the three traditional branches of philosophy, regard the supreme values of the true, the beautiful, and the good. Furthermore, there is nature and culture, which in turn are distinguished by their (non)relation to values. Nature has nothing to do with values. Culture, however, denotes the reality that is oriented towards values, aimed at the realization of values. It is thus practical, not pure reason.⁶⁴ Other than the natural sciences, therefore, the cultural sciences have human pursuits, constructs, relations, and actions as their object.

Radbruch develops his own theory on the basis of this systematization. Cultural sciences share the value-relating perspective, they study those realities that mean to realize values. In this way, they attempt to bridge the gulf between reality and value. Radbruch subsequently qualifies law as a cultural science. Law is oriented towards its 'own' supreme value, for Radbruch introduces a fourth supreme value, that of the idea of law (*Rechtsidee*) or justice (*das Gerechte*). Law then is the appropriate subject of the value-relating perspective. Law as a cultural phenomenon is a fact related to value, which can only be understood like any human creation as meant to realize its 'idea.' Thus the philosophy of values shapes the way in which Radbruch conceptualizes law: 'The law is the reality whose meaning is to realize justice.'⁶⁵ In short, the concept of law is a cultural concept, a concept related to value, viz. justice. Radbruch's idea of law is a regulative idea, because, transcending positive law, it is an end at which we aim our law-making and actions. The idea of law guides the concretization of law, but this positive law only is a partial concretization of the idea of law.⁶⁶ The idea of law is (progressively) approximated but never in fact actually realized. As shown above,

⁶¹ G. Radbruch, *Ihr jungen Juristen!* (Berlin: Verlag Gesellschaft und Erziehung, 1919), p. 13, quoted by S.L. Paulson, 'Statutory Positivism', *Legisprudence* Vol. 1 (2007) 1, p. 15 both quotes.

⁶² See Radbruch's acknowledgements to the Heidelberg neo-Kantians Wilhelm Windelband, Heinrich Rickert, and Emil Lask in G. Radbruch, *Legal Philosophy*, (trans. K. Wilk), in *The Legal Philosophies of Lask, Radbruch, and Dabin*, Cambridge (Mass.): Harvard University Press 1950, p. 49.

⁶³ See Radbruch 1950, p. 49-52. Cf. S. Taekema, *The Concept of Ideals in Legal Theory*, The Hague [etc.]: Kluwer Law International 2003, p. 49-50.

⁶⁴ W. Friedmann, *Legal Theory*, London: Stevens & Sons 1967, p. 192 point at the difference with Hans Kelsen's positivism according to which the essence of law is a 'formal ordering of norms.'

⁶⁵ Radbruch 1950, p. 75.

⁶⁶ The guidance towards the idea of law is the Kantian notion of the regulative idea of law. Cf. J. Stone, *Human Law and Human Justice*, Sydney: Maitland Publications 1965, p. 171: 'This guidance falls short of being a criterion, for it points in the direction of just solutions, rather than fixes their locus and description.'

Radbruch adopts the notion of striving toward justice in contradistinction with the command theory of law. He clarifies this notion of the striving with his claim that the concept of science turns on a striving toward the truth, whether or not the truth is ever attained.⁶⁷ According to Radbruch:

The concept of science is not identical with the value of truth; the science of an age embraces not only its scientific achievements, but also its scientific errors. When we bring together in the concept of science the failures as well as the successes of science, we do so because all these efforts at least strove toward the truth and claimed to be true: Science is that which, whether attaining or falling short of the truth, still has the significance, the sense, of serving the truth.⁶⁸

In the concept of law we find a counterpart to the striving toward the truth, namely, the striving toward justice, whether or not justice is realized in the end. This striving toward justice is the core of Radbruch's concept of law which has a normative function and is regulative.⁶⁹ Law-making is aimed at this regulative idea(1).⁷⁰

Note that this philosophy of values is about basic or fundamental values, in other words, the ultimate and pervasive values to underlie (public and private) law.⁷¹ The term values is often used in a broad sense referring to interests, pleasures, likes, preferences, duties, moral obligations, desires, wants, needs, aversions, and many other modalities of selective orientation.⁷² The sociologist Giddens defines values as 'ideas held by human individuals or groups about what is desirable, proper, good, or bad.'⁷³ However, from the perspective of a philosophy of values one should be on one's guard against 'value devaluation',⁷⁴ for these values are incomparable to the supreme values of the true, the beautiful, the good, and the idea of law (justice). According to Radbruch law is not just a social fact, because it is value-oriented. Radbruch's values, therefore, resemble 'values' as they are used in moral philosophy: 'goods that by their nature enhance life or a world or negatively are things by their nature would make a life or a world less desirable.'⁷⁵ Moreover, they are objective values which are generally favoured because they relate to some basic human good, they are goals or reasons for action for all impartial rational persons.⁷⁶ Values in a sense are purposes ultimately motivated by an understanding of a basic human good, and not 'by nothing more than feeling.'⁷⁷ Finally, ultimate values such as fairness and justice are a special kind of goods we regard as intrinsically valuable: we value them for their own sake regardless of any other things

⁶⁷ Cf. S.L. Paulson, 'Statutory Positivism', *Legisprudence* Vol. 1 (2007) 1, p. 25.

⁶⁸ Radbruch 1950, p. 50 (translation altered by Paulson (2007)).

⁶⁹ Cf. Paulson 2007, p. 24.

⁷⁰ Cf. Simmonds 2007, p. 9.

⁷¹ D. Oliver, 'The Underlying Values of Public and Private Law', in M. Taggart (ed.), *The Province of Administrative Law*, Hart Publishing: Oxford 1997.

⁷² Twining & Miers 2010, p. 86.

⁷³ A. Giddens, *Sociology*, Cambridge: Polity 1991, p. 732.

⁷⁴ K. Economides, 'What are fundamental legal values?', in K. Economides a.o. (ed.), *Fundamental Values*, Oxford/Portland: Hart Publishing 2000, p. 13.

⁷⁵ J.J. Kupperman, *Value ... And What Follows*, New York/Oxford: Oxford University Press 1998, p. 3.

⁷⁶ Cf. B. Gert, *Morality: Its Nature and Justification*, New York/Oxford: Oxford University Press 1998, p. 94-95 'Moral values, like goods and evils, are objective values [...] that all impartial rational persons wants everyone to have, other than e.g. 'family values' and 'religious values', which are 'favored by everyone favoring a certain kind of family or religion.'

⁷⁷ J. Finnis, 'Natural Law and Legal Reasoning', 1990, *Scholarly Works Paper* 79
<http://scholarship.law.nd.edu/law_faculty_scholarship/79>

we may value.⁷⁸ Thus, as Habermas clarifies, values are teleological. A value, insofar as it is a criterion for action and not simply the result of an evaluation, is the final goal that requires its realization through teleologically oriented activities. Like principles, different values compete for priority in concrete situations, they 'form flexible configurations filled with tension.'⁷⁹

To conclude, this section, it may seem that values are something 'out there', something transcendent without any connection to reality. As shown above, a dichotomy exists between 'is' and 'ought.' However, the value-relating perspective of law softens this gap between value and reality, for law must be conceived as a totality of facts and relations, whose purpose is to realize justice. The idea of the 'material qualification of the idea' (*Stoffbestimmtheit*) – signifying a mutual influence between matter and idea – provides another bridge. The idea of the *Stoffbestimmtheit* of the idea of law means that the idea of law, is related to its matter, law. The idea of law, justice, therefore is not a free floating value. Justice both determines and is determined by the reality of law.⁸⁰ The idea of the *Stoffbestimmtheit* is part of the legal doctrine of the 'nature of the thing' (*Natur der Sache*), which is essentially the idea that existing factual relations in part determine what rules and principles should regulate these relations.⁸¹ Making new regulations, one should take into account of existing natural, social and legal facts which set boundaries to the freedom to design new rules – to policy considerations. Moreover, our ideas themselves about law are limited by the historical era we live in. Though all this probably does not imply a reconciliation of complete fact and value no, they are somehow brought together. Legal values are not mere abstractions but are elaborated and clarified in concrete situations.

5.2 The Idea of Law

So, the point of departure of Radbruch's value theory of law is the idea that law aims to realize justice (although law does not necessarily serve it in fact); the idea of law is the specific regulative value of law. The idea of law initially refers to justice – but Radbruch quickly expands it beyond expands the idea of law beyond justice per se. However, the idea of law or justice is not something which has an existence of its own, independent from the reality of law. Justice both determines and is determined by positive law. Moreover, Radbruch's is a tripartite conception of the idea of law; he distinguishes three elements of justice that the law aims for: legal equality, purposiveness, and legal certainty.

Equality demands like cases to be treated alike, and unequal treatment to the degree of dissimilarity (inequality). This formal element, equality, does not determine the content of law, which depends on the purpose of law. Therefore, in order to know, who should be regarded as (un)equal and how to treat them, one needs another (fundamental) value. Here '*Zweckmäßigkeit*' comes in. This second value refers to the purposiveness of law. This notion seems to have not much clear empirical reference because the idea of the purpose of law must be sought in ethics.⁸² It embraces the notion of the general interest

⁷⁸ J. Raz, *The Morality of Freedom*, Oxford: Oxford University Press 1986, p. 200.

⁷⁹ J. Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy*, (trans. W. Rehg) Cambridge: Polity 1996, p. 255. Cf. Zagrebelsky 2003, p. 627.

⁸⁰ Radbruch 1950, p. 54ff. Cf. Taekema 2003, p. 51-52.

⁸¹ Cf. Taekema 2003, p. 52.

⁸² Cf. Stone 1965, p. 242 –245. J. Rawls, *A Theory of Justice* (rev. ed.), Oxford: Oxford University Press 1999, makes a comparable distinction between the concept of justice and specific conceptions of justice, which 'helps to identify the role of the principles of social justice' (p. 5). The concept of justice is abstract and formal and requires that we treat like cases alike, and different cases differently. Different conceptions

(*Gemeinwohl*).⁸³ Consequently, the purpose of law is the good which is determined by the political theories of the day. This second value is the gateway through which all kind of societal and ethical values may enter the legal system. I would suggest that these different societal and ethical values account for all kinds of policy goals in the legal system.⁸⁴ As a result, 'values have to contend with other considerations in the law and legal policy.'⁸⁵ However, there are many views (theories) about the good (society), and therefore about the actual purpose of law. According to Radbruch, a final determination of the purpose of law is impossible. So a choice between the many views about the actual purpose of law has to be made, to provide one order for all. For 'the law *qua* framework for living together cannot be left over to the differing opinions of individuals. It must stand as a *single* framework for all.'⁸⁶ Here the third element comes in: the value of legal certainty, which requires that law be positive. By introducing the value of 'Zweckmäßigkeit' the relation between law and other domains, e.g., politics, morality and economics, is conceptualized. The external – e.g., societal and statal – input from these domains into the legal order has to pass the filter of equality and legal certainty.⁸⁷

I will not elaborate further on Radbruch's theory, but restrict myself to one more remark on the relation between these fundamental values. Each of these values exerts a pull in a one direction, but undesirable overconcentration is kept in check by the countervailing forces of the other two values. In practice, these components of justice must be constantly weighed and balanced, for there is no hierarchy between these fundamental legal values.⁸⁸ This accounts for their non-conclusiveness, which they have in common with principles (see § 2.1 & 2.3).⁸⁹ 'Non-conclusiveness' is a crucial feature of values, no legal value may be made absolute. Though Radbruch himself gives great weight to legal certainty, with the experience of the chaotic political situation of the German Weimar republic in mind, after World War II he made clear it should not be given precedence even in cases of extreme injustice, for this 'could not be reconciled with the

of justice supply different principles in the light of which to determine when cases are materially alike and when materially different.

⁸³ Cf. G. Radbruch, 'Der Zweck des Rechts', in G. Radbruch, *Der Mensch im Recht: Ausgewählte Vorträge und Aufsätze über Grundfragen des Rechts*, Göttingen: Vandenhoeck & Ruprecht 1957, p. 88-104. Friedmann 1967, p. 193 rightly states that the question of what is ['Zweckmäßigkeit'] can only be answered 'by reference to different conceptions of state and law.'

⁸⁴ This way societal values feed into the legal order, e.g. the five key values identified by Oliver specifically in public law: autonomy, dignity, respect, status and security; Oliver 1997, p. 223.

⁸⁵ Oliver 1997, p. 224. That is one of the reasons she does not regard values as rights, though rights are expressions of, or means to, protect values.

⁸⁶ G. Radbruch, 'Legal Philosophy', in *The Legal Philosophies of Lask, Radbruch and Dabin*, Cambridge (Mass.): Harvard University Press 1950, p. 108 (transl. Paulson; see S.L. Paulson, 'Radbruch on Unjust Laws', (1995) *Oxford Journal of Legal Studies*, Vol.15 Autumn, p. 495).

⁸⁷ The values of legal equality and legal certainty constitute guarantees for a kind of autonomy of the law. Cf. Taekema 2003, p. 87-88.

⁸⁸ Cf. Economides 2000, p. 9: 'the fundamentality of a so-called legal value could be linked more to the fact that it is regularly associated with legal thought or action rather than having any intrinsic claim to status within legal hierarchies.'

⁸⁹ To my mind, the need to balance values is a check on the 'implicit totalitarian propensity', sometimes attributed to values. See Zagrebelsky 2003, p. 628 on this tendency. R. Dworkin, 'Response to overseas commentators', (2003) 4 *International Journal of Constitutional Law*, p. 653 seems to differ with Zagrebelski, speaking of his 'provocative distinction between values and principles.' However, Zagrebelsky concludes that: 'Much of the criticism directed at a "jurisprudence of values" should not be levelled against a "jurisprudence of principles.'

claim to correctness, which includes justice as well as legal certainty.⁹⁰ In effect, what is at stake is the best balance of the relative positions of these legal values – their exact meaning needs to be discovered and is moulded in every new situation. New facts and situations may account for a little shift in the balance between the three values.

Other fundamental legal values may be distinguished, e.g. impartiality and integrity. More important here, however, is the idea that legal values are necessarily very abstract. They cannot be identified with norms which are directly applicable: they can hardly be conceived as guidelines for human behaviour. Therefore, values as the (very abstract) expressions of people's basic commitments need a more concrete shape. Norms are the action-oriented concretizations of values. Likewise legal values find their more concrete shape in legal principles. These principles are guidelines to realize legal values.

Elaborating further on Radbruch's theory of law, one can say that norms and values, evolving over time, are not imposed on society by a sovereign power. In a way, they form a bulwark against (legislative) voluntarism – as defended by a command theory of law. Law seeks to implement legal values, such as equality, impartiality and certainty, which can be regarded as legal translations of important social and cultural values. These values – with norms as their sediment – guide the interactions and relations between free and equal people. No other institution than society can be regarded as the author of values. However, the entering of these social and cultural values, mixed with political values and policies, into the legal system is filtered by the values of legal certainty and legal equality. The latter mould the way in which those values permeate the legal system. This way the semi-autonomous legal system is a responsive system with sensitivity to policy, with some internal safeguards against the power of the state. On a more concrete level legal principles are, in a similar manner, translations, not reproductions, of societal norms within the legal system.

6 LEGAL PRINCIPLES AS THE NORMATIVE CORE OF LAW

It is time to recapitulate our quest up till here. Legal principles fit in a value-oriented theory of law. They are concretizations of legal values in the legal system. Legal principles may specify legal values as a whole: these fundamental legal principles are common denominators of the various sections of the legal system. Legal principles may also specify legal values in a specific part of the legal system, e.g., public or private law, or even a more specific subdivision of law, tort law or tax law. A principle can be supported by another more general one; general principles are often used to justify more specific ones.⁹¹ So they exist at varying levels of generality in the legal system. In the next section, we will take a closer look at the meaning of principles in modern law.

Law is connected to the fundamental norms and values prevalent in a society of free and equal citizens by means of fundamental legal principles. Principles can be considered as expressions of legal values, and constitute the normative core of law in a

⁹⁰ R. Alexy, 'A Defence of Radbruch's Formula', in Dyzenhaus (ed.) 2000, p. 32-33. Cf. Simmonds 2007, p. 173-176.

⁹¹ Fundamental legal principles may be conceived of as supreme principles of law. Subsequently mid-level principles can be distinguished, i.e., principles which are subordinate to those fundamental principles. Their justification usually refers to fundamental legal principles. Consequently, mid-level principles are not as general as fundamental principles, 'although they can be quite general'; Bayles 1986, p. 50. Bayles argues for mid-level justification: mid-level principles have an important place in legal justification and applied normative legal thought can profit from working within a theoretical framework of shared mid-level principles rather than immediately recurring to the abstract standpoint of fundamental ethical theory or supreme principles (or supreme values).

modern democratic state. Principles can be conceived as applications of fundamental legal values; thus principles are 'at a lower level on the ladder of abstraction.'⁹² Now, we can combine Radbruch's value-oriented theory of law with a conception of law which assigns to principles, because of their normative quality, a crucial place. Fundamental legal principles serve legal values. Therefore, a legal principle is to be observed as a standard because it is a requirement of the internal morality of law, which is, however, connected to society's moral values. As argued above, legal principles are standards which are specific for the law. Though they are influenced by the moral values of a society, they are not purely moral principles.⁹³ There is no identity between legal principles and moral ones.⁹⁴ Legal principles are like a concretizations of legal values – which in turn are translations of moral values outside the legal system. Law, therefore, is not an autonomous legal system. The development and actual meaning of legal principles is coloured by extra-legal influences, like the prevailing norms in society or the practice which the law aims to regulate.⁹⁵ Legal principles, therefore, are internal standards generated and developed by the legal system itself – although they are influenced by morality. Law-making institutions are collectively their stewards, not their authors. They have to develop these principles in a collaborate effort (mutual conflicts and irritations cannot be ruled out). In the context of this collective responsibility for the integrity of law, principles have an inter-institutional function: justification to other institutions. Robert Nozick argues that in this way, justification by general principles is convincing in two ways. First, by the face appeal of the principle, and, secondly, 'by recruiting other already accepted cases to support a proposition in this case.'⁹⁶

Principles are intermediaries between legal values and positive law, i.e., legal rules.⁹⁷ In other words, a principle is 'the *medium* in which we find a moral opening to the value and a practical opening to the rule.'⁹⁸ Rules, in the form of general and established laws, form the basis for government's interference with the liberties of the citizen. Government of laws and not of men is rule-governance. Making the law rule thus has a double meaning: legality of government and enforcement of law. In this formal sense of the rule of law, the rule of law is the rule of rules.⁹⁹ But 'this idea is an impoverished notion of the rule of law', argues Aharon Barak. This formal understanding of the rule

⁹² Oliver 1997, p. 224. According to Twining & Miers 2010, p. 387 a ladder of abstraction is 'a continuous sequence of categorisations from a low level of generality up to to high level of generality.'

⁹³ R. Dworkin, 'Philosophy, Morality, and Law', *University of Pennsylvania Law Review* 113, no. 5 (March 1965), p. 668-690 argues that a moral principle cannot be established by deliberate act, as some sorts of law can. In the same vein, see Hart 1994, p. 175: unlike legal rules, moral rules or principles cannot be changed by deliberate enactment.

⁹⁴ Cf. Dworkin 1977, p. 342: Natural lawyers advocate that there 'can be no difference between principles of law and principles of morality.'

⁹⁵ Actual moral principles will be among the influences on the actual content of general legal principles.

⁹⁶ R. Nozick, 'How to Do Things with Principles', in R. Nozick, *The Nature of Rationality*, Princeton: Princeton University Press 1993, p. 6.

⁹⁷ Cf. Radbruch 1950, p. 75: 'Justice needs to be complemented by other principles if rules of rules of right law are to be derived from it.' Note that Radbruch uses the concept of 'principle' instead of 'value' which suggests a not very sharp distinction between the two concepts, both indicating the value-relating perspective.

⁹⁸ Zagrebelsky 2003, p. 632. This also goes if one distinguishes between fundamental legal principles and mid-level principles. Then, mid-level principles 'are needed in the justification of rules in order to delineate them more elaborately or relate them systematically'; K. Henley, 'Abstract principles, Mid-level principles and the Rule of Law', *Law and Philosophy* Vol. 12 (1993), p. 125.

⁹⁹ Cf. L. Alexander & E. Sherwin, *The Rule of Rules. Morality, Rules and the Dilemmas of Law*, Durham/London: Duke University Press 2001.

of law is satisfied even in a dictatorship. Therefore, the legal rules must meet certain minimum standards. Legal principles constitute fundamental standards. Legal principles embody the 'internal morality of law', the moral core of law and refer to fundamental values of morality (of aspiration¹⁰⁰). Values and principles create a 'normative umbrella' and 'every legal norm seeks to give effect to these values.'¹⁰¹ Hence, the body of rules is legitimate if it is (*grosso modo*¹⁰²) consistent with the internal morality of law.

Thus, legal rules should be made by weighing and balancing principles. Taking into account the relative weight of intersecting principles is a normative process based on the identification of the relevant values and principles. Colliding principles make visible what values are really at stake on a deeper level.¹⁰³ Behind the metaphorical speech of 'balancing' and 'weighing' hides the assessment of the relative societal importance of the conflicting values and principles. The act of weighing is a normative act that is intended to grant the various reasons and considerations 'their proper place in the legal system and their societal worth in the totality of societal values.'¹⁰⁴ In this way, principles are the normative basis for the creation of rules. The validity of these principles cannot be derived from the authority or power of a specific person or institution. These principles are to be considered as vehicles in the movement back and forth between values and legal rules. Rules are to be seen as operationalizations of principles. Consequently, rules have a more concrete and 'technical' character than principles and are normally less value laden. Law-making and law-applying institutions concretize and weigh principles into rules which are directly applicable ('in an all-or-nothing fashion'). Moreover, principles set boundaries on acceptable solutions, on political consensus. Sometimes, for example, when it is a question of safeguarding 'rights that have a price' the 'minimum content' of the relevant principles must be taken into consideration – thereby limiting the discretionary power of the legislator.¹⁰⁵

7 TAXATION: SOME APPLICATIONS

7.1 Introduction

It's time to turn to taxation and show the way the model of principle enhances our understanding of law-making and the application of law in this field. Since fundamental legal principles constitute the legal expressions (translations) of the basic values of a society and the legal system, law-making should conform to legal principles. Similarly, government bodies, implementing the – written – laws are not only bound by the law promulgated by the legislature (on the basis of the principle of legality) but also by legal principles. Thus, officials confirm the commitment to a coherent set of principles, to the ideal of integrity in law: 'the promise that law will be chosen, changed and developed,

¹⁰⁰ Cf. Fuller 1977, p. 43: 'the inner morality of law is condemned to remain largely a morality of aspiration and not of duty.'

¹⁰¹ A. Barak, *The Judge in a Democracy*, Princeton: Princeton University Press 2006, p. 57. For Barak, as for many legal scholars, norms denote the genus, whereas principles and rules are the species. Cf. Zagrebelsky 2003, p. 629-630.

¹⁰² A body of rules which perfectly reflects the internal morality of law is simply not possible. See M. Kriele, *Recht und praktische Vernunft*, Göttingen: Vandenhoeck & Ruprecht 1979, p. 11.

¹⁰³ Cf. J. Pontier & E. Burg, *EU Principles on Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters according to the Case Law of the European Court of Justice*, The Hague: T.M.C. Asser Press 2004, p. 12ff.

¹⁰⁴ Barak 2006, p. 168. Cf. Friedmann 1994, p. 71: 'Rules in the modern state, no matter how technical, ultimately [...] depend on social norms and moral ideas.'

¹⁰⁵ Zagrebelsky 2003, p. 645.

and interpreted in an overall principled way.’¹⁰⁶ Again, this also goes for taxation. Taxes, therefore, should be levied in accordance with fundamental legal principles.

As stated above, debating case law in terms of principles may reveal a degree of consistency which otherwise would not be visible. Outcomes in concrete cases may seemingly completely lack consistency. However, tracing the underlying principles at stake may show principled coherence, for principles state reasons which argue in one direction, but do not necessitate a particular decision. The collision of principles, therefore, gives insight in the underlying diverging reasons.¹⁰⁷ Thus a relevant principle (reason) contributes to the decision even when it does not prevail – and may be decisive in the next case or situation to be decided.

Consequently, the body of tax laws – statute law, case law, and the decisions and regulations of the tax administration – should be consistent in principle. This implies that law is not legitimized only because it is issued by authorized institutions. Rather, legal principles function as essential criteria of evaluation, in the sense that the legislator is bound by legal principles. Of course, legal rules should be created by authoritative bodies. At the same time, however, they ought to be by and large consonant with fundamental legal principles. Legitimacy of positive law is guaranteed by its conformity to general legal principles. Legitimacy requires a substantive evaluation as to whether rules agree with the principles of law.¹⁰⁸

I will now deal with some examples in the field of tax law to show the added value of the principle-based method of (legal) reasoning.

7.2 Tax sovereignty and free movement

A fine example of a principle-based approach is Douma's reconstruction of the case law of European Court of Justice (ECJ) with regard the interpretation and application of the free movement provisions of the Treaty on the Functioning of the European Union (TFEU) in direct taxation cases. Here, the point of departure is ‘the conflict between two areas of legal competence of which the rules are more or less carved in stone.’¹⁰⁹ Although, as European Union (EU) law stands at present, direct taxation does not fall within the purview of the European Union, the powers retained by the member states must nevertheless be exercised consistently with EU law. The conflict between the two areas of legal competence can be modelled in terms of principles.

It is settled ECJ case law that EU law (striving for an internal market without frontiers) takes precedence over national law and that the free movement of goods, persons, services and capital provisions of the TFEU have direct effect. Consequently, any

¹⁰⁶ Dworkin 1986, p. 214. Legal principles may also offer guidance to taxpayers, see J.L.M. Gribnau, ‘Corporate Social Responsibility and Tax Planning: Not by Rules Alone’, forthcoming.

¹⁰⁷ Cf. J. Lang, ‘The Influence of Tax Principles on the Taxation of Income from Capital’, in P.H.J. Essers & A.C. Rijkers (eds.), *The Notion of Income from Capital*, Amsterdam: IBFD 2005, p. 13: ‘It is a common experience of law that every basic principle is limited by other basic principles, limited by the task of the law to consider a great variety of interests and limited by the real circumstances to enforce the law.’

¹⁰⁸ As Spinoza already observed, the power and the right of a legislator depend on the way it uses its competencies. Unlike the positivist Hobbes, he views law as not simply *voluntas* or will. Cf. H. Gribnau, ‘The Power of Law, Spinoza's contribution to Legal Theory’, in A. Santos Campos (ed.), *Spinoza and Law*, Aldershot: Ashgate forthcoming.

¹⁰⁹ Douma 2011, p. 3. He applies Alexy's theoretical optimization model, one reason being that this ‘theory does not juxtapose principles and policies’, which fits well in with ECJ's case law (the rights which individuals derive from the EU free movement provisions do not automatically trump the policies that EU member states pursue through their tax systems (p. 34)).

national tax measure which contravenes a free movement provision is rendered automatically inapplicable.¹¹⁰ Nonetheless, the EU member states as a matter of principle retain extensive competences in tax matters. They remain free to determine the structure of their tax system and to determine the need to allocate between themselves the power to tax. Moreover, apart from these 'internal' objectives, the member states are also at liberty to pursue 'external' objectives through tax measures, e.g., the protection of the environment or stimulation of research and development. Consequently, the ECJ, interpreting and applying TFEU's free movement provisions, has to reconcile the consequences of the fiscal sovereignty retained by EU member states with the obligations flowing from the EU law. 'How should sovereign rights be reconciled with the obligations enshrined in the EC Treaty?'¹¹¹

As Douma argues, the literature on this subject traditionally attempts to identify mistakes or missed opportunities by the ECJ by taking generally accepted principles of national and international tax law and existing ECJ case law as a starting point. In his view, this 'internal' approach cannot lead to a satisfactory answer to the question of whether the ECJ case law is correct or incorrect with respect to the reconciliation of national direct tax sovereignty and free movement, for it results in an oversimplified discussion in which positions are taken which are often motivated only by referring to the position itself. Douma submits that a proper analysis can only be made in the light of an assessment model which is external to and independent of the ECJ case law. This model should account for the fact that one cannot say that free movement always prevails over national direct tax sovereignty, nor that national direct tax sovereignty always prevails over free movement. Theories, therefore, which regard some principles as being absolute – instead of relative – cannot serve as an inspiration for the development of a theoretical assessment model. Douma concludes that a theory is needed which regards national direct tax sovereignty and free movement as *prima facie* reasons or principles and which provides a framework for reconciling these principles. The framework should be designed in such a way that no principle would always trump the other. They should be given a very wide scope.¹¹² Otherwise, narrowing the scope of the relevant principles in advance, this would essentially result in one principle always trumping the other.

Douma subsequently develops a model that recognizes that free movement and national direct tax sovereignty are fundamentally equal principles which when conflicting in individual cases have to be balanced. The theoretical optimization model he proposes has six phases:

1. To which disadvantage does the tax measure lead?
2. Does the tax measure at issue have a respectful objective?
3. If yes, does the tax measure have a sufficient degree of fit in relation to its objective?
4. If yes, is the tax measure suitable to achieve its objective?
5. If yes, does the tax measure reflect the most subsidiary means to achieve its objective?

¹¹⁰ The Treaty on the Functioning of the European Union TFEU contains only a few possible exceptions which are almost never applicable to national direct tax rules.

¹¹¹ Douma 2011, p. 4.

¹¹² Cf. R. Alexy, *A Theory of Constitutional Rights* (trans. J. Rivers), Oxford: Oxford University Press 2002, p. 201: A wide conception of scope is one in which everything which the relevant constitutional principle suggests should be protected falls within the scope of protection.'

6. If yes, is the cost to free movement caused by the tax measure in proportion to the objectives pursued by it?¹¹³

Next, he analyses the ECJ's case law in the light of this assessment model. He shows that the vast majority of the case law perfectly fits the theoretical model. Moreover, he shows that the theoretical assessment model predicts future developments in the case law which would at present be regarded as highly controversial. Hence, this elaborated principle-based model makes a normative and a descriptive claim.¹¹⁴ The normative claim concerns the question as how the conflict between free movement and tax sovereignty should be resolved in theory. The model also makes a descriptive claim because it enables scholars to structure and understand ECJ case law as a coherent body of law.¹¹⁵ As such it is able to serve as an objective framework which can be used to assess whether the ECJ's case law in the area of direct taxation and free movement strikes a fair balance between the competing principles or not. To conclude, a principle-based model has added value, because it prescribes the method through which the conflict between free movement and tax sovereignty in the case at hand should be resolved – thus 'limiting the number of possible outcomes and structuring the analysis in a coherent manner.'¹¹⁶ Thus, legal certainty is enhanced.

7.3 Testing tax legislation

Another example of the relevance of fundamental legal principles in taxation is the testing of tax legislation against fundamental principles. Fundamental legal principles may function as a check on legislative power protecting citizens against arbitrary interferences with their lives, for these principles are also standards of behaviour for law-making institutions. In the Netherlands, the principle of equality restricts the legislative power to tax. This constitutional principle of equality is the most important judicial instrument to check seriously flawed tax legislation. Acts of Parliament are tested against international treaties (Art. 14 European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR), in conjunction with Art. 1 of Protocol No. 1, Art. 1 of Protocol No. 12 of the ECHR, and Art. 26 International Covenant on Civil and Political Rights (ICCPR)).¹¹⁷ Here, the court has to balance the principle of democracy and the principle of equality.

As with regard to the method of judicial interpretation, the Dutch Supreme Court always demands an objective and reasonable justification for any inequality of treatment. This is in conformity with the method applied by the European Court of Human Rights. The Court underlines the significance of the principle of equality for fair tax legislation. After all, each violation of the principle of equality damages the integrity of the tax

¹¹³ Douma 2011, p. 117ff.

¹¹⁴ Dworkin also makes a descriptive and a normative claim. Cf. R. Dworkin, 'Principle, Policy, Procedure', in R. Dworkin, *A Matter of Principle*, Oxford: Oxford University Press 1985, p. 75-77.

¹¹⁵ Douma 2011, p. 296.

¹¹⁶ Douma 2011, p. 296. Thus the conceptual framework makes it possible to assess, explain and predict (future) ECJ case law in the area of direct taxation.

¹¹⁷ The principle of equality is enshrined in Article 1 of the Dutch Constitution. However, Acts of Parliament may not be tested against the Dutch Constitution, for it is the legislature's prerogative to decide upon the question of whether a statute violates any fundamental right (Art. 120 of the Dutch Constitution). However, Art. 94 of the Constitution provides that no national regulation may conflict with treaty provisions 'that are binding on all persons.' Consequently, if treaties contain general principles of law, the courts can test provisions of Acts of Parliament against these fundamental legal principles. See H. Gribnau, 'Equality, Legal Certainty and Tax Legislation in the Netherlands: Fundamental Legal Principles as Checks on Legislative Power: a Case Study', <www.utrechtlawreview.org>, Vol. 9, Issue 2 (March) 2013.

system. Nonetheless, the Supreme Court often acknowledges the wide margin of appreciation of the democratically legitimized legislator. The Court differentiates between fundamental and technical distinctions in tax legislation. It allows the legislator to have relatively little margin of appreciation when fundamental aspects are at stake. However, most cases are related to technical distinctions in tax statutes. Only in very evident cases has the Court sometimes decided that technical distinctions in a tax statute are discriminatory – a (very) wide margin of appreciation of the legislator is acknowledged. If the Court establishes a violation of the principle of equality, it acts very carefully. If no unambiguous resolution is available to eliminate the unjustified unequal treatment of equal cases, the Court leaves the choice to the legislator, which subsequently has to bring the legislation into line with the principle of equality in the short term (*terme de grâce*). If anything, a detailed analysis of Dutch case law with regard to the testing of tax legislation against the principle of equality shows that constitutional review is in no way an all or nothing affair.¹¹⁸ Hence, the Court could not develop rules out of the weighing and balancing of principles.

7.4 From principles to rules

7.4.1 Introduction

Rules are vital to a legal system. General rules solve problems of coordination, expertise, and efficiency. They reduce the uncertainty, error, and controversy that result when individuals follow their own unconstrained judgment. Rules can be seen as authoritative settlements that are ‘more general than the controversies and questions already resolved and thus anticipate and resolve controversies and questions that have not yet arisen.’¹¹⁹ Nonetheless, rules need underlying principles. Fundamental legal principles guide and constrain rule-making, rule-application and rule-following.

Principles may collide. As shown above, reasoning according to the model of principle thus may involve the creation of rules by balancing legal principles. But how are principles elaborated into rules in concrete situations? How do they become a reality in tax practice and not just an abstraction? Here, the case law of the Dutch Supreme Court may – once more - serve as an example. It shows how to do things with principles in the field of the implementation of tax laws. On the one hand, it has developed principles of proper administrative behaviour and, on the other hand, it has elaborated these principles in so called priority rules.¹²⁰ Thus, priority rules may concern the ranking and application of very abstract principles of justice,¹²¹ but also less abstract legal principles in the field of tax law.

¹¹⁸ See R.H. Happé & J.L.M. Gribnau, ‘Constitutional Limits to Taxation in a Democratic State: The Dutch Experience’, 2007 *Michigan State Journal of International Law* Vol. 15, No. 2 and Gribnau 2013.

¹¹⁹ Alexander & Sherwin 2001, p. 18.

¹²⁰ I use the term ‘principles of proper administrative behaviour’ instead of the literally translation of Dutch term ‘principles of proper administration’ (*beginselen van behoorlijk bestuur*) in order to highlight that these principles concern the behaviour of the (tax) administration. Cf. Tridimas 2006, p. 410ff. about the principle of ‘good’ or ‘sound’ or ‘proper’ administrative behaviour in EU law.

¹²¹ Rawls 1999, p. 267.

7.4.2 Principles of proper administrative behaviour

Discussing principles of proper administrative behaviour with regard to acts of the tax administration, we should be aware of the special force of the principle of legality in tax law. This rule of law requirement of general legislation, an important safeguard against arbitrary interferences with individual rights and liberties by the public authorities, is of special importance in tax law.¹²²

The tax administration applies the general laws within the limits of the powers vested in them on the basis of other legal rules. Part of its work is to determine the elaboration of the content of the general rules. This elaboration of tax legislation is inevitable because of the deficit of regulative capacity inherent to the normative structure of the rule of law. The general tax laws, with their formal characteristics of limited flexibility and reduced capacity for adaptation and self-correction, seem ill-suited to the 'exercise of effective and timely control of the growing variety and variability of the cases which emerge from a complex society.'¹²³

The tax administration has to apply the general and abstract norm, but often cannot but determine the content of the norm *in concreto*. It has to concretize, clarify, and specify — not just state — the norms of the general law.¹²⁴ The tax administration often has to make a choice as to the specific meaning of a general norm. To enhance consistent application by all the member of the tax administration policies are formulated containing standard interpretations and applications of legislation and judicial rulings. These policies are often laid down in rules and disseminated within the administration in order to be applied by tax inspectors.¹²⁵ These policy rules enable the tax inspectors to coordinate their behaviour with each other, to secure a reduction in individual decision-making error, and a reduction in individual decision-making costs.¹²⁶ These rules are established by the most specialized and experienced tax inspectors within the tax administration and have to be applied by the other tax inspectors and their assistants. Policy rules constrain the latter decision-makers in determining what they want to take into account. In this way, these administrative rules operate as tools for the allocation of power, determined by comparative competence, 'to consider certain kinds of facts, reasons, and arguments.'¹²⁷ Without these policy rules, the latter would be less constrained in their power to take into account. These policy rules are often published, providing the taxpayer with guidance as to the expected behaviour of the tax

¹²² As regards tax matters, the principle of legality is entrenched in the Dutch Constitution. Article 104 states that taxes imposed by the State must be levied pursuant to an Act of Parliament ('*uit kracht van een wet*'). Other levies imposed by the State must be regulated by Act of Parliament. Article 104, therefore, does not cover taxation by lower legislative authorities.

¹²³ D. Zolo, *Democracy and Complexity. A Realist Approach*, University Park: The Pennsylvania State University Press 1992, p. 127-128.

¹²⁴ H. Gribnau, 'Separation of Powers in Taxation: The Quest for Balance in the Netherlands', in A.P. Dourado (ed.), *Separation of Powers in Tax Law*, European Association of Tax Law Professors International Tax Series Vol. 7, Amsterdam: IBFD 2010, p. 169-170.

¹²⁵ To be sure, policy rules (*beleidsregels*) are concerned here, not secondary legislation on the basis of some kind of delegated legislative power conferred by an Act of Parliament. These policy rules, sometimes also known as "quasi-legislation", are laid down by an administrative body as a form of self-regulation over the exercise of its administrative powers. That is the reason why citizens nor courts are bound by these policy rules.

¹²⁶ Alexander & Sherwin 2001, p. 14-36.

¹²⁷ F. Schauer, *Playing by the Rules*, Oxford: Clarendon Press 1991, p. 158. This allocation enables efficient decision-making and the equal treatment of like cases in bureaucratic organisations like the tax administration.

administration. Thus, the taxpayer may derive legal certainty from administrative rules.¹²⁸

As a result, the citizens are often not governed by the provisions of statutes but by their specification in policy rules. Moreover, most citizens do not have much knowledge of the tax legislation in force and depend for their knowledge of tax law on communications by the (Dutch) tax administration. The tax administration, for example, may provide general information to a taxpayer, or to taxpayers in general by way of policy rules, for example on its website, but may also promise a taxpayer to apply the tax law in a certain way. Given this importance of policy rules and other communications the question is whether citizens can rely on them. Suppose a citizen invokes a policy rule, information or promise that is more favourable than the legislation.¹²⁹ The tax inspector, however, imposes an assessment in accordance with the less favourable legislation. The tax inspector deviates from the policy rule, from information previously provided or from his promise. Here, certainty derived from a statute conflicts with certainty derived from a communication on behalf of the tax administration. Hence, two aspects of the principle of legal certainty collide. What should the court decide when the taxpayer lodges an appeal? Should the court regard the tax legislation to be the only source of law, which may infringe upon legitimate expectations, or should it also take into account the principle of legal certainty which protects legitimate expectations?¹³⁰ Indeed, Dutch courts do. They nowadays recognize the importance of legal principles and test the tax administration's decisions against the principles of proper administrative behaviour.¹³¹ The judiciary, on the basis of case law, has developed legal principles with regard to improper actions and decisions of the administration.¹³²

7.4.3 Principles generating (priority) rules

The recognition by the Dutch courts that the (tax) administration is bound not only by legislation but also by principles of proper administrative behaviour raises the question of how to apply this approach. In which *hard cases*, in which exceptional circumstances do the principles of proper administrative behaviour justify a deviation from the strict application of the legislation? This question concerns the method of balancing of principles, for the hard cases can be viewed from the perspective of colliding principles, pointing into different directions (outcomes). The two principles regulating administrative behaviour are the principle of legality and the principle of proper administrative behaviour concerned. In the examples in the previous section it

¹²⁸ Policy rules also serve the principle of equality, another regulative ideal of tax law. Cf. A. Tollenaar, 'Soft law and policy rules in the Netherlands', *Netherlands Administrative Law Library*, July / September 2012, DOI: 10.5553/NALL/.000006, <www.nall.nl>

¹²⁹ The Dutch tax administration frequently takes a position which is not covered by a narrow, restricted reading (interpretation) of the tax statute, so as to enhance the aim and intent of the legal provisions. In these positions *praeter legem* (i.e., beyond the letter of the law), which favour the taxpayer, the tax administration puts aside the text of the statute in order to do justice to its spirit; R.H. Happé, *Drie beginselen van fiscale rechtsbescherming*, Deventer: Kluwer 1996, p. 36-38.

¹³⁰ R. Happé & M. Pauwels, 'Balancing of Powers in Dutch Tax Law: General Overview and Recent Developments', in C. Evans et. al. (eds.), *The Delicate Balance: Tax, Discretion and the Rule of Law*, Amsterdam: IBFD 2011, p. 237-245, at p. 246.

¹³¹ Note that not the legislative rule itself is under debate, but the application of the rule by the tax administration because of some kind of previous communication.

¹³² The same goes for the European Union; the European Court of Justice developed the principle of proper administrative behaviour was in its case law (mainly in the 1990s); *Tridimas* 2006, p. 410.

concerns the principle of honouring legitimate expectations.¹³³ Both the principle of legality and the principle of honouring legitimate expectations are regulative ideals at which the administration should aim its actions.

The Dutch Supreme Court has developed rules as a result of this weighing and balancing of principles in particular types of situations. 'Priority rules' are the result the balancing of principles in a certain situation with specific features. This situation will in the future be seen as a standard situation with its own priority rule describing specific criteria of application. A priority rule indicates which 'principle outweighs – and therefore gets priority above – the other principle in the standard situation concerned.'¹³⁴ It lays down the relative weight of both principles. Thus, different (priority) rules are developed for different 'situations in which there is no need any more for the balancing of principles. A priority rule has the same structure as a statutory rule. It is a rule which sets criteria: in a specific case, it should be verified whether the criteria are all met. If these criteria are all met in the case at hand, the priority rule applies in an all-or-nothing fashion.

Whenever one of the standard situations occurs in the future, the applicable priority rule can be applied. The priority rule 'replaces' the principles that were already involved in formulating the rule. However, a new situation may occur which differs from existing standard situations, in which the straightforward application of a legislative rule would be qualified as improper administrative behaviour. The court then has to weigh the principle of legality (the principle underlying the rule), and the principle of proper administrative behaviour concerned again, in order to establish a new priority rule – tailored to this specific situation.

With regard to the principle of honouring legitimate expectations, the Dutch Supreme Court has developed a typology which classifies several standard situations in which the expectations to taxpayers are raised by the tax administration. The classification is based on the origin (e.g., a promise or a policy rule) of the expectations, which accounts for different priority rules. If the criteria set in the applicable priority rule are all met in the case at hand, the priority rule applies. In that case the expectations concerned are deemed to be legitimate and are honoured.

In other words: the principle of honouring legitimate expectations then has priority over the principle of legality. If one of the criteria is not met in the case at hand, the priority rule is not applied. In that case, the principle of legality has priority. Note, that the relative weight of principles can not only be ascribed to the principles, for 'weight is case-related.'¹³⁵ Therefore, the relative weight of the principles depends on the criteria set out in the priority rule.

The priority rule for promises nicely illustrates this method for creating priority rules out of principles. This priority rule prescribes that the expectations raised by a promise – deviating from the legislative provision – are honoured if four criteria are met: 1) the taxpayer has the impression that the tax inspector is taking a certain position concerning the application of the tax law; 2) the taxpayer has informed the tax inspector of all relevant facts and circumstances of his or her case; 3) the taxpayer may reasonably think

¹³³ For a detailed analysis, see S.J. Schønberg, *Legitimate Expectations in Administrative Law*, Oxford: Oxford University Press 2000 and Tridimas 2006, p. 242-297; Groussot 2006, p. 24-25, 202-212 deals more briefly with this principle.

¹³⁴ Happé & Pauwels 2011, p. 247.

¹³⁵ Cf. J. Hage, *Reasoning With Rules: An Essay on Legal Reasoning and Its Underlying Logic*, Dordrecht [etc.]: Kluwer Academic Publishers 1997, p. 116.

that the promise is in the spirit of the law, and 4) the tax inspector is competent to deal with the taxpayer. To be sure, all criteria have to be met. For example, if the taxpayer is in bad faith, criterion 3 is not met and the principle of legality prevails.¹³⁶

Reviewing the behaviour of the tax administration, the Dutch Supreme Court has not only developed a system of priority rules in the field of the principle of legitimate expectations, but also in the field of the principle of equality as a principle of proper administrative behaviour.¹³⁷ Hence, different factual situations in part determine what principle should regulate these situations; they set different principles 'in motion'. The choice of the correct regulative principles to be balanced in a situation, therefore, depends on the nature of that situation (*Natur der Sache*; see § 5).¹³⁸

7.5 Retroactivity and priority principles

Colliding principles generate rules in the context of the tax administration's behaviour. However, in other (tax) contexts it is often not possible to translate the outcome of the collision of legal principles in (hard and fast) rules for lack of certain types of regularly occurring situations. Interestingly, there is another outcome possible when principles are balanced. This balancing can result in lower level principles, the so-called 'priority principles.'

As Radbruch argues, legal certainty is definitely one of the most fundamental legal values. This also applies to taxation. Here, Adam Smith's second maxim regarding taxation in general springs to mind: 'The tax which each individual is bound to pay ought to be certain, and not arbitrary.'¹³⁹ Notwithstanding its importance, the concept of legal certainty is not an easy one. 'Legal certainty is by its nature diffuse, perhaps more so than any other general principle, and its precise content is difficult to pin down.'¹⁴⁰

Non-retroactivity of law is one of the well-known desiderata formulated by Lon Fuller which links in to the value of legal certainty. Fuller criticizes retroactivity: in itself 'a retroactive law is truly a monstrosity'.¹⁴¹ However, he goes on to argue that there is no absolute prohibition on retroactivity, for, situations may arise in which granting retroactive effect to legal rules, 'not only becomes tolerable, but may actually be

¹³⁶ Happé & Pauwels 2011, p. 248.

¹³⁷ An example is the situation in which the tax administration has a certain favourable policy that is not published. Here, the principle of equality has priority over the principle of legality if the taxpayer is able to prove that such a favourable policy exists and his or her situation is covered by that policy rule. According to this the priority rule the tax administration should apply that policy rule to that taxpayer. Happé & Pauwels 2011, p. 248.

¹³⁸ This a well-known feature of principle-based reasoning. Cf. Rawls 1999, p. 25: 'The choice of the correct regulative principle for anything depends on the nature of that thing.'

¹³⁹ A. Smith, *The Wealth of Nations* [1776], Book V, Ch. II, Part II, Indianapolis: Liberty Fund 1981, p. 825.

¹⁴⁰ Tridimas 2006, p. 243. For the concept of legal certainty understood as an aspects concept, see M. Pauwels, 'Retroactive and Retrospective Tax Legislation: A Principle-based Approach; A Theory of 'Priority Principles of Transitional Law' and 'the Method of the Catalogue of Circumstances', in H. Gribnau & M. Pauwels (eds.), *Retroactivity of Tax Legislation* (2010 EATLP Congress Leuven), Amsterdam: EATLP 2013, p. 100-101.

¹⁴¹ Fuller 1977, p. 53. He points at a close affinity between the harm resulting from too frequent changes in the law and the harm done by retroactive legislation. Both make it hard for people to gear their activities to the law (p. 80).

essential to advance the cause of legality.' Hence, non-retroactivity can be conceptualized as a principle.

Retroactivity of tax legislation is a much debated topic.¹⁴² Pauwels raises the question how the tax legislator should deal with the various colliding interests when making transitional law. He advocates a framework for the tax legislator, based on a principle-based approach.¹⁴³ His starting point is that government is bound by legal principles, for example when making transitional law, but that these principles are not absolute. Therefore, notwithstanding that the principle of legal certainty, including the principle of honouring legitimate expectations, normally provides strong reasons contra retroactivity, this does not mean that there is an absolute ban on retroactivity. It is conceivable that in certain situations legitimate interests could be served if the legislator were to grant retroactive effect to legislation. In that situation the competing interests and principles should be balanced.

Subsequently Pauwels develops a framework for the tax legislator which consists of two parts. The first part concerns the principles of transitional law. These principles are the principle of immediate effect of new tax legislation without grandfathering and the principle of non-retroactivity. These principles are generally accepted. Pauwels proposes to conceptualize these principles as 'priority principles'. With respect to the theoretical foundation of these principles, he argues that they can be regarded as the result of the abstract balancing of the three main principles (or interests) involved when making transitional law.¹⁴⁴ These main principles are the principle of legal certainty, the principle of equality and the objective that is served by the new law.¹⁴⁵ From this perspective, the transitional law principle of non-retroactivity is the outcome of the balancing act in the sense that the principle of legal certainty supersedes any other interests. With regard to the principle of immediate effect without grandfathering, the objective of the new law and the principle of equality – which provide arguments against grandfathering – outweigh the principle of legal certainty – which advocates grandfathering.

In the second part of Pauwels' framework, he uses the method of the 'catalogue of circumstances' to approach the concept of 'legitimate expectations' in the field of transitional law. In a concrete legislative case there may be reasons to deviate from the principles of transitional law. In that respect the concept of 'legitimate expectations' is important. On the one hand, if no legitimate expectations are infringed, retroactivity may be permissible. On the other hand, if the immediate effect (retroactivity) were to infringe legitimate expectations, the legislator should provide for grandfathering. The question is, however, when expectations can be considered 'legitimate'. Pauwels distinguishes two steps to be taken. The first step – from subjective expectations to reasonable expectations – concerns a process of filtering by objectification of the expectations. This implies that the view of a reasonable person is taken. The second step concerns a balancing of the expectations with the interests that would be infringed if the

¹⁴² See Gribnau & Pauwels (eds.) 2013.

¹⁴³ Pauwels 2013, p. 95-116. This article is based on the Ph-D thesis: M.R.T. Pauwels, *Terugwerkende kracht van belastingwetgeving: gewikt en gewogen* (Retroactivity of Tax Legislation: Weighing and Balancing), Amersfoort: Sdu Uitgevers 2009.

¹⁴⁴ A priority principle is supported by other more general ones. They could be conceived of as a kind of mid-level principles (see § 6, note 91), provided a mid-level principle is not defined as a principle supported by another more general one (and only one).

¹⁴⁵ Here, Pauwels 2013, p. 103 argues that the law and economics literature correctly emphasizes that grandfathering has social costs as it entails delay and reduction of the benefits of the new law.

expectations were to be honoured. Although these steps provide something to hold on, in the end the question cannot be answered in abstract, but depends on the circumstances of the case.

Here, the method of the catalogue of circumstances is useful – as Pauwels shows. This method takes an intermediate position between, on the one hand, a non-specified reference to the circumstances of the case (an ‘open group of circumstances’) and, on the other hand, the method of priority rules (see § 7.4). Such a catalogue consists of the circumstances which the legislator should take into account when balancing the conflicting interests (as far as the circumstances are present in the legislative case at hand). This method not only provides the legislator a foothold for balancing, it may also contribute to the transparency and quality of the balancing during the legislative process. Again, this elaborated principle-based framework makes a normative and a descriptive claim, for Pauwels shows that the method of catalogue of circumstances is not a mere theoretical idea. It is true, that the combination of the priority principles of transitional law, on the one hand, and the method of the catalogue of circumstances, on the other hand, is not directly traceable in parliamentary proceedings, case law and the literature. Nonetheless, strong support for this combination is to be found in those sources. He is, therefore, able to draft a catalogue of circumstances that the legislator should take into account in balancing the colliding interests when making transitional law.¹⁴⁶

8 CONCLUSION

This article focused on the theoretical and practical role of fundamental legal principles on the European continent – so the focus was on legal principles outside the common law. The research question was: how to understand legal principles as regulative ideals in a broader philosophy of law which accounts for their relationship to rules? This question was answered in three steps.

First, Dworkin's theory of principles was used to elucidate the concept of a legal principle and its function in a legal system. Principles – in the narrow sense – are distinguished from policies. Principles embody the dimension of morality (justice, fairness), for principles appeal to moral values. For Dworkin the moral dimension of these legal principles is key. Principles differ from rules in that they state reasons arguing in a direction, but they do not dictate outcomes. Due this non-conclusiveness, principles providing diverging reasons may collide. This conflict must be resolved by taking into account the relative weight of each principle. Fundamental legal principles are the underlying justification for the body of explicit rules. Law-making and law-applying institutions are not the authors of legal principles; they find the principles in the law. They concretize principles, but their interpretations never exhaust the principles. Thus, the body of law should be consistent in principle. Legal principles - embodying the ‘internal morality of law’ – function as essential criteria of evaluation. This may imply a transfer of power to the courts and/or tax administrators but that is not the core of my argument, for law-making and law-applying institutions should also, or better, primarily, evaluate their own functioning in terms of fundamental legal principles. Hence, notwithstanding the primacy of democratically legitimized legislature in law-making, principles set boundaries to legislative policies.

Secondly, it was submitted that Radbruch's value oriented philosophy of law makes it possible to firmly entrench fundamental legal principles in the legal system. Law is

¹⁴⁶ Pauwels 2013, p. 110-112.

oriented towards its supreme value: the idea of law (*Rechtsidee*) or justice (*das Gerechte*). Law-making is aimed at this regulative ideal. It was shown, that the idea of law, justice, is not a free floating value. Justice both determines and is determined by the reality of law. Existing factual relations, therefore partially determine what rules and principles should regulate these relations. Values, like principles, are not imposed on society by a sovereign power. Law seeks to implement legal values, such as equality, impartiality and certainty, which can be regarded as legal translations of important social and cultural values. However, the entering of these values, mixed with political values and policies, into the legal system is filtered and moulded by the values of legal certainty and legal equality. Similarly, legal principles are translations, not reproductions, of societal norms within the legal system. Hence, fundamental legal principles are vehicles in the movement back and forth between values and legal rules. These rules must meet the minimum standards set by legal principles.

Thirdly, some examples in the field of tax law were discussed in order to show the added value of the ('European') principle-based method of legal reasoning which can take account of varying circumstances. Notwithstanding the high level of abstraction of principles, the model of principle appeared to constitute a theoretical model with a descriptive and a normative claim. An analysis of case law of the European Court of Justice, concerning the conflict between free movement and tax sovereignty, in terms of this model of principles to render coherence to judgments which appeared at face value inconsistent (descriptive claim). Moreover, this principle-based model prescribes the method through which the conflict between free movement and tax sovereignty in a concrete case should be resolved (normative claim).

Subsequently, the testing of tax statutes against the principle of equality showed how the Dutch Supreme Court tries to strike a balance between the principle of democracy and the principle of equality. In these hard cases, arguments of principle are used to evaluate existing (statute) law. This case law reflects the actual significance of a principle based normative theory. However, the Court cannot develop rules - applicable in an 'all-or-nothing fashion - out of the weighing and balancing of principles.

The next example showed how principles can be specified and elaborated into rules, for principles are indeed too abstract and non-conclusive to dictate outcomes in concrete cases. Here, the case law of the Dutch Supreme Court in the field of the implementation of tax law shows how balancing legal principles in concrete situations may lead to rules. Most citizens do not have much knowledge of the tax legislation in force and depend for their knowledge of tax law on communications by the (Dutch) tax administration. Given this importance of communications the question is whether citizens can rely on them. In other words, has the principle of honouring legitimate expectations priority over the principle of legality? In situations like this one, the Supreme Court nowadays tests the tax administration's decisions against the principles of proper administrative behaviour. The Court has developed these principles for different kinds of administrative behaviour, and it has elaborated these principles in priority rules. These priority rules lay down the relative weight of the principles balanced and describe the specific criteria of application. In this way, the judicial balancing of principles produces hard and fast rules. Again, a reconstruction of case law in terms of principles shows that in practice judges rely on arguments of principle. Thus, actual legal practice here reflects the normative claim that law should be conceived of as based on a coherent set of principles.

The last example dealt with priority principles developed to guide decisions with regard to retroactive tax legislation. As shown above, it is often not possible to translate the outcome of the collision of legal principles in rules for lack of certain types of regularly occurring situations. However, the balancing can result in priority principles. Although they are not rules, but principles, they provide more guidance than the very abstract fundamental legal principles. These priority principles are part of a framework developed for the tax legislator who has to deal with the various colliding interests when making transitional law. Here, a principle-based approach recognises that it is possible that sometimes certain interests could be served with retroactive tax legislation - notwithstanding that the principle of legal certainty, including the principle of honouring legitimate expectations, normally provides strong reasons contra retroactivity. The framework consists of two parts. The first part concerns the principles of transitional law, conceptualized as priority principles: the principle of immediate effect of new tax legislation without grandfathering and the principle of non-retroactivity. In the second part the method of the catalogue of circumstances is used to specify the concept of legitimate expectations in the field of transitional tax law, for in a concrete legislative case legitimate expectations may constitute a reason to deviate from the principles of transitional law. This method not only provides the tax legislator with a (normative) foothold for balancing, it may also contribute to the transparency and quality of the legislative balancing. Again, this principle-based framework also makes a descriptive claim, for strong support for the combination of the priority principles and the method of the catalogue of circumstances is to be found in parliamentary proceedings, case law and the literature.

Progressivity in the tax transfer system: changes in family support from Whitlam to Howard and beyond

Helen Hodgson¹

Abstract

Since the 1970s personal income tax rates have become less progressive throughout the OECD. During this period inequality has also increased. This is also true of Australia, where over the same period transfer payments have been more closely targeted to those in need. Accordingly over this time the Australian tax-transfer system has shifted from a system with highly progressive tax rates coupled with universal benefits in respect of children and pensioners to a system of flatter tax rates and transfer payments that are recognised as among the most targeted in the OECD. In this paper I will explore the relationship between personal income tax rates and means tested transfer payments in developing a progressive tax-transfer system since the 1970s, in the context of support for families.

Keywords: Tax-transfer; Family Tax benefit; Universal benefits; Progressive tax rates

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1 INTRODUCTION

One of the principles of tax policy design is equity, or the ability to pay principle. This is generally implemented through a progressive tax system in which the rates of tax increase as the income (or wealth) of the taxpayer increases. However over the past thirty years the progressivity of the personal income tax system has decreased in Australia, as in most OECD countries. This has been criticised by some commentators who advocate a return to more progressive income tax rates coupled with a universal welfare system.²

Tax and transfer systems are both used to redistribute income, although they work through different means.³ Tax systems redistribute through several main mechanisms: progressive tax rates, tax expenditures and the choice of the tax base. Progressive income tax rates apply the ability to pay principle effectively, but are based solely on income with taxpayers reporting higher incomes paying higher rates of tax than lower income earners. However, progressive tax rates cannot discriminate between categories of taxpayers, and accordingly tax expenditures have been devised to recognise taxpayers that meet the specified criteria. These tax expenditures may include tax offsets, rebates or credits that reduce the tax payable; tax deductions or allowances that reduce income subject to tax; modified tax thresholds or reduced tax rates. The effect of tax expenditures is to reduce tax collections, and accordingly the annual Budget Papers do not show tax expenditures as a direct expenditure,⁴ although details of the lost revenue attributable to tax expenditures may be available through annual tax expenditure statements.⁵

The major limitation of redistributing through the tax system is that the recipient must be a taxpayer. Accordingly, the tax system is not able to distribute to persons who are not within the tax system, whereas transfer payments can be more specifically targeted to recipients. A direct cash transfer payment may be made to a person who is not earning enough income to be required to pay tax, or to a non-working parent who is outside the tax system. The ability to pay principle may be applied through the application of means or asset testing. Unlike tax expenditures, transfer payments do show as a direct expenditure in the annual Budget Papers.

In contrast to a progressive tax rate schedule, a universal benefit is a tool of horizontal equity because it provides benefits to all eligible recipients: the issue is determining the criteria for eligibility. Welfare regimes can be classified by the features of that regime⁶: in a liberal welfare state universal benefits are modest with means testing being used to target benefits, while in a social democracy many, but not all, benefits are universal with higher income tax rates. In a social democracy support from the state through subsidised services is an entitlement that comes with citizenship,⁷

² P. Apps and R. Rees, 'Australian Family Tax Reform and the Targeting Fallacy' (2010) 43(2) *Australian Economic Review* 153.

³ Alison McClelland and Rick Krever, 'Social Security, Taxation Law, and Redistribution: Directions for Reform' (1993) 31(65) *Osgoode Hall Law Journal* 63.

⁴ Kerrie Sadiq, 'The Implementation of Social and Economic Policy Through the Tax Regime: A Review of Australia's Tax Expenditures Program' (2008) 23(4) *Australian Tax Forum* 339.

⁵ Charter of Budget Honesty Act, 1988 (Cth).

⁶ G. Esping-Andersen, *Three worlds of welfare capitalism* (Cambridge Polity Press, first published The Three Worlds of Welfare Capitalism, Polity Press, 1990, 2006).

⁷ Walter Korpi and Joakim Palme, 'The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality, and Poverty in the Western Countries' (1998) 63(5) *American Sociological Review* 661.

regardless of a person's means, but those deemed able to afford to pay make a higher contribution to the state. Further, if the benefit is also included in taxable income, a proportion of the benefit is clawed back which effectively applies a means test to that benefit. In contrast Australia is usually classified as a liberal welfare regime, in which the state and private enterprise work together: the state will subsidise the private sector in the provision of goods and services that are social goods, but does not usually provide the services directly, or may charge a fee for service where the user can afford to pay for that service.

While the tax and transfer systems coexist as a means of redistributing income in accordance with government priorities and programmes, they need to be considered as an integrated system. The major tax system reviews that have been undertaken over the past thirty years⁸ have regarded the two systems as two parts of the same redistributive system, which is the approach taken in this article.

Although the redistributive function of the tax-transfer system is a tool to address inequality there is evidence that disposable income is influenced more strongly by market income than by the tax-transfer system and the tax-transfer system is becoming less effective at moderating the effect of inequality in market income.⁹ Although transfers remain effective at reducing poverty among low income families, they are less effective in reducing income gaps between the highest and lowest income groups, as these are market driven, and the global flattening of personal income tax rates since the 1980s has reduced the progressivity of the tax system. Over the period of this study, western liberal democracies followed market-based economic policies that allowed disparities between the income and wealth of the highest and lowest income earners to flourish. OECD data show that from the mid 1980s to mid 1990s there was a general widening of income distribution disparity across the OECD.¹⁰ While Australian data for the earlier period are not reflected in the OECD tables, Australian studies reflect a similar pattern,¹¹ although less pronounced.

This paper considers those elements of the tax-transfer system that were available to families from time to time over this period, including both child-contingent benefits, which consist of benefits that are based on a family structure that includes dependent children and spousal benefits, which are dependent on the marital (or couple) status of the claimant.

The main categories of payments reviewed are universal payments, available to all families with children; means tested benefits that are targeted to low income families with children and benefits available to single income families, with either a sole parent or where only one parent participates in the paid labour force. Income support transfer payments, such as the Parenting Payment are not generally included, except to the

⁸ Kenneth W Asprey et al, 'Taxation Review Committee Full Report ' (AGPS, 21 Jan 1975 1975) <<http://setis.library.usyd.edu.au/oztexts/parsons.html>; Ken Henry et al, 'Australia's Future Tax System: Final Report ' (Commonwealth of Australia, 2010) <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm; James Edward Meade, 'The Structure and Reform of Direct Taxation' (Allen & Unwin, 1978; Sir James Mirrlees et al, *Tax by Design*, The Mirrlees Review (Oxford University Press, 2011).

⁹ OECD, *Divided We Stand: Why Inequality Keeps Rising* (OECD, 2011); Grace Anyaegbu, 'The Effects of Taxes and Benefits on Household Income, 2009/10' (Office for National Statistics, 2011) <www.ons.gov.uk>.

¹⁰ OECD, Above.

¹¹ Roger Wilkins, 'What Really Happened to Income Inequality in Australia over the Past Decade' (2012) (31 July 2012) *SPRC Public Seminar Series*.

extent that payments in respect of dependants are included in these benefit entitlements.

The benefits may be available as a tax concession, resulting in a reduction of personal income tax that would otherwise be payable by the taxpayer, or as a transfer payment paid directly to the claimants, but direct provision of services and consumption taxes are not discussed in this article.

2 THE 1970S: THE WHITLAM ERA

In the 1970s the Australian tax and transfer systems were not integrated, with family benefits within both systems. The predominant policy rationale was based on horizontal equity in order to recognise that families with children, compared with people without children at the same income levels, had greater calls on their available income. Hence family payments recognised this and increased the disposable income of all families with children. Vertical equity was delivered through a highly progressive tax system with personal tax rates ranging from 0.3% to 66.7% in 1972.

Family benefits consisted of tax deductions in respect of a taxpayer's dependant spouse and children; additional pension or benefit payments for parents on income support; and Child Endowment. Child Endowment was a universal payment, payable to all families with children, and based on the number of children in the family. It was intended to complement the minimum wage as the basis of ensuring that families received an adequate income; however, evidence was emerging that certain groups in the community, including low income families, large families and sole parents, were at a high risk of poverty.

Child Endowment was paid to the primary carer while tax deductions or additional income support payments were paid through the pay packet to the breadwinner. Taxpayers could claim concessional deductions through the tax system¹² concurrently with the universal Child Endowment for taxpayers. Families receiving pensions or benefits through the transfer system received additional payments for children, added to the basic pension or benefit, in addition to the Child Endowment.

A dependant deduction was available for spouse, daughter-housekeeper (where the taxpayer did not have a spouse), child under 16 and full-time student up to 25 years of age.¹³ There was no means testing on the income of the taxpayer, although the income of the family member was relevant in determining the dependency of that family member.

The use of tax deductions to deliver benefits was regressive, providing higher benefits to higher income families. Accordingly, the most significant proportion of family benefits, whether in relation to a taxpayer or a recipient of social security benefits, was paid to the primary breadwinner, generally the male partner. Further there was no indexation of benefits and over time the real value of the benefits had decreased.

These deficiencies were highlighted in the two major reform proposals of this period. Although the Whitlam government introduced a number of important social reforms, credit for reform in relation to the family tax-transfer system is more appropriately

¹² *Income Tax Assessment Act 1936*: s.82B.

¹³ Deductions were also available for an invalid relative or parent, but these categories of dependant are beyond the scope of this paper.

shared by the three governments of the period: McMahon, Whitlam and Fraser. The Henderson Commission¹⁴ and the Asprey Committee¹⁵ were both established by the McMahon government in 1972, although the Henderson Commission was expanded by the Whitlam government after its election. Reforms to the tax deductions in relation to families were implemented under Whitlam, but further reforms to Child Endowment were implemented by the Fraser government as the Family Allowance.

The government responded promptly to the recommendations of the Asprey Committee and Henderson Commission reports. The 1974–75 Budget guaranteed taxpayers a minimum tax reduction of 40% of the value of any deductions for children, and in the following year the deductions were replaced with a system of concessional rebates. Spouse rebates replaced spouse deductions, and the child deduction was repealed to be firstly replaced by rebates then incorporated in the Family Allowance. With effect from 1 July 1976, the Fraser (Coalition) government replaced Child Endowment with Family Allowance, which was a non-means-tested payment, available in respect of children or students up to the age of 25. The increased rates were a substantial increase on the former Child Endowment, but there was also a substantial increase in the rates, particularly in respect of the second and third child in the family, recognising that payments did not provide adequate support to larger families. However these increased rates were not indexed to inflation, which resulted in a substantial loss in value over this period of increasing prices.

3 THE ACCORD: HAWKE AND KEATING

Changing economic conditions which led to the recession of the early 1980s placed families under financial stress, with an increase in the number of children living in poverty. This was exacerbated by the failure of payments to keep pace with inflation and the increasing number of sole parent families. In 1983 the first means tested payment, the Family Income Supplement, was introduced in addition to the Child Endowment to assist low income families. Following the increase in benefit recipients under the previous government, the number of recipients and expenditure levelled off over the first term of the Hawke government, although the report of the Cass Review highlighted the problems faced by low income families.¹⁶

When elected in 1983 the Hawke government entered into an Accord with the union movement, under which the government agreed to maintain the social wage.¹⁷ Accordingly, from 1983 changes to the tax-transfer system were made that directed higher rates of payments to families in need, with the transfer system moving from a focus on horizontal equity to vertical equity. This was implemented through means testing family payments and increasing payment rates to low income families. To some extent this compensated for concurrent changes to the tax system that resulted in a flatter structure for personal tax rates, with lower marginal rates and wider tax bands that reduced the progressivity of the tax system. Indexation of family benefits was introduced to ensure that payments were adjusted for inflation.

¹⁴ Ronald F Henderson, 'Poverty in Australia: Australian Government Commission of Inquiry into Poverty: 1st Main Report' (AGPS, 1975).

¹⁵ Above note 8.

¹⁶ Bettina Cass, 'Income Support for Families with Children' (Issue Paper No 1, Department of Social Security, 1986).

¹⁷ Lloyd Cox, 'The Antipodean Social Laboratory, Labour and the Transformation of the Welfare State' (2006) 42(2) (June 2006) *Journal of Sociology* 107 :112.

In 1985 the tax reforms proposed in the RATS White Paper¹⁸ were debated at the National Tax Summit. This tax summit was established by the Hawke (Labor) government following the 1984 election in order to facilitate debate on future tax reforms. In the spirit of the Accord, the government was seeking consensus among the invited stakeholders, particularly business and the union movement. The major issues addressed in the RATS White Paper were related to broadening the tax base and tax avoidance issues. In many respects the paper followed up on reforms proposed by the Asprey Committee a decade earlier: the introduction of a broad-based consumption tax (although this did not eventuate for another 15 years, and was implemented by the Howard (Coalition) government); a capital gains tax; dividend imputation and a fringe benefits tax.

The RATS White Paper included a review of the relationship between the social security and income tax systems¹⁹; particularly the structural problems that arose from 'bracket creep', which could push the recipient of an indexed payment above the tax-free threshold; and the effective marginal tax rates (EMTRs) that applied where withdrawal rates for pensions and benefits combined with personal income tax rates.

While the first problem had been substantially addressed by the beneficiary and pensioner tax rebates introduced in 1983, the problems arising from the withdrawal rates of benefits was noted as being 'rather more intractable'.²⁰ The proposal of the Henderson Commission for a guaranteed minimum income scheme was reviewed, as were the Asprey Committee proposals for a separate tax scale for social security recipients, relaxing the means tests imposed under social security law and exempting pensions or benefits from tax.

The RATS White Paper recommendations to reduce income tax rates relied substantially on comprehensive reform that included the introduction of a broad-based consumption tax that would fund reductions in income tax rates for lower income earners, and compensatory packages for lower income earners (Options B and C). One form of compensation that was contemplated was the extension of family income support. The White Paper made no specific proposals regarding reform of withdrawal rates of means-tested payments, as the drafters relied on the proposed income tax rate reductions to address the high EMTRs imposed by the combined effects of the two systems.²¹

The proposed options incorporating the consumption tax were rejected at the National Tax Summit held in June 1985. The government proceeded with a number of base-broadening measures that did not include a consumption tax; accordingly, the personal income tax cuts, as set out below, were not in the order contemplated by Option C, which would have seen a tax rate of 20% applying on the lowest incomes, up to \$19,500 pa. The cuts were phased in over a number of years, with the new structure emerging by the 1987–88 year. As shown in Table 1 the biggest personal income tax cuts were to the highest tax brackets, which were reduced from 60% to 49%. Corporate tax rates were also reduced from 49% to 36%.

¹⁸ Australian Treasury, *Reform of the Australian Tax System - Draft White Paper* (AGPS, 1985).

¹⁹ Above, chapter 10.

²⁰ Above note 18 at p 104.

²¹ Australian Treasury, above n 18: 250; A 1985 proposal to reduce the withdrawal rate applied to pensions (*The Social Security (Poverty Traps Reduction) Act 1985*) was deferred to 1987 and overtaken by other changes to the pension system: Bob Dapre, *A Compendium of Legislative Changes in Social Security 1983 - 2000*, FACSIA Occasional Paper Series (FACSIA, 2006).

Table 1 Change in Personal Marginal Tax Rates Following RATS

1983–84: Before RATS Reforms		1987–88: After RATS Reforms	
Annual Income	Marginal Rates	Annual Income	Marginal Rates
1–\$4, 594	Nil	\$1–\$5, 100	Nil
\$4, 595–\$19, 499	30%	\$5, 101–\$12, 600	24%
		\$12, 601–\$19, 500	29%
\$19, 500–\$35, 787	46%	\$19, 501–\$35, 000	40%
\$35, 788 and over	60%	\$35, 001 and over	49%
	Medicare levy		Medicare levy
Over \$7, 050	0.416%	Over \$8, 980	1.25%

The effect of these changes was to reduce the progressivity of tax rates. High income earners received more benefit from the rate cuts than lower income families, but the base broadening measures captured fringe benefits, capital gains and other amounts frequently received by high income earners that had not previously been taxed effectively, and overall the changes were initially progressive.

However inflation was not recognised in either the tax or the transfer system and the progressive effect of the changes was eroded as family payments were not adjusted and bracket creep pushed low and middle income earners into higher tax brackets.

Although the outcomes of the 1985 Tax Summit did not produce any direct outcomes to assist families with children, in February 1986 the government established the Review of Social Security (Cass Review).²²

This review addressed a number of aspects of the social security system including income support for families with children including sole parent families; people with disability; the unemployed; and the aged. The interaction of social security with labour force issues for sole parents and unemployed people was also addressed.

The Cass Review progressed through the publication of a series of issues papers, the first of which considered the question of family income support. The paper used the framework of equity and adequacy to examine the effectiveness of the system and whether lower income families had adequate income to fulfil the needs of their children. In particular, the review highlighted the effect of the lack of indexation of benefits in a period of high inflation. Some of the proposals endorsed by the Cass Review included:

²² Cass, above n 16.

- a supplement for low income families, with additional supplements for families in specified circumstances;
- indexation of child-related payments;
- income payments to sole parent families, which are particularly vulnerable;
- income testing of dependant spouse rebates;
- positive steps to assist parents returning to the labour force;
- ensuring that the primary carer receives income support through directing payments to the carer; and
- retention of the universal family allowance as a base level of payment.

The Review also examined the option of income testing or taxing family allowances, but rejected that proposal. It highlighted the issues faced by families who were outside the paid labour force, or in low-paid employment.²³ In particular, it noted that the lack of indexation had eroded the increases that had been achieved in 1977 by about 30%.²⁴ It recommended the retention of a universal benefit with the addition of a means-tested layer to assist families in need.

The Cass Review heralded the introduction of reforms that targeted the Family Allowance to those families in most need, specifically low income families regardless of their work status. However, in implementing this targeted system the government went beyond the recommendations of the report to impose general means testing of benefits: a step not recommended by the Cass Review.

Reforms to the transfer system to target benefits to low income families were introduced in Australia when greater targeting of Family Allowance was introduced by the Hawke Labor government. In 1987 Hawke placed child poverty on the political agenda with his pledge to address child poverty.²⁵ In context, the government linked the welfare of the nation to the welfare of families, and the pledge to support families was a pledge to maximise that resource. Regardless of the outcome, the policy signal was unambiguous. Although the targeting of benefits was linked to expenditure restraint, and benefits were income tested from 1987, there was a significant trend upwards in the overall expenditure on family benefits. Over the next decade spending on family programs increased as a percentage of GDP from 1% in 1986 to 2.8% in 1996.

In the 1993–94 tax year the Low Income Tax Offset (LITO) was introduced to provide further assistance through the tax system. This offset, initially \$150, was available to low income earners, then phased out at 12.5% for each dollar earned over the threshold of \$20, 700, thus giving a tax cut that did not flow through to higher income earners, but increasing the EMTR over the taper range.

²³ Above at p 10.

²⁴ Above note 22 at p 51.

²⁵ Robert J Hawke, 'Election Speech' (1987) *Museum of Australian Democracy* <<http://electionspeeches.moadoph.gov.au/speeches/1987-bob-hawke>>.

4 ANTS AND BEYOND: THE HOWARD YEARS

The third period of reform was linked to the introduction of the GST in 2000. Following the election of the Howard (Coalition) government in 1996, this period was one of relative economic and political stability with relatively low and stable unemployment and inflation rates. The new Government introduced the Family Tax Initiative (FTI) in 1997 which partially returned family transfer payments to the tax system, although the Family Payment continued to be paid as a transfer payment to the primary carer in accordance with the Coalition's 1998 election campaign commitment to maintain the family components built into the existing social security system. In particular, this meant that the Family Allowance and Supplement continued to be paid to the principal carer as a transfer payment. To address criticisms of previous systems that providing family relief through the tax system ignored the needs of families that did not pay tax, a parallel payment, the Family Tax Payment (FTP), was made through the transfer system for families that earned less than \$20, 700 pa.

The FTI was soon replaced with the introduction of the GST reform package labelled as A New Tax System (ANTS). ANTS was the most significant tax reform during this period, and in addition to the introduction of the GST it incorporated adjustments to the income tax scales and a more substantial restructure of the family tax-transfer system through the introduction of the Family Tax Benefit (FTB) and rationalising childcare benefits.

The change to the income tax scales included a reduction in the rates and the thresholds, however the original proposals taken to the 1999 election were modified when the legislation was passed:

Table 2 Change in Personal Marginal Tax Rates Following ANTS

1997 - 1998 Rates		ANTS Proposal		Enacted 2000 – 2001 Rates	
Income \$	Rate %	Income \$	Rate %	Income \$	Rate %
0 – 5, 400	0	0 – 6, 000	0	0 – 6, 000	0
5, 401 – 20, 700	20	6, 001 – 20,000	17	6, 001 – 20, 000	17
20, 701 – 38, 000	34	20, 001 – 50, 000	30	20, 001 – 50, 000	30
38, 001 – 50, 000	43	50, 001 – 75, 000	43	50, 001 – 60, 000	42
Over 50, 001	47	Over 75, 000	47	Over 60, 000	47

The Low Income Tax Offset and Medicare Levy remained unchanged at \$150 and 1.5% respectively. The effect of this restructuring was to pass an income tax cut to all taxpayers through the reduction in rates at the lower levels but high income earners received a greater benefit through the increased threshold for the highest tax rates. This was justified on the basis that the higher consumption of these taxpayers would result in an increased tax burden through the GST.

The extension of thresholds and reduction in withdrawal rates extended family payments to more families with higher incomes, although they did not return to the universality of the 1970s. While family benefits increased during this period, there was an increasing emphasis on the use of the income support system to encourage jobless workers back into the labour force. The Howard government linked the FTB to tax cuts for families when it claimed to have achieved its policy objective of

reducing the tax paid by families.²⁶ However, although the tax payable by low income families may have reduced, the taper rates resulted in increased EMTRs over this period.

From 2000 the FTB could be claimed either as a tax benefit or a transfer payment, although it was clearly linked to the tax system by the government and promoted as reducing the effective tax rates paid by families.²⁷ However, from its inception over 90% of FTB payments were claimed by instalments as a transfer payment, not as an annual lump sum through the tax system. Income support recipients, who represented about 25% of FTB recipients in 2007, were required to claim the benefit on a fortnightly basis.

Unlike the GST component of the package, the changes to family benefits were evolutionary change, as the new system was based on the child-related payments in place before 2000: child-related payments remained means tested and affluence tested, with low income families being entitled to higher payments while high income earners lost entitlement. The dependant spouse rebate was removed from the tax system in relation to families with dependent children, being replaced by the FTB Part B. However, this development was also consistent with the Home Child Care Allowance that had been in place between 1994 and 1997, which had also paid the spouse-related benefit to the primary carer.

A more significant development was the increased rates of child-related payments payable to middle income families. This was a function of the increased payment rates and the lower withdrawal rates at both the upper and lower income thresholds that allowed more families to qualify for FTB, but the longer taper range meant that more families experienced increased EMTRs as FTB was withdrawn.

Analysis of the impact of the ANTS package on tax and benefits concluded that the package was, overall, redistributive towards lower income households.²⁸

However there were later adjustments to personal income tax rates that clearly benefitted higher income earners. Between 2001 and 2006 the thresholds for the higher income tax rates were increased, culminating in a substantial lift in the year ended 30 June 2006:

²⁶ Peter Costello, 'Costello Hands Down Ninth Budget' (2004) *ABC Lateline* 11/05/2004 <<http://www.abc.net.au/lateline/content/2004/s1106256.htm>>

²⁷ Australian Treasury, *Not A New Tax: A New Tax System* (AGPS, 1998): 52; Peter Costello, 'Meet the Press' (2006) 30/04/2006 <<http://legacy.ten.com.au/promo.aspx?currentpage=2&factSheetYear=2006&factSheetMonth=4&factSheetDate=0&promoID=22&promoSubSectionID=4&searchwords=Costello> ; ibid

²⁸ Ann Harding, Rachel Lloyd and Neil Warren, 'The Distribution of Taxes and Government Benefits in Australia' in Dimitri Papadimitriou (ed), *The Distributional Effects of Government Spending and Taxation* (Palgrave Macmillan, 2006)

Table 3 Change in Personal Marginal Tax Rates Following ANTS

2000 – 2001		2005 – 2006		2006-2007		2012-2013	
Income \$	Rate %	Income \$	Rate %	Income \$	Rate %	Income \$	Rate %
0 – 6, 000	0	0 – 6, 000	0	0 – 6, 000	0	0 – 18, 200	0
6, 001 – 20, 000	17	6, 001 – 21, 600	15	6, 001 – 25, 000	15	18, 201 – 37, 000	19
20, 001 – 50, 000	30	21, 601 – 63, 000	30	25, 001 – 75, 000	30	37, 001 – 80, 000	32.5
50, 001 – 60, 000	42	63, 001 – 95, 000	42	75, 001 – 150, 000	40	80, 001 – 180, 000	37
Over 60, 000	47	Over 95, 000	47	Over 150, 000	45	Over 180, 000	45

In another measure designed to assist low income earners the Low Income Tax Offset was also adjusted during this period. Until the 2006 year the maximum claim threshold was aligned to the lowest income tax rate, and the rate increased progressively from \$150 to \$235. However there were significant increases over the next five years until by the 2011 year the offset was \$1500, with a taper range from \$30, 000 to \$67, 500. This extended eligibility to any taxpayer on less than average weekly earnings,²⁹ and increased the EMTR of any person within the taper range by 4%. The policy reason for the initial introduction of the LITO was to target tax cuts at low income earners in a form that would not flow on to reduce the overall tax payable by high income earners. Over the period from 2006 to 2011 the form of the tax reduction became harder to justify as the top tax rates continued to be reduced while middle income earners faced a higher EMTR as the LITO was withdrawn. In 2012-2013 income tax rates were restructured as part of the compensation package associated with the introduction of the Carbon Tax, resulting in an increase in the tax threshold and a reduction in the LITO. Under the restructured package the LITO was again targeted towards the lowest bracket of taxpayers, with the withdrawal reflected in the official tax rates which were increased by 4% in the income brackets that had been affected by the taper to reflect the EMTR. Eligibility for FTB Part A was also used to test eligibility for a range of other benefits throughout this period, the most relevant being to assist parents with the cost of education. A tax rebate was available from 2008 until 2011, but this was moved to the transfer system as the ‘Schoolkids Bonus’ with effect from the 2011-2012 year. This was to be funded by the Minerals Resources Rents Tax (MRRT), and the current (Abbott) government has introduced legislation to repeal this payment in conjunction with the repeal of the MRRT.

The changes to the FTB since its introduction in 2000 have left the basic structure substantially unchanged. There have been changes to the taper rates to decrease EMTRs and increases to childcare rebates with the goal of increasing female workforce participation rates; and a family income threshold placed on FTBB. Significantly, since 2009 full indexation of FTBA has been abandoned. The loss of

²⁹ Full-time adult ordinary time earnings May 2011 were \$1, 305.40 pw: ABS, '6202.0, Labour Force Australia' (2012) (08/11/2012).

indexation of payments places financial pressure on low income families as the cost of living increases, while the freezing of the upper family income threshold for FTBA results in a form of bracket creep.

The FTB was within the terms of reference of the Henry Review,³⁰ which made a number of recommendations.³¹ The report recommended changes to child-contingent payments that would adopt a base level of payment that would be increased by a range of supplementary elements, including new-born, young child, sole parent of a child over six and a range of special circumstances. There would then be a single means test applied to the total of these elements. Importantly the income support system would remain separate. A sole parent supplement would be contingent on meeting a work test, but the child component would not be contingent on this work test. To date there has been no adoption of the recommendations of the Henry Review in relation to the family tax-transfer system.

As the family tax-transfer system evolved over the period of the study it became more complex. The application of means tests, particularly the tiered structure adopted in the Family Allowance and retained in the FTB, introduces complexity when compared to a universal benefit. Other complexities arose from measures to ensure that different groups of claimants, including sole parents and families in low-paid work, were able to access appropriate levels of income support: an example of how the quest for an equitable system can increase the complexity of the system. The move to targeted benefits also made the system less efficient as increased ETRs can create a labour force disincentive, which may be counter-productive when trying to increase workforce participation levels among low income families. However this is only one factor in the decision to participate in the paid workforce, and labour market participation rates have increased among low income families since 2000.³²

5 ANALYSIS

There are several reason put forward for supporting families through the tax-transfer system. Applying the principles of horizontal equity, all families should receive some level of support as the income earned by the parents must support a larger family unit; and supporting families is a social good. However the principle of vertical equity takes account of the ability of the parents to provide for their family from earned income and targets family payments to families that need additional assistance. Over the period examined in this paper the increase in targeted payments has had a redistributive effect, with the OECD recognising that the Australian system has long been the most targeted welfare system in the OECD.³³

The distributional goals of the family tax-transfer system can be clearly distinguished over the three periods discussed, which align approximately with changes of Government. The key changes, or critical junctures, were the restructuring of tax deductions in 1975–76 and the introduction of means testing in 1987. The first period, from the 1970s until 1983, adopted the principles of horizontal equity to provide

³⁰ Above note 8

³¹ Recommendations 90 - 96

³² Peter Whiteford, 'Family Joblessness in Australia' (Dept of Prime Minister & Cabinet, 2009) <http://www.socialinclusion.gov.au/sites/www.socialinclusion.gov.au/files/publications/pdf/family_joblessness_Jan2009.pdf>

³³ Peter Whiteford, 'The Australian Tax-Transfer System: Architecture and Outcomes' (2010) 86(275) *Economic Record* 528

assistance to families without reference to income levels, although the removal of tax concessions to the transfer system in 1975–76 addressed the regressivity in the system. Sole parent families also benefited from policies introduced during this period. During the second period, from about 1983 until 1996, vertical equity was given priority with the progressive introduction of means testing completed by 1987. Payments were firstly removed from high income earners then targeted to low income earners to address the rising family poverty rates. During the third period, from 1996, a hybrid approach was adopted, with families being the focus of redistribution. While family payments retained the targeted structure, the higher income tests and taper rates allowed more families to qualify for income support.

There are some clear differences in the political philosophy of the major political parties, particularly in relation to economic management and labour relations policies, which have influenced the direction of policy reforms when each party is in government, although these differences have less impact than expected in the area of family income support policies. The tendency for party policy to converge, regardless of the rhetoric and ideology, has been observed since before the commencement of this study.³⁴ The reasons for convergence in family transfer payments may lie in the role of such payments to support families during difficult economic periods, the lag time required to change tax-transfer systems, and the political imperative to ensure that transitions are accepted by recipients of benefits.

These considerations are not the same as those that are taken into account in setting personal income tax rates. The most commonly cited reasons for the lowering of corporate and maximum personal tax rates is based on the mobility of capital and income. The first argument is that capital is more mobile than labour, and that investment is driven by the after-tax rate of return. The trend across the OECD has been for declining corporate tax rates, from an average of 47.5% in 1981 to 27% in 2007.³⁵ Concurrently there has been downward pressure on top personal marginal tax rates. Where there is a significant difference between corporate and personal income tax rates, there is the opportunity for taxpayers who are earning income that is not from their personal labour to structure their affairs to take advantage of the lower corporate tax rate. While corporate tax systems have been redesigned over the period of this study to address the potential for double tax of corporate income or arbitrage of tax rates, significant deferral and alienation opportunities remain.

There is also some debate about the impact of increased mobility of labour in the personal tax-transfer system. Under a comprehensive income tax, income from investment is taxed to an individual at the same marginal rates of tax as income from labour. There are arguments that skilled labour can more easily obtain work overseas, and that 'people's choices about where to work may become more sensitive to tax'.³⁶ However, decisions on where to live and work are more complex than decisions on where to invest capital, involving personal as well as economic decisions. In the context of transfer payments, although capital investments and income from those investments are relevant in the application of income tests, the most significant impact

³⁴ Brian Head and Allan Patience, 'Labor and Liberal: How Different Are They?' in Allan Patience and Brian Head (eds), *From Whitlam to Fraser* (Oxford University Press, 1979).

³⁵ Simon Loretz, 'Corporate Taxation in the OECD in a Wider Context' (2008) 24(4) *Oxford Review of Economic Policy* 639; OECD, *OECD Tax Statistics* (OECD Publishing, 2011). Note that BEPS are not discussed in this article as it focusses on personal tax issues.

³⁶ Henry et al (2010). Above note 8 at page 6.

of the EMTR is the labour force participation impact. High income earners are more likely to be in receipt of investment income and are also more likely to be highly skilled and able to relocate to obtain or change employment. Accordingly, they are more likely to be responsive to changes in income tax rates at the highest marginal tax rates. The withdrawal rates for transfer payments are not likely to be a major consideration for high income earners because the application of the income test would limit any entitlement.

Evidence suggests that domestic tax policy is less sensitive to the effect of globalisation than predicted by globalisation theory. Swank and Steinmo³⁷ argue that the evidence shows that although statutory tax rates of developed capitalist countries have been cut in anticipation of the effects of increased capital mobility, the tax burden in these countries has not been significantly affected by these changes. They show that the effects of globalisation are moderated by domestic economic change, fiscal constraints and internationalisation. Although globalisation exerts downward pressure on tax rates, domestic conditions generate demand for increased spending, requiring governments to maintain the overall tax burden. Accordingly, this must come from other tax policy changes, for example the rationalisation of tax expenditures. They note a significant cut in general investment incentives between 1981 and 1992 across the countries examined, and that lower nominal tax rates have not resulted in a lower tax burden.³⁸

Over the period examined by Swank and Steinmo, which was based on data from 1981 to 1995, the developed economies were dealing with adverse economic conditions with structural unemployment the most significant domestic economic policy issue. During the 2000s but prior to the downturn of 2007–08 global economic conditions improved, however more recent OECD data on the tax burden bear out their conclusion.³⁹ This can be seen in Table 4, which shows that in Australia tax revenues have remained relatively stable as a percentage of GDP over the period from the early 1990s.

Table 4 Tax Revenue as % of GDP: Australia⁴⁰

	1990	1995	2005	2011
Total tax revenue	28	29	31	26
Personal income taxes	12	12	11	10
Other taxes	16	17	19	16

Table 4 also shows that in the Australian context the tax mix shifted with the implementation of the GST in 2000. However, the overall increase in tax collections as a % of GDP arose from the resources boom through increased corporate tax collections and mining taxes.

³⁷ Swank & Steinmo 2002.

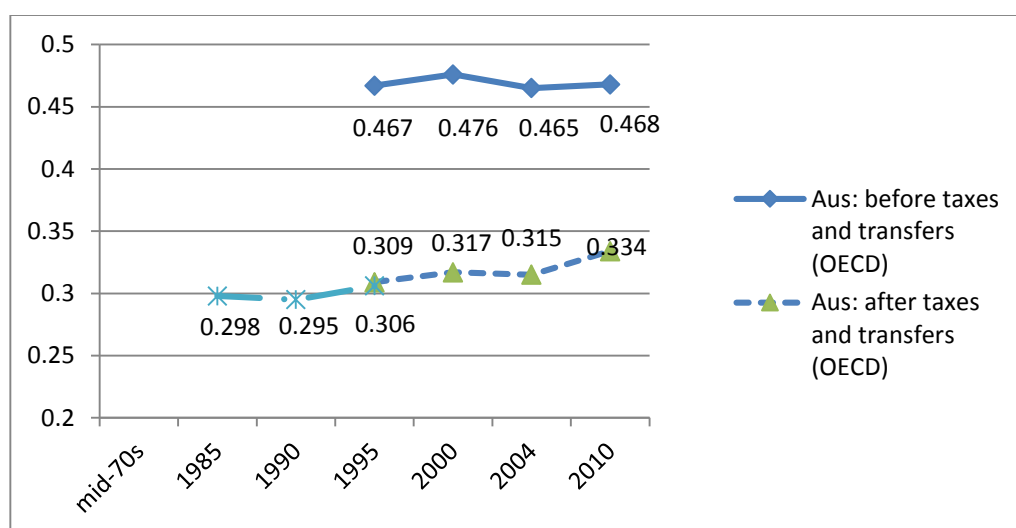
³⁸ Above at 642, Table 1.

³⁹ OECD, *Taxing Wages 2007-2008* (OECD Publishing, 2009).

⁴⁰ Above at 476, Table A1.

A further implication of the flattening of tax rates since the 1980s is that inequality in disposable income has increased, as high income earners retain more of those earnings as tax rates are reduced.⁴¹ In this context the role of the transfer system as a means of redistribution is increased. A number of measures can be applied to assess changes in policy priorities over the period of this analysis, including the Gini coefficient. Trends in the Gini coefficient over the period of this study are shown in Figure 1 below:

Figure 1 Changes in Income Inequality: Gini Co-efficient: ⁴²



Inequality in Australia before taxes and transfer payments was fairly steady over this period at around 0.47. The effect of the tax-transfer system was to moderate the impact of the market, reducing inequality by redistributing income within the community, but due to changes over this period, inequality after taxes and transfers increased from 0.298 to 0.334, particularly over the period of the 1990s. However, the Gini coefficient only looks at the overall inequality within society, and does not look at the redistribution between particular groups within society, for example from taxpayers without children to families.

An alternative method of examining the expenditure on families is the outlay on family benefits. To some extent it can be seen that over the period of this study all governments, but particularly the Fraser and Howard Liberal governments placed a higher priority on economic management than social policy. The 1970s saw the recognition that poverty rates had increased and that certain groups within society were more likely to live in poverty. Reforms to the tax-transfer system were implemented in order to address some of the inequity. However, the economic disruption of the mid 1970s created new pressures for government, particularly through the imposition of fiscal restraint.

⁴¹ Above note 9.

⁴²OECD series: OECD.Stat, *OECD.Stat* (OECD Publishing, 2012)

ABS Series: Senate Community Affairs References Committee, *A Hand Up Not a Hand Out: Renewing the Fight against Poverty. Report on Poverty and Financial Hardship* (Parliament of Australia, 2004). Note that OECD data is not available pre 1995: the ABS data has been used over the early part of this study. Although there are some differences in the methodology including the definition of income, the data is broadly comparable.

In Australia, the early 1970s represented a low point in relative spending on family benefits. The first significant increase in spending on family benefits over the period of this study was in 1977, when Child Endowment was restructured as Family Allowance.⁴³ This adjustment restored the historical balance of family payments against other forms of income support.⁴⁴ Among the commitments of the conservative Fraser government was reduced government spending, which could be expected to flow through into reduced spending on social welfare policies.⁴⁵ However, analysis of what actually occurred during the term of the Fraser government showed an ambivalent approach to social welfare.⁴⁶ In particular the recommendations of the Henderson Commission⁴⁷ were adopted with significant increases in spending on Commonwealth income support payments including pensions, benefits and family payments. Notably the Family Allowance was not adjusted for inflation, which quickly eroded the increase that had been achieved in 1977.

Over the Fraser years from 1975 to 1983 the economic recession resulted in a 50% increase in the proportion of the population receiving benefits to 19% of the total population. This was reflected in families, with 18% of children being in families reliant on social security payments, although the number of families receiving family benefits remained stable at 2.1 million families, comprising 4.3 million children. Accordingly expenditure on cash payments increased from 4.5% of GDP to 6.8%.⁴⁸ The amount expended on Family Allowance to 1983 remained fairly constant, partly due to the lack of indexation, but the amount expended on means-tested benefits, primarily as dependant allowances paid to social security recipients, increased by 70% between 1976 and 1983.⁴⁹

Political philosophy was also reflected in the justification for family benefits. The rhetoric of Liberal governments extolling personal responsibility and family values was carried over into welfare reform, but this was moderated by the electoral cycle that allowed the mass public to judge the performance of the government every three years. Accordingly the government responded promptly to economic and social change, and the changes to the tax-transfer system introduced by Fraser and by Howard were effective in increasing family incomes. Although committed to fiscal restraint, spending on family benefits increased under these governments, largely driven by economic factors that caused an increase in the number of low income families claiming benefits. Fraser implemented substantial increases to family benefits with the introduction of the Family Allowance; while Howard increased family payments with the introduction of the FTB as compensation for the impact of the GST. Payments were less targeted under the Coalition governments than under the ALP: Family Allowance was not means tested under Fraser, and the FTB retained the tiered structure of the former Family Allowance, but the thresholds and taper tests

⁴³ This also resulted in the restructuring of a tax expenditure as a cash benefit, thus part of the increase is attributable to this restructuring.

⁴⁴ Peter Saunders, *Equity and the Impact on Families of the Australian Tax-Transfer System*, Institute of Family Studies Monograph No 2 (Institute of Family Studies, 1982).

⁴⁵ Grant Elliott and Adam Graycar, 'Social Welfare' in Allan Patience and Brian Head (eds), *From Whitlam to Fraser* (Oxford University Press, 1979).

⁴⁶ Bettina Cass and Peter Whiteford, 'Social Security Policies' in Brian Head and Allan Patience (eds), *From Fraser to Hawke* (Longman Cheshire, 1989).

⁴⁷ Henderson, Above note 14.

⁴⁸ Above note 46.

⁴⁹ Above note 16:20.

allowed more families to qualify under each tier.⁵⁰ Notably, the Howard government responded to the concerns of working mothers by improving childcare rebates for two-income families and through its withdrawal of the First Child Tax Offset and replacement with the Baby Bonus.

In contrast, in 1987 as Prime Minister Bob Hawke made a political commitment to reduce child poverty. As the government was committed to fiscal responsibility, this was to be achieved through targeted payments that would redistribute payments from better-off households to poorer families. Although the Hawke Government did not fully achieve the stated goal, the commitment ensured that alleviating child poverty became a government objective, with a range of policies, including tax-transfer policies, being co-ordinated to achieve the goal, and the evidence showed that child poverty rates were reduced. The Hawke Government inherited the problem, coming to government during an economic downturn, during which unemployment had placed families at a higher risk of poverty.

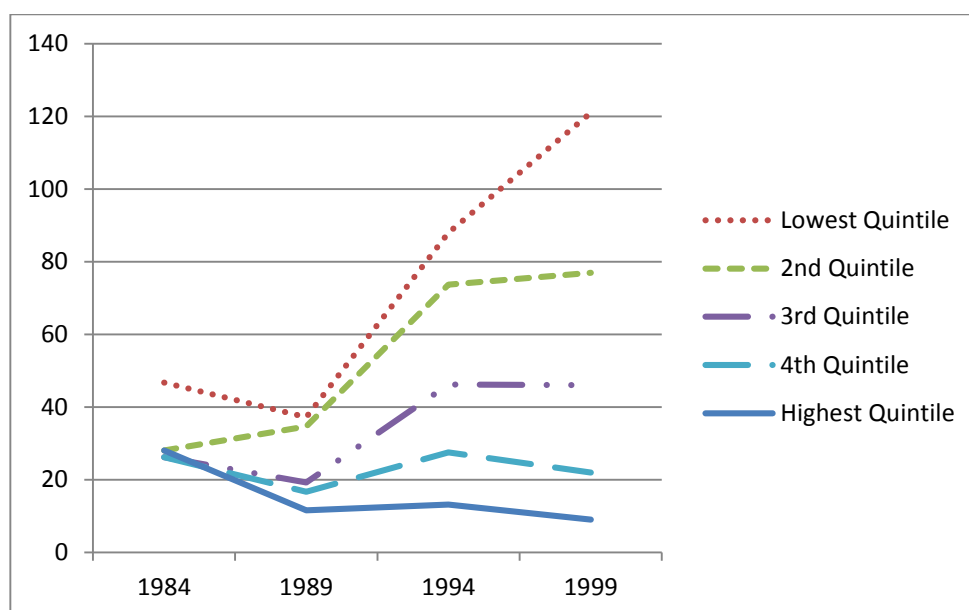
Under the Howard government Australia experienced a long period of economic growth, although poverty was concentrated around joblessness. Accordingly, from the late 1990s joblessness became the focus of government policy and the income support system focused more on improving levels of labour force participation.⁵¹ Over the period of the Howard government the benefits paid to families were maintained – although as a percentage of GDP they did not grow significantly after the overcompensation paid as part of the GST reforms. The extended thresholds and taper rates available under the FTB extended base benefits to more families, although the highest benefits were still targeted toward the poorest families, resulting in some redistribution of benefits to middle income families although this was an intended design feature, as compensation for the GST.

The effect of these changes can be seen in Figure 2 which shows the distribution of family transfer payments.

⁵⁰ Matthew Toohey and Gillian Beer, 'Financial Incentives to Work for Married Mothers under A New Tax System' (2004) 7(No. 1) *Australian Journal of Labour Economics, Special Issue: Microsimulation Models in Policy Making* 53

⁵¹ Patrick McClure, 'Participation Support for a More Equitable Society' (Reference Group on Welfare Reform, 2000) (30/10/2006)

Figure 2 Couple Family Benefits in Australia 1984 - 1999, by Quintile \$ per week 1999 prices⁵²



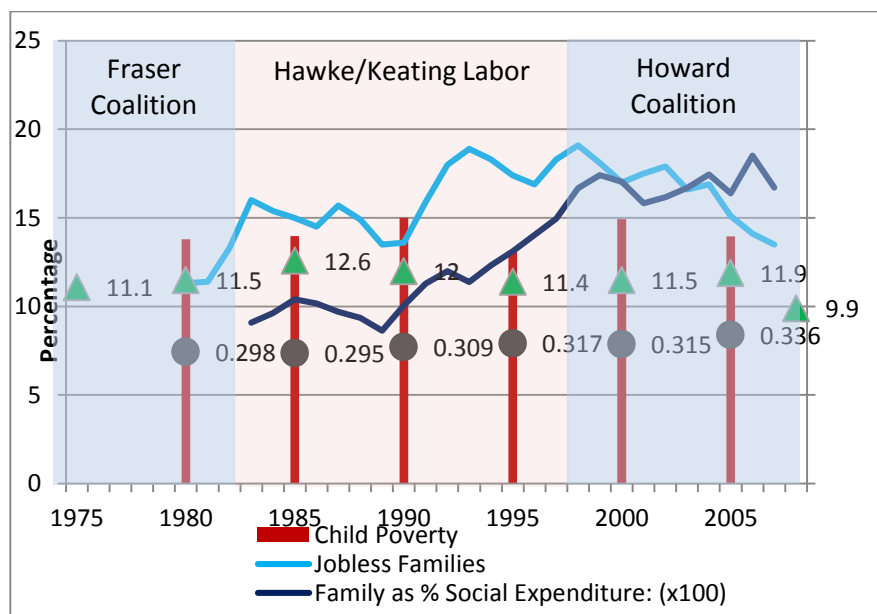
The biggest distributional shift followed the reforms to Family Allowance from the late 1980s. Although the 1983 Family Income Supplement had assisted low income families when introduced, the low rate eroded its effectiveness until the 1987 reforms directed increased Family Allowance and FAS to families in the lowest quintiles.

The effect of the 2000 reforms is not reflected in Figure 2 because data from the 2004 Housing and Income Survey are not directly comparable with data for the previous surveys due to changes in measurement. However, Harding et al.⁵³ found that when analysed on the basis of income quintiles, substantial redistribution occurred following the introduction of ANTS, including the FTB, in 2000 through both direct and indirect benefits. Sole parents and lower income families were better off, although on average couples with children did not gain under the 2000 reforms.

Applying a range of key indicators applicable to families, the effect of changes in the tax-transfer system from the early 1970s until the mid 2000s is set out in Figure 3 below:

⁵²ABS, 6537.0, *Household Expenditure Survey Australia: Effects of Government Benefits and Taxes on Household Income* (Australian Bureau of Statistics, 1984; 1986; 1989; 1994; 1999)

⁵³Harding, Lloyd and Warren, above n 28

Figure 3 Trends in Key Indicators: Australia⁵⁴

Inflation and employment trends reflected those apparent throughout the OECD⁵⁵ and were largely the result of globalisation of economic and trade policies and cultural change resulting from changing attitudes among the ‘baby boomer’ generation. The rate of jobless families fell from about 2000 as a result of the increasing women’s employment rate, but many of these jobs were part-time, and many families in low-paid or part-time work earned an inadequate market income. The response to the inflationary pressure of the 1970s to 1980s was fiscal tightening, with a move away from Keynesian economic policies based on direct government intervention in the economy to other, more market-based philosophies. Means testing of transfer benefits was initially justified on the grounds that scarce resources could be better targeted through means testing, although the actual cost was dictated by economic conditions and the anticipated savings were illusory.

The most significant developments in the tax transfer system, as it affected families, were the transfer of family assistance from the tax system to the transfer system in the mid 1970s; the introduction of means-tested benefits in the late 1980s; and the integration of the administration of the tax and transfer systems in the late 1990s.

The first significant change, the transfer of benefits from the tax to the transfer system, was an endogenous response that grew from the acknowledgement that the system was no longer meeting its core function of protecting low income families from poverty. The family tax-transfer had been stable, without significant change for many years, which had resulted in stasis in the system. The ‘rediscovery of poverty’ in the 1960s

⁵⁴ Child Poverty Series: LIS, ‘Luxembourg Inequality and Poverty Key Figures’ (LIS, 06/11/2012 <<http://www.lisdatacenter.org>>

Family as % of Social Expenditure: OECD.Stat, above n 42
Gini after Taxes and Transfers: OECD.Stat, above n 42
Jobless Families: ABS, 6291.0.55.001, *Labour Force, Australia, Detailed* (Australian Bureau of Statistics, 2012)

Personal Income Tax as % GDP: OECD.Stat, above n 42.

⁵⁵ OECD, *OECD Historical Statistics 2000* (OECD Publishing, 2002).

was a trigger that signalled the need to address the redistributive effect of the tax-transfer system.

In contrast the second significant change, the application of means and affluence tests to target benefits to low income families, was a response to exogenous economic and political factors. The economic shocks of the 1970s were followed by structural change to the global economy that was reflected in the Australian economy from the 1980s, with an impact on poverty levels.

The political philosophy of the government affected the policy design: the Hawke Labor government in Australia used the transfer system in conjunction with the social wage as an income support strategy.

In the late 1990s the Howard Liberal government increased integration of the tax and transfer systems, providing compensation to low and middle income families for the impact of the GST. Although increases in rates were linked to the GST in Australia the increased integration of family benefits with the tax system was an endogenous change triggered by feedback within the system. It had become clear that the family tax transfer system was not effectively redistributing resources to needy families; accordingly the system was adjusted in an attempt to align the tax and transfer aspects of the system.⁵⁶

6 CONCLUSIONS

Change to the basic structure of the family tax transfer system has been incremental as a response to feedback within the system, although successive governments have shown a tendency to badge change as reform, and to rename the benefits in question regardless of the extent of change: for example in 1983 the Family Income Supplement was redesigned and renamed as the Family Allowance Supplement.

The ability of the system to adapt without resulting in major policy failure shows the flexibility of the system. The most notable policy breakdown in Australia was when the First Child Tax Offset was abandoned in 2004; it was restructured into the Baby Bonus, which was more in tune with economic and social trends. Accordingly the main distinguishing exogenous factors that impacted on the reform pathway in Australia were political factors. The political response to global economic factors was different depending on the government in power at the time of the critical juncture.

Overall, the system has been effective in compensating for the restructured tax rates, as shown by the comparison of the Gini index before and after taxes and transfers are taken into account (Figure 1) and the quintile analysis showing the distribution of family benefits (Figure 2). While a system of universal benefits coupled with progressive tax rates should result in a redistribution to low income earners, given the evolution of the system in Australia it is unlikely that there will be any political will or public interest in reverting to a system of higher personal tax rates coupled with universal benefits.

⁵⁶ Although this alignment resulted in administrative issues relating to the timing and recovery of payments: Helen Hodgson and Rebecca Boden, 'Not So Distant Cousins' (2008) 61(3) (July 2008) *International Social Security Review* 29; Commonwealth Ombudsman, 'Own Motion Investigation into Family Assistance Administration and Impacts on Family Assistance Office Customers' (Commonwealth Ombudsman, February 2003) .

The impact of British colonial rule on the Malaysian income tax system

Ern Chen Loo¹ and Margaret McKerchar²

Abstract

Malaysia has a long history of colonisation by Europeans dating back to 1511, though this article focuses mainly on the colonisation by Britain from 1786 to 1957. It was during this era of British colonial rule that the first income tax statutes were introduced in the territories that are now Malaysia. Based on historical research methods, this article seeks to gain an understanding of the impact of British colonial rule on the development of Malaysia's tax system. In the face of sustained and strong domestic opposition, the then British colonial governors exerted their power and introduced income tax in both Malaya and Singapore from 1 January 1948. The form of statute adopted was based on the Model Colonial Territories Income Tax Ordinance of 1922. There appeared to be very little, if any, consideration of the jurisdictional context in which it was to apply, either in terms of needs or suitability. That is, it appeared that that 'one size fits all' in respect of taxation in these colonies and taxation without representation was the norm.

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1 INTRODUCTION

Since the Portuguese first captured Malacca in 1511, Malaysia has had a long and chequered history of colonisation by Europeans. Whilst the Dutch also played a part in the history of Malaysia's colonisation (the Portuguese surrendered to the Dutch in 1641), it was the British from 1786 to 1957 that colonised and then controlled the territories that are now Malaysia. This lengthy and more contemporary period of colonial rule by the British had wide reaching impact on the development of Malaysia as a nation, from its constitutional and administrative structure (Gullick, 1981), to its legal and tax systems (Singh, A. 1982) and its culture and society.

The first income tax statutes in these territories were introduced during this era of British rule. However, in spite of it having been recognised that the Malaysian tax system has its roots in the British tax system (Chin, 1997), there does not appear to have previously been an investigation of the extent and nature of this impact over time. This article sets out to address this gap by studying the history of the Malaysian tax system and seeking to gain an understanding of its development and, in particular, the impact of British colonial rule.

The methodological approach used is one typical of historical comparative research where social scientific explanations of major societal processes are sought (Neuman, 2006). In this case, the societal process of first attempting to introduce income tax in Malaysia in the early 1900s took place in a very different cultural context to that of its colonial ruler, and in a quite different era, since Britain had first introduced an income tax in 1799. Thus the dimensions of this study are across time (i.e. the period of British colonisation in Malaysia) and to some extent across nations (i.e. those ruled and the ruler). The 'across nation' dimension is further complicated by the changing composition of the Federation of Malaysia over time. It is by analysis and interpretation of these past events that perspectives on more contemporary issues can be broadened and lessons learned that can inform and shape the future. This is of particular importance in the case of Malaysia as it strives to become a fully developed and united nation by 2020 (Mohamad, 2008), which in turn requires an appropriate, well designed and administered tax system.

This article is presented in five parts. Following on from this introduction the second part traces the historical background of Malaysia to provide an insight into the cultural and political changes that have occurred over time. The revenue raising strategies that existed in Malaysia prior to the 20th century are explored in part 3. In part 4 the events that led to the introduction of an income tax in Malaysia are examined, from the beginning of the 20th century up until 1967, at which time the current income tax legislation first applied. This part also includes some consideration of the impact of British colonisation on Malaysian case law. Concluding comments are made in the final part of the article.

2 TRACING THE HISTORY OF THE NATION OF MALAYSIA

The Federation of Malaysia³ (generally referred to as Malaysia in this article) today consists of Peninsular Malaysia, and the States of Sarawak and Sabah on the island of Borneo. Malaysia is the successor nation to the former British colonies and protectorates in South East Asia. Peninsular Malaysia previously consisted of three

³ A summary of the formation of the Federation of Malaysia is included at Appendix I.

British administrative territories, namely the Straits Settlements (comprising the Crown Colonies of Penang, Malacca and Singapore); the Federated Malay States of Perak, Selangor, Pahang and Negeri Sembilan; and the Unfederated Malay States (comprising Kedah,⁴ Johor, Kelantan and Terengganu). These three territories, excluding Singapore, emerged as a nation known as the Federation of Malaya, and gained independence from Britain on 31 August 1957. Whilst Singapore was part of the Federation of Malaysia when first formed on 16 September 1963, it subsequently separated and became an independent republic on 9 August 1965 (Shaikha, 1986; Clutterbuck, 1984).

In particular, each of the three territories or states that are currently Malaysia, namely Peninsular Malaysia, Sarawak and Sabah, were subjected to extended and significant influence by the British. Englishman Francis Light first colonised Penang in 1786. There were other British settlements (including Singapore) established in the region, and British control over the entire Malay Peninsular was recognised in 1824 with the signing of the Anglo-Dutch Treaty, which defined the boundary between British Malaya and the Netherlands East Indies (to become Indonesia).

Beyond the Peninsular, James Brooke, an Englishman, became the governor and independent ruler in 1846 of Sarawak in North Borneo.⁵ Brooke had helped put down rebellions in the region and, in grateful recognition of his efforts, the Sultan of Brunei ceded the territory to Brooke and his family. The Brooke family ruled Sarawak until it was ceded to Britain in 1945 (Nicol, 1977). Sabah first came under British influence in 1881 when the British North Borneo Company was granted a Royal Charter to govern the State. Sabah became a British colony proper in 1946 (Shaikha, 1986).

3 REVENUE RAISING IN MALAYSIA PRIOR TO THE 20TH CENTURY

It is expected that the changing of boundaries, allegiances and control, as has been evident in the development of Malaysia, would have posed considerable challenges for governments. Raising taxes would have been only one of many issues faced, but still, the need for revenue is fundamental to any government. Going back as far as the 15th century, the then Sultan (or Ruler) of Malacca relied on customs duties as the main source of revenue. Malacca was located on an important maritime trade route between Europe and the Far East, and was at the time the regional trade port of South East Asia. Every commodity imported or exported was required to be weighed in accordance with the port's standard measures and custom duties were payable, with considerably higher duties imposed on imports compared to exports, thereby ensuring a thriving and prosperous trade centre and a steady stream of revenue for the Sultan (Gullick, 1981).

Prior to the introduction of British rule, the largest political unit in the Peninsular was traditionally the state, with each state ruled by a sultan. The political hierarchy usually comprised the village headman, the district chiefs, and above them the sultan who was the supreme ruler (ASEAN Law Association, 2013), while a systematic form of government was already in place in various states since the Malacca Sultanate (Zaki et. al., 2010).

⁴ The State of Perlis was then part of Kedah.

⁵ Although the British Royal Navy assisted James Brooke against rebels in Sarawak and against pirates in and around the waters of Sarawak, the British Government did not recognise James Brooke as the ruler, nor make Sarawak a British protectorate (Turnbull, 1989).

States were divided into districts which were usually centred at an estuary or section of a river. Each district was ruled by a chief, whose main source of power was the freedom to raise revenue, particularly tolls on traffic passing along the waterways through the districts (Butcher, 1979). The Malay peasants were subjected to certain obligations, such as payment of tithes on land, agriculture or forest products to the sultans (Zaki et. al., 2010). Traditionally, a sultan's other sources of revenue were from such activities as charging port fees, exacting tribute from vassal states within the empire, and taking a share of goods confiscated from passing vessels (Lopez, 2001).

With colonisation the British took over the functions that were previously performed by the district chiefs,⁶ including the collection of revenues (Emerson, 1964; Butcher, 1979). Thus, under British rule the existing feudal structures gave way to new British-inspired political and economic arrangements, including state revenue and expenditure being controlled by British-appointed administrators. As a result, the influence of the Malay chiefs was eliminated as they relinquished access to their traditional sources of revenue based on territorial control (Noh, 2010).

Similarly, during the 19th century the authorities in the Straits Settlements relied on excises imposed on the 'vices and pleasures' enjoyed by the local inhabitants. These Settlements did not have the trade advantages of the port of Malacca, hence the need for more tailored strategies such as revenue farming. Revenue (or excise) farming was a system used during this era by which the colonial government auctioned, to private individuals, the right to commercial monopoly over excisable commodities. Payment to the colonial administrators took the form of rent, thus the revenue was 'farmed' without the need for significant investment in bureaucratic administration and infrastructure (Trocki, 2002a). Revenue was thus farmed from a range of commercial activities including the trade in both opium and liquor; prostitution and gambling. Opium farms constituted the largest component of revenue and the most important revenue source of the British colonial government from the early nineteenth century (Trocki, 2002b; Kenji, 2012).

Stamp duties were introduced in the Straits Settlements in 1863 but were abolished in 1867 (Turnbull, 1989). The Federated Malay States in the 19th century relied on port dues and river tolls (these were abolished in 1875), and customs and excise duties (Emerson, 1964; Turnbull, 1989). The bulk of revenue came from tin export duties and from import duties on opium (Turnbull, 1989). Revenue was also raised by taxes imposed on the preparation of cooked opium, the sale of spirits, the running of spirits, gambling and on pawn shops (Sadka, 1970; Butcher, 1979). That is, similar to the Straits Settlements and (to a lesser extent) Malacca, the local population of the Federated Malay States, as consumers (and possibly suffering from a range of addictions), were easy targets for those charged with raising the revenue. During this same era the main sources of revenue in the Unfederated Malay States were import duties and receipts from opium and land revenue (Emerson, 1964). The British administration imposed a unified system of taxation on opium, spirits and gambling (Noh, 2010). This shift to a more centralised system of revenue collection and taxation severely limited the royalty's modes of acquiring wealth (Lopez, 2001).

The revenue raised in Sarawak came mainly from excise farms in opium and spirits, royalties on minerals, and from poll taxes (Andaya & Andaya, 1982; Turnbull, 1989).

⁶ The district chiefs collected revenue for the Sultans.

Sabah, under the administration of the Chartered Company of British North Borneo, was managed avowedly for profit. Taxes were minimal and were based on the production of minerals, extraction of forest products and plantation crops such as tobacco and rubber. Tariffs were imposed on imports, such as imported rice in 1885, but were lifted in 1903 (Tate, 1979).

As the 19th century drew to a close, there was no form of income taxation imposed in any of the British colonial territories in Southeast Asia. This may seem unusual given that the taxation of income was a well-established phenomenon in Britain by this time. Indeed, income tax in Britain had been first introduced as early as 1799 (abolished in 1802), albeit as a temporary measure to fund the Napoleonic Wars. It was then reintroduced in 1842 to fund the Crimean wars. Whilst it was intended to be a temporary measure and expected to expire in 1860, this was not to be. Instead its permanency in Britain became more or less accepted by the mid 1870s (Stebbings, 2010; Daunton, 2001).

The British colonial administration was custodial in nature rather than developmental. Its main function was collecting revenue and maintaining law and order (Abdul Khalid, 2008). The British colonial administration sought stability in order to ensure ongoing trade and access to property, and largely played the role of 'advisors' to the sultans (Lopez, 2001). The policy approach by the British tended to be *laissez faire* regarding trade and taxation, with greater emphasis on law and order and maintaining macroeconomic stability. The income from export of tin, rubber and timber provided ample foreign exchange for the import of consumer goods and repatriation of profits, and generated substantial revenue for the colonial government (Khan, 2002).

Realistically, the collection of customs and excises in the colonies was likely to be less of an administrative challenge than that of collecting a tax on income. Instead of imposing their taxing systems, the British seemed satisfied to simply take control of the age-old systems that were already functioning and presumably generating sufficient revenue. Indeed, to seek to raise additional revenue to fund what were ostensibly European war efforts may not have met with great enthusiasm by the colonies in South East Asia, and could have threatened British control in the region.

4 INTRODUCING INCOME TAX IN MALAYSIA THE 20TH CENTURY

Amongst the most peculiar aspects of British colonial rule of Malaya was the opium trade, where in the late 19th and early 20th centuries, revenue raised formed a major part of colonial government budgets (Bailey & Truong, 2001). In the early 1920s, revenues derived from the government opium monopoly together with import duties on alcohol and tobacco were the three largest components of the colony's revenues of the Straits Settlement, and remained as major sources of revenue until the end of the 1930s.⁷

By the beginning of the 20th century the problem of opium addiction in British Malaya, particularly among the Chinese community, had become a major concern. Under mounting pressure from the Chinese community leaders, an Opium

⁷ In 1937 in the Straits Settlements, revenues from opium trade and import duties on alcohol and tobacco accounted for almost 47 per cent of government revenue. In 1923 in the Federated States, revenues from these three sources amounted to around 25 per cent of total revenues, and 20 per cent in 1938. In the Unfederated States, revenue from opium trade in Kedah amounted to more than one third of total revenues from the early 1920s until the late 1930s (Booth, 2011).

Commission was set up in 1907 to investigate the problem and this resulted in the abolition of opium tax farms in 1912 and the subsequent loss of a major source of revenue for the colonial government (Turnbull, 1989; Sugimoto, 2002). In order to address this major loss of revenue, the British colonial administration attempted to introduce income tax in the Straits Settlements.⁸

A Bill to impose a tax on income (effective from 1912) was first introduced in the Straits Settlements Legislative Council in 1910. However, due to strong opposition, the Bill was subsequently withdrawn (Chin, 1997). However, the colonial government was successful in introducing income tax in the Straits Settlements during World War I, but not so in the Federated Malay States. In 1916 a proposal was put forward to supplement the contribution by the Straits Settlements towards the Imperial War Expenditure by means of an income tax. This led to the introduction of Ordinance No. 8 (1917) to impose a tax based on income, effective from 1 January 1917. For the next two years a 'war tax' on income was levied under the War Tax Ordinance of 1918 and that of 1919 (Lee, 1972).

From 1920 to 1922 the 'war tax' was replaced by an income tax, but such was the level of public protest that it was abolished only to reappear in 1940, when two Bills modelled on the War Tax Ordinance (1919) were introduced. One of these Bills was for the Straits Settlements and the other for the Federated Malay States. Both imposed a tax on profits and income, but only for one year effective from 1 January 1941. The objective was to defray war expenditure. Similar Bills were passed in December 1941 for imposition of income tax in 1942, also for war purposes (Lee, 1972). In some respects this linking of taxation to the funding of war efforts is common to many jurisdictions, including Britain and Australia (Frecknall-Hughes & McKerchar, 2013). In contrast to these developed countries, the Malayan population clearly had little tolerance for a tax on income and, at the same time, the extent of colonial power was under threat.

During World War II (1942-45) the Japanese occupied Malaya, Singapore, Sabah and Sarawak. The Japanese military regime did not impose a tax on income, but did set up a Joint Income Tax Organisation to recover arrears on any of the 'war tax' assessed for 1941 and to collect the remaining unassessed taxes for the same year. Further, rather than 'impose' taxes and further aggravate the local population, the Japanese military regime 'invited' them, particularly the Chinese community, to contribute \$50 million⁹ to the Japanese war effort (Gullick, 1981). The Chinese community considered the contribution as a 'fine', a form of financial retribution. The Chinese community leaders were made responsible for its collection. This was problematic, as many refused to pay. A 'solution' was reached in late 1942 when the Japanese Yokohama Specie Bank lent the money, thereafter to be recovered from the community by the Overseas Chinese Association (War Museum, Penang).

After the Japanese surrendered in August 1945, the British colonies and protectorates in South East Asia were ruled by the British Military Administration (Shaikha, 1986). Prior to World War II, Malaya had a rather fragmented and socially regressive tax

⁸ Since no similar tax was to be imposed in the Federated Malay States and Unfederated Malay States, commercial interests in the Straits Settlements were against the discriminatory treatment, leading to the withdrawal of the proposal (Sugimoto, 2002).

⁹ The currency in use was known as the Straits Dollar. As an indication of its value, a copy of the Heasman's Report in 1947 was priced at one Straits Dollar or two shillings, 4 pence (the British currency at that time).

system. The Federated Malay States (FMS), Unfederated Malay States (UMS) and the Straits Settlements each imposed their own levies. After the end of World War II it was contended that other than by way of loans, the financing for the post war rehabilitation must be found by taxation and that taxation must be heavy (The Straits Times, 27 July 1946:5). Reliance on indirect taxes, mainly export duties on rubber and tin exports and import duties on rice, was particularly sensitive to conditions prevailing outside the country (The Straits Times, 20 August 1947:2). In addition, the burden of taxation then was inequitably distributed across industries with tin and rubber exporters paying substantial duties whilst the merchant and professional classes had no such impositions. Thus the only way to redress the inequalities and satisfy the need for revenue was seen to be by the imposition of an income tax (The Straits Times, 20 August 1947:1). It was argued that income tax was an established and well understood form of taxation and that it would spread the burden of social responsibility fairly (The Straits Times, 25 November 1947:6).

The British Military Administration was entrusted with the crucial role of integrating and revising the tax system in line with the Colonial Office's financial directive. In addition, when the Labour Party came to power in Britain after World War II, income taxation was officially described as the only practicable and fair method by which sufficient revenues could be raised to meet Malaya's rehabilitation and development goals (Rudner, 1994).

The introduction of income taxation was considered urgent due to the need for additional expenditure on reconstruction and development. A Select Committee was established in 1946 to consider the possibility of re-introducing tax on income in Malaya and Singapore. Although members of the Select Committee were not in favour of an immediate imposition of a tax on income,¹⁰ the Secretary of State for the Colonies appointed Mr R.B. Heasman,¹¹ a tax expert from the United Kingdom, to advise the governments of the two territories (i.e. Malaya and Singapore) on the subject (Lee, 1972).

Mr. Heasman's terms of reference were (1) to advise whether income tax would be a practical basis for the taxation policy of either territory or both territories; (2) to consult business and other interests which would be affected, before making a recommendation under item (1); (3) if the conclusion was that income tax would be a suitable basis for the taxation policy of both territories, to advise whether there should be a separate income tax department for each territory or a joint one for both; (4) to draft any legislation necessary; and (5) to make recommendations as to the establishment or establishments necessary to operate the legislation (Heasman's Report, 1947:1). Thus Mr. Heasman's terms of reference were specifically confined to whether income would be a practicable basis for the taxation policies of the governments in Malaya and Singapore, and, if so, how it should be introduced and established (The Straits Times, 22 August 1947:4). He was not asked to advise as to whether the need for revenue (and therefore presumably income tax) was urgent; nor

¹⁰ The primary reason was that most businesses had suffered serious losses as a result of the Japanese occupation and it was necessary to make good these losses out of current income. The imposition of income tax would retard that process. In addition, income taxation was a war measure and since the war had ended, it was argued, tax on income should not be imposed.

¹¹ Mr. Heasman, a tax officer of the UK Inland Revenue Department, was appointed to report to the Governments of Singapore and Malaya on the feasibility of levying income tax. He was subsequently appointed the Comptroller of Income Tax for Malaya and Singapore (The Straits Times, 22 February 1948:5).

whether it was imperative or vital. He was asked whether income would be a practicable basis for taxation, and if his conclusions were that income would be a suitable basis for the taxation policy of both territories, to advise whether there should be a separate income tax department for each territory or a joint one (The Straits Times, 2 September 1947:6).

Mr. Heasman's report and recommendations, including draft legislation and proposals for administration and staffing, were completed within a relatively short period.¹² Heasman's sceptics contended that, even before his appointment, the Colonial Office had already decided that income tax should be imposed on the country (The Straits Times, 3 September 1947:4).

Based on Heasman's recommendations, the governments of both Malaya and Singapore re-introduced income tax in their territories by passing identical ordinances with effect from 1 January 1948, the Income Tax Ordinance No. 48 (1947) (in Malaya) and the Income Tax Ordinance No. 39 (1947) (in Singapore) (Singh, V., 2003). Both ordinances were based on the UK's Colonial Territories Model Income Tax Ordinance (1922) (Wong, 2008) and remained identical, even in respect of amendments, until the middle of the 1950s (Lee, 1972). It was during this same post World War II era that income taxation was first introduced in Sabah and Sarawak, with the passing of the Income Tax Ordinance (1956) and the Inland Revenue Ordinance (1960) respectively.

The Colonial Territories Model Income Tax Ordinance (1922) was said to have been produced by the Imperial Inter-Departmental Committee on Income Taxation, relying on Australian and New Zealand precedents (Singh, A., 1982). By the early 20th century the British Government apparently regarded it as self-evident that colonial governments ought generally to finance themselves by means of an income tax and this Ordinance became the standard form of income tax statute at the time for the smaller colonies (Littlewood, 2010) and was widely enacted (The Straits Times, 4 September 1947:6).

However, there was strong opposition to an income tax in Malaya and Singapore post World War II. Apart from the fact that there was no longer a need to fund the war effort, after the Japanese occupation many companies and businesses were struggling to rehabilitate themselves, as much of their income was being channeled to the restoration of their capital and building of trading reserves (The Straits Times, 25 November 1947:6). There was also a very strong feeling that, despite the strength of opposition to income tax, both the British colonial governments of Malaya and Singapore might enforce direct taxation by decree (The Straits Times, 28 August 1947:7). The European, Chinese and Indian business, mercantile and professional communities as a whole were opposed to the imposition of an income tax (The Straits Times, 9 August 1947:7). The objections to income taxation were (1) the absence of properly constituted legislative bodies, that is, no taxation without representation; (2) there would be evasion on a large scale, which would entail an unfair incidence of the burden of taxation on those who did pay; (3) the major industries (namely tin and rubber) were being rehabilitated with borrowed money; (4) the extravagance on the part of the Government in the administration of the country; and (5) it had not been

¹² Heasman arrived in Malaya in February 1947 (The Straits Times, 19 April 1947:1) and his report was presented on 22 July 1947 [a duration of only six months].

shown by the Government how much of the expenditure was revenue expenditure (The Straits Times, 17 August 1947:3).

Opposition to the proposed income taxation was based more on the alleged unfair incidence of tax, resulting from anticipated evasion and inopportuneness, rather than on matters of principle. There was concern that the cost of setting up a new taxation department would be out of all proportion to the yield of tax and would also accentuate the existing bribery and corruption practices. There was also a lack of confidence in the then government and mistrust based on the issues of evasion, corruption and extravagance (The Straits Times, 16 September 1947:6). Objections were also based on misconceptions and failure (or disinclination) to appreciate the implications of the then very serious post-war financial situation, particularly in relation to the instability of indirect taxes and the abolition of revenue from the opium trade (The Straits Times, 20 August 1947:2).

There was however support for income taxation from organised trade unions which argued strongly that the tax burden be shifted from indirect levies, as indirect taxation invariably placed a greater burden on the poor than on the well-to-do. In addition, the workers' representatives saw in the introduction of income tax some hope of the Malayan Government carrying out the policy of social betterment of the people. Malay nationalist movements and the influential English language newspapers (such as The Straits Times) expressed support for income taxation (Rudner, 1994). Although the Malays agreed to income taxation in principle based on their religious beliefs (The Singapore Free Press, 6 September 1947:5), they were primarily concerned with the political implications of economic policies (The Straits Times, 20 August 1947:2).

Although some sectors of the community were in favour of the imposition of income tax, on the whole, the responses from the business, mercantile and professional communities were hostile. The Government then agreed to set up an ad hoc committee to consider the finances of the country (The Straits Times, 3 September 1947:4).¹³ The opponents of the Heasman Report argued that this committee should have sat and reported before Mr. Heasman was asked to make his report, and felt that government was not anxious to have the facts found by an independent committee. Such mistrust was further fueled by the contention that the draft Income Tax Ordinance proposed by Mr. Heasman was the very same one adopted by the Colonial Office as a model Income Tax Ordinance in 1922. That is, it was lying in the Colonial Office in Whitehall long before the name of Mr. Heasman was ever heard of in Malaya (The Straits Times, 4 September 1947:6).

The 1950s and 1960s were quite challenging times politically for the emerging nation of Malaysia. Under the new Federal Constitution in 1963, only the Federal Government had the power to raise income tax.¹⁴ Thus, a process to harmonise the taxation systems in the four territories was put into motion, with the introduction of The Modification of Laws (Income Tax) Order (1964). Although Singapore subsequently separated from Malaysia just two years after the Federation of Malaysia

¹³ The terms of reference were to inquire into (1) the financial position; (2) the need for further revenues; (3) the feasibility of further economies in administration; (4) if further revenue was required, whether it could be obtained from the existing sources; and (5) if it could not be so obtained, what adequate new sources of revenue were recommended.

¹⁴ Malaysian Federal Constitution, Article 96 states, "No tax or rate shall be levied by or for the purposes of the Federation except by or under the authority of Federal law".

was formed, the move towards harmonisation of the taxation systems continued for the remaining three territories of the Federation of Malaysia. The income tax statutes of the Federation of Malaya (1947), and of the States of Sabah (1956) and Sarawak (1960) were subsequently repealed by the current Income Tax Act (1967) (Act 53), that has applied to Malaysia as a whole from the year of assessment of 1968 (Subramaniam & Teo, 1989).

Finally, based on the preceding discussion it is clear that the development of tax laws in Malaysia has been dramatically impacted on by British colonisation. Malaysian case law also reflects these same British principles, along with judicial decisions from other Commonwealth countries including Australia. Although such judicial decisions are not binding on the Malaysian judicial system, they nevertheless have had persuasive authority (Singh, V., 1993), and have thus contributed towards the development of tax principles and practices in Malaysia. Although the Federal Court in Malaysia is currently the final court of appeal, it is pertinent to note that prior to 1985, the London based Judicial Committee of the Privy Council was the final court of appeal in the Malaysian hierarchical judicial system. However, for criminal and constitutional cases, effective 1978, appeals to the Privy Council from the Federal Court of Malaysia were abolished. Appeals in civil cases to the Privy Council continued until 1985, after which such appeals were abolished. However, the abolition does not affect the doctrine of binding precedents in respect of past decisions of the Privy Council, which continue to bind all courts in Malaysia below the level of the Federal Court. Since the Malaysian Federal Court is now the final court of appeal, the Privy Council's decisions are considered as persuasive only.

It is noted that there were tax cases among the appeals to the Privy Council, though an analysis of these cases is beyond the scope of this article. Among the landmark Malaysian tax cases decided by the Privy Council were *American Leaf Blending Co. Sdn. Bhd v DGIR* [1979] 1 MLJ 1; *River Estates Sdn. Bhd. v DGIR* [1984] 1 MLJ 1; *AP v DGIR* (1950 – 1985) MSTC 47; *CC & Ors v Collectors of Stamp Duties* (1950 – 1985) MSTC 56; *Lahat Datu Timber Sdn Bhd v DGIR* [1979 – 1996] AMTC 1087 and *Mamor Sdn Bhd v DGIR* [1979 – 1996] AMTC 1037. There is undoubtedly scope to research the impact of these decisions on contemporary Malaysian tax law.

5 CONCLUDING COMMENTS

This article has explored the historical development of taxation, particularly in respect of income, in Malaysia, and the impact of British colonisation. In spite of sustained domestic resistance to its introduction (mainly from the mercantile community), ultimately the British colonial governors¹⁵ vetoed the decision of the business-dominated members of the Legislative Council¹⁶ and effectively adopted income tax in Malaya and Singapore from 1 January 1948. That is, in spite of there being no elected legislative body in Malaya and Singapore at that time, the principle of no tax without representation was ignored by the then British colonial governments in both Malaya and Singapore. The form of statute adopted was based on the Model Colonial Territories Income Tax Ordinance of 1922 which had been designed for the British Colonies some 25 years previously (Singh, V., 2011). There appeared to be very little,

¹⁵ The British colonial administration was headed by two Governors, one for Malaya and the other for Singapore.

¹⁶ Members of the Legislative Council were by appointment.

if any, consideration of the jurisdictional context in which it was to apply, either in terms of needs or suitability.

This desire to transplant the British Colonial Office's Model Income Tax Ordinance throughout the colonies appeared to be based on the notion of 'one size fits all' and failed to consider cultural or societal differences (Likhovski, 2011); or even basic governance principles. Moreover, the processes and capacities of tax administration (i.e. to apply the law properly and fairly) appeared to have been assumed to be equally attainable and this seems to be quite unreasonable in the case of Malaysia, at least immediately post World War II. Indeed, perhaps this is the most important lesson to be learnt from reflecting on the tax history of Malaysia. Having appropriate statute in place is essential, but broader support for tax laws and greater transparency in governance are important if voluntary compliance is to be maximised (Loo et. al., 2012). Society expects government revenue to be well spent and for officials, including tax administrators, to be above and beyond corruption. Trust is a key element in successful modern day tax systems, and Malaysian tax history provides many examples of the unfortunate consequences that can arise when trust is lacking and power is over exerted.

Finally, the extent to which British colonial influence on other colonies has varied from that of Malaysia could indeed be a fruitful area for further research. It may well clarify the degree to which cultural issues or perhaps socio-economic factors play a major role in the degree of acceptance of colonial taxation laws and the success in their implementation across other parts of the Commonwealth.

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¹⁷ "Gent" refers to Sir Edward Gent, the Governor of Malayan Union.

APPENDIX I: FEDERATION OF MALAYSIA: CHRONOLOGY FROM BRITISH INFLUENCE AND RULE TO INDEPENDENCE

1786 - 1942 ¹⁸		1946 – 1962 / 1963 ¹⁹		1963 – 1965		1965 - current	
Straits Settlements	Singapore	British Colony	Singapore	Singapore ²⁰			
	Penang		Penang		Penang		Penang
	Malacca		Malacca		Malacca		Malacca
Federated Malay States	Perak		Perak		Perak		Perak
	Selangor	Malayan Union ²¹	Selangor	Federation Of Malaysia ²²	Selangor	Federation Of Malaysia	Selangor
	Pahang	(and later)	Pahang		Pahang		Pahang
	Negri Sembilan		Negri Sembilan		Negri Sembilan		Negri Sembilan
Unfederated Malay States	Kedah	Federation Of Malaya ²³	Kedah		Kedah		Kedah
	Perlis		Perlis		Perlis		Perlis
	Kelantan		Kelantan		Kelantan		Kelantan
	Terengganu		Terengganu		Terengganu		Terengganu
	Johore		Johore		Johore		Johore
British Protectorates	Sabah	British Colonies	Sabah		Sabah		Sabah
	Sarawak		Sarawak		Sarawak		Sarawak

¹⁸ Perlis was then part of Kedah.

¹⁹ Japanese Occupation (1942 – 1945).

²⁰ Singapore was separated from the Federation of Malaysia on 9 August 1965.

²¹ The British proposal for a Malayan Union was rejected by the Malay community. The Federation of Malaya was formed.

²² The Federation of Malaysia was formed on 16 September 1963.

²³ The Federation of Malaya gained independence from Britain on 31 August 1957.

The Dutch East India Company's tax farming in 18th century Malacca

Diane Kraal* and Jeyapalan Kasipillai#

Abstract

This study concerns eighteenth century Dutch East India Company (VOC) tax farming practices in the Southeast Asian port town of Malacca. Empirical data from VOC archives are used to determine the value of VOC's tax farming. Adopting a qualitative methodology, and drawing on perspectives from Adam Smith's tax maxims, the study focuses on determining the impact of the VOC's tax farming practices on Malacca's taxpayers, whether they were inter-continental or local intra-island traders, townspeople, or Malay farmers. The study facilitates a further understanding of the global phenomenon of tax farming practice and its demise. Findings suggest that the impact of the VOC's Malacca tax farming varied across groups of taxpayers, but more negatively affected minority and local Malay groups, demonstrating why Adam Smith's governance maxims still guide government tax policy in many countries today. The study complements the paper published from the 2012 Tax History Conference in Cambridge, which covered the nineteenth century handover of Malacca by the Dutch to the British.

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1 INTRODUCTION

This study concerns the eighteenth century tax farming practices and impacts of the Dutch East India Company, or *Verenigde Oost-Indische Compagnie* (VOC) in Malacca (Melaka), a port town situated on the west coast of the Malay Peninsula. Malacca was one of many trading posts controlled by the VOC in its Asian trading region. The VOC was managed from the Dutch Republic with a state mandate to sail via the Cape of Good Hope to south, southeast and north Asia. The company's commercial purpose was to procure goods for resale in Europe.¹

From the early fifteenth century, Malacca was a thriving, geographically central *entrêpot* or 'warehouse', where goods were imported and re-exported to places within and beyond the Malacca Straits. It was a key trade destination where products from China and the Far East were exchanged.² In 1511, the Portuguese wrested the town from the Malays and built a fort at the estuary of the Malacca River to control trade and exact toll payments from vessels sailing the Straits. The Portuguese, in turn, were routed from Malacca by the Dutch VOC and its Johor Malay allies in 1641. This conquest entitled the Dutch to taxation rights, such as the collection of waterway tolls, and the opportunity to contract trade monopolies on key commodities, such as tin and pepper.³

Trade and tax were the two streams of VOC revenue. Regarding the tax, the company auctioned out tax farms in Malacca for a range of goods and services.⁴ Tax farming might be defined as a system of indirect taxation, whereby the institution or state allows, through either auction or tender, the acquisition by private interests of a periodic lease for a monopoly of taxation rights on goods or services.

The value of tax farming was an integral aspect of the VOC's profitability, and the known negative aspects of tax farming were vigorously debated by liberal, social and economic thinkers in the eighteenth century. That tax farming – with data so meticulously gathered, tabulated and reported by the Dutch VOC – should be subject to debate by Enlightenment philosophers, is a research area worthy of investigation.

The major question herein concerns the impact of eighteenth century VOC tax farming practices on Malacca's taxpayers, be they traders (inter-continental or local intra-island), townspeople of various ethnic origins, or local Malay farmers. In addition, a subsidiary question asks about the VOC's tax farming practices from the perspective of the tax maxims of Adam Smith (1723-1790) regarding good governance. Critical theory provides some explanations regarding the impact of tax farming on the taxpayers. Some minor aspects of

¹ Femme S Gaastra, *The Dutch East India Company: expansion and decline* (Walburg Pers, 2003).

² D G E Hall, *A History of South-East Asia* (Macmillan, 2nd. ed, 1966) 190-204.

³ S. Arasaratnam, 'Monopoly and Free Trade in the Dutch-Asian Commercial Policy: Debate and Controversy within the VOC' in *Maritime Trade Society and European Influence in Southern Asia* (Variorum, 1995a); S. Arasaratnam, 'Some notes on the Dutch in Malacca and the Indo-Malayan Trade 1641-1670' in *Chapter IV, Maritime Trade, Society, and European Influence in Southern Asia* (Variorum, 1995b); Barbara Andaya Watson and Leonard Y Andaya, *A History of Malaya* (Macmillan, 1982).

⁴ See, eg, the tax farm data for 1681 in Appendix A. See also Michael J. Bremner, 'Report of Governor Balthasar Bort on Malacca, 1678' (1927) 5 (Part 1) *Journal of the Malaysian Branch of the Royal Asiatic Society* 1.

institutional theory are used to explain the VOC's persistence with the practice of tax farming.

Empirical evidence was accessed from archives⁵ and from VOC material that was previously collated. The study considers the eighteenth century generally, but then focuses on the years 1770 to 1790, as VOC trading through the Straits of Malacca was negatively affected by events of the time, including the French revolutionary and Napoleonic wars, and British strategic reactions to the revolt by the American colonies.

The findings suggest that the impact of VOC tax farming in Malacca varied across groups of taxpayers, and that there were inequities between taxpayers, as well as demands for uncertain and inconvenient tax payment arrangements. The study contributes to an appreciation of the importance of the subsequent adoption of Adam Smith's tax maxims, which were eventually applied in British Malacca from the 1820s.⁶ It also contributes to the literature on the history of tax systems, as it furthers an understanding of the global phenomenon of tax farming, specifically in Southeast Asia.

The following section presents a discussion on the global patterns of revenue and tax farming to contextualise the progression of pre and early modern tax practices in Southeast Asia. The methodological approach is then outlined. The origins of VOC taxation rights are explained, and a description of the trading port of Malacca is provided, including details on its financial reporting, trading and administrative apparatus. The focus shifts next to Malacca's trade and tax systems for specific periods in the eighteenth century, and empirical data on large and small tax farms during these periods is presented. This completes the framework supporting the study's qualitative analysis of the impact of tax practices on the VOC's taxpayers. Lastly, conclusions are presented, and areas for future research are highlighted.

2 AN OVERVIEW OF REVENUE AND TAX FARMING

Copland and Godley use a comparative approach to address the past worldwide phenomenon of tax farming.⁷ They provide some useful insights into the early modern VOC tax farming system (from the Dutch colonial period to about 1790), such as the type of arrangement employed and the quality of its management. Early modern practices can be contrasted to those of pre-modern eras, where persons could collect taxes through hereditary right or sovereign favour. This latter system is labelled as 'revenue farming' in this study. In pre-modern Malacca, revenue farming was used by the Malay sultanates. The Portuguese conquerors of Malacca continued the existing revenue farming practice, and used it not only as an indirect means of raising income, but as a common option for accessing a wider source

⁵ Matheson Library, Monash University, Australia. Dutch East India Company (hereafter VOC) files 1610-1793 (Amsterdam copies on microfilm): 1266, 3443, 3495, 3544, 3599, 3812, 3907, 3940 & 3961.

National Archives, The Hague, The Netherlands. Dutch East India Company (hereafter VOC) files: 3418, 8633, 8638, 8640, 8642, 8641, 8643, 8644, 8645, 8646, 8647, 8649, 8651 & 8652.

⁶ See Diane Kraal, 'Of Taxes: An enquiry into Dutch to British Malacca 1824-1839' in *Studies in the History of Tax Law*, ed. John Tiley (Hart Publishing, 2013) 293.

⁷ Ian Copland and Michael R. Godley, 'Revenue Farming in Comparative Perspective: Reflections on Taxation, Social Structure and Development in the Early Modern Period' in *The Rise and Fall of Revenue Farming: Business Elites and the Emergence of the Modern State in Southeast Asia*, ed. J. Butcher and H. Dick (St. Martin's Press, 1993) 45.

of funds.⁸ One of the elements shared in common by VOC tax farming and pre-modern revenue farming was the use of an agent's physical *coercion* against taxpayers.

Copland and Godley consider tax and revenue farming in a range of eras, such as Pharonic Egypt and Greco-Roman times, the thirteenth century state monopoly in Mongol China,⁹ and the sixteenth century middle eastern Ottoman Empire and Safavid Persia.¹⁰ In Pharonic Egypt, for instance, Egyptians paid their taxes to collectors called scribes, on items such as cooking oil and livestock, while the Roman Empire levied customs duties called *portoria*.¹¹ The practice in fifteenth century Spain¹² was replicated in its colonies in Mexico and the Philippines. From the sixteenth century, revenue farming could be found in Mughal India and Tsarist Russia. Equivalent systems were not established in Europe until the seventeenth century. Such systems included England's 'Great Farm' for customs revenue, France's *Ferme Generale* (General Farm) that was inspired by the practice in the Ottoman Empire, and an extensive system established in the Netherlands. As for China, tax farming re-emerged in the Ch'ing period (1644-1911), where merchants actively bid for tax farm leases. Copland and Godley note that tax farming lingered in the Americas and Asia well after it was dispensed with in Europe. However, their discussion on British India does not clearly distinguish tax farming from land rent as a means of government fund raising.¹³ The Copland and Godley tax comparative does not extend to Southeast Asia, however the study by Kwee on revenue and tax farming on Java's northeast coast partly fills this gap.

Kwee finds that prior to the European colonisation of Java, income was raised in the form of a poll-tax. In 1743, the Dutch VOC assumed taxation privileges for Java's northeast coast after its subjugation of the Mataram, with whom a treaty was set. Thereafter, the poll-tax was collected by northeast coastal regents and paid to the VOC.¹⁴ Kwee notes that regents accumulated wealth and power from farming out revenue collection such as toll-gate duties. The VOC initially knew little about the local Javanese intricacies of tax farming, but was aware of the financial gains and decided to engage in the activity through its first tax farming auction in Batavia in 1743.¹⁵ Local disputes arose out of the VOC's system, with claims of tax farmers overcharging and intimidating taxpayers, the result of farmers over-bidding for their leases. To overcome these types of issues, the VOC initiated a closed tender system in the next year and set the tax rates to be charged. The VOC's directors in Europe became aware of the more oppressive tax practices suffered by Javanese taxpayers over toll-gate duties and inquired about mitigating measures – for the directors were concerned about the impact on the company's commercial trade. The VOC abolished toll-gate duties, but retained the closed tender system for other tax farms and created additional goods and

⁸ Markus Vink, 'Passes and Protection Rights: the Dutch East India Company as a Redistributive Enterprise in Malacca, 1641-1662' (1990) 7 *Moyen Orient & Ocean Indien [Middle East & Indian Ocean]* 76-77.

⁹ See also Morris Rossabi, 'The Muslims in the Early Yuan Dynasty' in *China Under Mongol Rule*, ed. John D Langlois (Princeton University Press, 1981) 278.

¹⁰ See also A K S Lambton, 'Reflections on the Role of Agriculture in Medieval Persia' in *Islamic Middle East, 700-1900: studies in economic and social history*, ed. A L Udovitch (The Darwin Press, 1981) 283, 292.

¹¹ See also Samuel Blankson, *A Brief History of Taxation* (Lulu Inc., 2007) 3, 17.

¹² See also Earl J. Hamilton, *Money, prices, and wages in Valencia, Aragon, and Navarre, 1351-1500* (Harvard University Press 1936) 91.

¹³ Copland and Godley, above n 7, 52-43.

¹⁴ Hui Kian Kwee, *The Political Economy of Java's Northeast Coast c. 1740-1800* (Brill, 2006) 76.

¹⁵ *Ibid.*, 78.

services farms. The VOC in Batavia preferred to tender out tax farms to foreigners as a way to arrest the rise of political opponents from the local population. Overseas Chinese, in particular, became dominant due to their extensive regional business knowledge.¹⁶

Reid writes of taxation in Southeast Asia by covering the pre-modern tribute or poll-tax revenue farms based on hereditary relationships.¹⁷ He argues that from the seventeenth century onwards, revenue farming in this region expanded beyond sovereign tributes as a result of contact with the Europeans. Tax farming at that time was well established in the Dutch Republic. Reid claims that by 1653 the VOC's tax farms were a major source of revenue, representing 27% of its income from Asia.¹⁸ A closer examination of taxation in Southeast Asia is found in Hussin's comparison of the trading ports of Malacca and Penang over the period 1780-1830.¹⁹ He provides an overview of tax farming based on archival records on income raised from leases on the various tax farms.²⁰

Diehl's research also covers tax farming in Southeast Asia, and concerns Dutch colonial Java from 1816 to 1925.²¹ He notes the need for the institutional entity to raise revenue from any locally available goods or services, and that this varied the practice from area to area. However, one common element (as Kwee also notes) was that the tax farmers were generally overseas Chinese. Diehl provides evidence of tax farmer harassment of the local population that, together with addiction promoted by opium farming and associated financial hardship, led VOC authorities to discontinue tax farming in Java by 1925.²²

Copland and Godley make conclusions about the characteristics of the institutional success of pre and early modern systems of tax farming: cost-efficiency, quality of contractual arrangements and obligation enforcement.²³ This paper takes these three characteristics and considers them from the opposite perspective of the tax farm system's effect on taxpayers. Kwee's general survey of tax farming in VOC Java's northeast also informs this study, as it is likely that VOC Malacca had to follow similar arrangements for customs duties tax farming, as discussed later at section 5. Diehl's findings on post-VOC tax farming practice in Java, and its parallels to Malacca, are taken into account. The paper draws on Hussin's primary VOC Malacca data on tax farms and extends his numerical analysis. To gain a fuller understanding of Malacca's tax farming, Reid's findings on the VOC Malacca are used to help interpret Hussin's data.²⁴

¹⁶ Ibid., 79- 83.

¹⁷ Anthony Reid, 'The Origins of Tax Farming in Southeast Asia' in *The Rise and Fall of Revenue Farming: Business Elites and the Emergence of the Modern State in Southeast Asia*, ed. J. Butcher and H. Dick (St. Martin's Press, 1993) 69.

¹⁸ Ibid.

¹⁹ Nordin Hussin, *Trade and Society in the Straits of Melaka Dutch Melaka and English Penang, 1780-1830* (NIAS Press, 2007).

²⁰ Hussin Nordin Hussin, *Melaka and Penang 1780-1830: A study of two port towns in the Straits of Melaka* (PhD thesis, Vrije Universiteit, 2002).

²¹ F W Diehl, 'Revenue Farming and Colonial Finances in the Netherlands East Indies, 1816-1925' in *The Rise and Fall of Revenue Farming: Business Elites and the Emergence of the Modern State in Southeast Asia*, ed. J. Butcher and H. Dick (St. Martin's Press, 1993) 196.

²² Ibid., 207.

²³ Above n 7.

²⁴ Above n 20.

3 METHODOLOGY

The research design first takes an objective, positivist approach to analyse and present a detailed picture of tax revenue under the Dutch VOC in Malacca. Clearly, if the sum of tax revenues raised is found to be substantial, then outcomes of some importance may result in posing the major research question about the impact of the eighteenth century Dutch VOC tax farming practices on Malacca's taxpayers. The study graphs and analyses the tax revenues of eighteenth century VOC Malacca.

The major question requires an investigation of the societal impacts of tax farming, and uses a subjective, non-positivist epistemological approach. Thus, the historical method is used together with critical theory. The power relationships between the taxpayers and the 'institution' of the Dutch VOC are interpreted to elicit answers about the impact of tax practices on the wider constituency. The qualitative aspects of the research design are also appropriate for the subsidiary question regarding how the VOC's Malacca tax farming practices compare to Smith's maxims of good tax governance.

3.1 Theoretical perspectives

Hopwood and Johnson urge business historians to evaluate practices on the economic, institutional and social paradigms in places where they operate.²⁵ Hopwood also highlights the need for researchers to investigate how internal systems shape the way in which organisations function.²⁶ Lee claims that taxation is an area of business practice where few studies have been carried out from these perspectives.²⁷ Lamb asserts that an improvement in the quality of tax research follows from a better appreciation of the interdisciplinary nature of tax research and its link to broader systems, such as accounting and economics.²⁸

This study adopts critical theory (or critical enquiry), a non-positivist paradigm that involves empowering human beings to transcend the restrictions placed on them by class, gender and race.²⁹ It is said to have the goals of a 'just society, freedom and equity', with key theoretical assumptions being dominative relationships and empowerment, or dealing with the suppression of individuals. The theory calls into question the socio-political structures in which individuals find themselves.³⁰ Critical theory assists in considering how tax farming might have been discriminatory on the basis of ally or enemy, by race, or by ethnicity.

²⁵ A G Hopwood and H T Johnson, 'Accounting History's Claim to Legitimacy' (1986) 21, no. 2 *International Journal of Accounting* 37.

²⁶ A G Hopwood, 'On Trying to Study Accounting in the Contexts in which It Operates' (1983) 8, no. 2/3 *Accounting, Organisations and Society* 387.

²⁷ See eg, G A Lee, 'The tithe rent charge: a pioneer in income indexation' (1996) 6, no. 3 *Accounting, Business & Financial History* 301; Ross Vosslamber, 'Taxation for New Zealand's future: The introduction of New Zealand's progressive income tax in 1891' (2012) 17 *Accounting History* 105.

²⁸ Margaret Lamb, 'Questions of Taxation Framed as Accounting Historical Research: A Suggested Approach' (2003) 30, no. 92 *Accounting Historians Journal* 176.

²⁹ John Creswell, *Research and Design* (Sage, 2nd ed, 2003); Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters Lawbook Co., 2010).

³⁰ Michael Crotty, *The Foundations of Social Research: Meaning and Perspective of Social Research* (Allen and Unwin, 1998) 159; Gary Rolfe, Melanie Jasper, and Dawn Freshwater, *Critical Reflection in Practice* (Palgrave Macmillan, 2011).

Institutional theory is a field of critical enquiry that can provide explanations about organisational linkages with the environment, social expectations and an organisation's internal practices and characteristics.³¹ Daunton applies a form of institutional theory in his survey of the 'tax history' of numerous European countries.³² This study uses institutional theory in a minor way to understand the eighteenth century colonial Dutch VOC as an institution, and the impact of its taxation practices on 'actors' located in Malacca.

3.2 Adam Smith: economic theory

The theoretical tax maxims of Adam Smith (1723-1790) are used to help evaluate the subsidiary question of whether the Malacca tax farming practices of the Dutch VOC embodied good tax governance. Smith is regarded as the founder of modern economics. His establishment of four broad maxims of taxation (equity, certainty, convenience and efficiency) are still relevant, and underpin much contemporary taxation legislation, tax reform and modern tax publications.³³

Smith described the tax maxims in his seminal work, *An Inquiry into the Nature and Causes of the Wealth of Nations*, first published in 1776. The four maxims are summarised below.

1. The first maxim stipulates that the tax burden should be **equitable**, with contributions proportionate to a taxpayer's level of income. This is also known as vertical equity. The result is the payment of a fair share of taxes. Today, this maxim is also generally acknowledged as embodying horizontal equity, whereby taxpayers with a similar level of income should pay a similar amount of tax.
2. The second maxim points out that taxpayers should be able to predict tax timing and amounts with reasonable **certainty**, as arbitrariness in liability or in the valuation of tax payments could encourage corruption.
3. The third maxim provides that the payment of taxes should be **convenient** to the taxpayer, in terms of both the capacity to pay and in the mode of payment.
4. The fourth maxim highlights the need for an **efficient** mechanism to collect the taxes. Penalties for non-payment of taxes should be reasonable so as not to encourage corruption (such as smuggling), and collectors should not be vexatious.³⁴

³¹ J F Dillard, J T Rigsby, and C Goodman, 'The making and remaking of organization context: Duality and the institutionalization process' (2004) 17, no. 4 *Accounting, Auditing & Accountability Journal* 508.

³² Michael Daunton, *Just Taxes: The Politics of Taxation in Britain, 1941-1979* (Cambridge University Press, 2002) 87.

³³ E.g., Australian Treasury, *Australia's Future Tax System: Architecture of Australia's Tax and Transfer System* (2008); Joseph E Stiglitz, *Economics of the Public Sector* (WW Norton, 3rd ed, 2000); C Sandford, M Goodwin, and P Hardwick, *Administrative and Compliance Costs of Taxation* (Fiscal Publications, 1989).

³⁴ Kathryn Sutherland, ed. *Adam Smith: An Inquiry into the Nature and Causes of the Wealth of Nations* (Oxford University Press, 2008) Book V, ii, 451-454.

It is noted that Adam Smith wrote in the field of political economy, 'a branch of science of a statesman or legislator', which contains two distinct objectives: to provide revenue, or enable people to generate enough revenue for subsistence, and to supply the state with enough revenue to provide for public services.³⁵ Smith outlined two systems of political economy: agriculture and commerce. The latter provided a choice between the mercantile monopolistic system or the free-market economy. He argued that free-market economies are more beneficial to society than mercantilism and its inherent (VOC-like) monopolies. For instance, Smith saw customs duties as restricting imports, raising prices and inducing corruption and noted, 'Taxes imposed with a view to prevent or to diminish importation, are evidently as destructive of the revenue of customs as of the freedom of trade'.³⁶ Smith viewed the mercantile system as placing the interests of the producer ahead of those of the consumer.³⁷

The period of VOC tax farming under this study's consideration coincides with the wide dissemination of Smith's ideas: after the 1776 first edition, there were later editions in 1778, 1784, 1786 and 1789. In fact, a Dutch translation of his work, published in 1796, was one of many European translations at the time.³⁸

3.3 Data

The data on eighteenth century tax farming can be found in the VOC Malacca port's annual reports and letters (*overgekomen brieven en papieren*) to its head office in Batavia. This study has accessed the raw empirical data previously collected by Lewis and Hussin, as well as some financial observations by Harrison in his seminal monograph, *Holding the Fort*.³⁹ Through independent sourcing of tax farming data from original and microfilm copies of VOC records, this study has verified the Lewis and Hussin VOC statistics for selected years from 1772 to 1792. British colonial records are used for reference to Dutch VOC practices.⁴⁰ Similarly, Braddell's raw Malacca population data and Reid and Fernando's raw Malacca shipping data are used for analysis.⁴¹

4 VOC TAXATION RIGHTS

This study considered Gaastra's detailed account of the history of the VOC, which was formed in 1602 in the Dutch Republic from a range of smaller trading companies.⁴² The States-General, or Dutch parliament, granted the VOC Charter, which was renewed

³⁵ Ibid., Book IV, 275.

³⁶ Ibid., Book IV, 301.

³⁷ Ibid., Book IV, viii, 376.

³⁸ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations. Part 1* (Brave Wouter, 1796).

³⁹ Dianne Lewis, *Jan Compagnie in the Straits of Malacca 1641-1795* (Ohio University Press, 1995) 135-139. Hussin, *Melaka and Penang*, above n 20, 422-423; Brian Harrison, *Holding the Fort: Melaka under two flags 1795-1845* (Malaysian Branch of the Royal Asiatic Society Monograph no.14 ed, 1986).

⁴⁰ Original VOC journals and ledgers were inspected at the National Archives of The Netherlands, The Hague in 2011. Relevant Straits Settlements Records were inspected at the British Library, London in 2012. The Amsterdam microfilm copies of these records are held at the Matheson Library, Monash University, Australia.

⁴¹ Thomas Braddell, *Statistics of the British Possessions in the Straits of Malacca* (Pinang Gazette Printing Office, 1861); Anthony Reid and Radin M. Fernando, 'Shipping on Melaka and Singapore as an Index of Growth, 1760-1840' (1996) Vol. XIX Special Issue *South Asia* 59.

⁴² Gaastra, above n 1.

periodically. The Charter permitted the VOC to enter into treaties with foreign powers in the course of its trade.⁴³ The VOC's hegemony in Malacca ended in 1795 with Napoleon's invasion of the Netherlands, and the company was finally declared bankrupt in 1798.

Insights into Dutch sovereignty and taxation rights in the Dutch eastern colonies were found in an examination of the legacy of the Dutch jurist Hugo Grotius (1583-1645). The Grotius treatise *Mare Liberum* (Freedom of the Seas) rejected the seventeenth century Portuguese claims to the right of exclusive trade in the East, which they based on Catholic doctrine and canon law.⁴⁴

The directors of the Dutch VOC contracted Hugo Grotius to defend the legality of the VOC Charter, which they understood allowed them to conduct activities in the name of the States-General and 'meant there was no transfer of authority or sovereignty, but only a restricted mandate'.⁴⁵ It has been shown that Grotius was willing to adapt his *Mare Liberum* argument to the needs of VOC trading.⁴⁶

A treaty between the Johor Malays and the VOC (on behalf of the Dutch States-General) was concluded in 1606. Its underlying purpose was to join forces to oust the Portuguese – their common enemy – from Malacca. The treaty contained key tax clauses, including provisions giving the States-General the sole right to collect tolls from waterways and the recognition of another sovereign.⁴⁷ The treaty was established decades before the Johor Malays and the VOC finally subjugated Portuguese-held Malacca;⁴⁸ the VOC assumed the taxation rights of the Johor Malay sultanate and the Portuguese upon taking Malacca by conquest in 1641.⁴⁹

⁴³ Ibid., 23.

⁴⁴ C H Alexandrowicz, 'The Grotius-Freitas Controversy over the East Indies' in *An Introduction to the History of the Law of Nations in the East Indies* (Clarendon Press, 1967) 41; C. Wilson, 'Hugo Grotius and his World' in *The Royal Netherlands Academy of Arts and Sciences: the World of Hugo Grotius (1583-1645)* (Holland University Press, 1984); A Eyffinger, 'Hugo de Groot' in *Hugo Grotius: 1583-1983*, ed. Members of the Faculty of Law University of Limburg (Van Gorcum, 1984); M. J. Van Ittersum, *Profit and Principle: Hugo Grotius, Natural Rights Theories and the Rise of Dutch Power in the East Indies 1595-1615* (Brill, 2006); M. J. Van Ittersum, 'The Long Goodbye: Hugo Grotius' Justification of Dutch Expansion Overseas, 1615-1654' (2010) 36 *History of European Ideas* 386.

⁴⁵ Gaastra, above n 1, 23.

⁴⁶ Van Ittersum, 'The Long Goodbye', above n 44, 407.

⁴⁷ For the English translation of the 1606 VOC/Johor treaty, see: Borschberg P, 'The Johor-VOC Alliance and the Twelve Years' Truce: Factionalism, Intrigue and International Diplomacy 1606–13', unpublished paper, International Law and Justice Working papers, Appendix 3, <<http://www.iilj.org>>. See also Peter Borschberg, *The Singapore and Melaka Straits* (National University of Singapore, 2010).

⁴⁸ In relation to the treaty, Vink cites VOC 317, fol. 29, d.d. 9 Nov. 1645. See Vink, above n 8, 82.

⁴⁹ In the case of the VOC in Java, the 'assumption' policy is noted by Kwee, above n 14, 76. Hui Kian Kwee, *The Political Economy of Java's Northeast Coast c. 1740-1800* 76; Lewis mis-interpreted 'assumption rights' by conquest, taking it to mean a legal right to monopolise trade. Rather, conquest conferred on the victor the assumption of taxation rights, see Lewis, above n 39, 8, 17, 20. Dianne Lewis, *Jan Compagnie in the Straits of Malacca 1641-1795* 8, 17, 20. Vos also made a similar error in his reference to 'monopoly on navigation... to which the VOC made claim', see Reinout Vos, *Gentle Janus, Merchant Prince: the VOC and the tightrope of diplomacy in the Malay World, 1740-1800* (KITLV Press, 1993) 158.

5 MALACCA OVERVIEW

5.1 The VOC trading port of Malacca

Malacca was an entrépot or 'warehouse' destination for all the known seafaring peoples: Chinese, Persians, Arabs, Indians, Siamese, Khymers, the Bugis of Sulawesi and others from the surrounding archipelago. Europeans, Burghers, Eurasians, Indians, Chinese and Malays comprised the town's population. The VOC's directors in the Dutch Republic saw the Malaccan port as having a key role: that of keeping the Malacca Straits open for the passage of company ships to and from the VOC's Batavia headquarters and its trading ports further north, in China and Japan. However, Malacca's decline as a trading port began from at least the 1780s with the rise of British trade dominance from bases in India. This was accompanied by the continually damaging and ruthless insurrections by varying Malay Sultanates, and incursions by the local firebrand Bugis, characteristically portrayed by the Europeans as relentless pirate-traders.

The VOC in Batavia began the process of financial data gathering by assembling reports from various trading stations, including Malacca. Bookkeepers would compile trading and taxation figures from all the trading posts and enter the data into the general journal (*generaal journaal*). Entries from the general journal were posted to the general ledger (*grootboek*) to derive the operating statements for each trading post and then construct the consolidated accounts. A typical VOC ledger account, showing 'tax leases' as a credit entry in the Profit and Loss Account, is presented in Figure 1.

Figure 1. VOC Malacca: 18th century general ledger accounts, sample⁵⁰

Profit and Loss A/c			
General expenses	xx	Trade income	xx
Pay	xx	General income (tax leases)	xx
Expenses for ships	xx		
Fortifications	xx		
Gifts	xx		
Bal c/f	xx		
	xx		xx
		Balance b/f	xx
Current A/c			
Inward Goods	xx	Returns	xx
Bal c/f	xx		
	xx		xx
		Balance b/f	xx

⁵⁰ Source: authors.

The names of the company-appointed Governors of Malacca for the period 1717-1795 are shown in Figure 2. The relatively short terms of the Governors reflect the practice of controlling abuse of power by limiting the length of appointments.⁵¹

Figure 2. Governors of VOC Malacca: 1717-1795; and post-VOC⁵²

Herman Van Suchtelen	1717-1727
Johan Gobius	1727-1730
Pieter De Chavonnes	1731-1735
Rogier De Laver	1736-1743
Willem Albinus	1743-1749
Pieter Van Heemskerk	1749-1753
Willem Decker	1754-1758
David Boelen	1758-1764
Thomas Schippers	1764-1772
Jan Crans	1772-1776
Pieter Gerardus de Bruijn	1776-1788
Abraham Couperus	1788-1795
Post-VOC	
Jan S. Timmerman-Thijssen	1818-1823

According to the company Charter, the primary role of the VOC's Governor was the promotion of company trade. The VOC collected tax farm monies, but there was no requirement for the application of tax receipts to social welfare or infrastructure,⁵³ even though a stable and ordered community was an important element of the VOC's trading success. Social services and infrastructure funds for community benefit were privately

⁵¹ Vink, above n 8, 85.

⁵² Source: Barbara Watson Andaya, 'Melaka under the Dutch, 1641-1795' in *Melaka: The Transformation of a Malay Capital, C. 1400-1980*, eds. Kernial Singh Sandhu and Paul Wheatly (Oxford University Press, 1983) 239.

⁵³ Gaastra, above n 1, 23.

funded by Malacca's Orphan Chamber and the Burgher Fund, as described at items 5.2 and 5.3 respectively.

5.2 Orphan Chamber

The Orphan Chamber (*Weeskamer*) in Malacca had important fiduciary functions for its wards, for it supported them through a privately funded 'banking system'. Boxer wrote of the need to care for the abandoned progeny of transient maritime personnel, some of whom had inherited monies.⁵⁴ These monies were augmented by loans to members of the community at set interest rates.⁵⁵ One infamous post-VOC incident concerned the reckless theft of Orphan Chamber funds by Malacca's Dutch Governor J.S. Timmerman-Thijssen (in office between 1818 and 1823) without any thought as to overriding social need.⁵⁶

5.3 Burgher Fund

Malacca's 'Burgher Fund' is an example of a another private fund that used monies for public good.⁵⁷ The Burgher Fund (*burgerije cassa*) financed the construction and maintenance of basic infrastructure, such as the town's roads and bridges and the night-time security patrols (*burgerije wacht*). Each of the ethnic groups living in Malacca Town (Chinese, Malay, Indian, Burgher, etc.) had a community leader who was responsible for the group's contribution to the Burgher Fund. As noted previously, the Dutch VOC was not required to contribute its tax receipts to infrastructure:⁵⁸ its role was simply to account for the contributions.⁵⁹

5.4 Trade and tax in VOC Malacca: 1721-1790

This section presents VOC financial data that has been graphed to assist in the fundamental analysis of the value of VOC tax farming; the higher the value, the more likely that its impact on taxpayers would be significant.

Tin was the main mineral resource found on the Malay Peninsula. Access to tin was generally controlled by the Malay Sultans of the various peninsular states. The Dutch VOC purchased tin for export, either directly from these rulers or through intermediaries assigned to control the mining operations.⁶⁰ The VOC applied a margin to the cost of tin and other commodities for resale and the profits formed its *trade* stream of revenue. Tin, opium and tropical foodstuffs such as bird's nests, were the main VOC traded commodities that China accepted for its tea, silk, porcelain and other unique products.

⁵⁴ Charles R Boxer, *Jan Compagnie in war and peace 1602-1799: A short history of the Dutch East-India Company* (Heinemann Asia, 1979).

⁵⁵ Diane Kraal, 'From VOC to Merchant: The Story of Hendrik Kraal (1758-1826)' (2008) September issue *Journal of Malaysian Biographies* 66.

⁵⁶ Diane Kraal, 'The circumstances surrounding the untimely death of Jan S. Timmerman-Thijssen, Governor of Malacca 1818-1823' (2010) 83, Part 1 *Journal of the Malaysian Branch of the Royal Asiatic Society* 19.

⁵⁷ Hussin, *Trade and Society*, above n 19, 211.

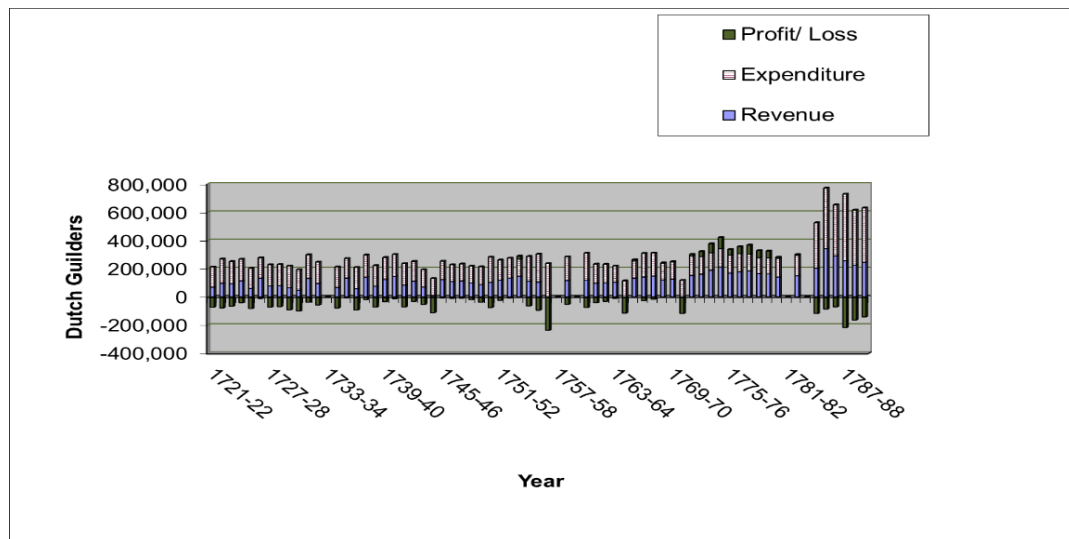
⁵⁸ *Ibid.*

⁵⁹ VOC 3418, Report for 1775.

⁶⁰ For eighteenth century commodity exports from Malacca, see Table 22 in Els M Jacobs, *Merchant in Asia: The trade of the Dutch East India Company during the eighteenth century* (CNWS Publications, 2006) 334.

Figure 3 highlights VOC Malacca revenue and expenditure over a 69-year period. It must be noted that tax income is included in the revenue figures. While a few years are missing from the data, the trend is of net losses averaging about 100,000 Dutch Guilders per annum for the years 1721 to 1769, under nine successive VOC Governors. Profits were achieved from 1769 to 1783, but these were followed by a spiral of losses to 1790.

Figure 3. VOC Malacca: 1721-1790, profit/loss, expenditure, revenue⁶¹



Arasaratnam wrote of the cross-subsidy from Batavia to cover Malacca's losses, as expenses such as administration, military pay, expenses for ships and fortifications needed to be covered. The subsidy was provided because the Straits of Malacca was an important waterway that needed to be kept open for VOC ships.⁶² The VOC's customs system was tied to the requirement for a pass to sail through the Straits. These measures protected and promoted the VOC's shipping interests by re-routing competitive trade to Malacca.⁶³ Thus, the customs system was strategically important, otherwise Batavia would have been burdened by providing even greater subsidies to Malacca.

From 1641, a VOC Malacca official called the *ontwanger* (collector) directly levied customs duties on all incoming and outgoing vessels by assessing duties on the market value of the shipped goods. However, given the number of entry points to Malacca that needed to be covered to prevent evasion of tax, the number of VOC personnel available for collection was too low and administrative costs were too high.⁶⁴ In a 1741 report by VOC Batavia Governor-General-designate, Baron Van Imhoff, the VOC was described as a company in decline, requiring drastic policy reforms. He recommended easing the restrictions on free trade with Asia and making up the difference from customs revenue. He found the VOC monopoly system 'ineffective, expensive and counter-productive'.⁶⁵ His report was

⁶¹ Source: Lewis, *Jan Compagnie*, above n 39, 135-39.

⁶² Arasaratnam, 'Monopoly and Free Trade', above n 3, 12-14.

⁶³ Vink, above n 8, 90.

⁶⁴ See Harrison, *Holding the Fort*, above n 39, 11.

⁶⁵ Arasaratnam, 'Monopoly and Free Trade', above n 3, 10-12.

discussed by the VOC's Directors in the Netherlands, but only small reforms were enacted.⁶⁶ These included the encouragement of the expansion of tax farming in Java and Malacca,⁶⁷ and implementation of the indirect method of tax collection by auctioning customs collection rights to private individuals.⁶⁸

From 1744, private tax farmers bid at auction for the *boom pacht* (customs farm) for the privilege of the monopoly rent.⁶⁹ One early mention of a Malacca customs tax farmer was of a person by the name of Intje Soereen. The record noted that Soereen did not have to keep the old style registers that included the captain's name, number of crew and specifications of ship and cargo: all that was needed was a list of the goods carried aboard.⁷⁰ In conjunction with the changeover to customs tax farms, Dutch officials at Malacca received between them a quarter of the profits from customs duties, in accordance with their rank.⁷¹

5.5 VOC accounts data: 1770-1790

The study now focuses on VOC Malacca revenue for a narrow 20-year period, from 1770 to 1790. The stable trend of revenue against even levels of expenditure from 1772 to 1780 is in contrast to the change from 1785 onwards, when erratic results started to become the norm, with regular losses incurred through to 1790.

Figure 4 depicts these financial contrasts, first for the period when Governors Schippers, Crans, and de Bruijn successively managed Malacca to 1788, and then for the era of the Governorship of Abraham Couperus (1788-1795). The VOC never recovered its trade position after the Fourth Anglo-Dutch War (1780-84); essentially, events that occurred in far-off Europe affected the security of trading through the Straits of Malacca.⁷²

⁶⁶ Gustaaf Van Imhoff, 'Considerations on the Present State of the Dutch East India Company' (first published 1853, 1930 ed.) Reel 66 *Bijdragen tot de taal-land en volkenkunde van Nederlandsch-Indie*.

⁶⁷ J P De Korte, *The Annual Accounting of the Dutch East India Company* (Martinus Nijhoff, 1984) 48.

⁶⁸ The first-time lease revenue for the indirect collection of customs duties can be seen in Hussin's data for 1744 of 15,500 rijksdollars, see Hussin, *Melaka and Penang*, above n 20, 422.

⁶⁹ See Vol. 5, page 176, 27 Dec. 1743 for Governor-General Van Imhoff's reference to the original edict on customs tax farms, Jacobus A Van der Chijs, ed. *Nederlands-Indisch Plakaatboek 1602-1811 (Collection of Edicts of the Netherlands East Indies)*, 17 vols. (Batavia and The Hague Landsdrukkerij, 1885-1900).

⁷⁰ National Archives of The Netherlands, The Hague. Tax farmer, Intje Soereen: VOC 8633, pp.82, 86 and 88, d.d. 23 Feb. 1746.

⁷¹ Lewis, *Jan Compagnie*, above n 39, 64. See also Lewis Dianne Lewis, 'The Growth of the Country Trade to the Straits of Malacca, 1760-1777' (1970) 43, no. 2 *Journal of the Malaysian Branch of the Royal Asiatic Society* 114. At footnote 79 Lewis cites Batavia's *Uitgaande Briefboeken*, Batavia to Malacca, 12 November 1745, p.714.

⁷² Lewis, 'The Growth of the Country Trade', above n 69, 123-124.

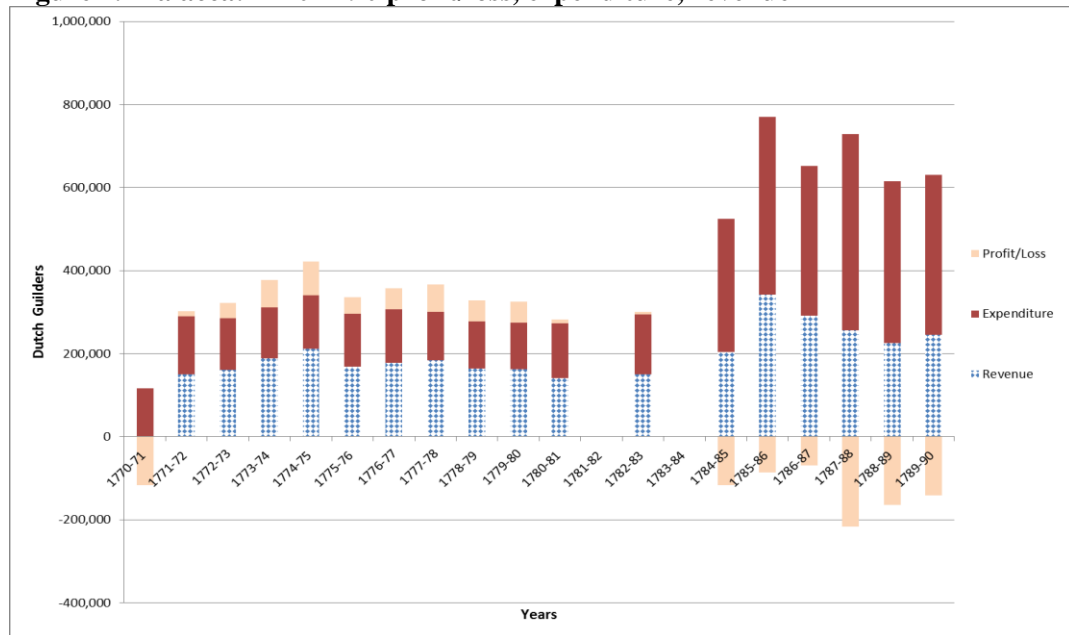
Figure 4. Malacca: 1770-1790 profit/loss, expenditure, revenue⁷³

Figure 5 provides an even closer look at revenue for VOC Malacca in the 15 years from 1775 to 1790. Revenue, trade and tax leases are denoted in rijks dollars, a medium of exchange introduced by the VOC into Asia from the Dutch Republic. Trade revenue averaged 56% of total revenue, which is consistent with other research findings.⁷⁴ Thus, on average, tax lease fees in the two categories of goods and services, and customs duties, contributed a vital 44% of revenue. Earlier VOC data corroborated the key contribution of taxes to overall revenue as follows: 1641-42: 17%, 1642-43: 14.6%, 1643-44: 12%, 1661-62: 28.8%,⁷⁵ and 1653: 27%.⁷⁶

⁷³ Source: Lewis, *Jan Compagnie*, above n 39, 135-39.

⁷⁴ Gastra calculated trade at 'about 60%' of total VOC revenue for Asia in the 18th century', see Gastra, above n 1, 127.

⁷⁵ Vink, above n 8, 84.

⁷⁶ Reid, above, n 17.

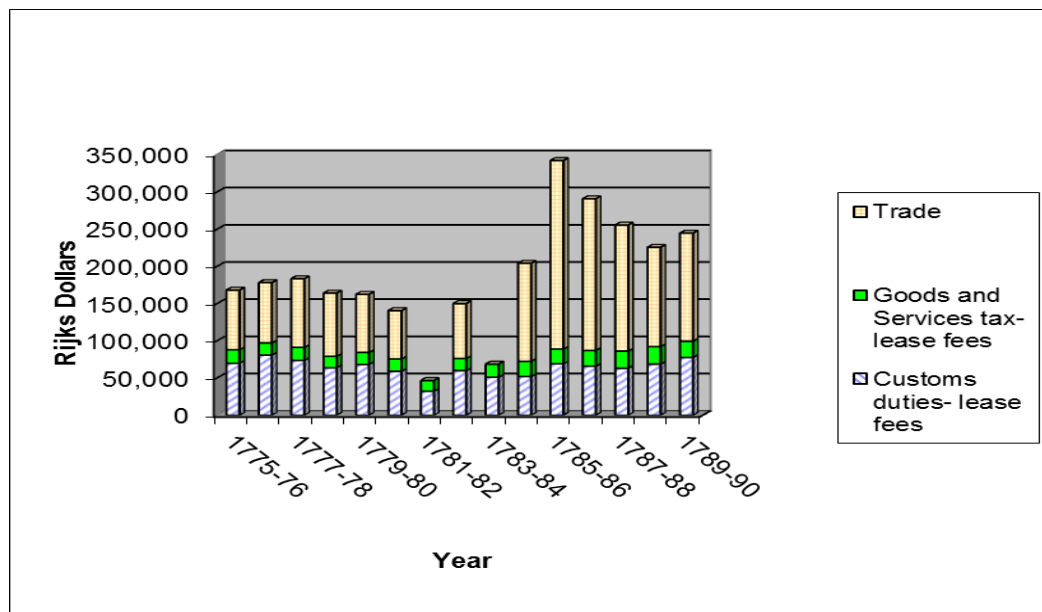
Figure 5. Malacca: 1775-1790, revenue by type⁷⁷

Figure 5 also shows that customs duties lease fees from 1775 to 1780 were proportional to changes in trade revenue. There are gaps in the trade data covering the Fourth Anglo-Dutch war years (1780-84). From 1785 to 1790, trade revenue rose sharply in comparison to earlier periods, most likely due to a huge rise in European demand for tea from China, as consumer demand increased dramatically in the late 1700s.⁷⁸ One would expect that the customs duties lease fees would also be proportionately higher, as the fees were driven by trade conditions, but the rising trade trend was not matched. In buoyant times, the VOC should have accepted only higher bids or tenders for the customs farms.

VOC officials had been allowed a percentage of customs duties since 1745. It is outside the scope of this study to look at tax fraud but, arguably, the customs lease revenue should have been higher. The proportionately lower customs duties suggest that VOC officials took more than their permitted allocation of duties, which put pressure on lessee bidding prices for customs farms, and on subsequent profits. The custom farms lessees, in turn, put pressure on taxpayers for higher taxes. Indeed, there were many accounts of bullying and oppressive tactics to extract taxes.⁷⁹

5.6 Tax farm revenue

As discussed, from 1744 the VOC Malacca administration annually auctioned the rights to collect customs duties and took private bids for the right to tax basic goods (such as rice or timber), to provide certain public services (such as weights and measures), or to tax certain

⁷⁷ Source: Lewis, *Jan Compagnie*, above n 39, 135-39 and Appendix A.

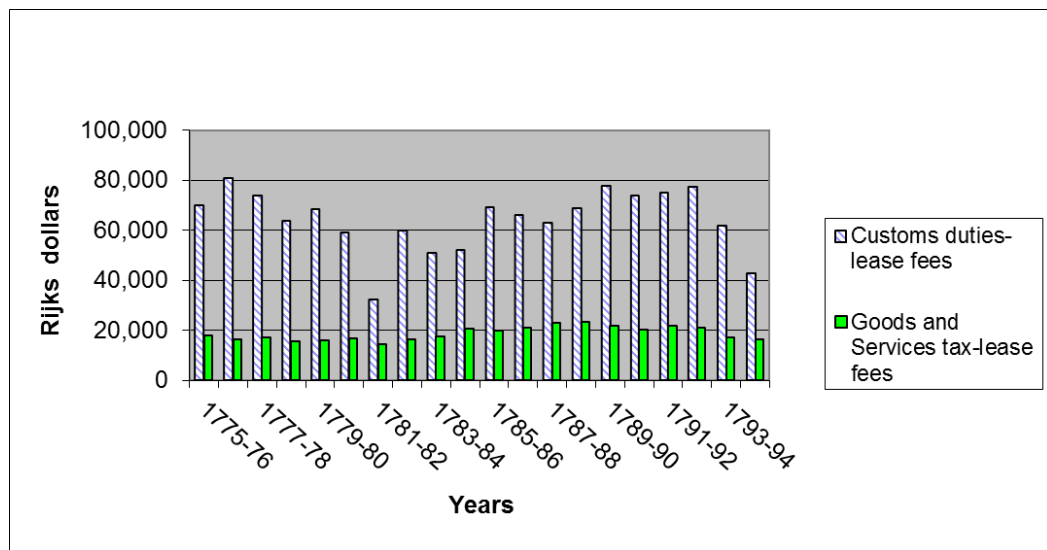
⁷⁸ See data on tea sales as follows, 1698/1700: 4,100 Guilders; 1738/1740: 24,920 Guilders; 1778/1780: 22,920 Guilders, per Kristof Glamann, *Dutch Asiatic Trade 1620-1740* (Martinus Nijhoff, 1981) 14. See also De Korte, above n 65, 65.

⁷⁹ See eg, Kraal, 'From VOC to Merchant', above n 54, 84.

lifestyles (such as the consumption of pork and spirits). The tax farmer paid some cash at the time of the auction or tender (that is, in advance of revenue earned) for the monopoly. The contractual agreement stipulated dates, the amount bid or tendered, and the monthly payments for the year.⁸⁰ The security was forfeited upon default. The farmer then had to recover the fee – and make a profit – by levying tax or dues on the taxpayer for the commodity or service bought or used. The tax farmer bore the risk of any tax farm income fluctuations, whilst the VOC received a stable income from the leases.

Figure 6 shows two categories of VOC Malacca tax farm lease fees. Most variable were the customs farm lease fees, which fell from about 1776 to 1784 as a result of the VOC's strict maintenance of its trade monopolies that negatively affected local trade. Customs lease fees then marginally rose from 1785 to 1793, as tin became an important trading commodity.⁸¹ Tin was used to purchase tea from China, but customs farm lease fees were not proportionate to the sharp rise in trade revenue (as seen in Figure 5).

Figure 6. Malacca: 1775-1795, tax farm lease fees⁸²



5.7 Small goods and services tax farms

Small goods and services tax farms in Malacca included the monopoly right to collect tax on taverns, shops, sea and river fish, timber, public weighbridges, opium, spirits, betel leaves, cock fighting and the slaughter of cows and pigs. At times, it included the right to collect a poll tax on the Chinese population.⁸³

⁸⁰ For instance, the Chinese Head Tax farm for the 1782/83 financial year was leased to Solong Shing, VOC 8664/4 107, 6 May 1782.

⁸¹ Jacobs, above n 59, 199-211.

⁸² Source: Appendix A.

⁸³ For police regulation of tax farms, see India Office Records, IOR, R/9/32/8, British Library.

Figure 7 provides information on the mix of Malacca's population, showing the dominant grouping of Europeans, burghers (*vrijburgers*) and Eurasian Christians (*inlands burger*). Although Chinese and Indians were the 'foreign' minority, these ethnic groups were often owners of Malaccan tax farms, a pattern that was evident in VOC Java.⁸⁴

Figure 7. Malacca Town, 1678-1817: ethnic mix⁸⁵

	1678	1750	1766	1817
European, Burgher, Eurasian Christians	2514	2339	1668	1667
Malay	893	3615	3135	13988
Indian	761	1520	1023	2966
Chinese	716	2161	1390	1006
Totals	4884	9635	7216	19627

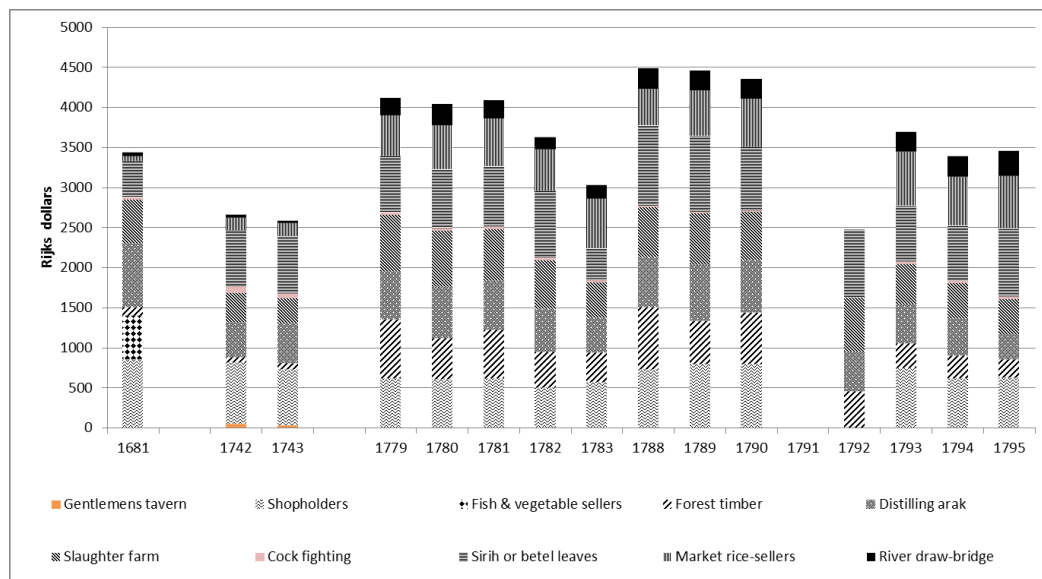
Figure 8 shows increases in VOC lease fees from small tax farms beginning early in the eighteenth century to about 1790. From 1744, a closed tender system for small tax farms was put in place and later endorsed. Hence, there was a gap in the data until 1778.⁸⁶ The VOC's directors later requested that some tax farms should go again to auction, rather than to closed tender,⁸⁷ and data appeared again from 1779 onwards. Apart from another closed tender policy in 1791, there was a stable trend in lease fees from 1793 to the end of the VOC's hegemony in Malacca in 1795.

⁸⁴ In 1755 Que Theko was licensee of a Chinese Gambling Farm, Malacca: VOC 8642/37 d.d. 9 Apr. 1756. In 1754, Mirantje Chittij, a southern Indian Hindu, was licensee of a Weights and Measures Farm, Malacca: VOC 8641/61, 25 Mar. 1754 and 327, 11 Jan. 1754.

⁸⁵ Source: Braddell, above n 41, Table 1.

⁸⁶ See customs tender example for Batavia, Vol. 5, p.589-92, 3-6 December 1748, Jacobus A Van der Chijs, ed. *Nederlands-Indisch Plakaatboek 1602-1811 (Collection of Edicts of the Netherlands East Indies)* Vol 5: 592, 596 December 1748.

⁸⁷ Ibid. vol. 8, p.943, 19 June 1775.

Figure 8. VOC Malacca: 1681-1795, small tax farms-lease fees⁸⁸

5.8 Customs and other large tax farms

Customs duties were levied on Malacca's imports and exports. Import duties were paid on items such as pepper and Indian cloth. Export duties were levied on tin, timber, fruit, vegetables, sugar cane and *sirih*.⁸⁹ Duties were paid to the customs farm lessee at tolls at the various entrances to Malacca, such as the harbour tax office at the Malacca River estuary.⁹⁰ The VOC's Accountant of Incoming and Outgoing Duties registered vessel traffic, and the Harbourmaster ensured that the lessee paid over the agreed percentage of customs duties to senior Dutch administrators. As mentioned previously, the cut from customs was an additional emolument to the basic VOC salary and allowances, but it had the effect of overcharging taxpayers.⁹¹

The lease fees from the customs farms were the most significant stream of revenue in Malacca, as depicted in Appendices A and B. In addition to customs duties, minor taxes such as poll taxes and anchorage and weigh-house dues were levied on the spot. From the earliest days of Dutch Malacca, the VOC set the customs rates of 10% for imports and 5%

⁸⁸ Source: Appendix A.

⁸⁹ Thomas J. Newbold, *Political and Statistical Account of the British Settlements in the Straits of Malacca*, vol. 1 (Oxford University Press, first published 1839, 1971 ed.) 63.

⁹⁰ Examples of lessees, Customs Farm, Malacca:

Years: 1751, 1753, 1755, 1757-1759, Moetoe Mara Chittij, a southern Indian Hindu: VOC 8638/374 d.d. 30 Jan. 1751; VOC 8640/318 en 324 d.d. 8 Sept. 1753; VOC 8641/215 d.d. 30 Aug. 1753; VOC 8642/41 d.d. 9 Apr. 1756; VOC 8643/19 d.d. 30 Apr. 1755; VOC 8645/99 d.d. 26 Aug. 1757; VOC 8646/1 40 no 18 d.d. 10 Mar. 1758; VOC 8647/61 d.d. 10 Mar. 1759.

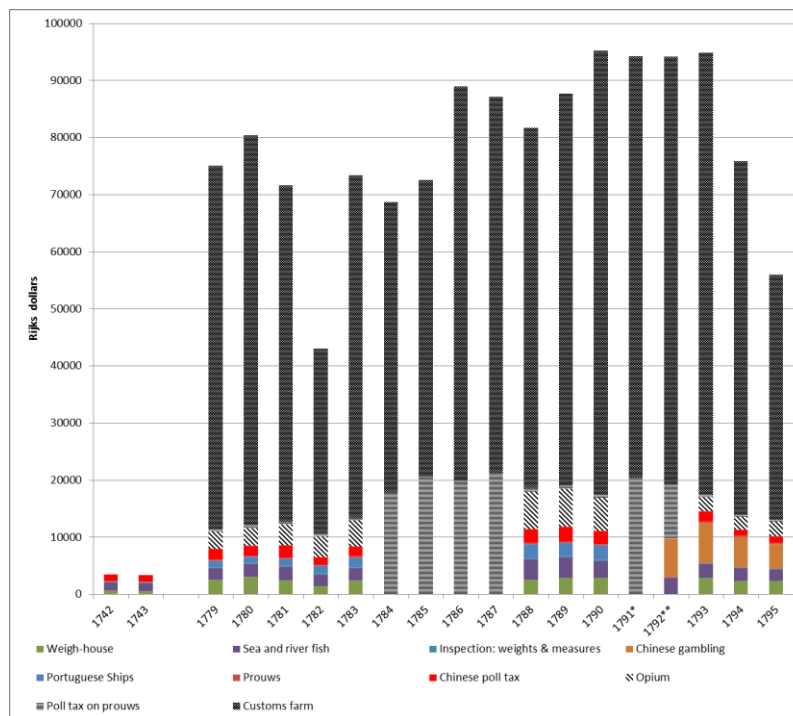
(b) Years: 1750, 1760-1762, Malek Fasulla, from Surat, VOC 8638/374 d.d. 30 Jan. 1751; VOC 8649/43 d.d. 23 Feb. 1760; VOC 8651/54 d.d. 4 Sept. 1761; VOC 8652/1, 177-178 d.d. 29 Mar. 1762.

⁹¹ See also VOC 3961, Governor Abraham Couperus' report 1792; See Harrison, *Holding the Fort*, above n 39, 12.

for exports, based on the *ad valorem*, or market value of goods. By 1643, certain items such as imported rice and pepper were exempt from duty.⁹² The 1668 customs rates table in Appendix C shows that there were additional exemptions of foodstuffs for local consumption, as Malacca's agricultural production was inadequate. Slaves were also duty-free to provide much-needed labour. Appendix C also shows that duty-free import rates privileged the VOC's Siamese and Johor allies. A doubling of the customs rates took place in 1676.⁹³ According to Lee, by the mid-eighteenth century the VOC had changed from a fixed to a progressive scale of customs rates, based on size and tonnage fees levied on vessels entering or leaving Malacca.⁹⁴ The customs lessees continued to collect the tax.

Figure 9 shows a disaggregation of figures for the larger tax farms, with customs farm lease fees yielding the highest revenue, followed by the poll tax on *prouws* (small vessels) and then opium. Small vessels (*banting*, *gonting*, *baluk* and *chialop*) sailed by non-Johor Malays, Acehnese and Chinese, additionally paid both a poll and prouw tax.⁹⁵ As the number of Chinese in Malacca increased, the gambling farm had become quite lucrative. As mentioned previously, closed tenders accounted for missing data from 1744 to 1778.

Figure 9. VOC Malacca: 1681-1795, large tax farm-lease fees⁹⁶



⁹² Vink, above n 8, 82.

⁹³ Jacobs, above n 59, 206.

⁹⁴ Kam Hing Lee, 'The Shipping Lists of Dutch Melaka: A source for the study of coastal trade and shipping in the Malay Peninsula during the 17th and 18th centuries' in *Kapal dan Harta Karam, Ships and Treasure*, ed. Mohd Yusoff Hashim et al. (Persatuan Muzium 1985) 59.

⁹⁵ Ibid., 61-64.

⁹⁶ Source: Appendix A.

6 ANALYSIS OF TAX

The preceding graphs of quantitative data have shown that tax farm lease fees were significant. The significance of the fees provides a foundation for considering the main research question regarding the impact of VOC tax farm practices on Malacca's taxpayers. From this study's general observations of the VOC's tax system, the VOC accounted for tax farm lease fees as income to the company (see Figure 1). By contrast, in today's free-market economies, only governments collect tax revenue. Adam Smith observed the mercantile system's shortcomings when he advocated his theory that the ideal political economy contains an objective to supply the state with enough revenue for public services.⁹⁷ The VOC Malacca's Orphan Chamber and Burgher Fund were examples of privately funded institutions that served social and infrastructure projects. As part of Smith's legacy, the maintenance of public infrastructure is an expenditure of a modern government-run tax system. The reckless theft of Orphan Chamber funds by post-VOC Dutch Governor J.S. Timmerman-Thijssen (1818-1823), without thought to overriding social need, was an example of what Smith's tax governance maxims tried to address.⁹⁸

Tax farm lease fees contributed around 44% of overall revenue (see Figure 5) and were an important source of funds to cover VOC Malacca's administrative and garrison costs. They also minimised the need for subsidies from Batavia.

6.1 Analysis of taxpayers subject to customs and large tax farms

Other researchers have used basic shipping numbers as an indicator of trade growth. This study followed the precedent and used shipping data as an indicator of customs tax paid per taxpayer grouping.⁹⁹ Reid and Fernando expanded on the relationship between the size and number of ships to trade volume:

The largest ships were European, with the British East Indiaman plying between India and Canton in the 400 to 800 ton range, and most of the other English, Danish and French vessels between 150 and 500 tons. But in numbers, the small locally-based Indonesian and Chinese vessels, probably averaging about twenty tons, were overwhelmingly dominant, and tended to become more so. Although the larger European ships may have presented as much tonnage as the Southeast Asian craft, they probably represented a smaller share of Melaka's commerce since they tended to use the Dutch base more as a provisioning rather than a loading point.¹⁰⁰

Figure 10 highlights the number of ship arrivals at the port of Malacca by nationality or ethnicity during the period 1761 to 1785.¹⁰¹ It shows that the number of arrivals increased almost three-fold in 25 years: from 188 in 1761 to 539 in 1785. Nationality or ethnicity of

⁹⁷ Sutherland, above n 34, Book IV, 275.

⁹⁸ Ibid.

⁹⁹ The leading (English language) publications that present VOC Malacca shipping data as trade volume indicators are: Reid and Fernando, 'Shipping on Melaka', above n 41; Lewis, 'The Growth of the Country Trade', above n 69; Lee, above n 87.

¹⁰⁰ Reid and Fernando, 'Shipping on Melaka', above n 41, 68.

¹⁰¹ Ibid., 23. Reid and Fernando drew upon the VOC Harbourmaster records.

the ship's captain was important for taxation purposes; this does not reflect modern day practice where taxation is generally based on source of profits with some tax concessions dependant on the vessel's country of registration.

Figure 10. VOC Malacca: 1761 to 1785, number of ship arrivals¹⁰²

	1761	1765	1770	1775	1780	1785
Nationality/Ethnicity	Number of Ships					
Malay	54	197	135	182	178	242
Chinese	55	98	134	62	106	170
Acehnese	5	1		2		14
Bugis	7	7	63	76	66	1
Javanese & Madurese	3	5	3	1	4	
Dutch	4		1	3		
Burgher	11	13	8	3	5	2
English	17	25	40	56	54	37
Danish		1		1	3	4
French		2	4	5	2	4
Other European				1	2	
Arab	8	4	11	8	14	12
Indian	2					1
Moor	5	18	20	11	13	13
Portuguese	13	20	20	19	31	36
Spanish			1		1	
Swedish	1					
Turkish	1					
Others	2	2	5	4	5	3
Total	188	393	445	434	484	539

From 1761 to 1775, the number of English captains bringing in ships rose moderately. In contrast, the number of ships brought in under Malay and Chinese captains grew four-fold, from 99 in 1761 to 412 in 1785. As a result of the Bugis-Dutch war in 1784, there was a

¹⁰² Source: Reid and Fernando, above n 41, 23.

virtual disappearance of Bugis vessels in the following year, while the number of Moor and Portuguese vessels from south Indian and Macao (Macau) ports was relatively steady.¹⁰³ Generally, from 1761 to 1785, the numbers of non-European ships (particularly Malay and Chinese) increased consistently. With the exception of the Johor Malays, the burden of customs duties fell heavily and inequitably on these two racial groups; there was no modification for vertical equity considerations (ability to pay), the key shortcoming of a regressive tax system. Although progressive rates were introduced later, it was too late for Malacca, which had already begun losing its shipping trade to the duty-free port of Penang.¹⁰⁴

A surge in ship arrivals should have been reflected in increased VOC customs lease revenue, but it was found that this income did not increase in line with the rise in trade volume (see Figure 5). While the number of visiting large, inter-continental Portuguese vessels (for example) rose progressively from 1761 to 1785, and trade revenue increased, VOC customs lease revenue did not match the trend. Although the system of tax farming may have been efficient for the VOC, Smith's maxims of convenience and certainty were not met, as taxpayers were frequently overcharged for customs and the monies paid were subsequently diverted for private gain. Unfavoured taxpayer groups could not transcend the monopolistic customs tax. The lack of horizontal tax equity, where taxpayers of similar circumstances should be treated equally, discouraged non-Dutch sources of trade (such as the Bugis), and promoted smuggling and tax evasion. These negative practices were identified by Adam Smith as preventing optimal wealth creation.

The seventeenth century customs rates (Appendix C) show that privileged treatment was given to some, including the VOC's Johor and Siamese allies. Further, the privileges for the Johor elite continued into the eighteenth century.¹⁰⁵ In addition, VOC Governor David Boelen (1758-1764) privately owned four large ships, but paid no tax.¹⁰⁶

The unfairness of the tax farm system can be explained by critical tax theory. The customs farm regime could arguably be described as 'institutionally endorsed discrimination' against certain taxpayers across a wide geographic area. For instance, Portuguese nationals trading between Macao, Goa and Lisbon were subject to an additional 'Portuguese ship' tax. The Chinese and non-Johor Malays paid more tax because of their shipping volume, but Dutch burghers (whether free-settlers or ex-VOC) who were permitted intra-island trading, paid no tax. Small non-Johor vessels (banting, gonting, baluk and chialop) sailed by Malays, Acehnese and Chinese, additionally paid both a poll and *prouw* tax.¹⁰⁷

From Malacca's subjugation by the VOC in 1641, *ad valorem* customs duties were levied on all incoming and outgoing vessels. By 1668, the customs rates changed, providing early

¹⁰³ Ibid., 68.

¹⁰⁴ Hussin, *Trade and Society*, above n 19.

¹⁰⁵ The Johor elite were provided passes, so no customs duties were paid. Johor allowed their allies to fly the 'Johor colours' for a customs exemption as well, see Jacobs, above n 59, 207.

¹⁰⁶ Governor David Boelen owned four large vessels that were duty-free on arrival and departure from Malacca. (1758-1764) NA 1.04.02, VOC 8652, fol. 235-36, Lijst der aangekomen en vertrokken schepen en vaartuijgen sedert primo, Januarij 1761.

¹⁰⁷ Lee, above n 87, 61-64. Kam Hing Lee, 'The Shipping Lists of Dutch Melaka: A source for the study of coastal trade and shipping in the Malay Peninsula during the 17th and 18th centuries' 61-64.

evidence of the discriminatory rate differentials based on criteria such as ally, enemy, nationality and ethnicity. It is acknowledged that by the eighteenth century there was a change in the tax basis of customs rates based on the size and tonnage of ships, but the underlying lack of horizontal tax equity during the VOC era remained.¹⁰⁸ Groups not aligned with the VOC were suppressed in their bid for free-market trading by the dominance of Dutch mercantilism and its practice of forced docking at VOC ports.

The larger goods and services tax farms levied imposts on Malacca's taxpayers by ethnicity. The Chinese community, for example, was subject to both poll and gambling taxes. These shortcomings of the VOC tax farm system were typical of what Adam Smith tried to address through his maxims on tax governance. Importantly, to enjoy widespread support, a tax system has to be perceived as fair.

6.2 Analysis of taxpayers subject to small tax farms

Under the treaty with the Johor Malays, the Dutch VOC had the right to collect a 10% tithe from the produce of Malacca territory land.¹⁰⁹ However, the VOC granted away the tithe collection to an exclusive group of individuals or family groups known as 'proprietors'.¹¹⁰ In return for the grants, the VOC expected the proprietors to facilitate an increase in the level of cultivation for the benefit of the wider community, but this was only marginally met.¹¹¹

A proprietor's income was nominally based on one-tenth of the rice cultivated on his land. Quite often, proprietors never bothered to visit their holdings, preferring to use a local headman (*penghulu*) to extract the tithes from Malay tenant cultivators.¹¹² This arrangement meant that the proprietors received less than the one-tenth tithe and the *penghulu* was free to extract as much as he could from the cultivators. The Malay cultivators responded to this lack of vertical equity (that tax should be proportionate to income) by only planting for subsistence.¹¹³ Given that the tithes were exacted at tolls on the roads and rivers to Malacca's markets, only cultivators who sold their surplus were taxed.¹¹⁴ From the viewpoint of Adam

¹⁰⁸ Ibid., 59.

¹⁰⁹ Straits Settlements Records (henceforth SSR) G/34 series. SSR/G/34/168, 5 July 1827, ff 108-247. Minutes of British Governor Fullerton, on the history of Malacca's land tithe arrangements with the Dutch & other with land proprietors'. Microfilm copy of Straits Settlements Records, Matheson Library, Monash University, Australia.

¹¹⁰ SSR/G/34/168, 5 July 1827, ff. 108-247. See also Thomas J. Newbold, *Political and Statistical Account of the British Settlements in the Straits of Malacca* 162-163.

¹¹¹ SSR/G/34/168, f. 252, Lewis for Garling 30 April 1828: The British uncovered a Dutch regulation dated 1 November 1755 issued by the Dutch Governor, Willem Decker (1753-1758). It compelled peasant tenants to clear and cultivate waste land around Malacca. The regulation evidences VOC perceived sovereignty however, the order failed for lack of incentive to the cultivator.

¹¹² SSR/G/34/168, 5 July 1827, f. 94, Diary entries of British Resident S. Garling: Landed proprietors abandoned their own and tenants' best interests by not 'residing on their estates' Refers to the 'sloth' of landed proprietors. See also Diane Kraal, *The Far East Remembered: Animal trading and change* (2009) 46.

¹¹³ SSR/G/34/168, 5 July 1827, f.187, diary entries of British Resident, S. Garling: made observations on the effects of the tax collector methods on taxpayers, 'Landed proprietors appear to assume the right of the sovereign and as a result the *penghulus*, who are not accountable to the police, are leading the tenants into vassalage.'

¹¹⁴ See eg, SSR/G/34/169, Malacca Diary, f.28, 6 January 1829. Collection of the tithe was made on the principle of a road duty.

Smith's maxims, the tithe was an inconvenient and uncertain arrangement for the cultivator.¹¹⁵

Tax farming may have been an efficient arrangement for both the Dutch VOC and proprietors, but tithe sharing with *penghulu* and the regressiveness of a tithe levied irrespective of crop type (whether rice, pepper or fruit) resulted in land holdings around Malacca being poorly maintained, underdeveloped or just left as swamp and jungle. Little was returned to community members by way of socio-economic expenditure.¹¹⁶

The VOC's revenue from small tax farms (e.g., betel and arak) was not reinvested to improve local community facilities (as advocated by Smith), since this was the responsibility of the privately sponsored Burgher Fund.

The slaughter tax on pork appeared to be inequitable and discriminatory, as pigs were eaten exclusively by the Chinese and Christian communities. The tax on cock fighting, a popular Malay recreation, was also discriminatory and horizontally inequitable (see Figure 8).

These cases illustrate a lack of 'governance' in the tax farming system. According to Adam Smith, 'as much as taxpayers contribute, in respect of their abilities, towards the support of government, the latter too has a role in protecting the interests of individuals, failing which it may diminish or even destroy some of the funds which it would otherwise garner.'¹¹⁷

7 CONCLUSION

This study's analysis of Dutch VOC tax farm lease revenue for Malacca was narrowed down to between 1770 and 1790, and is thus limited. Nonetheless, the value of revenue was found to be significant enough to justify further investigation into the impact of tax farms on the various societal groupings of Malacca taxpayers.

By referencing the four taxation maxims of Adam Smith (equity, efficiency, certainty and convenience), inequities were found in relation to customs farming. These inequities included institutionally endorsed discrimination against non-allies, competitors, and certain national and minority ethnic groups of taxpayers. In particular, there was a lack of horizontal tax equity. Smith called for an efficient mechanism so that penalties for the non-payment of taxes should not be excessive to the point of encouraging smuggling. Undermining the customs tax farms was the sanctioned diversion of a percentage of customs revenue to VOC officials.

As for the smaller tax farms, observations were made about vertically inequitable, uncertain and inconvenient payment arrangements that faced the typical agricultural Malay taxpayer. The flat, regressive rate of the tithe on all types of land produce negatively affected the ability of the proprietor to improve infrastructure as necessary to increase yields.

¹¹⁵ See eg, Sutherland, above n 34. Book III, ii, 9. Kathryn Sutherland, ed. *Adam Smith: An Inquiry into the Nature and Causes of the Wealth of Nations* 9, Book III, ii.

¹¹⁶ See eg, SSR/G/34/168 Report from Lewis, Superintendent of Lands, on private landholders, particularly ff. 50, 55, 56, 30 January 1828.

¹¹⁷ Smith, above n 38, 653-725.

A VOC marine officer based in Malacca for three months, A.E. Van Braam Houckgeest, criticised the VOC's commercial policy in a 1790 report.¹¹⁸ His critique referred to the 'freedom of the seas' in an attack on the VOC's policy of forcing shipping away from Malacca to Batavia. Van Braam claimed that by removing the VOC's trade monopoly, overall revenue would increase through reinvestment, while tolls and other taxes were recommended to be maintained. The Dutch VOC continued with tax farming (despite its shortcomings) to 1795. This may be explained by the institutional theory term, 'normative isomorphism'; the bureaucratically cumbersome VOC used the tax farming system as an easy choice, being a predominant norm as similarly practiced in eighteenth century Netherlands, France, Tsarist Russia, Ch'ing China and Mughal India. As Copland and Godley pointed out, tax farming was cost efficient for an institution, and a good conduit for quick capital raising.¹¹⁹ Reid claimed that the VOC developed a unique tax farm system in Java, consisting of 'an economic partnership between the Chinese and the Dutch.'¹²⁰ The same might also be concluded for VOC Malacca, but with a wider range of minority ethnic groups. Despite the VOC's rejection of the reforms in the 1741 Van Imhoff and the 1790 Van Braam reports, European support for the concept of free-market trading eventually gathered momentum in the eighteenth century, partly because of the dissemination of Adam Smith's theories through his *Wealth of Nations*. Smith went beyond the thinking of his time with an economic philosophy that 'markets must belong to everyone.'¹²¹

This study has drawn on the qualitative approach of critical theory to further an understanding of the global history of tax and revenue farming by considering eighteenth century Malacca. Findings suggest that the impact of tax farming in Malacca varied across groups of taxpayers, but was felt more negatively by minority and local Malay groups. This demonstrates why Adam Smith's governance maxims still guide government policy today. The study has shown the importance of the subsequent adoption of Adam Smith's tax maxims, which were applied in British Malacca from the 1820s. It sheds light on the VOC's tax farming practices (which were adapted according to local conditions) in an eighteenth century Dutch colonial outpost. The study has provided increased understanding of the tax farming system's practices and problems prior to the modern system of mixed direct and indirect taxation. Finally, further insight has been gained into how the VOC Malacca's eighteenth century tax practices were adapted in accordance with local conditions. An interesting topic of future research would be a comparative study of tax farming practices at other eighteenth century VOC trading ports.

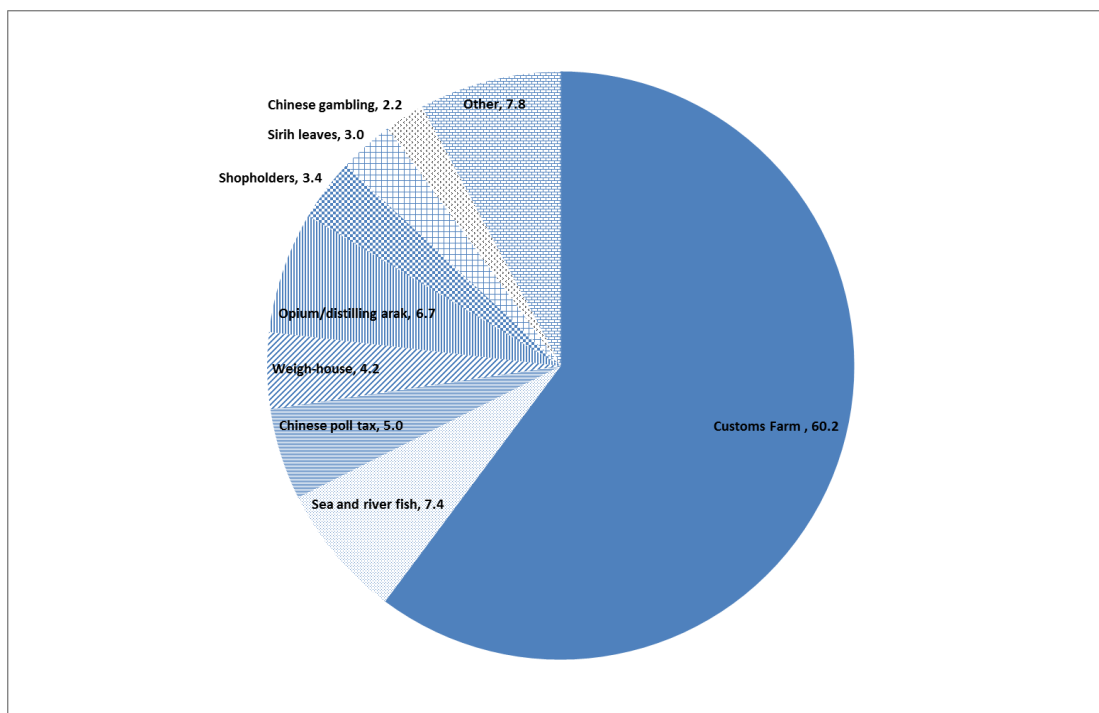
¹¹⁸ J De Hullu, 'A.E. Van Braam Houckgeest's *Memorie Over Malakka en den Tinhandel Aldaar* (1790)' (1920) 76 *Bijdragen tot de Taal-Land- en Volkenkunde van Nederlandsch-Indie*.

¹¹⁹ Copland and Godley, above n 7. Ian Copland and Michael R. Godley, 'Revenue Farming in Comparative Perspective: Reflections on Taxation, Social Structure and Development in the Early Modern Period'.

¹²⁰ Reid, above n 17, 79.

¹²¹ A Keller, 'Debating co-operation in Europe from Grotius to Adam Smith' in *International Co-operation: the extent and limits of Multilateralism*, ed. W W. Zartman and S Touvla (Cambridge University Press, 2010) 15-37.

APPENDIX A		VOC Malacca: 1681- 1796, Tax Farms (Rijks Dollars)																		
	1681	1742	1743	1779	1780	1781	1782	1783	1784	1785	1786	1787	1788	1789	1790	1791	1792	1793	1794	1795
Gentlemen's tavern		40	20	10	10	10	10	10 *	*	*	*		10	10	10 *	**		10	10	10
Shopholders	850	770	708	600	590	600	485	550 *	*	*	*		720	780	780 *	**		730	600	610
Fish and vegetable sellers	550																			
Timber cut from forest	100	70	75	740	510	610	450	370 *	*	*	*		770	545	645 *		455	305	285	230
Distilling arak	800	430	500	600	650	610	540	440 *	*	*	*		630	700	660 *		492	500	470	310
Slaughter tax	550	371	310	710	700	650	610	450 *	*	*	*		620	640	600 *		675	500	440	450
Cock fighting	30	80	60	25	25	25	25	25 *	*	*	*		25	25	25 *	**		25	25	25
Sirih or betel leaves	450	700	720	700	740	760	830	400 *	*	*	*		1000	940	780 *		845	700	700	850
Rice-sellers in the market	60	160	161	520	550	600	520	610 *	*	*	*		460	570	610 *	**		675	605	660
Draw-bridge over the river	50	40	30	210	270	225	160	170 *	*	*	*		250	250	250 *	**		250	255	310
Weigh-house	550	540	440	2400	2970	2320	1250	2300 *	*	*	*		2400	2765	2785 *	**		2780	2225	2225
Sea and river fish	1040	1500	1482	2100	2270	2440	2160	2200 *	*	*	*		3660	3605	3050 *		2835	2505	2300	2100
Inspection of weights and measures	100	140	120	180	170	155	150	150 *	*	*	*		130	200	155 *	**		130	140	60
Chinese gambling	600														*		6850	6970	5250	4295
Portuguese ships				1110	1060	1230	1420	1630 *	*	*	*		2500	2385	2505 *	**	-	-	-	
Prouws		45	40	230	170	185	100	335 *	*	*	*		200	200	200 *	**		273	275	275
Chinese poll tax	400	1105	1168	1840	1780	2180	1320	1720 *	*	*	*		2390	2550	2340 *	**		1770	1075	1150
Opium				3010	3120	3660	3700	4600 *	*	*	*		6610	6745	5860 *	**		2550	2250	2550
Poll tax on prouws				470	470	420	445	420	17700	20530	19785	21140	610	505	490	20270	9463	350	280	330
Customs house++				63700	68350	59050	32400	60000	51000	52050	69150	66000	63250	68760	77780	74000	75000	77555	62050	42975
Total	6130	5991	5834	79155	84405	75730	46575	76380	68700	72580	88935	87140	86235	92175	99525	94270	96615	98578	79235	59415
Sources:																				
-Year 1681, Reid, above n 17, 75-76.																				
per VOC Generale Missiven, Vol 4 . 1675-1685, p.904																				
- Years 1742-1795, Hussin, above n 20, 422-423.																				
* All the farms were sold in sealed proposals.																				
** In 1792 the value of many farms were not known due to sealed tenders.																				
++ Hussin's data shows that Malacca customs duties tax farm was auctioned by the VOC from 1744. See for instance, customs farmer- Intje Soereen, VOC 8633/82, d.d. 23.2.1746.																				
Amsterdam chamber, microfilm records, Monash University, Australia: Matheson Library: 1772-73: VOC 3443; 1777: VOC 3495; 1778-79: VOC 3544; 1788: VOC 3812; 1780-81: VOC 3599; 1778-79: VOC 3907; 1789-90: VOC 3940; 1791-92: VOC 3961.																				

APPENDIX B.**VOC Malacca: 1681-1796 tax farm lease fees, average per cent share of revenue**

Tax Farm		Ave %tage	**Other - tax farm		Ave %tage
Customs Farm		60.2	Slaughter tax		2.1
Sea and river fish		7.4	Portuguese ships		1.2
Chinese poll tax		5.0	Rice-sellers in the market		1.1
Weigh-house		4.2	Timber cut from forest		0.8
Opium/ distilling arak		6.7	Fish and vegetable sellers		0.6
Shopholders		3.4	Inspection of weights and measures		0.6
Sirih or betel leaves		3.0	Prouw poll tax		0.4
Chinese gambling		2.2	River draw-bridge		0.4
**Other		7.8	Prouws		0.3
		<u>100.0</u> Total	Cock fighting		0.2
			Gentlemen's tavern		0.1
					<u>7.8</u> Total

APPENDIX C.

Customs Rates Table, VOC Malacca, 1668			
		Rates as at 21 Sept. 1668	
Hours of Opening: Mon-Sat 07:00 to 11:00 & 14:00 to 17:00.			
Customs toll/duty (paid by Ships Captain)	Customer	Amt of toll/ import duty	Amt of toll/ export duty
Pepper, tin, resin	VOC /Johor nobles	Duty-free	
Tin	State of Johor	Duty-free	
Rice, buffalo	VOC /Johor Nobles	Duty-free	
Gold, silver, precious stones	VOC /Johor Nobles	Duty-free	
" "	non-VOC	10%	
Cloths, cattle, vegetables	non-VOC	10%	5%
VOC orchards	non-VOC	-	50%
Malacca private orchards	non-VOC	-	10%
Slaves	VOC /Johor Nobles	Duty-free	5 rks*
" "	non-VOC	10rks	10rks
(slave children, 50% disc.)			
Iron and lead	VOC /Johor Nobles	Duty-free	5%
" "	non-VOC	20%	5%
Coins	All	-	10%
Small wares: fowls, eggs, rattan etc.	VOC /Johor Nobles	Duty-free	-
" "	non-VOC	10%	5%
Moors /Portuguese: all goods	All	10%	10%
Non-Malaccans		Poll tax	5%
Inter-region trade	All	Levy/ Anchorage	-
Siamese ships	All	Duty-free	Duty-free
			*rks -rijks dollars

Sources: Amsterdam chamber, microfilm records, Monash University, Australia: Matheson Library, VOC 1266; and C.O. Blagden, 'Report of Governor Balthasar Bort on Malacca, 1678' (1927) 5(1) *Journal of the Malaysian Branch of the Royal Asiatic Society*, Translated by M.J. Bremner, 109-11.