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Income Tax : A Critical Analysis

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INCOME TAX: A CRITICAL ANALYSIS

by Stan Ross and Philip Burgess (Sydney: LBC Information Services,
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When I received my copy of the second edition of *Income Tax: A Critical Analysis*, I was interested to see, prominently placed on the back cover of the book, an extract from my review of the first edition¹ and a further quote from that review on the first page of the book. I knew then that I was compelled to write a review of the second edition, so that my views on it could be expressed.

The second edition, like the first, is divided into three parts. The first part deals with the historic context of income tax (Chapters 1 and 2), the second deals with substantive income tax issues (Chapters 3 through 8) and the third takes a multi-disciplinary approach, looking at political and social perspectives on tax (Chapters 9 through 13).

Chapter 1, "Historical Outline", provides a good history of income tax law and taxation law generally both in Australia and overseas. The chapter also covers tax law developments since publication of the first edition of the book.

Chapter 2 provides the reader with a basic grounding in tax design issues and criteria for their analysis; and the functions that taxes can play, such as providing merit goods or social goods, correcting market failures and redistributing economic wealth. Adam Smith's four canons of taxation as a method of evaluating how effective a tax is, are discussed in some detail. These sorts of "big picture" issues are sadly lacking in many of the income tax courses taught in Australia

¹ (1991) 13 Adel LR 317.

today. Too much time is spent on the minutiae of the law, with no time left for the far more interesting issues of tax design, the policy roles tax law may play and an analysis of how well the law achieves those policy goals. Burgess and Ross concentrate on these issues and thus get the reader to focus on them too.

In Chapter 2 there is a discussion of the shortcomings of the tax system. The chapter begins with statistics showing distribution of income. It is interesting and ironic to see how the disparity of income has increased in the five year period of Australian Labor Party rule. Whereas, in 1987, only 2% of the population earned more than \$50,000 per year, in 1993-94, 5% were earning more than \$60,000, and the number earning in excess of \$500,000 per year increased from 290 to 1900. During this time there was little change in the amounts of income earned by the larger part of the community. In 1987, 50% of taxpayers earned between \$15,000 and \$30,000 and this middle group only moved up to the \$16,000 to \$35,000 range by 1993-94. In light of these trends, there is discussion of how the Australian progressive income tax is not particularly progressive.

There is also a discussion of the politics involved in the formulation of tax law. This discussion is very important for students to understand, because sometimes law, which may appear perverse in terms of general policy aims, can only be explained in terms of political forces impinging on the policy formulation process. The chapter closes with interesting charts and analysis showing revenue collected as a proportion of Gross Domestic Product in member nations of the Organisation of Economic Cooperation and Development (OECD). This is essential information for students, since it shows in striking terms how, despite what many politicians and journalists say, Australia is a low tax nation when compared to similar nations. This point deserves emphasis, since the general discussions in the media on the level of taxation are generally so ill-informed. Further information shows the importance of income tax as a revenue source in Australia and compares the tax mixes of the OECD member nations. The section could have been improved had there been a bit more discussion of the tax mix as a policy issue and how changing the tax mix can effect and affect tax policy.

The second part of the book begins with Chapter 3, "the Concept of Income". The chapter introduces a fictitious jurisdiction which has no tax system. The ruler seeks advice from economists and lawyers on devising a tax on income, starting with the development of a definition for the term "income". This fiction is an effective way to demonstrate the difference in intellectual approach between most

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lawyers and economists, when looking at this same question. The chapter looks at the jurisprudential development of the concept of income in Australia and how it was taken wholesale from England, despite the very different legislative structures of the respective income tax laws. It also looks specifically at a number of categories of income receipts, and discusses their characterisation by the courts.

"Taxation of Capital Gains" is the title of Chapter 4, one of the two chapters written by Professor Richard Krever. Professor Krever gives, in the relatively brief space allotted, a comprehensive look at capital gains taxation in Australia. The chapter begins with a description of what capital gains are, and how the law has developed in Australia, culminating in the introduction of Part IIIA in 1985. There is also analysis of the policy arguments in favour of and against capital gains taxation, discussion of some of the structural features of capital gains taxation, and a discussion of the tax preferences given to capital gains. This preliminary and policy discussion is followed by a comprehensive look at the taxation of capital gains in Australia, including a detailed view of the legislation. The chapter concludes with a look at the possible future of capital gains taxation, including a critique of the policy rationales given by the Coalition when suggesting narrowing of the scope of capital gains taxation or otherwise undermining it.

Chapter 5 studies "Deductions". An introduction explains why deductions are made available under the income tax law. There is then a discussion of the structure of the deduction provisions, in particular the operation of s 51 and the requirements of causal nexus and temporal nexus. There is a passing mention of apportionment under the current wording of the legislation, but no further discussion of what apportionment is and its importance. A paragraph dealing with apportionment would have been helpful in understanding why s 51 is drafted as it is. In the discussion of private and domestic expenditures, it would have been interesting in my view, to have explored some of the cases which have unique and entertaining facts, such as *FCT v Cooper*² (rugby league player seeking to deduct the cost of food) or the conflicting tropical clothing cases, *Case N97*³ and *Case Q72*.⁴ However, the cases chosen as examples by Professor Burgess in this chapter are equally valid. The chapter closes with a discussion of the concept of tax expenditure.

² (1991) 91 ATC 4396 (Full Fed Ct).

³ (1981) 81 ATC 521, also cited as 25 CTBR (NS) *Case 50*.

⁴ (1983) 83 ATC 366, also cited as 26 CTBR (NS) *Case 136*.

Chapter 6, "Tax and the Salary and Wage Earner", is the first of the two wholly new chapters in this edition of the book. This chapter focuses on fringe benefits taxation and the taxation of superannuation contributions and superannuation funds. In discussing the introduction of the fringe benefits tax, Professor Burgess points out that the decision to tax the employer was copied from New Zealand legislation. It is therefore appropriate that the tax year for FBT purposes is 1 April through 31 March, the former financial year in New Zealand. This provides a possible explanation for the otherwise inexplicable taxation year used in the FBT law. Professor Burgess closes the chapter with a brief, but very effective explanation of the taxation of superannuation, both pre-1983 and post-1983.

Chapter 7 is the other new chapter to come with this edition. It is entitled "Taxation of Entities and International Tax". In the entities part, there is a brief outline of the taxation of partnerships, trusts and a more extensive discussion of the taxation of companies. There is a very interesting chart showing the statutory rate of corporation tax and the amount of actual tax paid as described in the company annual reports. The chart shows that, in all but the most recent year, 1993-94, when the corporation tax rate was reduced to 33%, there was a large gap between the rate of tax charged and the actual rate paid. The accompanying discussion gives some explanation of why this gap existed. The other part of the chapter deals with international taxation, covering issues such as residence of individuals and companies and source of income and double tax agreements. There is also a discussion of transfer pricing rules, which have become of paramount importance in the current climate of international business transactions. With the increasing importance of international taxation, more attention could have been given to the topic by the authors. Furthermore, it is unclear why these two disparate issues, entities and international tax, were included in the same chapter. Each of them merits a separate chapter in the next edition.

In Chapter 8, Professor Krever deals with "Tax Accounting". Professor Krever explains why issues of timing, or tax accounting, are of critical importance to the operation of the tax system. The distinction between commercial accounting rules and the legal rules governing accounting for tax purposes are mentioned. Reference is also made to the fact that in many nations the same rules apply for commercial accounting and tax accounting purposes. There is a very good discussion of accruals and cash basis accounting, both for income and expenses. The chapter closes with a brief discussion of a

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proposal made in 1993 to introduce comprehensive accrual rules in relation to a wide variety of financial arrangements. Through this proposal, taxation of accrued gains would take place on an annual basis.

The final part of the book begins with Chapter 9, "Politicians, Bureaucrats, Courts and Tax Reform". This chapter looks at the tax system and tax policy formulation as a political process involving the struggle between various structural elements. There is also, under the Bureaucrat heading, a brief discussion of tax administration issues such as the audit and investigation powers of the Taxation Office. For anyone studying income tax law it is important to recognise that the tax system is the product of the interplay of political forces, each with different roles and sometimes with differing or even incompatible visions. Chapter 9 helps serve this purpose.

Chapter 10, "Tax and Poverty", looks at the interrelation of the income tax system and poverty. This chapter begins with a discussion of the differences between the role and aims of the income tax system as compared to the social security system. The chapter also looks at the income tax system and the social security system as means of effecting policy goals, such as redistribution of income, and promotion of vertical equity. It looks at what the effect of the introduction of a broad based consumption tax (BBCT) would be on the poor. It is welcome to see some informed discussion of the economic effect of a BBCT on the poor, in particular focussing on how to compensate for potential regressivity. This is in stark contrast to the immoderate and uninformed debate which was proffered by both the Coalition and the Labor party in 1993, when the Coalition campaigned unsuccessfully to introduce such a tax. The Coalition described the BBCT as a panacea for all of Australia's economic and tax system ills and the Labor Party described it as the policy incarnation of Satan. Neither view was valid, accurate or shed light on the issue.

Chapter 11, "Tax Ethics", is written by Stan Ross, one of the acknowledged scholars in the field of legal ethics and perhaps the foremost writer in Australia on tax ethics. Dr Ross points out that ethics is a subject which has been neglected in the law curriculum generally and in tax in particular. Dr Ross also points out that, when ethics are dealt with, it is invariably in the context of tax avoidance, which he criticises as being too narrow a view of the issue. Some time is spent on the theoretical aspects of ethics. The reader is also exposed to the literature, mainly American, dealing

with how to balance robust representation of your client while at the same time maintaining ethical responsibility to the tax system and society in general. There is also a discussion of legislative rules which impose ethical standards and the rules of the professional organisations governing tax professionals.

Chapter 12, "Tax Avoidance and Evasion", considers the two terms and attempts to provide definitions for each form of behaviour. The chapter also considers the attempts both legislatively (s 260 and Part IVA) and through jurisprudence, to deal with evasion and avoidance. There is an interesting discussion pointing to the complicity of tax professionals in tax avoidance and evasion and the meagre attempts by the professional licensing bodies to govern their members and curtail this behaviour.

Just as in the first edition, the closing chapter is called "The Future". This chapter begins with a view of what the tax system may look like in 2010. There is also discussion of the future of income tax. Is it destined for reform or abolition? This is followed by a description of both an expenditure tax and a consumption tax model as possible alternatives to the income tax. There is even mention of the Henry George model of a single tax on the value of land. The mention of Henry George is indicative of one of the things which makes this such a good book. Students get exposure to theorists and their ideas which otherwise are never touched on in most university, student-oriented, income tax law writing.

One of the great features of this book is that it is well referenced and covers such a wide range of the academic literature dealing with income taxation. This gives the student, or other reader, the opportunity to further explore issues by looking at the original sources. Another great strength of the book is that reform proposals are found throughout. They give the reader a much broader view of the law, not only as it existed and now exists, but also how it may exist in the future.

One structural criticism of the book is that the table of contents only gives the starting pages of each chapter. There is no reference made to page numbers of headings within the chapter. Chapter 4 is almost 60 pages long and would benefit from a more extensive table of contents.

The second edition of *Income Tax: A Critical Analysis* is an expansion and improvement on what was a very good and unique approach to the study of income tax law. The student's eyes are opened to the

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multi-disciplinary nature of income taxation and the complexity of the political process as it affects policy formulation. This book should be a welcome addition to the reading lists of Australian income tax courses.