AUSTRALIAN TAXATION LAW

30TH EDITION

ROBIN WOELLNER
STEPHEN BARKOCZY
SHIRLEY MURPHY
CHRIS EVANS
DALE PINTO

2020

OXFORD

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FOREWORD TO THE FIRST EDITION

If two of the important criteria of a ‘good’ taxation system are simplicity and certainty (¶1-190 and ¶1-195), the Australian taxation system and particularly the *Income Tax Assessment Act 1936* fail the test miserably. The spate of anti-avoidance legislation, a reaction to the excesses of the tax avoidance era of the seventies, and the more recent taxation reform package have brought about legislation of almost unrivalled complexity.

The legislation is in some cases unintelligible: without a commerce or law degree the ordinary taxpayer stands no chance of finding his way through the morass and even with these qualifications his advisers will of necessity have to struggle to make sense of language that is as convoluted as it is confusing. Nor is the task of the taxation officer any easier. Many provisions in the legislation are not applied for the simple reason that no one is able to comprehend them. The need for a work that will operate as a guide to the traveller through these murky waters is painfully apparent.

In 1946, Mr Hannan, in his ‘Treatise on the Principles of Income Taxation’, while adverting to the desirability of enunciating a series of authoritative propositions (on s 51(1)), resignedly accepted the impossibility of such a task. Some 40 years on, the possibility of formulating authoritative principles on any matter relating to tax is even more daunting. The torrent of decisions, judicial and administrative, that has been handed down over that time, together with the outpourings of the legislature, have made the study of taxation almost unmanageable.

The need for a systematic approach to the study of taxation is obvious enough to the student. If the student were to see taxation as involving no more than an endless series of individual instances no overview of the subject would be possible. But it is not only the student who is in need of a systematic approach to the problem. The practitioner who is unaware of the system will have endless difficulty even finding the problem, let alone proceeding to a solution for that problem.

So it is not the student alone who will benefit from the present work. Indeed there are to be found discussed in these pages many of the great taxation

issues of the present, without an appreciation of which it would be impossible to predict the outcome of particular factual situations.

By way of example, no issue could be more significant in the judge-made law of income taxation than the issue of the role of purpose in s 51(1) of the Act. The course of authority from *Ure v FC of T* 81 ATC 4100 and *Ilbery v FC of T* 81 ATC 4661 to the more recent cases of *FC of T v Just Jeans Pty Ltd* 87 ATC 4373 and *FC of T v John* 87 ATC 4713 have been a judicial reaction to tax avoidance; yet the boundaries of the doctrine (that purpose is relevant) are far from clear.

Two taxpayers incurring the same outgoings in circumstances identical save for their subjective motives and purposes should be treated in the same way for the purposes of an income tax law. To grant a taxation deduction to the taxpayer who is naive, while denying it to the taxpayer who is sophisticated, would be arbitrary. If an outgoing is incurred in circumstances where there is, objectively seen, a connection between the incurring of the outgoing and the activity which is directed towards the production of assessable income, that outgoing should satisfy the tests of deductibility irrespective of either subjective motivation or purpose.

Once it is accepted (as it must presently be) that subjective purpose intrudes to some extent into the issue of deductibility (albeit not necessarily as a test of deductibility),there is opened up the question whether the relevant purpose is the sole purpose, the dominant purpose or some purpose less than the dominant purpose. For the present these issues are best discussed, in *Magna Alloys & Research Pty Ltd v FC of T* 80 ATC 4542, in judgments in which two members of the present High Court, then sitting in the Federal Court, participated.

What, however, has not yet been the subject of discussion is the problem thrown up when a deduction is disallowed on the basis, say, that it was incurred for the sole purpose of obtaining a tax deduction, yet assessable income is in fact derived in the course of the scheme. Is the assessable income to be ignored, or is the result that the deduction only is to be ignored, leaving the taxpayer nevertheless in receipt of the assessable income upon which he is then to be taxed? Further in deduction cases, what role does an anti-avoidance section play?

In the long run, however, it is not the ‘common law’ of taxation that holds the greatest significance. If there is one lesson that must be learned by anyone

who wishes to understand taxation it is this: Go back to the Statute and read it!

One of the all-time great taxation advisers was once asked a question by a client concerning s 51(1). The adviser had undoubtedly read the section hundreds, perhaps thousands of times. Yet, perhaps to the surprise of his lay client, he opened the Statute, perused the words and tested the issue by reference to the words he read.

There is no other alternative.

So it is, that the authors of the present work return the reader to the Statute, offering on the way a helpful summary of its salient features.

Australia has over the years been well served by its taxation literature—the present work continues the tradition.

23 September 1987
Graham Hill, QC

PREFACE TO THE THIRTIETH EDITION

Australian taxation law has experienced considerable changes over the past few decades, and the deluge shows no signs of abating. Recent years have seen the introduction of a range of new laws designed to deal with ‘phoenix’ behaviour and the promotion of tax exploitation schemes, a ‘remedial’ power enabling the Commissioner to avoid unintended consequences of legislation, refinement of the attribution regime for managed investment trusts, GST on low value imports and the ‘Netflix’ tax. Increased penalties for Significant Global Entities have been introduced, as well as the Multinational Anti-Avoidance Law and the Diverted Profits Tax. Other recent developments include clarification of the status of bitcoin as currency, several measures to combat the black economy, withholding tax on purchases of Australian real estate by foreign investors as well as obligations on buyers of new residential properties to pay GST direct to the ATO, changes to the eligibility rules for small business CGT concessions, and the long-overdue “similar business” test for carry-forward of corporate losses.

All this has been accompanied by endless ongoing tinkering with superannuation (including the introduction of a transfer balance cap), CGT rules (with changes to the main residence exemption and modified treatment for ‘angel’ investors), small business concessions, corporate and individual tax rates, imputation rules and various other aspects of the already complicated tax system in Australia.

The stream of significant court and tribunal decisions also continues apace, with a regular flow of key decisions that impact on the interpretation and operation of the tax laws. In 2019 these included, for example, the High Court decision in *Glencore* confirming that legal professional privilege is a shield but not a sword, and the landmark decision in *Moreton Resources Ltd v Innovation and Science Australia*, clarifying the meaning of “core R & D activities”.

In addition, the ATO continues to produce a steady stream of rulings, determinations, advices, taxpayer alerts, decision impact statements and other materials, including Law Companion Guidelines and Practical Compliance Guidelines.

Australian Taxation Law aims to provide guidance in clear and simple language through this morass of complex and ever-changing law. To make it easier to understand the application of the law to practical situations, we have made extensive use of flow charts and practical examples.

While the book covers State land tax, payroll tax and stamp duties, its primary focus remains the federal taxation system, with particular emphasis on income tax, capital gains tax, corporate tax, fringe benefits tax, goods and services tax, and the operation of the tax administration system that drives the whole process.

This 30th edition of *Australian Taxation Law* incorporates the major legislative, case law and administrative reforms up to 1 September 2019, as well as various key developments since that date, ensuring that it remains the most relevant and up-to-date tax text available.

The authors would like to thank all those who have provided insightful feedback, comments and assistance in updating chapters for this new edition. In particular, Robin again thanks Prof Steve Graw for his assistance with an aspect of Chapter 17, and Chris would like to thank Sally-Ann Joseph and Tim Russell, who provided invaluable assistance in updating various chapters.

Most importantly, we particularly wish to thank our families, whose ongoing support, encouragement and sacrifices make completion of each edition possible.

September 2019

Robin Woellner, Stephen Barkoczy, Shirley Murphy, Chris Evans and Dale Pinto

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LIST OF ABBREVIATIONS

The following abbreviations are used in *Australian Taxation Law*.

AAT	Administrative Appeals Tribunal
AAT Act	*Administrative Appeals Tribunal Act 1975*
ABN	Australian Business Number
ABN Act	*A New Tax System (Australian Business Number) Act 1999*
ABR	Australian Business Register
ADF	Approved deposit fund
ADI	Authorised deposit-taking institution
ADJRA	*Administrative Decisions (Judicial Review) Act 1977*
ADR	Alternative Dispute Resolution
AFOF	Australian venture capital fund of funds
AFTS Report	Australia's Future Tax System Report to the Treasurer (Final Report of the Henry Tax Review)
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
ATC	*Australian Tax Cases* (CCH)
ATO	Australian Taxation Office
ATR	*Australian Tax Review*
AUSTRAC	Australian Transaction Reports and Analysis Centre
AWOTE	Average weekly ordinary time earnings
BAS	Business Activity Statement
BELC	Broad-exemption listed country
CFC	Controlled foreign company

CGT	Capital gains tax
COT	Continuity of ownership test
CPI	Consumer price index
DAC	Departure authorization certificate
DFC of T	Deputy Federal Commissioner of Taxation
DPO	Departure prohibition order
DTA	Double taxation agreement
DVS	Direct value shift
EST	(Australian) Eastern Standard Time
ESVCLP	Early stage venture capital limited partnership
ETP	Employment termination payment
FBT	Fringe benefits tax
FBTAA	*Fringe Benefits Tax Assessment Act 1986*
FC of T	Federal Commissioner of Taxation
FIF	Foreign investment fund
FIFO	First in first out
FLA	*Family Law Act 1975*
FLIC	Film licensed investment company
FMD	Farm management deposit
FOIA	*Freedom of Information Act 1982*
FTC	Foreign tax credit
FTRA	*Financial Transaction Reports Act 1988*
GIC	General interest charge
GST	Goods and services tax
GSTA	*A New Tax System (Goods and Services Tax) Act 1999*
GVSR	General value shifting regime

HECS	Higher Education Contribution Scheme
HELP	Higher Education Loan Programme
IED	Income equalization deposit
IGT	Inspector-General of Taxation
IRDB	Industry Research and Development Board
ISC	Insurance and Superannuation Commissioner
ITAA36	*Income Tax Assessment Act 1936*
ITAA97	*Income Tax Assessment Act 1997*
ITAR	Income Tax Assessment Regulations 1997
ITR	Income Tax Regulations 1936
ITRA	*Income Tax Rates Act 1986*
ITTPA	*Income Tax (Transitional Provisions) Act 1997*
IVS	Indirect value shifting
JALTA	*Journal of the Australasian Law Teachers Association*
LILO	Last in last out
LPR	Legal personal representative
LTA	*Land Tax Act 1956*
LTMA	*Land Tax Management Act 1956*
MRRT	Minerals resource rent tax
OSSA	*Occupational Superannuation Standards Act 1987*
PAYE	Pay-as-you-earn
PAYG	Pay As You Go
PDF	Pooled development fund
PPLL	Paid parental leave levy
PPS	Prescribed payments system
PRRT	Petroleum resource rent tax

PRRT Act	*Petroleum Resource Rent Tax Act 1987*
PRRTAA87	*Petroleum Resource Rent Tax Assessment Act 1987*
PST	Pooled superannuation trust
R&D	Research and development
RBA	Running balance account
RBL	Reasonable benefit limit
RPS	Reportable payments system
RSA	Retirement savings account
RSAA	*Retirement Savings Accounts Act 1997*
RSAR	Retirement Savings Accounts Regulations 1997
SBT	Same business test
SCTACA	*Superannuation Contributions Tax (Assessment and Collection) Act 1997*
SCTIA	*Superannuation Contributions Tax Imposition Act 1997*
SGAA	*Superannuation Guarantee (Administration) Act 1992*
SGAR	*Superannuation Guarantee (Administration) Regulations 1993*
SGC	Superannuation guarantee charge
SGCA	*Superannuation Guarantee Charge Act 1992*
SISA	*Superannuation Industry (Supervision) Act 1993*
SISR	*Superannuation Industry (Supervision) Regulations 1994*
SME	Small or medium enterprise
SPOR	Shorter period of review (taxpayers)
SSAA	*Small Superannuation Accounts Act 1995*
STCT	Small Taxation Claims Tribunal
STS	Simplified Tax System
TAA	*Taxation Administration Act 1953*

TBRL	Temporary budget repair levy
TFN	Tax file number
TLIP	Tax Law Improvement Project
TPTACA	*Termination Payments Tax (Assessment and Collection) Act 1997*
UAP	Uniform administrative penalty
VCA	*Venture Capital Act 2002*
VCF	Venture capital franking
VCLP	Venture capital limited partnership
VCMP	Venture capital management partnership

KEY TAX WEBSITES

KEY TAX AND TAX REFORM SITES

Australia's Future Tax System (Henry Tax Review): www.taxreview.treasury.gov.au
Australian Taxation Office: www.ato.gov.au
Board of Taxation: www.taxboard.gov.au
Tax Practitioners Board: www.tpb.gov.au

FEDERAL GOVERNMENT

Australian Business Register: www.abr.business.gov.au
Australian Competition & Consumer Commission (ACCC): www.accc.gov.au
Australian Government Entry Point: www.australia.gov.au
Australian Prudential Regulation Authority (APRA): www.apra.gov.au
Australian Securities & Investment Commission (ASIC): www.asic.gov.au
Commonwealth Ombudsman: www.comb.gov.au
Department of Finance & Deregulation: www.finance.gov.au
Department of Treasury: www.treasury.gov.au
Inspector-General of Taxation: www.igt.gov.au
Parliament House: www.aph.gov.au
Single Business Service: www.business.gov.au
Tax Issues Entry System (Ties): www.ties.gov.au
Treasurer: www.treasurer.gov.au

STATE AND TERRITORY REVENUE OFFICES

Australian Capital Territory: www.revenue.act.gov.au
New South Wales: www.osr.nsw.gov.au
Northern Territory: www.nt.gov.au/ntt/revenue
Queensland: www.osr.qld.gov.au
South Australia: www.treasury.sa.gov.au
Tasmania: www.treasury.tas.gov.au

Victoria: www.sro.vic.gov.au
Western Australia: www.finance.wa.gov.au

COURTS

ACT Supreme Court: www.courts.act.gov.au/supreme
Administrative Appeals Tribunal: www.aat.gov.au
Family Court of Australia: www.familycourt.gov.au
Federal Court of Australia: www.fedcourt.gov.au
High Court of Australia: www.hcourt.gov.au
Supreme Court of NSW: www.lawlink.nsw.gov.au/sc
Supreme Court of Victoria: www.supremecourt.vic.gov.au
Supreme Court of Queensland: www.courts.qld.gov.au
Supreme Court of Tasmania: www.supremecourt.tas.gov.au
Supreme Court of Western Australia: www.supremecourt.wa.gov.au

OTHER USEFUL SITES FOR SOURCE MATERIALS

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Australian Tax Law Library: www.austlii.edu.au/au/special/tax
ComLaw (Commonwealth Law): www.comlaw.gov.au
Worldlii: www.worldlii.org

KEY TAX AND SUPERANNUATION ASSOCIATIONS/ORGANISATIONS

Association of Superannuation Funds of Australia (ASFA): www.superannuation.asn.au
Self-Managed Super Fund Professionals' Association of Australia (SPAA): www.spaa.asn.au
Taxation Institute of Australia: www.taxinstitute.com.au

ACCOUNTING ASSOCIATIONS/ORGANISATIONS

Association of Taxation & Management Accountants: www.atma.com.au
CPA Australia: www.cpaaustralia.com.au
Institute of Chartered Accountants in Australia:

www.charteredaccountants.com.au
Institute of Public Accountants: www.publicaccountants.org.au
National Tax & Accountants Association: www.ntaa.com.au

INTERNATIONAL TAX AUTHORITIES

Canada (Canada Revenue Agency): www.cra-arc.gc.ca
China (State Administration of Taxation): www.chinatax.gov.cn
Hong Kong (Inland Revenue Department): www.ird.gov.hk
Malaysia (Inland Revenue Board of Malaysia): www.hasil.gov.my
New Zealand (Inland Revenue): www.ird.govt.nz
Singapore (Inland Revenue Authority of Singapore): www.iras.gov.sg
United Kingdom (HM Revenue & Customs): www.hmrc.gov.uk
United States of America (Internal Revenue Service): www.irs.gov
United States of America (US Department of the Treasury): www.treasury.gov

Chapter 1

Introduction To Income Tax Law

[¶1-000] Overview

Before proceeding to a technical analysis of taxation law in later chapters, it is useful to provide a broader context and perspective on income and other taxes. This overview involves a brief analysis of the history of taxation and its socio-economic and political role and implications, and the present structure of taxation in Australia.

It is all too easy to lose sight of these wider aspects, and to focus exclusively on the increasingly intricate technical principles and practices of taxation law. However, taxation is a social process and, without some understanding of how and why taxation develops and changes, it is difficult to understand the present system or the dynamics which precipitate change, or to develop a feeling for likely future changes and directions.

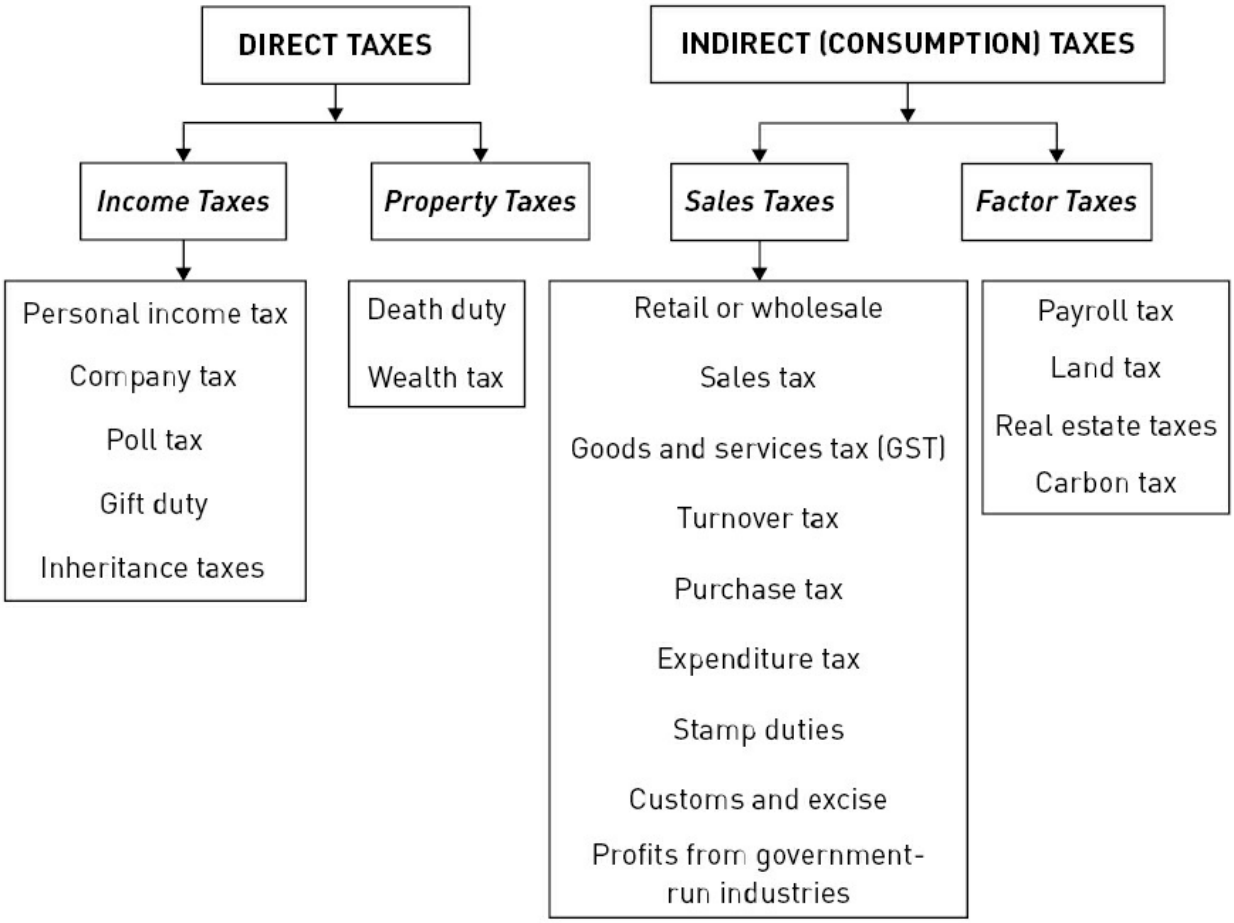
What is a tax?

There are technical definitions of a 'tax' for constitutional law and other purposes, which are discussed at ¶1-550. However, at a general level, the *Concise Oxford Dictionary* defines a 'tax' as a 'compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions etc', while the OECD defines a tax as 'a compulsory, unrequited transfer … to the general government sector'.[1]

Allan prefers the wider view of tax as 'any leakage from the circular flow of income into the public sector, excepting loan transactions and direct payments for publicly produced goods and services up to the cost of producing these goods and services'.[2] This view would regard profits made by nationalised postal services as taxes levied on postage; and would also cover 'taxes in kind', such as the loss or 'cost' to the owner of property compulsorily acquired by a government at less than free market prices. On this view, pensions and subsidies would also be seen as (negative) taxes.

There is a wide range of possible taxes—one possible categorisation of common taxes is set out in Figure 1.1.[3]

Figure 1.1 Common taxes


DIRECT TAXES
INDIRECT (CONSUMPTION) TAXES
Income Taxes
Property Taxes
Sales Taxes
Factor Taxes
Personal income tax
Company tax
Poll tax
Gift duty
Inheritance taxes
Death duty
Wealth tax
Retail or wholesale
Sales tax
Goods and services tax (GST)
Turnover tax
Purchase tax
Expenditure tax
Stamp duties
Customs and excise
Profits from government-run industries
Payroll tax
Land tax
Real estate taxes
Carbon tax

Historical Background: General (¶1-020 – ¶1-045)

[¶1-020] Introduction

It has long been recognised that a democratic government needs to raise revenue in order to govern effectively, and that one of the most effective means of raising this revenue is by the imposition and collection of taxes.[4] Indeed, as Mills observes:

> It is one of the empirical certainties of history that no structural society has ever arisen without taxation. [The] power of taxation is one which is particularly liable to abuse … but without that power no Government … is possible. 'The power to tax is the one great power upon which the whole national fabric is based. … It is not only the power to destroy, but the power to keep alive.'[5]

It is not surprising, therefore, that attitudes to taxation vary radically. At one extreme, Justice Oliver Wendell Holmes (Jr) observed in *Compania de Tobacos v Collector* that 'taxes are what we pay for civilized society'.[6] This view was echoed more recently by the Hon Bill Shorten, who commented in 2011:

> With taxes you buy civilisation … Taxes fund the provision of goods and services that the private sector cannot or will not provide, but are of crucial importance to the way we live … [and also] provide us with resources to pay for vital community services such as roads, hospitals and medical care, schools, colleges and universities, defence of the nation, courts, police, museums, libraries, sporting facilities, [and] parks.[7]

Not all commentators have been so positive. A more cynical view is that the 'art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing',[8] and it has also been said that 'there is one difference between a tax collector and a taxidermist—the taxidermist leaves the hide'.[9]

Whatever view one takes, an understanding of the history and dynamics of taxation is important—the lessons of the past can be instructive for modern proposals and reforms, and many of the older taxes have their modern equivalents. The politicians and citizens of different countries and times have shared many of the visions and problems which modern taxation systems still face—questions of tax equity, simplicity, incidence and efficiency have been perennial difficulties, as have the existence and implications of tax avoidance and evasion (see ¶1-045 for a definition of these terms).

The main focus of this book is on income tax, and the following segment accordingly deals mainly with the development and introduction of the Australian income tax. The goods and services tax (GST) which changed the face of taxation in Australia is dealt with in Chapter 27; state taxes are dealt with in Chapter 28; and CGT and FBT are dealt with in Chapters 7–8 and 26 respectively.

[¶1-030] Early developments

Taxation has been part of organised society for much of recorded history.[10] In early times, the emphasis was on indirect taxes. In ancient Persia, for example, taxes included tributes paid as a proportion of produce and by the provision of personal service, as well as dues paid at ferries and market places.

Customs duties (*portoria*) were levied by Roman kings up to the 7th century BC, reintroduced together with a broad-based excise tax by the Emperor Augustus in the Roman Empire,[11] and brought by the Romans to Britain upon its conquest. Other Roman taxes included consumption taxes and, under Julius Caesar, a 1% general sales tax, as well as a 'head' tax (later extended to land holdings) and temporary property taxes levied in times of war to support the state's military needs.

Other taxes followed: in England a 'subsidy' on goods and land was levied in the early Middle Ages, while the 'Danegeld' (a form of land tax based on the amount of land held) was originally levied in times of emergency as a direct tax on landowners,[12] but became a regular tax under the Norman kings until it was abolished in the 12th century.[13]

Other taxes levied in medieval England included 'scutage' ('shield money': 1159–1332), which was payable by a feudal landowner in lieu of military service in the King's army. There were also taxes on movable goods, beginning with the 'Saladin tithe', which was levied in 1188 to fund the Crusade against the Saracens, and was the forerunner of modern property taxes.

In the early 17th century, 'ship money' was levied by the Stuart kings for the defence of the realm, and poll taxes were also levied from time to time as required.[14]

[¶1-040] Beginnings of the modern taxation system

In 1715, customs and excise duties produced some 73% of total English tax revenue, and this proportion grew to 82% by 1755. The heavy reliance in England on indirect taxation of goods continued up to the end of the 18th century. During this period, English taxes were levied mainly on the external indicia of wealth; for example, the 'window tax' of 1696 levied a progressive tax based on the number of windows in a house, while the 'assessed taxes' were levied on carriages, female servants, racehorses, hair powder, clocks, watches and the like.

Direct taxation and income tax did not become a regular feature in England until the 19th century, and even then direct taxation was usually imposed only when additional revenue was needed for extraordinary purposes; for example, during times of war or other social upheaval.

One reason for the ad hoc nature of taxes up to the 19th century may have been a lack of the administrative infrastructure and expertise necessary for the efficient control of an ongoing broad-based system of taxation. Indeed, until the 17th century, it was not uncommon for the Crown to sell the right to collect taxes to private individuals ('farming the revenue'), as had been the case in ancient Rome. It was not until the latter half of the 17th century that the practice ceased, and government officials ('inspectors') were appointed to administer and collect taxes.

Gradually, an efficient staff and system of taxation administration began to develop in England, and by the end of the 18th century the administrative machinery for regular taxation was in place. However, as so often happens in the history of taxation, the final impetus came from a national emergency.

Introduction of income tax

By 1798, the armies of Emperor Napoleon Bonaparte controlled continental Europe. England and its allies were hard-pressed to resist the French advance, and widespread evasion by taxpayers meant that the 1797 'triple assessment' on 'taxable establishments' had failed to produce adequate revenue to support the War.

William Pitt, who was Prime Minister of England at the time, viewed a tax on incomes as 'repugnant to the customs and manners of the nation'.

Nevertheless, the desperate military situation forced Pitt to impose a general tax ‘on all the leading branches of income’.

Ironically, in light of subsequent developments, Pitt justified the move to an income tax on the basis of the need ‘to prevent all evasion and fraud’ which had plagued the triple assessment.

The first *Income Tax Act* (in 1799) was only moderately successful in its revenue-raising aims, yielding some 50% of targeted revenue. With the temporary peace following the Treaty of Amiens in 1802, the tax was abolished, but renewed hostilities with the French shortly afterwards saw the reintroduction of income tax under the pseudonym of ‘duties on land and property’. The *Income Tax Act 1803* introduced the concept of the five schedules or categories of taxable property (which still characterises the English taxation system), as well as the concept of deduction of tax at source for certain classes of income.[15]

The 1803 income tax was repealed in 1816, apparently because it was feared that the tax might become a permanent feature, and a ‘potential instrument of tyranny’.

England remained free of income tax until the next social crisis, in 1842. Then, at a time of great commercial depression and social unrest, Sir Robert Peel reluctantly felt compelled to impose a tax on incomes at a maximum rate of some 3%. The tax was intended to be an experiment for three years only, but the ‘experiment’ has survived (with various modifications) to the present day—a story by no means unusual in the taxation context.

[¶1-045] Tax resistance through the ages

From the earliest biblical times, taxes and tax collectors have been unpopular, and historical commentaries suggest that some people have always tried to evade or avoid the payment of taxes.

Not surprisingly, therefore, taxes and taxation systems have regularly been the cause of heated (and sometimes violent) controversy. The Boston Tea Party, with its slogan of 'no taxation without representation', is perhaps the best-known 'revolt' against perceived tax injustices. However, the Stuart 'ship money' taxes were a factor contributing to the outbreak of the English Civil Wars in the 1640s; and the 20th-century poll tax introduced by the British Thatcher Government was widely seen as a factor in that government's fall.

While many tax protests are symbolic, this is not always the case: during the 1381 'Peasants' Revolt' in England, a group of citizens aggrieved at a poll tax and oppressive collection methods cut off the Chief Justice's head and paraded it round Bury St Edmunds on a pike; frustrated taxation reform was a factor in the onset of the French Revolution; and the imposition of miners' licence fees was a factor in the bloodshed of the Eureka Stockade rebellion on the Ballarat goldfields in 1854.

A more subtle but equally significant revolt against taxation is through *tax avoidance* (the creation by legitimate means of a situation in which a taxpayer is liable to pay less or no tax) or *tax evasion* (the intentional non-declaration of income or over-claiming of expenditure or other benefits).

In a sense, tax avoidance/evasion 'is the Siamese twin of the charge to tax in any system based upon certain statutory enactment. No other area of the law touches human activity at so many points, so that it is scarcely surprising that tax avoidance should be so widespread and ingrained in our consciousness'.[16]

Indeed, tax avoidance and evasion are not new. The actions of 17th-century English taxpayers who sought to avoid the window tax by blocking up windows until the tax collector had gone and then reopening them were merely somewhat less subtle predecessors of the tax avoidance schemes of modern times.

Yet however understandable tax avoidance and evasion may seem from some perspectives,[17] they can have serious consequences for the equity of a taxation system.[18] For example, the economic impact of the underground or untaxed 'black' economy in Australia was estimated in 2018 as perhaps as large as 3% of GDP, or around $50 billion pa.[19] This means that billions of dollars in tax revenue are lost each year through evasion, and this lost revenue must then be made up by other means; for example, by imposing higher rates on those who do pay tax.

In response, a number of national governments have in recent years taken strong steps to block egregious tax avoidance and evasion[20]—see, for example, ¶33-221—while, ironically, at times themselves using the lure of tax benefits to attract taxpayers to their jurisdictions.

Chapter 25 considers tax evasion and avoidance in more detail.

Historical Background: Australia (¶1-050 – ¶1-070)

[¶1-050] History of income tax in Australia

Early taxes

Although the different Australian states had levied taxes of various types from the time of their establishment, the first income tax in Australia (on land and incomes) was introduced by the *South Australian* Government in 1884. The history of income tax in Australia began with commendable moderation, with the South Australian tax imposing a flat rate of 1.25% on income from personal exertion, 2.5% on income from property, and 0.2% on landholdings.

Victoria imposed an income tax in 1895 through the *Land and Income Tax Assessment Act 1895*, which was motivated by economic necessity—Victoria had a huge deficit of more than £650,000, almost 10% of total revenue.

New South Wales had attempted to introduce an income tax in 1886, but opposition was so vehement that the proposal was dropped. Indeed, one member of parliament is quoted as saying that: 'If the Devil had sent a representative here to institute a means of destroying the morality of the people, he could have found no better instrument than an income tax.'[21]

However, an income and land tax was successfully introduced into New South Wales in 1895, again following heated debate and driven by economic necessity: the New South Wales Government faced a large revenue deficit. The New South Wales income tax was levied at a flat rate of 2.5%, with a number of exemptions. The land tax was levied at a flat rate of 0.42%, with a threshold of £240.

In 1899, *Western Australia* introduced a tax on company dividends and profits at a rate of 5%, and ultimately introduced a general income and land tax in 1907, with a flat rate of tax on incomes at 1.66% for residents (2.49% for non-residents).

Tasmania had introduced a tax on dividends as early as 1880, but did not introduce a general income tax until 1902, when income tax was levied at progressive rates on property income between £100 and £400, and above that amount at a flat rate of 5%.

Queensland followed in 1902 with an income tax at progressive rates up to a maximum of 5% on personal exertion income and a flat rate of 3.75% on

property income.

[¶1-060] The federal government and income tax

Until 1915, the revenues derived from customs and excise duties had sufficed to meet the fledgling Australian Government's revenue needs. Moreover, many of the early federal cabinet ministers were former state premiers, and were not initially sympathetic to the idea of a centralised federal income tax.[22]

Once again, however, the pressures of war led to a fundamental change. In 1915 the Commonwealth was forced to impose an income tax in order to raise the additional revenue needed to successfully maintain Australia's efforts in the First World War. Accordingly, the federal government introduced an Act which imposed tax at differing rates on income from personal exertion, income from property, and income of companies.[23]

In introducing the Act, the Commonwealth Attorney-General observed that:

> This Bill, of course, is frankly a War measure designed to meet the present circumstances … No doubt this Bill reaches the high-water mark of income taxation, but it does not do so without ample warrant[24]

However, the lesson of history is that income taxes tend to take root once in place, and the rates imposed rarely fall in real terms. The 1915 Act was no exception: despite the circumstances of its birth, the tax survived the ending of the War, and the 'high-water mark' of the 1915 tax rates was soon eclipsed.

[¶1-070] Between World Wars

Following the end of the First World War in 1918, the Commonwealth continued to levy its own income tax. The various states also continued to impose their own income taxes, though there was little uniformity in the states' legislation, and the differing bases and rates used by the various governments created difficulties.

It gradually became clear that an optimal system could only be achieved if there was greater uniformity or integration between the state and federal government income taxes. Accordingly, a series of conferences was held for federal and state ministers from 1916 to 1921, aimed at increasing uniformity in the revenue laws. Little was accomplished—draft uniform income tax legislation was put forward in 1917, but was not adopted by any of the states, and only partially by the Commonwealth.

Little more was done to encourage uniformity until another major social crisis intervened. This time the catalyst was not war, but the coming of the Great Depression of 1930, which exacerbated the problems created by having both state and Commonwealth income taxes.

Driven by economic pressures, the Commonwealth government appointed a Royal Commission on Taxation (1932–33) to investigate Australian taxation. The Commission ultimately developed a draft Uniform Tax Bill, which was adopted in substance by the Commonwealth and the states in 1936.

However, differences gradually developed again between the Acts of the various states and the Commonwealth, though it was not until 1942 and the pressures generated by the Second World War that the Commonwealth government seized sole control of income tax, ousted the states from the income tax field and introduced the Uniform Tax Scheme which still operates today. The political mechanism by which the Commonwealth government achieved this result is discussed at ¶1-600.

Background Issues (¶1-100 – ¶1-115)

[¶1-100] Taxation and the social process

The revenue system is an intrinsic part of, and affected by, the broader social process. For example, the taxation system is inevitably affected by:

- political changes (such as the election of a new government with a different ideology)
- economic developments (such as the onset of a recession or 'boom'), and
- social factors (such as an ageing population).

Modern governments recognise the impact that taxation can have upon social behaviour patterns, and from time to time intentionally use the taxation system not only for direct financial purposes such as the generation of revenue, but also indirectly to try to influence or modify aspects of society or societal behaviour to achieve 'social engineering' objectives.

Thus, a government may seek to discourage certain activities it deems undesirable by imposing a high tax on those activities for (ostensibly at least) socially beneficial purposes. For example, it may impose a high tax on petrol to reduce consumption and thus conserve a scarce social resource; or increase tax on lump sum retirement benefits to encourage retirees to take out annuities rather than relying on the government age pension; or impose a carbon tax on heavy polluters, to reduce damage to the environment.

Alternatively, a government may seek to encourage activities which it sees as desirable by offering tax incentives or benefits; for example, to assist those engaging in petroleum exploration, primary production and the like; or to people prepared to live in remote areas; or by providing tax breaks for buildings that utilise 'green' (environmentally friendly) technology such as solar heating.[25]

The use of the taxation system for social engineering is complicated by the possibility that taxation may also have unintended and sometimes undesirable results. These issues are discussed more fully below (at ¶1-130 to ¶1-170).

[¶1-110] ‘Incidence’ of taxation

In analysing the impact of taxation, it is important to identify the real ‘incidence’ of taxation (loosely, the ‘burden’ of taxation).

A tax is ‘*regressive*’ if it takes a *decreasing* proportion of income as income rises, so that its impact is proportionally greatest on lower income earners. Many consumption taxes (including the GST) are regressive. For example, if the tax component of the price of a loaf of bread is $1, this will represent tax at 10% to a taxpayer on an income of $10, but only 1% to a taxpayer on an income of $100.

A tax is ‘*proportional* ’ if it takes the *same* proportion of income at all levels, so that all persons pay the same ‘flat rate’ of tax; for example, a tax at a flat rate of 20% on all income.

A tax is ‘*progressive*’ if it takes an *increasing* proportion of income as income rises, so that the tax impacts proportionally more heavily on higher income earners. For example, income tax in Australia is currently levied at progressive rates for resident individuals, varying from 0% on the first $18,200 of taxable income to 45% on taxable income over $180,000. Australian personal income tax is therefore highly progressive in theory.[26]

A distinction must also be drawn in the income tax context between marginal rates and average rates of tax. The *marginal tax rate* is the rate of tax payable on certain ranges or ‘brackets’ of income. For example, tax on the income in the ‘bracket’ between the tax-free threshold of $18,200 and $37,000 might be set by the Act at a prescribed statutory rate of 19%, while the ‘bracket’ between $37,001 and $80,000 might be taxed at 32.5%. The *average* or *effective* rate of tax, by contrast, is the rate actually paid overall on total income and, because of tax-free thresholds and the like, the actual tax imposed on a taxable income of, say, $80,000 might be only around $17,547 or 21.9%.[27]

The other aspect of incidence is the *financial impact* of a tax; that is, who actually bears the burden of paying the tax. In this context, it is important to distinguish between *formal* (or nominal) incidence and *effective* (economic or actual) incidence. As the Henry Tax Review observed, ‘[a]ll taxes ultimately bear on people, not businesses or other entities. It is the economic burden of taxes that is important for equity, not who remits the tax’.[28]

Thus, although X may be nominated by the legislation as the taxpayer (formal incidence), if X can shift the impact of the tax forwards or backwards to Y, the effective (or actual) incidence of the tax will fall on Y. For example, a manufacturer may be the nominal taxpayer, but may be able to shift the effective incidence of the tax *forward* onto consumers (by increasing the price of the goods sold). Employees may be able to shift the impact of an income tax *backward* onto employers by demanding higher wages.

However, the issues are complex, and it is sometimes hard to determine the actual incidence of a tax; for example, because the ability to shift incidence may depend on how easily other items can be substituted for the taxed item.

The issue is further complicated by the need to take account of the effect of 'tax transfers'—that is, cash payments by governments to individuals and families through pensions (eg the age pension), allowances (eg the carer allowance or Austudy), supplementary payments (eg rent assistance) and family payments (eg the child care benefit). Where a cash payment is made to one group (rather than another), this effectively redistributes income within society and reduces the net effect of taxation on the group receiving the payment.[29]

[¶1-115] Tax expenditures

A ‘tax expenditure’ is a provision in a tax law that gives a benefit to a specified activity or class of taxpayer that is different to the tax treatment that would normally apply.[30]

Most tax expenditures are positive; that is, they usually confer a benefit, such as the exemption of most food from GST, or lower taxation of funded superannuation payments. However, on occasions, a tax expenditure may be negative—where the arrangements impose a higher cost rather than a benefit (such as the higher excise duties on certain cigarettes).

Tax expenditures can be provided in many forms—through a tax exemption, tax deduction, tax rebate or offset, concessional tax rates, or by deferring a tax liability.

Thus, for example, a government could either seek to encourage primary production by paying direct monetary subsidies to farmers, or, alternatively, could use tax expenditures to achieve the same broad aim by providing farmers with tax (expenditure) concessions such as lower tax rates (eg via ‘averaging’ of income) and special tax rebates or deductions (eg for farm fences and equipment). Sometimes direct subsidies and tax expenditures may be used at the same time.

A tax expenditure inevitably changes the distribution of tax between taxpayers, because those benefiting from a positive tax expenditure pay less tax, while those excluded from the benefit will generally need to pay more tax in order to enable the government to raise the same total revenue.

There are important differences between direct payments and tax expenditures, including:

- tax expenditures generally involve forgoing revenue which is never received, rather than the expenditure of an amount which is received and then publicly spent, and
- direct payments must generally be approved again in each government budget, whereas a tax expenditure ‘once legislated becomes part of the tax law with a recurring fiscal impact and does not receive regular scrutiny through the budget process’.[31]

While tax expenditures provide various benefits,[32] a cynic might argue that using a tax expenditure rather than a direct payment may be an attractive option where a government wishes to provide benefits to a particular group of taxpayers, or implement government policies, without drawing attention to what it is doing.

Indeed, critics point to a number of issues with tax expenditures. For example:

> because … tax expenditures do not require annual appropriation bills … [they] are less transparent and accountable than program measures, they are not subject to routine evaluation and usually there is no 'sunset' provision
>
> … Because Australia has a progressive tax system … most tax expenditures deliver a higher rate of subsidy to the more affluent … [and] … are often granted as a result of lobbying, and due to their lack of transparency, are often seen as unfair … more often than not, [they] make the taxation system more complicated.[33]

In its *Tax Expenditures Statement 2017*, the Commonwealth Treasury estimated the largest *positive* tax expenditures in 2017/18 (calculated on a 'revenue forgone' approach)[34] as being:[35]

- CGT main residence exemptions ($74,000 million)
- superannuation ($36,150 million)
- GST exemption on food ($7,100 million)
- GST exemption on education ($4,550 million)
- GST exemption on health ($4,100 million), and
- GST exemption on financial supplies ($3,400 million).

The largest *negative* tax expenditures were customs duty (–$1,260 million), and the higher rate of excise levied on cigarettes not exceeding 0.8 grams of tobacco per stick (–$2,360 million).

[¶1-130] Conventional view of the taxation system

In seeking to explain the current role of the taxation system, theorists traditionally begin from the proposition that in a perfectly competitive economy, the problems of production, distribution and exchange would be solved by the competitive process itself—'the free actions of men pursuing their personal desires in free markets'.[36]

According to this theory, entrepreneurs in a free market would attempt to maximise profits, but would be restrained by market forces from improperly exploiting their position. Similarly, workers would attempt to maximise pay and conditions, but again market forces would prevent them from obtaining more than the value of their labour and its products. Thus the self-regulating market would find its own balance, and, by definition, the exchanges between persons in such a market would be 'fair', because unless both parties to a transaction received an acceptable benefit they would refuse to exchange money for goods (or vice versa).

If this is so, why then do governments impose taxes? The conventional answer is that the market is *not* in fact in a state of perfect competition, and there are three main factors which create a need for taxation:

(1) the need for governments to provide social and merit goods (see ¶1-140)
(2) the need for governments to support those for whom a free market would not otherwise provide (see ¶1-150), and
(3) the intentional use of taxation to correct other free market imperfections (see ¶1-160).

[¶1-140] Provision of social and merit goods

Allan[37] argues that the free market operates upon two key principles:

(1) *exclusion*: meaning that those who do not pay the market price for goods are excluded from the consumption of those goods, and
(2) *revealed preference*: meaning that the market operates upon information revealed by consumers about their consumption preferences. Consumers reveal their preferences for particular goods through their consumption patterns; for example, if people want to eat a roasted chicken, they must buy one, thus 'revealing' their preference for chicken rather than other food, such as hamburgers. The market then organises itself to supply those revealed preferences.

The principles of exclusion and revealed preference tend to be effective in organising the production, distribution and exchange of 'private consumption goods'; that is, those goods where supply is limited and consumption by one person excludes others from consumption of the same goods (eg eating a chicken). Market forces are able to cater for the supply of such goods because the principles of exclusion and revealed preference provide the market with the necessary information about consumer demand.

However, market forces will be less able to provide efficiently for goods which do not trigger the exclusion and revealed preference principles, and thus do not provide the necessary market information. Two such categories are *social* and *merit* goods.

Social goods

Social goods are characterised by 'joint' (or 'non-rival') consumption and 'non-excludability'. An example is street lighting, because the more street lighting that one person receives, the more benefit *everyone* in that area receives—and it is in practice impossible to exclude anyone from enjoying the benefits of the lighting. Hence individuals do not have the same incentive to pay for street lighting. As a result, the private market may not obtain accurate information on the extent to which potential consumers want, need or value street lighting, and therefore may tend not to supply appropriate amounts of it.

On this view, social goods therefore need to be provided by the state rather than by the private sector.

Merit goods

In the case of merit goods (meaning, simplistically, goods which are deemed to be ‘beneficial’ to their user, such as education, health foods and exercise), the problems in ensuring adequate supply through free market forces arise mainly because of the factors of ignorance and externalities.

Ignorance

People may be expected to make rational consumption choices in relation to goods which generate easily understood benefits and costs. It is comparatively easy, for example, for people to understand that clothing or housing provides warmth and protection, and thus to calculate the extent of their needs for such products.

However, other goods may have costs and benefits which are less easily perceived or evaluated. There may be difficulties because, for example, the nature of the costs and benefits of a particular product may not easily be understood by consumers (eg a carbon/pollution tax), or else because there might be a significant time gap before the consumer can evaluate the cost/benefit of the product (eg the benefits of education or the dangers of smoking may not become apparent to the consumer until many years after the opportunity for consumption arises).

Externalities

The free market's effectiveness in supplying merit goods is also reduced by difficulties in perceiving and evaluating externalities (the effect of one person's actions upon others)—such as the costs to family and society when a smoker develops lung cancer and requires expensive treatment or hospitalisation.[38]

To correct for consumers' perceived inadequate analyses of the effects of their behaviour, a government might attempt to discourage consumption of certain ('demerit') goods; for example, by imposing heavy discriminatory taxes upon those goods or their component materials (eg on cigarettes or tobacco).[39] On the other hand, it might attempt to encourage consumption of other ('merit') goods by providing subsidies or tax benefits (eg tax rebates on health foods).

Thus taxation may be used either *directly* (to fund the supply of goods) or *indirectly* (through onerous taxation on the one hand, or benefits or subsidies on the other) to attempt to modify patterns of supply and consumption of goods and intangible items.

[¶1-150] Support for those not provided for by the free market

Taxation is also required to enable governments to support those persons whom a free market might otherwise ignore (eg the poor). That is, even where free market forces *do* make available necessary goods (such as food, clothing, housing and education), there may be persons who cannot pay the market price for these goods (whether in terms of money, skills, or other means of payment).

If society deems it desirable that all citizens have food, clothing and education, the taxation system can be used to help achieve this aim; for example, by using tax revenue to fund low-cost housing or by making cash grants to those in need.

[¶1-160] Correcting other free market imperfections

Free market forces may also create what a political or wider social perspective regards as other market imperfections requiring correction. Examples might include at one extreme *monopolies*, which may cause prices to be set arbitrarily at excessive levels or, at the other extreme, *wasteful competition*, such as where competing airlines use the same routes at the same time, with each company operating at less than optimal capacity.

A government may use taxation to remedy these and other imperfections; forexample, to:

- *accelerate the rate of economic growth*—by using taxation subsidies to counteract investors' ignorance of long-term external benefits of investment, or
- *maximise economic stability*—by using increases or decreases in tax levels to smooth out trade cycles, or to reduce inflation or unemployment (eg increasing taxes or lowering subsidies when excess private expenditure threatens to cause inflation).

Of course, taxation is not the only method of correcting free market imperfections, nor is it necessarily always the best method. More direct methods might include:

- correcting consumer ignorance through advertising and labelling laws (as with notices and graphic pictures warning of the damage caused by tobacco products)
- controlling demerit goods through production quotas, or restrictions in relation to food and other health law
- controlling the location of dangerous industries in cities through zoning laws
- controlling or prohibiting monopolies, price fixing and other 'undesirable' market dealings through competition or consumer protection legislation, or
- using the criminal law as a control mechanism or deterrent.

[¶1-170] Problems in using taxation for social engineering

Taxation is a powerful and intrusive tool, which can sometimes be effective in modifying private behaviour to more closely reflect a government's policy objectives (at least where there is some elasticity of demand).[40] However, the use of taxation in this way has a number of limitations, including the following.

(1) Taxation is a *blunt instrument*—taxation rules are usually framed in general terms and apply to broad groups or classes of persons (such as spouses, primary producers, employees and the like), who are generally all treated in the same way.

The taxation system is not inherently well suited to dealing differently with unique individuals within a single category (eg individual 'employees'), although granting broad discretions to the Commissioner may enable solutions to be tailored to individuals in some cases.

(2) Taxation is an *indirect instrument*—it is sometimes difficult to predict how effective a tax will be in achieving its stated aims.

(3) Taxation may create *unintended or undesirable side effects*. For example, it has been argued that a high level of income tax lowers the incentive to work and save because the bulk of additional earnings are lost in taxation.[41] It has even been suggested that tax changes may impact on birth rates.[42]

Such issues are rarely straightforward. For example, the relationship between progressivity and incentive is complex. Some studies suggest that people *think* tax is a disincentive *for others*, but not necessarily for themselves, and for persons with fixed levels of post-tax outgoings, progressivity may actually result in *increased* work effort in order to maintain the net income needed to cover their fixed expenses.[43]

Criteria For Evaluating A Taxation System (¶1-180 – ¶1-232)

[¶1-180] General outline

It is probably true to say, as Alexander Pope sagely observed, that: 'Whoever hopes a faultless [tax] to see, hopes what ne'er was, or is, or e'er shall be'.[44]

Somewhat facetiously, Hugh Dalton suggested that the ideal taxation system is one under which 'the rich should pay more taxation than they think, while the poor should think that they pay more than they do. This double illusion … will keep the rich contented and the poor virtuous, and will tend to maximise work and saving by all'.[45]

However, assuming that a society has (or is considering creating) a particular taxation system, it is important to be able to evaluate the performance of that system. That is, how does one identify a 'good' taxation system?

Structuring a taxation system appropriately is important because, as Parsons observed, '[a] tax will not have respect, and will not deserve respect, unless it is coherent in principle and has a claim to fairness'.[46]

Accordingly, it is important to identify some guidelines or criteria which can be used to judge the performance of a taxation system, or to evaluate proposed reforms, so that a system can be re/structured appropriately.

A number of functional criteria have been suggested traditionally; for example, the Henry Tax Review applied design criteria of equity, efficiency, simplicity and sustainability.[47]

Several traditional criteria[48] are discussed in the following paragraphs (¶1-185 to ¶1-215). However, a problem in evaluating such criteria is that often there can be an inherent tension between the needs of individual taxpayers or groups, and the need to protect the revenue for the benefit of the community as a whole.[49]

[¶1-185] Fairness or equity

'Equity, or fairness, is a basic criterion for community acceptance of the tax system ...'.[50]

Indeed, fairness is a practical as well as moral necessity, because a system which is perceived by taxpayers generally as being basically unfair or discriminatory is unlikely to enjoy widespread support. Perpetuating an unfair system may eventually provoke an informal 'taxpayer revolt', in which significant numbers of taxpayers seek to avoid or evade their tax liabilities; or a more formal revolt, in which taxpayers seek to remove (perhaps forcibly) the tax or the government which imposed it (see ¶1-045).

General problems in measuring 'fairness'

As the Asprey Committee pointed out long ago, 'in tax matters [fairness] is an ideal exceedingly difficult to define and harder still to measure'.[51]

One problem is that there is a wide diversity of views on how to measure the 'fairness' of a particular taxation system, and views invariably also differ on whether a particular system is *sufficiently* fair. That is, even if agreement could be reached on a definition of 'social justice', there remains the question of *how much priority* social justice should be provided through taxation policy; for example, assuming the better-off should pay more tax, how much more should they pay? There is no definitive or objective answer to this question.

A divergence of views on the meaning of fairness is significant, because different perspectives may lead to support for markedly different types of taxation systems. For example, persons defining fairness in terms of merit and reward for effort may tend to favour a system with low marginal rates of income tax, and no capital gains, death or wealth taxes. By contrast, persons viewing fairness from a social equality or 'needs' perspective are likely to favour a system with high progressive personal income taxes, as well as capital gains, death and wealth taxes designed to redistribute wealth.

Particular difficulties with horizontal and vertical equity

Traditionally, two particular aspects of equity are identified: *horizontal equity* (people in similar positions should be treated similarly), and *vertical equity* (persons in different positions should be treated differently, with those who are better off bearing an appropriately heavier burden).

The problem with horizontal equity *in practice* is that, while persons with the same taxable income can be required to pay the same amount in income tax, this will only produce 'fairness' if taxable income is the appropriate measure of a taxpayer's economic well-being. However, two persons (X and Y) each earning $80,000 pa may not be in the same overall economic position; for example, because X has no dependants, whereas Y has a dependent spouse and three young children, or because Y has a chronic illness which costs $20,000 pa for treatment. In these circumstances, X arguably is in a stronger financial position, even though X is earning the same income as Y.

The Asprey Committee pointed out a number of other difficulties facing those attempting to improve horizontal equity:[52]

(1) It is difficult to determine the appropriate taxing unit—should economic well-being be measured by reference to individuals, or to the average or total income of all members of a family (or some other measure)?[53]

(2) While it is administratively convenient to calculate and levy taxes on an annual basis, this may not be equitable. For example, a progressive rate income tax, together with such things as zero tax thresholds, means that a person whose taxable income varies markedly from year to year (eg $50,000 in Year 1, $30,000 in Year 2 and $40,000 in Year 3) will usually pay more tax in total under a progressive taxation system over a given period of years than a person earning the same total income by way of equal annual sums over the same period (eg $40,000 each year).

    Thus, on the basis of published 2017/18 income tax rates (ignoring levies and other items), the 'irregular income' taxpayer would pay a total of around $14,586 in income tax for the three years, whereas the taxpayer earning $40,000 each year would pay only $13,641.

(3) The effects of inflation may also reduce the practical equity of a system which is conceptually fair.

Vertical equity is also intrinsically meritorious, but it too is often difficult to achieve in practice, for reasons analogous to those discussed above in relation to horizontal equity. Moreover, also as noted above, views may differ as to the appropriate degree of unequal treatment which the taxation system should prescribe (eg *how much more* income tax should be paid by a person deriving taxable income of $100,000 pa than by a person earning $60,000 pa?).

Overall, then, it may be said that while most persons would see equity or fairness as an essential attribute of a revenue system, it is often quite difficult to structure a taxation system in such a way as to ensure that both horizontal and vertical equity are simultaneously maximised.

[¶1-190] Simplicity

Governments often identify simplicity as a major aim of taxation reforms.[54]

A tax may be described as 'simple' if the cost of official administration and collection together with the 'compliance costs' (the costs in money, effort and stress involved in taxpayers meeting their obligations) are low. These costs will be minimised if both the assessor and the taxpayer can establish easily and with certainty the tax payable, and the system minimises the number of dealings that taxpayers must have with government departments or others in order to complete their taxation obligations.

Where a taxation system does not optimise simplicity, the costs of complexity include reduced transparency,[55] which makes it harder for people to understand their taxation rights and obligations without incurring additional expenses for professional advice. This impacts most heavily on those who are least able to deal with complexity and have least access to professional advice.

The Ralph Committee in its *Final Report* suggested that:

> Complexity is one consequence of continually building the business tax system upon a foundation deficient in policy design principle … [and is] reflected in unintended or inconsistent statutory interactions, as well as excessively specialised provisions which lack general application and adaptability. Such structural complexity fuels a dynamic process of exploitation and anti-avoidance response that generates escalating complexity …
>
> Complexities in the administrative arrangements add to business (and government) costs, and do little to promote voluntary compliance.[56]

Australian income tax law has certainly become much more complex and voluminous over time. The 1915 Act was only 22 pages in length, while the original 1936 Act was a mere 126 pages. By contrast, ITAA36 and ITAA97 now total some 5,700 pages. In *Denlay v FC of T*, Logan J lamented that at the time of introduction of the 1915 Act:

> we were able, even under the revenue demands of a world war, to encapsulate everything then considered necessary not only for the assessment of liability to income tax but also for its collection and recovery into a statute of no more than 25 pages of provisions readily comprehensible by a literate layman. A century later, neither of these features remains in our current income tax law.[57]

Indeed the High Court commented some time ago on the 'extraordinarily complex' CGT provisions before it, which 'must be obscure, if not

bewildering, both to the taxpayer who seeks to determine his or her liability by reference to them and to the lawyer called upon to interpret them'.[58]

Similarly, Hill J observed in *FC of T v Cooling*,[59] that the provision in question was 'drafted with such obscurity that even those used to interpreting the utterances of the Delphic oracle might falter in seeking to elicit a sensible meaning from its terms'.

Reducing complexity

The Ralph Committee observed that because of the inherent complexity in many business transactions, it is not possible to make all taxation legislation completely simple, and the objective of simplification therefore needs to be approached from two perspectives:

- The business tax system should be designed in as simple a manner as possible, recognising economic substance in preference to legal form.
- Where the tax treatment of particular transactions is likely to be complex, such additional complexity in the tax law should be justified by the improvement in the equity or economic growth that may be achieved.[60]

Various techniques have been utilised over time to help reduce complexity. For example, the Tax Law Improvement Project (TLIP) in 1993 was intended to simplify the wording and structure of taxation legislation significantly, and render it more user-friendly.[61] This was replaced in 1998 by the more general Tax Reform project,[62] and subsequently by 'coherent principles-based' drafting in 2005.[63]

The principles-based approach to policy development and its legislative expression and administration[64] aims to draft the law 'in a series of operative rules or statements of principle about what the law is intended to do—rather than details about the mechanism that gets it there'.[65] However, principles-based drafting requires 'legislation which is clearly thought through and clearly expressed'.[66] Unfortunately, this has not always been a strong feature of Australian taxation legislation.

More recent reforms designed to reduce complexity include: trebling the zero tax threshold to remove the need for many people to lodge tax returns; reducing the complexity of information required for 'ordinary' taxpayers (eg by allocating standard deductions to taxpayers in certain categories or

introducing simpler ‘short-form’ returns for taxpayers with simple affairs); and ‘pre-filling’ tax returns with information already held by the ATO.[67]

[¶1-193] Compliance costs

A taxpayer's compliance costs will include costs of record-keeping, completing tax returns and other documents, and calculating and paying their tax liability. These costs may be:

- *monetary* (eg fees for advice or assistance paid to professional advisers)
- *temporal* (eg the time needed to keep records or complete returns),[68] or
- *psychological* (eg anxiety caused by inability to understand complex laws).[69]

Such costs may be:

- 'regular' (ongoing)
- 'temporary' (as where an existing tax is changed)
- 'commencement' (once-only start-up costs), or
- mandatory/voluntary.

Research has identified several key characteristics of compliance costs.[70] They:

- tend to be more diffuse, less visible and more likely to be overlooked than administrative collection costs
- are often capricious in their incidence, regressive in their impact, and do not reduce over time, and
- tend to be resented more by the taxpaying population than administrative costs.

Compliance costs may be offset to some extent by benefits flowing from the compliance, in the form of:

- cash flow benefits (holding tax collections from, eg, GST or PAYG for a period of time before remitting them to the ATO)
- tax deductibility benefits (some tax compliance costs can be deducted for tax purposes), and
- managerial benefits (eg where information obtained during compliance procedures enables taxpayers to manage their business or personal affairs

more efficiently).[71]

The average gross annual tax compliance costs in 2012 for micro, small and medium enterprises in Australia was estimated to be A$3,392, $12,169 and $54,605 respectively, with an overall average of $11,004.[72]

The other side of taxpayers' compliance costs is the cost to government of collecting tax owing. The gross costs per $100 of tax collected by the ATO amounted to $0.67 in 2017/18.[73]

[¶1-195] Certainty

The Ralph Committee, in its final report, commented that because the collection of (business) tax relies largely on voluntary compliance by taxpayers:

> compliance should be fostered by making the business tax system as simple, inexpensive and certain in its application as possible.
>
> Tax laws should be designed from the perspective of those who must comply with and administer them … [They] should be as clear and concise, and provide as much certainty as possible. They should be framed in plain English and based upon a consistent set of stated design principles. Their structure should be able to accommodate continuing change.[74]

There are four aspects of tax 'certainty':[75]

(1) *certainty of incidence*: the degree of certainty with which taxing authorities can predict who will actually bear the burden of the tax (there can often be a significant difference between the intended and actual incidence of a tax—see ¶1-110)

(2) *certainty of liability:* the ease and accuracy with which liability to tax can be assessed. Retrospective legislation causes particular difficulties in relation to certainty of liability[76]

(3) *evasion ratio:* the extent of evasion and avoidance, and the extent to which the taxing authorities can overcome avoidance and evasion techniques, and collect the intended revenue, and

(4) *fiscal marksmanship:* the certainty with which taxing authorities are able to predict the revenue which will be collected in a particular year.

Each of these aspects of certainty can affect the extent to which taxation legislation achieves its policy and revenue aims.

[¶1-200] Efficiency/neutrality

One important aspect of efficiency is administrative efficiency, that is, minimisation of administrative and compliance costs (see ¶1-193).

Neutrality is another key aspect of efficiency; that is, the impact of tax should not *unintentionally* influence individual or business choices by artificially distorting or altering the costs (and therefore attractiveness) of alternative goods, different modes of investment or different activities. For example, taxation should not affect the choice of operating through a partnership versus a company, or buying orange juice versus soft drink, by making the taxed product more expensive.

Governments may nevertheless intentionally use taxation to interfere in free market dealings in order to encourage—or discourage—the output or consumption of particular goods or services (see ¶1-140, ¶1-170). However, the Asprey Committee suggested that such 'non-neutralities' should be introduced only 'in a deliberate and explicit way for proven, explicit and quantified purposes', after it had been shown that other approaches (such as tariffs, subsidies, monetary control, marketing organisations and the like) were likely to be less effective.[77]

[¶1-205] Flexibility

If the taxation system is to be effective in achieving non-fiscal objectives, then tax structure and rates need to be easily adjustable, and changes in a tax should have a speedy and decisive impact on revenue yields and taxpayers' behaviour.

Indirect taxes tend to be 'flexible', since changes in rates can be made readily and then have a relatively swift impact upon taxpayers' behaviour (eg an increase in tax on petrol will lead almost immediately to price increases at the petrol pump). On the other hand, death duties and CGT tend to have a delayed impact, since it may be many years before a liability for tax arises.

[¶1-210] Evidence

‘Evidence’ is the extent to which taxpayers ‘know about’ or are made aware of their tax liabilities.

An argument for high ‘evidence’ in relation to taxation is that citizens in a democratic society should have full information about the actual impact of various taxes, so that as voters they can decide upon the extent to which they wish to support or subsidise a government’s programs and objectives.

Income tax has high ‘evidence’—each PAYG taxpayer knows or can ascertain how much tax is taken from their earnings, because it is shown on pay slips and is reinforced in annual tax return calculations. In contrast, the GST has lower ‘evidence’ in Australia, because the tax payable tends to be ‘hidden’ in the total price of goods.

[¶1-215] Other criteria

In addition to the above criteria, a tax should:

- have ‘fiscal adequacy’, meaning that it should generate the requisite amount of revenue needed by the government
- have ‘political acceptability’; that is, the tax should not provoke political difficulties, either within Australia or with other tax jurisdictions, and
- be suitable for promoting and achieving the macro-level economic objectives that a government is seeking to achieve—including, for example, optimising economic stability and growth, redistributing income or wealth, raising employment levels or lowering inflation.

[¶1-230] Conflict and compromise between objectives

There is considerable potential for tension or conflict between the above 'ideal' criteria, and it is unlikely that anyone will ever create a taxation system which simultaneously maximises each of these elements.

In practice, there need not be any significant conflict between simplicity and neutrality: a broad-based tax at uniform rates on all consumption of goods and services would be both simple and neutral.

However, the potential conflict between simplicity and equity is often significant. Taxes which aim to maximise equity tend to be complex—the Australian CGT and GST being good examples. One reason is that many fine distinctions and exceptions/exclusions may be deemed necessary in order to achieve equity among selected taxpayers and groups (or provide political 'handouts' to select groups). Another reason may be that the need for greater equity requires more complex anti-avoidance legislation, and as detailed anti-avoidance provisions increase, the tax and the overall system become correspondingly more complex.

[¶1-232] Overview of the Commonwealth taxation system

The Commonwealth taxation system has changed dramatically over time, with the introduction of important new taxes (eg CGT, GST, FBT, dividend imputation and others), the removal of others (eg wholesale sales tax), and significant reductions in the statutory rates of tax (eg company and personal tax).[78]

Historical tax data

The following table sets out key Commonwealth revenue data for selected years over the period 1949/50 to 2017/18.

Year	Gross PAYE/ PAYG $m	Gross other individuals $m	Companies $m	Sales tax $m	Excise $m	GST $m	Customs duties $m
1949/50	392 (38.7%)		167 (16.5%)	85 (8.4%)	132 (13.0%)		155 (15.3%)
1954/55	720 (38.4%)		343 (18.3%)	201 (10.7%)	286 (15.3%)		202 (10.8%)
1959/60	884 (35.1%)		455 (18.3%)	328 (13.0%)	504 (20.0%)		168 (6.7%)
1964/65	1,569 (41.1%)		722 (18.9%)	363 (9.5%)	631 (16.5%)		268 (7.0%)
1969/70	2,855 (44.7%)		1,187 (18.6%)	569 (8.9%)	939 (14.7%)		414 (6.5%)
1974/75	7,966 (54.9%)		2,566 (17.7%)	1,105 (7.6%)	1,765 (12.2%)		770 (5.3%)
1989/90	50,027 (65.8%)		12,926 (17.0%)	10,132 (13.3%)			
1994/95	51,239 (58.0%)	9,481 (10.7%)	15,588 (17.7%)	11,624 (13.2%)			

Year	Gross PAYE/ PAYG $m	Gross other individuals $m	Companies $m	Sales tax $m	Excise $m	GST $m	Custo duties $m
1999/00	79,731 (52.2%)	13,370 (8.7%)	24,346 (15.9%)	16,560 (10.8%)	19,811 (12.9%)		
2004/05	97,304 (45.0%)	22,554 (10.4%)	40,404 (18.7%)	–10	21,888 (10.2%)	35,063 (16.3%)	
2012/13	149,807 (47.8%)	33,294 (10.6%)	66,924 (21.4%)	0	25,412 (8.1%)	48,271 (15.4%)	
2017/18	192,229 (48.4%)	43,866 (11.0%)	84,549 (21.3%)	0	22,703 (5.7%)	63,265 (15.9%)	

Notes to the figures: see Notes (a)–(k) to Table 2.14 in Commissioner of Taxation, *Annual Report 2017–18*, 74.

Trends in Australian taxation over time are revealing.[79] For example:

- In 1910, there was only one tax; some 15,000 returns were lodged; and around £1.4 million was collected. By contrast, there are currently some 125 taxes imposed in Australia (99 imposed by the Commonwealth government, 25 by the states and territories, and one by local government).[80] In 2017/18, total net tax revenue collected was some $528,587 million.
- In 2016, total tax was some 28.6% of GDP (Commonwealth government: 23.1%; state/territory governments: 4.6%; local governments: 1%).[81]
- The Commonwealth in 2017/18 collected 80.8% of total tax revenue ($427,237 million from a total of $528,587 million) for that year, with the states and territories (15.9%; $84,261 million) and local government (3.4%; around $18,122 million) collecting the balance.[82]
- Despite a slump following the global financial crisis in 2008, total ATO tax collections increased by some 258.2% over the period 1999/2000 to 2017/18, and more than trebled (an increase of some 449.6%) over the period 1994/95 to 2017/18: from $88.306 billion to $396,984 million.
- Until 2000, Australia had placed comparatively little reliance on indirect taxes—such as sales tax—as a source of Commonwealth revenue. This situation changed with the introduction of the GST, which in 2017/18

generated 15.9% ($63,265 million) of total revenue collected by the ATO.[83]

However, despite the introduction of the GST and other changes, Australia is still similar to most advanced Western countries in that it raises the majority of its tax revenue through direct taxes on income (eg wages, salaries and profits). Indeed, Australia's reliance on direct taxes is heavier than most OECD countries.[84]

- Australia has traditionally placed more reliance on company tax than other OECD countries,[85] a trend which has become significantly more pronounced over the past 30 years. Collections from companies are volatile, but still increased by some 347% between 1999/2000 and 2017/18 (despite occasional dips—eg in the period 2008/09 to 2010/11, as a result of the global financial crisis).
- Historically, Australia has generally not been heavily taxed *overall* by international standards, being regularly placed within the bottom third of OECD countries in terms of overall tax burden,[86] and comparatively low in respect of taxes on goods and services.[87]

  However, Australia is among the *highest* OECD countries in levels of personal income and company tax.
- In 2014/15, the distribution of the tax burden in Australia was: 20.1% on capital, 47.5% on labour, 23.6% on consumption, and 8.9% on other bases.[88]
- In 2017/18, total average taxation per capita in Australia was $21,150, an increase of 6.9% from 2016/17, with average state and local taxes being $4,087. Over the same period, Commonwealth taxation per capita rose 8.2% to $17,094.[89]
- Despite a progressive taxation system (see ¶1-170), the distribution of wealth in Australia is uneven. In 2013/14, it was reported that the wealthiest 20% of the population owned 62% of total wealth, while the bottom 20% owned less than 1%.[90]

  This inequality appears to be increasing: in 1980 the top 20% of the population received five times their 'share' of household income—but by 2009/10, this had doubled to 10 times their 'share'.[91]

Tax Reform Initiatives In Australia(¶1-235 – ¶1-250)

[¶1-235] Criticisms of the current Australian taxation system

Some general criticisms of the current system include suggestions that:

- it is not sufficiently equitable, because taxable income is not the best measure of economic well-being
- the neutrality of the system has been unduly eroded over time by successive governments' attempts to appease sectional interests by granting them ad hoc tax benefits, and
- the system has comparatively low political acceptability.[92]

These and other criticisms have from time to time generated calls for reform of the taxation system. The materials below discuss some of the proposals for reform that have been put forward.

[¶1-237] Challenges of e-commerce

Using traditional source and residence rules,[93] taxation systems can generally cope reasonably well with transactions that take place physically within a country's borders. However, traditional (national) taxation systems have struggled to cope with the rapid development of the international digital/internet economy, because '[t]oday's international corporate tax rules … do not capture business models that can make a profit from digital services in a country without being physically present … [and current tax rules] also fail to recognise the new ways in which profits are created in the digital … economy, [where] value is often created from a combination of algorithms, user data, sales functions and knowledge'.[94] Taxpayers have increasingly taken advantage of these factors to avoid tax through complex multi-jurisdictional cyberspace arrangements.

These activities have provoked responses from host countries (eg the introduction of a 'diverted profits' tax in Australia and elsewhere)[95] aimed at ensuring that taxpayers pay their 'fair share' of tax.[96]

Australia has also introduced general legislation designed to combat multinational tax avoidance (the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* (Cth): see ¶24-910), as well as specific legislation that seeks to deal with other aspects of e-commerce (see ¶27-167: non-residents supplying intangible property to Australian consumers, and ¶27-169: offshore supplies of low value goods).

This area is likely to see significant further development over coming years.

[¶1-240] Guidelines for tax reform

In evaluating possible future reforms, Mathews[97] suggested some time ago that tax reform is effective only if it achieves the 'overriding requirement' that the taxation system's intended and actual effects are the same. This in turn requires that opportunities for avoidance, evasion and other manipulations are minimised.

The broad criteria that Mathews suggested for evaluating reform proposals included:[98]

- The revenue bases should be easily identifiable and measurable, and should, as far as possible, be determined by reference to market or other objectively verifiable values.
- Transactions and transfers should, so far as possible, be taxed at the time they take place (eg by deduction of tax at source) to avoid the need for multiple records of transactions and to enable tax liabilities to be finalised when the transactions occur.
- Transactions and transfers should be taxed at proportional rates. Exemptions and concessional allowances should be consistent with social security arrangements and paid directly to eligible taxpayers.
- Tax bases should be consistent, eg between business and personal taxation.
- Generally, the broadest possible revenue base should be used, except where specific taxes are intentionally imposed to achieve vertical equity or other particular distributional, stabilisation or allocative objectives.
- As far as possible, internal checking mechanisms should be built into the taxation system as a means of verifying tax liability.

The Ralph Committee suggested that in designing a taxation system, international factors also need to be taken into account.[99]

Given the various reform proposals that have been put forward from time to time, it may be puzzling that so few have actually been implemented. Perhaps part of the reason is that, as Edmonds pragmatically observed:

> changes to the taxation system are so riddled and infected by politics, [that] changes amounting to real tax reform cannot even make it to the table for consideration and discussion, let alone be adopted as policy for implementation … For too long now, structural reform of many areas of the Commonwealth's legislative jurisdiction has been anaesthetised by … politics[100]

[¶1-250] Options for further tax reform

The 2008 Henry Tax Review: *Australia's Future Tax System*

The Henry Tax Review[101] took a long-term perspective and foresaw a number of significant changes with which the Australian taxation system would have to cope, including technological advances and the ageing of the population (with the latter predicted to significantly reduce some tax bases and raise the costs of health, aged care and dependency).[102]

One of the review's key recommendations was that that revenue raising should be concentrated on four robust and efficient tax bases, namely:

(1) *Personal income tax*—the tax and transfer system should be simplified and progressivity in the taxation system increased by introducing a broader definition of 'income', as well as other steps.

(2) *Business income taxes*—to encourage innovation, entrepreneurship and investment in Australia the company income tax rate should be reduced to the OECD average of 25% over the short to medium term.

Australia should also adopt a broader, more uniform company income tax base, together with simplified arrangements for small business and, in the longer term, should move towards a business-level expenditure tax.

(3) *Private consumption*—consumption spending is potentially an efficient and robust tax base if broadly defined—and one of the least damaging to economic growth. However, Australia currently has a number of inefficient taxes on consumption.[103]

For example, the GST is not optimally efficient because it does not tax consumption on a comprehensive basis (eg it does not include the family home), and is operationally complex and costly, particularly for small business.

Accordingly, the GST and inefficient state consumption taxes on insurance and payroll taxes should gradually be replaced by a low-rate, broad, destination cash flow tax.

(4) *Economic rents from natural resources and land*—the immobile nature of natural resources and land means that they provide an efficient tax base, at least where the taxes are imposed on a comprehensive base[104].

> Land tax should apply equally to all land uses (including the family home) and aggregate a taxpayer's holdings, but with a threshold set to exclude most lower-value use land (eg agricultural property), and moderate rates (eg 1% of value) applying to most other land.[105]

Beyond the four 'robust' taxes above, the Review recommended that the only taxes which should be retained are specific taxes imposed in order to:

- efficiently address social outcomes or market efficiency through better price signals (eg taxes on tobacco, alcohol and gambling)[106]
- improve market or social outcomes by addressing spill-over costs and benefits, or
- help counteract self-control problems.

Current taxes, such as payroll taxes, stamp duties, property transfer taxes and other taxes that do not meet the above criteria should be abolished over time.

The review also observed that: 'Australia's ageing population will create rapidly increasing demands for governmental support in the future, and accordingly, significant changes should be made to improve the equity of the superannuation and pension systems.'[107]

Subsequent developments—the *Re:think* tax discussion paper

In March 2015, the federal government released a tax discussion paper[108] as a first step towards development of a promised Tax White Paper (now apparently abandoned).

The *Re:think* discussion paper covered a wide range of issues and sought to develop a 'better tax system' that delivered lower, simpler and fairer taxes, which would 'improve productivity and foster jobs, growth and opportunities'[109] in order to respond to the significant problems identified by the Henry Tax Review, namely:

- globalisation
- declining productivity growth in Australia, and
- an ageing population and shrinking workforce.[110]

Key points raised in the discussion paper included that the Australian taxation system is outdated, with the changing global environment, technology and other developments placing it under increasing strain. Particular issues discussed included the following.

- The Australian taxation system is too complex. This is a major driver of costs to individuals and entities, and also produces unintended consequences inconsistent with good policy outcomes. Various steps need to be taken to reduce complexity, including making use of technology to simplify processes and provide assistance to taxpayers.[111]
- Compared to most developed countries, the Australian system relies too heavily on personal and corporate income tax, with 'bracket creep' likely to see individuals' effective rates increase dramatically in coming decades. Accordingly, Australia should place greater reliance on broad-based consumption taxes such as the GST and improve the mix of indirect taxes.

  The taxing of savings raises issues of potential double taxation, and whether different forms of income from savings and negative gearing should be taxed differently.
- The relatively high level of Australian corporate tax will make it harder for Australia to attract necessary (particularly international) investment,

imposes high long-term costs on living standards, and encourages tax minimisation.

- There are important current developments driving the need for tax reform in Australia, including globalisation and the growth of the digital economy, resulting in opportunities for tax minimisation through Base Erosion and Profit Shifting (BEPS) and other means;[112] and posing a threat to the GST.
- The GST rate is one of the lowest among developed countries—around half the OECD average. As with the Henry Tax Review, *Re:think* recommended that the GST rate and base should be reviewed and expanded in light of the significant amount of GST revenue foregone because of the broad exemptions (see ¶27-133ff),[113] which reduce the efficiency of the GST and the reward for effort and incentives to work,[114] and increase complexity and compliance costs, which fall disproportionately on small businesses.[115]
- The traditional distinction between revenue and capital as a basis for taxing or non-taxing should be reviewed and alternatives explored.[116]
- Concessions intended to benefit small business may increase complexity and compliance burdens; therefore their overall effect should be reviewed and alternatives such as a lower or zero rate for small businesses explored.[117]

Other possibilities for reform

There are a number of other possible avenues for reform of the Australian taxation system. One of the more interesting is a wealth tax.

Wealth tax

There is currently considerable inequity in wealth distribution in Australia (see ¶1-232), which a wealth tax might help to reduce.

A wealth tax is usually levied on the annual value of all property owned by the taxpayer, less the value of their liabilities.[118] Exemptions are often provided on the basis of equity, efficiency and administrative expediency; for example, for persons with net wealth below a prescribed threshold, and for household effects.[119]

Wealth tax is generally levied at low progressive rates (0.5% to 2.0%), and the resulting revenue often forms only a small proportion of overall tax revenues (0.5% to 5.4%). Thus wealth taxes are generally aimed at increasing social equity rather than generating large revenue returns.[120]

- *Advantages* of a personal net wealth tax include increasing the overall equity of the taxation system by reducing the concentration of wealth. If there are no exempt categories of assets, taxpayers may be encouraged to make more productive use of resources—particularly because, being a tax on individuals, it is difficult to 'shift' liability from one taxpayer to another.
- *Disadvantages* include that a personal net wealth tax may tend to discourage savings because of 'double taxation', and that it may generate significant administrative difficulties. It may also inhibit the capacity or willingness of persons to take entrepreneurial risks, thus reducing levels of employment and productivity.

To date, these advantages and disadvantages remain theoretical, because while a wealth tax has conceptual merit, it seems to be politically unacceptable in Australia, and no Australian government in recent times has shown any strong inclination to introduce this type of tax.

The Current Australian Legal System (¶1-310 – ¶1-520)

[¶1-310] Sources and principles of taxation law

The tax consequences of a transaction (eg the question whether an amount is deductible or a receipt is assessable) will in many cases depend upon whether or not that transaction falls within a particular provision of the taxation legislation. It is therefore necessary to have a basic understanding of:

- the sources of taxation law, and
- the legal principles which the Commissioner—and ultimately the AAT and courts—apply when they seek to resolve taxation questions or disputes.

[¶1-320] Sources of Australian taxation law

There are in effect three sources of taxation law in the Australian context:

(1) statute law
(2) case law, and
(3) the practice of the ATO as a de facto source of 'law'.

Statute law (or 'legislation')

Statute law is the law made by parliament and contained in statutes and ancillary legislation, including regulations made under such Acts (see ¶1-520).

Australia is a federation with two main levels of government (federal and state/territory), each of which has its own parliament that passes appropriate legislation. The federal or Commonwealth government is responsible for governing (and taxing) the whole of Australia, and taxation statutes passed by the federal parliament include ITAA36, ITAA97, TAA, and the FBT and GST Acts.

The various state and territory governments are responsible for governing their particular state or territory, and taxation legislation passed by these governments traditionally includes stamp duties, land tax and payroll tax Acts (see Chapter 28).

There is also a third 'local' level of government. Local councils govern municipalities or districts and levy taxes, usually in the form of land rates and various other service charges, pursuant to authority conferred by the various local governments and other enabling Acts.

Case law (or ‘common law’)

Case law is created by the decisions of courts and tribunals.[121]

The courts have two main roles in relation to the operation of the taxation system.

(1) Creation of law to fill a legislative vacuum

The courts *create* common law in situations not covered by legislation. An example in the tax context is the issue of identifying a ‘business’, where there is as yet no definitive provision in the general tax legislation (see ¶29-210ff).

Some have been concerned that judges may at times take too proactive a role in creating law.[122]

(2) Statutory interpretation (interpretation of legislation)

In recent times, the increasing tendency of governments to introduce very detailed taxation legislation to deal with perceived problems means that 'to an ever greater extent, the energies of the superior courts are devoted to … the intellectually exacting, but spiritually sterilising duty of interpreting [Acts of Parliament]'.[123]

In an ideal world, there would be no need to 'interpret' legislation, because its intended meaning would be so perfectly clear that it would be indisputable. Unfortunately, parliaments cannot always achieve this—a problem which tends to increase with the complexity of the legislation. Many English words have more than one possible meaning, and as Hill J noted, 'the English language is seldom so clear and unambiguous that only one construction [of a provision] is open'.[124]

Thus, in a complex area such as taxation, where tax arrangements are often sophisticated and sometimes artificial, it can be particularly difficult to achieve the dual aims of comprehensively covering all relevant aspects of a problem area, and at the same time ensuring that the legislation is clear and unambiguous. Indeed, GSA Wheatcroft observes that:

> no country has yet succeeded, or is likely to succeed, in framing its tax laws in such a way that it is clear how the tax liability will be calculated on any conceivable set of facts. Even the most accurate draftsman of a law will not always be able to find precise language to convey his meaning and the wisest legislator cannot foresee every possible situation that may arise.[125]

Some neutral body is therefore needed to interpret legislation when disputes arise, in order to determine what a particular piece of legislation means in a given context, and 'to expose the meaning of the words which Parliament has enacted'.[126] Under the common law system, that task of statutory interpretation falls ultimately to the courts and the judges who preside in them.[127]

In determining the meaning of a statutory provision, judges apply principles of statutory interpretation[128] which have been developed over time and—more recently—been supplemented by statutory provisions.[129] The principles of statutory interpretation and their application, as well as the doctrine of precedent are dealt with in texts such as *Statutory Interpretation in Australia*.[130]

While the prevailing view in recent times has been that revenue statutes are to be interpreted in the same way as other legislation, Allsop CJ in *Channel Pastoral Holdings Pty Ltd v FC of T* observed that:

> Revenue statutes of the detail of the 1936 [ITAA] Act and the 1997 [ITAA] Act may not admit of the flexibility of interpretation that may attend statutes expressed in more general terms … As [Judge Learned Hand] said in *Helvering v Gregory* 69 2d 809 at 810 (1934 2nd CCA) 'as the articulation of a statute increases, the room for interpretation must contract'[131]

(3) The practice of the ATO as a de facto source of 'law'

The practice of the ATO is applied through its assessment and review procedures; day-to-day decisions in formal and informal dealings with practitioners and the public; public and private rulings and other advices; and its objection and review (litigation) procedures.

While not technically 'law', in some situations ATO interpretations or actions create *informal* law, in that many practitioners and their clients accept ATO practices or rulings without challenge, and structure their affairs accordingly.[132]

ATO rulings

ATO rulings are in an unusual situation because specified ATO rulings are binding on the ATO in the sense that the ATO must apply such rulings even if they are found subsequently to be wrong (see ¶30-010ff). These specified rulings have moved closer, therefore, to 'formal' law.

ATO discretions

To enable taxation law to apply to a myriad of different taxpayers and situations, Commonwealth governments have conferred various discretionary powers upon the Commissioner and their delegates.

The Commissioner's formal discretions may be divided loosely into three broad categories:

(1) 'machinery discretions' (relating to time, or factual or operational matters) designed to enable the Commissioner to administer the day-to-day operation of the taxation law
(2) 'anti-avoidance' discretions designed to enable the Commissioner to negate 'improper' tax avoidance, and
(3) 'discretions used in the calculation of elements of taxable income'; for example, empowering the Commissioner to determine a 'reasonable amount', and so on.

To the extent that the determination of an element of the taxpayer's assessable income or other matters is left within the discretion of the Commissioner or their delegate,[133] the Commissioner does, in a sense, have a power to 'make' law in the individual case.

While this flexibility is useful, it has disadvantages—in some situations, reliance on the exercise of a discretion increases uncertainty for taxpayers, because it may be difficult to predict how the Commissioner will exercise that discretion in particular circumstances.

In 2017, the federal government passed legislation giving the Commissioner a 'statutory remedial power' which enables the Commissioner to alter the administration of statutory provisions in order to avoid unintended consequences and ensure that the provisions achieve a fair result in individual cases, consistent with the policy objectives underlying the provisions:[134] see ¶29-010

Review of Commissioner's discretions by the AAT and courts

There are very significant differences between the powers available to courts and administrative bodies such as the AAT to review an exercise of the Commissioner's discretion.

In reviewing a decision of the Commissioner, the AAT stands in the shoes of the Commissioner, and may exercise all the Commissioner's powers and discretions under the legislation. Thus, the AAT can review the *merits* of the decision, consider whether the Commissioner's exercise of a discretionary power was the correct or preferable one in the circumstances, and override that decision where it feels that a different decision is preferable (see ¶31-570).

By contrast, a court has a far more limited power to review discretions, and can overturn an exercise of the Commissioner's discretion only where the Commissioner has made an error of law; for example, by taking into account irrelevant factors, or excluding relevant factors (see ¶31-165).[135]

Thus, taxpayers seeking to challenge an exercise by the Commissioner of a statutory discretion on the basis that it is unduly harsh or inappropriate (but not wrong in law) may only be able to effectively challenge that decision in the AAT (see ¶31-500ff).

[¶1-520] The role of taxation regulations

Section 266 of the ITAA36 and s 909-1 of the ITAA97 empower the Governor-General to make regulations (delegated legislation)[136] dealing with relevant matters, and prescribing penalties not exceeding five penalty units (currently $1,050) for breach of those regulations. The Commissioner, therefore, has a limited formal power to 'make law' through these regulations.

Constitutional Aspects Of Taxation (¶1-530 – ¶1-620)

[¶1-530] Distribution of legislative powers

Each level of government in Australia (Commonwealth, state and local) has only limited power to make laws, and cannot make laws of unlimited scope on any topic it might wish.[137] For example, the Commonwealth government can only legislate on specified topics (see ¶1-540), while state governments can generally only legislate for the 'peace, order and good government' of that state.[138]

Significantly, the Commonwealth does not have exclusive power to impose taxes. The states have concurrent power to tax,[139] subject to the constraints of provisions such as ss 90 and 109 of the Commonwealth Constitution (see ¶1-570, ¶1-595).

Nevertheless, it has always been clear that the Commonwealth taxation power is potentially very broad in scope (see ¶1-580), extending to 'any form of tax which ingenuity may devise', with federal parliament free to 'select such criteria as it chooses, subject to any express or implied limitations prescribed by the Constitution, irrespective of any connection between them'.[140]

[¶1-540] The Commonwealth's power to make laws with respect to taxation

The Commonwealth government is a government of 'enumerated powers', and can only exercise those powers which are specifically or impliedly granted to it by the terms of the Commonwealth Constitution. Accordingly, for a Commonwealth law to be valid, it must be possible for the court to 'pigeon-hole' that law within one of the heads of power granted to the Commonwealth.[141]

These heads of power are contained mainly, though not exclusively, in s 51 of the Constitution, which gives the Commonwealth government power to make laws 'with respect to' 38 specific areas, together with an express incidental power to legislate with respect to 'matters incidental to the execution' of any of those powers.

The Commonwealth's taxation power is found primarily in s 51(ii), which provides that: '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'.[142]

Accordingly, for a Commonwealth law to be valid under s 51(ii), it must be possible to characterise that law as being one which both satisfies the positive test of being a law 'with respect to … taxation',[143] and also one which does not offend the prohibition against discrimination between states or parts of states. A law which fails either of these tests is invalid.

Not surprisingly, there have been a number of constitutional challenges to taxation laws over the years, some raising unusual issues. In *Melkman v FC of T*,[144] the court held that imposing tax on a Dutch pension awarded to a survivor of a Second World War concentration camp did not breach the *Racial Discrimination Act 1975* (Cth); while in *Clark v FC of T*,[145] the AAT held that the ATO had not breached the *Age Discrimination Act 2004* (Cth) by declining to apply concessional tax treatment to an alleged 'redundancy' payment made to a 76-year-old taxpayer. In *Skyring v FC of T*,[146] the Full Federal Court rejected an argument that by requiring taxpayers in effect to pay income tax out of property owned by them, ITAA36 was unconstitutional because it violated rights guaranteed by Magna Carta.

The taxpayer in *Re Burrowes; Ex parte DFC of T*[147] put forward the ingenious argument that he should be excused from any liability to pay tax because he held a conscientious objection to paying taxes which might be used for military expenditure. The taxpayer also relied on legal principles arising from the Nuremberg War Trials, international conventions and the defence of necessity. Heerey J rejected all of these arguments.[148]

With equal optimism, the taxpayer in *Atkinson v FC of T*[149] argued that he had paid the tax owing by tendering a number of shovels. Heerey J rejected this argument on the basis that the ITR required payment by legal tender rather than in kind (see ¶32-040).

Some taxpayers have gone further. Inspired perhaps by the US tax resister movement,[150] the self-styled 'sovereign citizens' argue that taxation is unconstitutional and illegal—and refuse to pay taxes at all.[151]

Interesting challenges to taxing regimes are not confined to Australia. In the UK, regulations which required businesses to file VAT returns and pay tax electronically were held to be unlawful on the basis that the regulations breached the human rights of older taxpayers, those with disabilities, and those living in remote areas where broadband access was unreliable or non-existent.[152]

Against that background, the taxing power in s 51(ii) raises two particular issues which are worthy of closer examination, namely:

(1) the concept of a 'tax' in the context of s 51(ii) (¶1-550), and
(2) the prohibition against discrimination between states (¶1-560).