Revenue Law Journal

Volume 20 | Issue 1 Article 2

5-1-2011

Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance

Lidia Xynas

Follow this and additional works at: http://epublications.bond.edu.au/rlj

Recommended Citation

Xynas, Lidia (2010) "Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance," *Revenue Law Journal*: Vol. 20: Iss. 1, Article 2.
Available at: http://epublications.bond.edu.au/rlj/vol20/iss1/2

This Journal Article is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Revenue Law Journal by an authorized administrator of ePublications@bond. For more information, please contact Bond University's Repository Coordinator.

Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance

Abstract
This article examines tax avoidance strategies used by Australian taxpayers over the last four decades and analyses the regulatory responses by the government, noting a move away from the 'command-and-control' approach of the 1980s towards one of 'responsive regulation' and 'meta risk management'. It is argued that despite inherent complexity issues, this regulatory approach has nevertheless contributed to the fostering of trust and a perception of fairness in the Australian tax system.

Keywords
Tax avoidance, regulation, compliance

This journal article is available in Revenue Law Journal: http://epublications.bond.edu.au/rlj/vol20/iss1/2

TAX PLANNING, AVOIDANCE AND EVASION IN AUSTRALIA 1970 - 2010: THE REGULATORY RESPONSES AND TAXPAYER COMPLIANCE

LIDIA XYNAS[1]

This article examines tax avoidance strategies used by Australian taxpayers over the last four decades and analyses the regulatory responses by the government, noting a move away from the 'command-and-control' approach of the 1980s towards one of 'responsive regulation' and 'meta risk management'. It is argued that despite inherent complexity issues, this regulatory approach has nevertheless contributed to the fostering of trust and a perception of fairness in the Australian tax system.

INTRODUCTION

By the early 1970s, a significant number of Australian taxpayers were taking advantage of many structural loopholes in the taxation laws to minimise tax. This article begins with an analysis of a number of tax minimisation schemes that Australian taxpayers engaged in throughout the 1970s and 1980s, together with the legislative and regulatory responses implemented to tackle these undesirable activities and the 'associated problematic tax leakages'.[2] Initially adopting a command-and-control[3] regulatory approach in the late 1970s and early 1980s, rather

---

1 Lecturer in Law, School of Law, Deakin University Burwood, Victoria, Australia.

2 P Browne, 'Fair Shares' (1985) *Legal Services Bulletin* 52: 'the amount of tax revenue being lost annually from avoidance schemes was variously estimated to be anything from $3,000M to over $10,000M (AUD).'
Also see the Commonwealth, ATO Australian Taxation Office, *1986-1987 Annual Report of the ATO* (1987): 'the avoidance schemes of the late 1970s to mid 1980s involved some 6,688 companies and resulted in tax evasion of between $500m and 1000M.'
Also see A Freiberg, 'Ripples from the Bottom of the Harbour: Some Social Ramification of Tax Fraud' (1988) 12 *Criminal Law Journal* 169.

3 R Baldwin and M Cave, *Understanding Regulation*: *Theory, Strategy and Practice. An Introduction to Regulatory Theory* (Oxford University Press, 1999) 35. The authors note that under a general command-and-control approach, 'law is used to control and monitor certain behaviours with sanctions (penal and criminal) used to ensure that certain conduct is discouraged or even prohibited…[where it] can be used to impose fixed standards with immediacy and to prohibit activity not conforming to such standards.'

than relying on the often difficult process of launching prosecutions under the then existing General Anti-Avoidance Rules *(GAAR)* under s 260 of the *Income Tax Assessment Act 1936* (*ITAA36*), government agencies imposed explicit criminal charges to deal with wrongdoers, by making specific legislative amendments to federal statutes. By 1981, the new *GARR* contained under Part IVA of the *ITAA36* were introduced.[4] These new rules were designed to overcome the problematic *GARR* under s 260 of the *ITAA36,* which had proved to be inefficient and inadequate in combating the 'blatant, artificial or contrived tax avoidance schemes',[5] so prevalent in the 1970s and 1980s.

To further foster taxpayer confidence in the Australian taxation system and to improve taxpayer compliance, the Australian government in the 1990s began to move away from the command-and-control approach in dealing with undesirable taxpayer activities, towards one of 'responsive regulation'[6] and 'meta risk management'.[7] These regulatory developments have arguably fostered a perception of fairness in the Australian taxation system by its taxpayers where taxpayers' own 'economic welfare'[8] is not their only driving force when contemplating compliance with their

---

4 Terry Murphy, Part IVA: From Here To … (2000) 13 *Journal of Australian Taxation* 1 <http://www.austlii.edu.au/Journals/JATax/2000/13.html>.

5 Julie Cassidy, *Concise Income Tax* (Federation Press, Sydney, 4th ed, 2007) 80. Support for the application of Part IVA measures is further found in *Tax Laws Amendment (2006) Measures No 1) Act 2006* (Cth), which in effect deters tax avoidance and evasion schemes via tax havens and off shore financial centres.

6 Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press 1992) 29, 35 and 36 where the authors describe 'responsive regulation' as 'requiring regulators to be responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required … [where] … 'responsive regulation has two components. … First, it is responsive to variation in citizens' and corporations' regulation of themselves. Thus, consistency (or 'like treatment' for 'like cases') is unimportant; more important is realising the desired outcome in each case. Second, punishment needs to be in the background as a threat, but not in the foreground. When punishment is in the foreground, it increases "reactance" (acting contrary to a group norm) and an inability for an offender to be "other-regarding".'

7 John Braithwaite, 'Meta risk Management and Responsive Regulation for Tax System Integrity' (2003) *25 Law and Policy* 1, 1-2, who describes 'meta risk management' as '…risk management of risk management.' In relation to taxation systems, and their risk management, Braithwaite also notes that this is a 'tax administration reflexively remaking tax administration in a risk paradigm'. He also notes that a 'further risk paradigm in this context is for a tax authority to monitor and seek to remake the risk management systems of the organisations that it regulates.'

8 Kristina Murphy, 'The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders' (2004) 2 *Law and Human Behaviour* 187. Murphy notes that the 'rational choice model [propounds that] people are motivated entirely by economic welfare, assessing all

tax obligations. It is advocated that in order to maintain and improve taxpayer compliance, this regulatory approach delivered by the Australian government through its administrative tax agency, the Australian Taxation Office (ATO), should continue. This article concludes that this, together with a reduction in the complexity of the taxation system will help deliver a fairer, trustworthy, and more efficient tax system.

PART 1 -TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

Legal and illegal tax arrangements

Most transactions ultimately have a tax effect.[9] To anticipate this and minimise one's taxation 'costs' is part of competent business. Accordingly, 'tax minimisation is not prima facie illegal'.[10] Businesses and individuals can engage in tax minimisation where it does not amount to a contravention of the *GAAR*[11] or general law anti-avoidance rules.[12] Naturally, taxpayers 'do not wish to pay any more taxes than their obligations permit'.[13]

While taxpayers partake in minimisation in the pursuit of personal or business wealth, the difference between tax planning, tax avoidance and tax evasion activities lies between what is acceptable legally and what is considered unacceptable or

---

associated risk and opportunities and disobeying the law when they anticipate the probability (a monetary fine) of being caught are lower than the economic gain that would result from non compliance.'

9 M Calegari, 'Flat Taxes and Effective Tax Planning' (1998) 51 *National Tax Journal* 690.

10 G Cooper, R Krever and R Vann, *Income Taxation – Commentary and Materials* (Thomson Reuters, 5th ed, 2005) 913.

11 See Part IVA, *Income Tax Assessment Act 1936* (Cth).

12 This concept refers to judicial barriers to tax avoidance. For example, where a transaction is a 'sham'. See *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) FCR 449, para 16, where Lockhart J described a sham as 'something that is intended to be mistaken for something else or that is not what it really purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. …It is something false or deceptive.'
Also see Cassidy, above n 5, 87 where the author notes that '[I] if an arrangement is a sham, it is ineffective for tax purposes and a court may ignore it without having to rely on ss6-5(4) and s 6-10(3) ITAA97, Part IVA ITAA36 or Part 2-42. …The conclusion that an arrangement is a sham would logically prevent the operation of other anti-avoidance provisions, such as Part IVA, because there would be no scheme upon which those provisions could operate. *Bell v FCT* (1953) 87 CLR 548 at 573.'

13 Ivan Potas, 'Thinking About Tax Avoidance (No 43)' (1993) *Australian Institute of Criminology: Trends and Issues in Crime and Criminal Justice,* Canberra, 2. <http://www.aic.gov.au/publications/tandi/ti43.pdf>.

illegal.[14] Theoretical distinctions can be drawn between tax planning, avoidance and evasion activities. However, the last 40 years in Australia has seen a blurring of the three categories, in particular 'the distinction between [what constitutes] tax avoidance and tax evasion'.[15]

Acceptable tax planning is the 'legitimate exploitation of legislated tax incentives and ordinary business structures that can result in the obtaining of a favourable tax result for a taxpayer'.[16] It is, as Fisher explains, 'within the letter of the law and within the intent of the tax law'.[17] Joseph Stiglitz[18] regards effective and acceptable tax planning as:

> postponing taxes from the current period into future periods, arbitraging across different income streams facing different tax treatment (referred to as source-based arbitrage), and transferring income from higher tax brackets to lower tax brackets (or rate-based arbitrage).[19]

John Braithwaite agrees:

> Tax planning requires taxpayers and their advisors to consider four basic principles: the reduction of taxable income, the increase in allowable deductions,

---

[14] See *R v Mears* (1997) 37 ATR 321, 323 where Gleeson CJ outlines the distinction between tax avoidance and tax evasion, as was the view of the courts in 1997. 'Although on occasion it suits people for argumentative purposes to blur the difference, or pretend that there is no difference, between tax avoidance and tax evasion, the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful … there is a simple test. ... If parties to scheme believe that its possibly of success is entirely dependant upon the authorities never finding out the true facts, it is likely to be a scheme of tax evasion, not tax avoidance.'

[15] John McLaren, 'The Distinction Between Tax Avoidance and Tax Evasion has become blurred in Australia: Why has it happened?' (2008) 3 (2) *Journal of the Australasian Tax Teachers Association* 141, 142. The author notes that in relation to the governments objective to deter Australians from using foreign tax havens to avoid paying tax, the 'blurring of the distinction between tax avoidance and tax evasion [under various Acts] … allows government agencies to detect Australian taxpayers using tax havens by requiring their accountants, lawyers and financial advisors to report 'suspicious transactions' that involve the transfer of money between tax havens and Australia.'

[16] W Pederick, 'Fair and Square Taxation for Australia' (1984) 19(6) *Taxation in Australia* 576.

[17] R Fisher, *Making Tax Laws Work for You: A Simple Guide to Tax Planning* (McGraw-Hill Australia 2001) 126.

[18] Joseph E Stiglitz, 'The General Theory of Tax Avoidance' (1985) 38 *National Tax Journal* 325, 337.

[19] Ibid.

> the reduction of the applicable tax rate and the deferring or delaying of the payment of tax.[20]

So, these tax minimisation activities are within the letter of the law and allowable under the law.

Until recently, tax avoidance activities also were not seen as illegitimate *per se* since in 'the past the term was used to signify that the taxpayers had employed legitimate methods or "schemes" for reducing their tax liability'[21] thus enabling taxpayers to lessen their own tax obligations. The judiciary supported this. The famous dictum of Lord Tomlin in *IRC v Duke of Westminster* [1936] said, 'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be.'[22] A slight shift in attitude came in *Tatilla* (1943), where the court commented that whilst the employment of tax avoidance schemes was legal, it was not commendable:

> however elaborate and artificial [tax avoidance] methods may be, those who adopted them are 'entitled' to do so … they are within their legal rights but that is no reason why their efforts … should be regarded as a commendable exercise of ingenuity or a discharge of the duties of good citizenship.[23]

Despite this sentiment, in *William Vicars* (1944), the court was not concerned about the morality of such actions: 'we are not however concerned with the desirability or morality of the course taken in the present case but only with its legal operation and legal consequences.'[24] This attitude was also echoed by Mr Kerry Packer, Australian billionaire and media magnate, who famously declared at the Australian Federal Parliament's *Print Media Inquiry* in November 1991, 'I am not evading tax in any way, shape or form. Now of course I am minimizing my tax ... because as a government I can tell you you're not spending it that well that we should be donating extra'.[25] Such sentiments are today out of mood with *GAAR* provisions.[26] Current Australian tax law says that tax minimisation, whilst 'not prima facie illegal',[27] nevertheless comes into question where an arrangement is created solely or for the dominant purpose of avoiding the payment of tax, and consequently a contravention of the law is more

---

20 John Braithwaite, 'Penalties of White-Collar Crime', *Complex Commercial Fraud*, Conference Proceedings No 10, ed P Grabosky, Australian Institute of Criminology, Canberra, 1992.

21 Potas, above n 13, 2.

22 [1936] AC 1, 19.

23 *Tatilla v Inland Revenue Commissioners* [1943] AC 377.

24 *In the Estate of William Vicars (dec'd)* (1944) 45 SR (NSW) 85.

25 As quoted in N E Renton, *Income Tax and Investment* (Wrightbooks, 2nd ed, 2005).

26 See Part IVA, *Income Tax Assessment Act 1936* (Cth).

27 Cooper et al, above n 10, 913.

likely to have occurred.[28] This may involve taxpayers engaging in certain tax avoidance schemes where the minimisation of tax 'is achieved through albeit legal means but which are artificial and contrived and have no rationale other than obtaining a tax benefit'.[29]

Tax evasion activities on the other hand are defined as the 'criminal falsification or non-disclosure as a means of reducing tax'[30] and have always been regarded as unacceptable at law. Tax evasion can occur where taxpayers employ fraudulent methods to evade the payment of taxes. Tax evasion activities are in:

> contravention of the law whereby a person who derives a taxable income either pays no tax or pays less tax than he would otherwise be bound to pay. Tax evasion includes the failure to make a return of taxable income or a failure to disclose in a return the true amount of income derived.[31]

At common law, the difference between tax avoidance and tax evasion is illustrated in *R v Mears*.[32] Gleeson CJ noted:

> the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful.[33]

In recent times, tax avoidance strategies that had once been viewed as legitimate are now argued to be tax evasion. The boundaries between acceptable, legal tax planning activities and unacceptable, illegal tax planning activities have significantly changed over the last 40 years.

The problematic 1970s and early 1980s

Facilitated by poorly-drafted and inequitable legislative restrictions, the attitudes of taxpayers, tax advisers and the judiciary, and a free market, a 'tax avoidance industry' evolved and flourished in Australia.[34] By the 1970s, taxpayers had become dissatisfied with the tax system which had evolved in Australia since the 1940s. Between 1955 and 1971, prices rose by 54.6%, wages by 116.6%, and income tax

---

28 See s 177D, *Income Tax Assessment Act* 1936 (Cth).

29 J Slemrod, 'An Empirical Test for Tax Evasion' (1985) *Review of Economics and Statistics* 67, 235.

30 G Lehmann and C Coleman, *Taxation Law in Australia* (Butterworths, 1994) 877.

31 KW Asprey and Ross Parsons, *Taxation Review Committee* 1975, University of Sydney Library 2001, *Chapter 11 – Income Splitting*, Para 11.1, 215.

32 *R v Mears* (1997) 37 ATR 321.

33 Ibid 323.

34 Asprey and Parsons, above n 31.

collections by 332.14%.[35] This grossly disproportionate increase in tax liability spurred on the use of artificial vehicles and structures by many taxpayers in order to minimise taxation, including the use of tax havens and other tax planning devices. Those taxpayers with high incomes and assets in particular, strived to reduce their tax liability. This group (sometimes referred to as High Wealth Individuals (HWI)) had the means and the funds to engage tax professionals, accountants and advisors to aid them in their tax minimisation activities. By the 1970s and 1980s, tax avoidance schemes that were being engaged in by taxpayers became 'less blatant and more sophisticated'[36] with tax professionals openly promoting, marketing and selling such schemes and assisting taxpayers to take advantage of statutory structural loopholes.[37] One example was the evocatively-termed 'Bottom of the Harbour' scheme. Some 7000 companies were sent to the 'bottom of the harbour' between 1974 and 1981.[38]

A distrust of tax officials by taxpayers as well as by the judiciary had also developed. Lord Esher MR had described revenue officials as 'unpleasant, tyrannical monsters'

---

35 Australian Bureau of Statistics, Year Book Australia (1972 AGPS) Canberra.

36 Cassidy, above n 5.

37 Potas, above n 13, 7.

38 P N Grabosky, 'Wayward governance: illegality and its control in the public sector' (1989) *Australian Institute of Criminology*, 143. <http://aic.gov.au/en/publications/previous%20series/lcj/1-20/wayward/ch9t.aspx>.
'Bottom of the Harbour' schemes involved the stripping of assets and accumulated profits from a company prior to the time its tax obligations were due leaving nothing behind. The stripped companies were then transferred to persons with limited means and were insolvent when the tax was due. The ATO then stood as an unsecured creditor and were unable to be paid. The sale of the subject company's assets, usually through an intermediary accountant or solicitor, was deemed a capital gain rather than income and thus was generally non taxable being prior to the implementation of Capital Gains Tax regime in 1985.
Grabosky notes 'At the time, a company with no debts and with an annual profit of $100,000 would have a tax liability of $46,000. To avoid this liability, the owner of the company had only to sell the company to a promoter for the value of the profits, less an agreed-upon commission (for example 10 per cent). Instead of finishing the year with $54,000, the former owner of the company would walk away with $90,000. The promoter, in turn, would keep the $10,000 commission and dispose of the company by turning it over to a person of limited means, with no knowledge of the company's tax liabilities and no interest in retaining company records and books. The Australian Taxation Office and ultimately the honest taxpayers of Australia were $46,000 the poorer,' at 143.
Also see, Australian Taxation Office, *Capital Gains in Australia* <http://www.ato.gov.au/corporate/content.asp?doc=/Content/64155.htm>.

in *Grainger & Sons v Gough*,[39] an attitude which continued through to the late 20th century.[40]

There were other schemes entered into by taxpayers to minimise their tax liability, with their temporary successes being generally attributed to the Australian judiciary's liberal interpretation of s 260 of the *ITA*A36 - the then operative *GAAR*.[41] Section 260 rendered contracts void as against the Commissioner that had been entered into to avoid tax or where they altered 'the incidence of any income tax or relieved any person from liability to pay income tax, or defeated, evaded, avoided any duty or liability imposed on any person by the Act, or prevented the operation of the Act.'[42] It was apparent that s 260 was very broad and if taken literally could have applied to almost every business activity. As a consequence, the judiciary in its application of the section read it down significantly, deciding themselves when it should or should not apply. For example in the 1957 case of *Keighery v Federal Commissioner of Taxation*[43] the High Court on appeal held that s 260 did not apply to matters where the statute contained alternatives available to the taxpayer. It was noted by the court that:

> whatever difficulties there may be in interpreting s 260, one thing at least is clear: the section intends only to protect the general provisions of the Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them.[44]

In that case, the taxpayer had chosen to structure his business as a public company, rather than a private one, and was able to avoid additional tax liability. In the later case of *Mullens v Federal Commissioner of Taxation (*1976),[45] the Court again gave s 260 a broad application. There the taxpayer had claimed deductions for investments in shares that related to prospecting or mining operations.[46] The taxpayer '… in his

---

39 (1894) 3 TC 311.

40 See, eg, *Europa Oil (NZ) Ltd (No 2) v CIR (NZ)* (1976) 1 WLR 464.

41 Cassidy above n 5.

42 See Australian Taxation Office, Practice Statement Law Administration Statement, PS LA 2005/24. Also refer to s 260, *Income Tax Assessment Act 1936* (Cth). (This section no longer applies to contracts entered into after 27 May 1981).

43 [1957] HCA 2; (1957) 100 CLR 66.

44 Ibid 93.

45 135 CLR 290.

46 See sub-s 77A(3) and s 77(4), *Income Tax Assessment Act 1936* (Cth). Under ss 77A (3) and (4) of the *ITAA36*, such investments could be deductible to a taxpayer where a company engaged in prospecting or mining operations made a declaration to the Commissioner that they would expend moneys received from allotments of shares in the 'carrying on prospecting or mining operations in Australia for the purpose of discovering or obtaining petroleum or on plant necessary for carrying on such operations.'

return of income for the year ended 30th June 1969, claimed deductions for moneys paid on shares of a company which had made a declaration appropriate to the operation of s 77A(4).'[47] The Commissioner denied the deductions, arguing that the activities of the taxpayer were shams or were avoided by the operation of s 260. In this case the High Court confirmed that where the Act offers taxpayers a choice of alternative tax consequences, and the taxpayer chooses the alternative that is most favourable to it from a tax point of view, then s 260 does not arise.[48]

Accordingly, the High Court found that s 260 did not strike out those transactions merely because they were to the taxpayer's advantage. *Mullens'* reasoning was later followed and further extended by the High Court in *Cridland v FCT* [1977].[49] The High Court yet again refused to follow the legislature's spirit and intention with respect to tax avoidance, choosing instead a literal approach to its legislative interpretation of s 260, thus allowing them to overlook the tax scheme that has been entered into by the taxpayer, who had employed it with the sole purpose of obtaining tax benefits. The High Court agreed with Cridland that the 'choice principle' which had been delineated in *Keighery* [1957][50] and later followed in *Mullens* [1976][51] should apply. Accordingly, the High Court in *Cridland* [1977] held:

> The transactions into which the appellants entered in the present case…were not…transactions ordinarily entered into by university students. Nor could they be accounted as ordinary family or business dealings. They were explicable only by reference to a desire to attract the averaging provisions of the statute and the taxation advantage which they conferred … (however) … these considerations cannot in light of recent authorities, prevail over the circumstance that the appellant has entered into transactions to which the specific provisions of the

---

47 *Mullens v Federal Commissioner of Taxation* [1976] HCA 47; (1976) 135 CLR 290, 296.

48 Ibid 318.

49 *Cridland v FCT* [1977] HCA 61; (1977) 140 CLR 330. This test case concerned a tax scheme that had been employed by approximately 5000 university students who had classified themselves as 'primary producers', enabling them to gain some income averaging benefits. The Australian Taxation Office argued that this was tax avoidance; however on appeal to the High Court, the case was decided in favor of the taxpayer, an engineering student, Brian Cridland.

50 *WP Keighery Pty Ltd v Federal Commissioner of Taxation* [1957] HCA 2; (1957) 100 CLR 66.

51 *Mullens v Federal Commissioner of Taxation* [1976] HCA 47; (1976) 135 CLR 290. As quoted by Mason J in *Cridland v Federal Commissioner of Taxation* [1977] HCA 61; (1977) 140 CLR 330 at 15, 16: 'Barwick CJ said (1976) 135 CLR, at p 298 : "The Court has made it quite plain in several decisions that a taxpayer is entitled to create a situation to which the Act attaches taxation advantages for the taxpayer. Equally, the taxpayer may case a transaction into which he intends to enter in a form which is financially advantages to him under the Act".'

> Act apply, thereby producing the legal consequences which they express. (at 340)[52]

Accordingly, s 260 was found to have no application in this case because the taxpayers 'merely took advantage of tax consequences for which the Act makes provision.'[53]

It was apparent that the attitude of the courts up until the 1970s and early 1980s with respect to s 260 of the *ITAA36* allowed taxpayers the right to choose between alternatives. Section 260 was not invoked just because a taxpayer merely utilised tax advantages as allowed under the Act itself.[54] In addition, the courts also supported the notion that if there was a 'rational commercial objective for the transaction, s 260 would not apply'.[55] The subjective nature of this test made it difficult for the Commissioner of Taxation[56] to successfully argue that a taxpayer was avoiding tax because the taxpayer would then mount an argument around the rational commercial objectives of their action as in the 1977 case of *Slutzkin v FCT*.[57] There Barwick CJ held:

> [T]the choice of the form of transaction by which a taxpayer obtains the benefit of his assets is a matter for him: he is quite entitled to choose that form of transaction which will not subject him to a tax, or subject him only to less tax than some other form of transaction might do.[58]

This had the effect of again frustrating the Commissioner's efforts to counter perceived avoidance by insisting on a literal reading of the legislation thus enabling taxpayers to continue to choose any course of action open to them. As a result of such

---

52 *Cridland v FCT* [1977] HCA 61; (1977) 140 CLR 330 (30 November 1977) at 21.

53 Julie Cassidy, 'Are Tax Schemes Legitimate Commercial Transactions? *Commissioner of Taxation v Spotless Services Ltd and Commissioner of Taxation v Spotless Finance Pty Ltd*'. Commentary on a Judgment of the Full Court of the Federal Court, 27 November 1995, (reported in 1995, 95 ATC 4775, *High Court Review*) 18, 4. <http://www.austlii.edu.au/au/journals/HCRev/1996/7.html>.
Also note that legislative amendments were made which subsequently tightened the definition of a primary producer, so that such a scheme would fail today. Refer to *Income Tax Assessment Amendment Bill 1978* (Cth) and s 157 *Income Tax Assessment Act 1936* (Cth).

54 See *W P Keighery Pty Ltd v Federal Commissioner of Taxation* [1957] HCA 2; (1957) 100 CLR 66 (19 December 1957) at 93 and *Cridland v FCT* [1977] HCA 61; (1977) 140 CLR 330 (30 November 1977).

55 M Cashmere, 'Towards an appropriate interpretive approach to Australia's general tax avoidance rule – Part IVA' (2006) 35 *Australian Tax Review* 232.

56 The Commissioner of Taxation is the Chief Executive Officer of the Australian Taxation Office.

57 *Slutzkin v FCT* (1977) 140 CLR 314, 319.

58 Ibid.

attitudes by the judiciary, the usefulness of s 260 was questionable. As tax minimisation schemes became more prevalent and appealing there was impetus for change.

The response by the Australian government from the late 1970s

By the late 1970s there had been growing concern and recognition by the general public that the tax system in Australia lacked equity and efficiency and that the tax laws were becoming very complex and voluminous.[59] By 1974 the Australian Government began its investigation into the Australian taxation system by establishing the Taxation Review Committee. This committee produced the *Asprey Review*[60] in 1975, whose key theme was to improve equity and efficiency of the tax system by broadening the tax base. The Review set out the three principles of tax policy reform: 'fairness, efficiency and simplicity.'[61] It was this initial Review that has laid the foundations for the Australian Government's continued revisions, investigations and rationalisation of the Australian tax system in its entirety right up until the present day. In addition, the engagement by taxpayers in many dubious tax minimisation schemes[62] was also an important focus of the Review. These schemes also came under the radar of the Australian government as part of the McCabe-Lafranchi Report (1979-1983)[63] and the following Costigan Royal Commission (1984).[64] By 1983 and 1984, when the Reports' findings were released, the Australian public had become aware that hundreds of companies had paid no tax over the preceding years as a result of their engagement in tax minimization schemes. A number of principal reasons for the epidemic of taxation frauds were identified by the *McCabe-Lafranchi Report*:

> One was Federal and High Court decisions unsympathetic to Australian Taxation Office enforcement that embolded the promoters; another was

---

59 S Reinhart and L Steel, 'A Brief History of Australia's Tax System' (Paper presented at the 22nd APEC Finance Ministers Technical Working Group Meeting, Khanh Hoa, 15 June 2006 in Vietnam) 10.

60 K W Asprey and Ross Parsons, Commonwealth Taxation Review Committee (Asprey Committee), *Full Report* (1975), The Australian Government Publishing Service, Canberra, 1975.

61 Ibid.

62 Section 260, *Income Tax Assessment Act 1936* (Cth) (This section no longer applies to contracts entered into after 27 May 1981).

63 PW McCabe and DJ Lafranchi, *Report of Inspectors Appointed to Investigate the Particular Affairs of Navillus Pty Ltd and 922 other companies (1983)* Government Printer, Melbourne, 1983.

64 FC Costigan, (Chairman), Royal Commission on the Activities of the Federated Ship, Painters and Dockers Union, *Final Report* (1984) APGS Canberra, 1984.

> payments of commissions to accountants and solicitors who referred vendors; a third was timidity and chain dragging by the ATO in taking action, and a fourth was increased willingness of the community to participate in tax avoidance.[65]

The financial costs to Australia's economy because of this period in Australian taxation history has created much discussion amongst legal commentators. Grabosky and Braithwaite (1987) estimated that some '7,000 companies and over 30,000 taxpayers became involved in the tax avoidance schemes of the late 1970s'.[66] By 1985, engagement by taxpayers in such tax avoidance and evasion schemes were said to be responsible for tax revenue losses around $3 billion per year.[67] The Commonwealth government at the time referred to these activities as 'having been the largest cases of fraud committed against the Commonwealth government'[68] and J Braithwaite also referred to those that engaged in such schemes as 'fiscal and moral termites'.[69]

Following these investigations and reports, the Australian government initiated the introduction of 'specific legislation designed to ameliorate the economic and social effects'[70] of that infamous tax evasion period in its nation's history. By 1980, the Australian government had already begun its attack on those tax avoidance and tax evasion schemes that were seen to be having a negative effect on its revenue base. Adopting a command-and-control regulatory approach, rather than relying on the often difficult process of launching prosecutions under s 260 of the *ITAA36*, government agencies also began to use explicit criminal charges as a means of dealing with wrongdoers, by making specific legislative amendments to Federal Acts. For example, engagement in the 'Bottom of the Harbour' tax avoidance schemes, which had been prevalent in the 1970s, was made a criminal offence in 1980 by the enactment of the *Crimes (Taxation Offences) Act 1980* (Cth). Such was the outrage against these schemes that the government also enacted the *Taxation (Unpaid Company Tax) Assessment Act 1982* (Cth) which retrospectively allowed the collection of tax avoided under 'Bottom of the Harbour' schemes for the period 1 January 1972 to 4 December 1980.[71]

---

65 A Freiberg, 'Ripples from the Bottom of the Harbour: Some Social Ramifications of Taxation Fraud' (1988) 12 *Criminal Law Journal* 137.

66 P Grabosky and J Braithwaite, 'Corporate Crime in Australia', Trends and Issues No.5 (1987) *Australian Institute of Criminology*, Canberra, 153, as quoted in Chris Evans, 'Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions' [2007] *University of New South Wales Law Review* 12. Also see P Browne (1985) 'Fair Shares' *Legal Services Bulletin* 52.

67 Ibid.

68 Freiberg, above n 65, 169.

69 Braithwaite J, above n 20.

70 Potas, above n 13, 3.

71 Grabosky and Braithwaite, above n 65.

The retrospective application of this Act was viewed with great suspicion because of the rule of law breach in making something illegal after the event. Senator Don Chipp commented, 'I do not trust politicians to legislate retrospectively. One of the few protections the ordinary citizen has is that he knows the law.'[72] This backlash concerning the retrospectivity of the legislation was tempered somewhat by the ill feeling generally felt by the majority of taxpayers towards those that had engaged in the blatant tax avoidance schemes. Parliament ultimately overcame the reluctance and passed the retrospective legislation, surrendering a long standing principle in favour of its urgent purpose – to protect revenue. Over the next 5 years in particular, a number of new legislative provisions were introduced by the Australian government, with the purpose of prosecuting those identified as wrongdoers, and deterring others who were of like mind. This was predominately achieved under a command-and-control approach 'by imposing pecuniary penalties, and confiscating tainted property (the fruits of crime)'[73]. For example:

> in 1984 … further tax legislation was introduced adding criminal offences and prescribed tax offences to the Act. …In the same year the *Crimes Act 1914* (Cth) was amended. By s 29AD of the Act, it became an offence to defraud the Commonwealth. … By 1987 the *Proceeds of Crime Act 1987* (Cth) was also introduced to further extend the power of the authorities to investigate and prosecute individuals. In 1988, the *Cash Transaction Reports Act 1988* (Cth) was also introduced in an effort to counter the underworld cash economy, tax evasion and money laundering.[74]

Lecturing the public as to the harsh national economic effects of tax avoidance, the government seized the opportunity to enact a new general anti-avoidance measure, Part IVA of the *ITAA36*[75] in 1981. By 1982, the government had also targeted the literal interpretation of tax legislation – specifically s 260 of the *ITAA36* – as a major influence in cultivating taxpayers' negative attitudes to compliance. Accordingly, the *Acts Interpretation Act 1901* (Cth) was amended by including a new section, s 15AA, which allowed courts, when 'interpreting ambiguous provisions … to draw upon the purpose and intention of the legislation thereby impeding the opportunities for those seeking to exploit the tax system by appealing to a literal interpretation of the legislation'.[76] In addition to the introduction of the new anti-avoidance provisions

---

72 Commonwealth, *Parliamentary Debates*, Senate, 19 November 1982, 2592 (Don Chipp, Leader of the Australian Democrats).

73 Potas, above n 13, 3.

74 Ibid.

75 Coleman and Freeman, 'Cultural Foundations of Taxpayer Attitudes to Voluntary Compliance' (2007) 13 *Australian Tax Forum* 311, 335-336.

76 Potas above n 13, 3. Also refer to s15AA(1), *Acts Interpretation Act 1901* (Cth), which states 'In the interpretation of a provision of an Act, a construction that would promote the

under Part IVA of the *ITAA36*, the income tax base was also broadened. Potas notes this was achieved by the:

> introduction of fresh legislation in order to also impose taxes on previously untouched transactions. Capital Gains Tax, introduced in 1985 was intended to prevent taxpayers taking advantage of the income/capital dichotomy… Fringe Benefits Tax was introduced in 1986 partly to close a large loophole that had been exploited mostly by high income earners.[77]

A foreign tax credit system[78] was also implemented in 1987 to address international transactions. The year 2000 saw a broad-based goods and services tax[79] introduced which *inter alia* was to keep a lid on the cash economy. This gradual broadening of the tax base attacked anomalies, and also helped roll back the tax avoidance and evasion industry.

The 1980s and GARR: Part IVA ITAA36

Australia's *GARR* are currently covered by Part IVA of the *ITAA36,* introduced to apply to 'schemes' entered into after 27 May 1981.[80] Part IVA was ostensibly introduced in order to 'bury the doctrines that rendered (s 260) … largely ineffective throughout those tax evasive years'[81] and to also crack down on the 'blatant, artificial or contrived tax avoidance schemes'[82] of the past. The effect of Part IVA allows 'the Commissioner of Taxation to set aside certain financial transactions if satisfied that they were made with a view to avoiding tax.'[83] For Part IVA to apply, the Commissioner is required to prove to the court that the taxpayer entered into a tax avoidance scheme with the sole or dominant purpose of obtaining a tax benefit.[84] In

---

purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object'.

77 Ibid. Also refer to *Fringe Benefits Tax Assessment Act 1986* (Cth),

78 For a discussion on the operation of the foreign tax credit system in Australia see generally Phillip Hourigan, 'A Critical Analysis of the Foreign Tax Credit in Australia and its Relationship to the Imputation and Controlled Foreign Entities Legislation' (1993) 3 *Revenue Law Journal* 1, Article 3. < http://epublications.bond.edu.au/rlj/vol3/iss1/3>.

79 *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

80 As introduced by the *Income Tax Laws Amendment Act (No 2) No 110 1981* (Cth).

81 SE Crane and F Nourzad, 'Tax Rates and Tax Evasion: Evidence from California Amnesty Data' (1992) *National Tax Journal*, vol XLIII.

82 Cassidy, above n 5, 84. Also refer to Commonwealth of Australia 1981, *Explanatory Memorandum for Income Tax Laws Amendment Bill 1981 (No 2)*, Commonwealth of Australia, Canberra.

83 Potas, above n 13, 4.

84 See Section 177D, *Income Tax Assessment Act 1936* (Cth).

1994, the High Court in *FCT v Peabody* [1994][85] considered the application of *GARR* under Part IVA of the *ITAA36*. The Full Court of the Federal Court had said that, 'in determining the dominant purpose of the scheme or part of a scheme, s 177D required a balance between the commercial and tax elements of an arrangement'.[86] The High Court agreed with the taxpayer who had argued that the transactions that they had entered did not fall foul of Part IVA, because any tax benefit they had received 'was only an incidental result of a larger scheme whose primary objective was not to avoid tax'.[87] In 1996, *FCT v Spotless Services* [1996][88] also considered the application of Part IVA of the *ITAA36*. There, the court swept away Lord Tomlin's dictum in *IRC v Duke of Westminster* [1936] which had noted that 'every taxpayer is entitled to order his affairs so that the applicable tax was less than it otherwise be'.[89]

FCT v Spotless Services [1996] also saw a change in legislative interpretation by the High Court:

> Much turns upon the identification, among various purposes, of that which is "dominant". In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing or most influential purpose…if the taxpayers took steps which maximised their after-tax return and they did so in a manner indicating the presence of the "dominant purpose" to obtain a "tax benefit", then the criteria which were to be met before the Commissioner might make determinations under section 177F were satisfied.[90]

This change in approach was indicative of a move towards a purposive interpretation of the tax law. Later in 1991, in *DFCT v Chant* [1991],[91] Kirby J observed:

> The modern approach to statutory construction requires courts to avoid a purely textual examination of legislative works and to seek out, instead, the purpose of the legislature, so as to fulfil that purpose within the words actually used.[92]

This view was also upheld in *FCT v Consolidated Press* [2001], where it was noted 'the application of Part IVA was not dependent on the fiscal awareness of the taxpayer.'[93] In 2004, Gleeson CJ and McHugh J in *FCT v Hart* [2004][94] applied s 177F so that the

---

85 (1994) 181 CLR 359.

86 *Federal Commissioner of Taxation v Peabody* (1994) 96 ATC 4101, 4117.

87 Potas, above n 13, 5.

88 (1996) 186 CLR 404.

89 *IRCF v Duke of Westminster* [1936] AC 1, 19.

90 *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 418.

91 *DFCT v Chant* (1991) 24 NSWLR 352, 356.

92 Ibid 356.

93 *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) ATC 4343, 4360.

94 *Commissioner of Taxation (Cth) v Hart (2004) HCA 26*; 217 CLR 216; 206 ALR 207; 78 ALJR 875 (27 May 2004).

transaction entered into by the taxpayer could be reconstructed in such a way to enable the taxpayer an allowable deduction for interest that would have been applicable under a standard loan agreement, whilst interest charges that were connected with the wealth optimiser scheme that the taxpayer had engaged in were not. Their Honours agreed that the Part IVA issue should succeed and that the deductibility of the interest as found in favor for the taxpayers in the Federal Court was not in issue:

> We agree that the Commissioner's appeal on the Pt IVA issue should succeed, and that the question relating to the deductibility, in the circumstances, of interest upon interest (which was answered by all four members of the Federal Court in favour of the respondents) does not arise.[95]

This was further illustrated by the following:

> Let it be assumed that … even if the "wealth optimizer structure" had not been available the [taxpayers] would have borrowed money to buy their new home and also borrowed money in order to retain their former home as an income-earning investment. The 'wealth optimiser structure' depended entirely for its efficacy upon tax benefits generated by arrangements between the [taxpayers] and the lender that had no explanation other than their fiscal consequences. What "optimised" the [taxpayers'] 'wealth' was the tax benefit … not the deductibility of interest as such; but the deductibility of additional interest … contrived by the particular form of borrowing transaction.[96]

This initiative seemed to mean that the courts could look beyond the words of the statute and think about what Parliament had in mind as to the purpose of the legislation and what mischief was to be remedied.

Part IVA, more comprehensive than s 260, is Australia's key anti-avoidance measure. Part IVA allows the Commissioner to reach an effective compromise, which is important in situations that call for some flexibility. Much of this has to do with the Commissioner's 'reconstruction power'[97] contained within Part IVA under s 177F, as noted in *Hart's* case.[98] Section 177F allows the Commissioner to strike down an anti-avoidance scheme in a number of ways. For example, under s 177F(1) the Commissioner can disallow a tax benefit to the taxpayer in whole or in part. Section

---

95 Ibid 1.

96 Ibid 18.

97 Explanatory Memorandum to the *Income Tax Laws Amendment Bill (No 2) 1981* (Cth) at 60. 'Section 177F is the "reconstruction" provision of Part IVA.'

98 *Commissioner of Taxation (Cth) v Hart (2004) HCA 26*; 217 CLR 216; 206 ALR 207; 78 ALJR 875 (27 May 2004) at 86. Also refer to s 177F (1) of the Income Tax Assessment Act 1936 which states that 'where the Commissioner makes such a determination (under s 177F(1)), he shall take such action as he considers necessary to give effect to that determination.'

177F(2A) operates where there is a tax benefit as obtained under s 177CA.[99] Under this subsection the Commissioner can apply an amount of withholding tax in whole or in part. Section s 177(3) enables the Commissioner to determine that certain amounts in relation to a scheme, where it is fair and reasonable, are not contra to Part IVA of the *ITAA36*.[100] This allows for compensatory adjustments to be made in favour of a taxpayer where circumstances deem it necessary. Comparing these powers under Part IVA to those available under s 260, s 260 was 'an all-or-nothing provision which was not sufficiently flexible to deal with complex tax avoidance schemes.'[101] Unlike the restricted 'all-or-nothing' approach taken by the courts with respect to s 260, Part IVA provides the Commissioner with a wider (and more flexible) range of powers.[102]

Current strategies: 2000 and beyond

Tax planning and Tax avoidance

In recent times, tax avoidance arrangements entered into by a taxpayer have 'drawn further distinctive pejorative connotation'[103] by the ATO and the courts. There is no longer the view that such avoidance schemes 'entered into by a taxpayer will be free from the taint of illegality'[104] with the ATO now taking a narrower approach on what constitutes acceptable tax planning or allowable avoidance strategies. The test of whether a transaction falls foul of the provisions in Part IVA of the *ITAA36* however

---

[99] See s 177CA *Income Tax Assessment Act 1936* (Cth): '(1) This section applies in relation to a particular amount if a taxpayer is not liable to pay withholding tax on an amount where that taxpayer would have, or could reasonably be expected to have, been liable to pay withholding tax on the amount if a scheme had not been entered into or carried out. (2) For the purposes of this Part, if this section applies in relation to an amount, the taxpayer is taken to have obtained a tax benefit in connection with the scheme of an amount equal to the amount mentioned in subsection (1).'

[100] Section 177F, *Income Tax Assessment Act 1936* (Cth).

[101] Potas, above n 13, 4.

[102] See *Explanatory Memorandum to the Income Tax Laws Amendment Bill (No 2) 1981* (Cth) at 60: 'Section 177F is the "reconstruction" provision of Part IVA and will come into play once section 177D, together with section 177C (for the general run of cases), or section 177E (for dividend stripping and similar schemes) has done its work of both exposing for annihilation a sought-for 'non-taxable' position and quantifying the amount of the 'tax benefit' that stands to be cancelled. The essential function of section 177F is to enable the Commissioner of Taxation, against the background of the other sections mentioned, to determine precisely what tax adjustments should be made in the assessments of the taxpayer concerned and of other taxpayers affected by the scheme.'

[103] Potas, above n 13, 2.

[104] Ibid. See also Part IVA, *Income Tax Assessment Act 1936* (Cth).

is essentially a matter for the courts when determining cases brought to them by the ATO, where it argues that the anti-avoidance provisions should apply. In this regard, it seems that the ATO takes the view that it 'tolerates minimisation activity until it reaches a point where there are either significant drains on revenue because of widespread use, or public disquiet concerning certain sections of the community who seem to be behaving in a way, which undermines confidence in the taxation system'.[105]

The ATO has in recent times adopted the nuance 'aggressive tax planning' which inaugurates the blur between lawful and unlawful tax minimisation strategies, outlining it as 'planning that goes beyond the policy intent of the law and involves purposeful and deliberate approaches to avoid any type of tax.'[106] In order to combat and deter the use of such aggressive tax planning activities or schemes by certain groups of its taxpayers, the ATO has *inter alia* adopted a number of combative strategies including the use of taxpayer alerts. These taxpayer alerts act as a 'pre-emptive early warning to certain taxpayers who engage in … significant new and emerging higher risk tax planning issues or arrangements that the ATO has under risk assessment'.[107] For example, in February 2010, the Commissioner for Taxation Michael D'Ascenzo issued a taxpayer alert,[108] its object to act as a warning to those taxpayers involved in takeover schemes which predominately are '… uncommercial arrangements … in order to claim unintended GST benefits for a company float, merger or acquisition.'[109] Whilst such arrangements are not specially prohibited, they are as the ATO describes, 'uncommercial in nature and therefore subject to risk

---

105 Cashmere, above n 54, 232.

106 Australian Taxation Office, *About tax minimisation and tax avoidance schemes* (2010) <http://www.ato.gov.au/atp/content.asp?doc=/content/00242194.htm&mnu=49310&mfp=001/008>.

107 Australian Taxation Office, *Taxpayer Alert TA 2010/1, GST - interposing an associated 'financial supply facilitator' to enhance claims for reduced input tax credits for expenses incurred in the course of a company takeover* (2010) <http://law.ato.gov.au/atolaw/view.htm?Docid=TPA/TA20101/NAT/ATO/00001&PiT=99991231235958>.

108 Australian Taxation Office, *ATO Examining Takeover Arrangements*, < http://www.ato.gov.au/corporate/content.asp?doc=/content/00231795.htm>, where it is noted that 'taxpayer alerts are intended as an 'early warning' to taxpayers and their advisers of significant tax planning issues or arrangements that the Tax Office has under risk assessment or about which it has concerns.'

109 Ibid. An example provided by the ATO is where a 'taxpayer uses a related associate as a go between to gather in all the services required for such a takeover, that associate then bundles all the services together and issues only one invoice. The taxpayer then claims reduced input tax credits that they normally would not have been entitled to had they obtained the services directly from the suppliers themselves'.

assessment by the ATO (and) … people considering these arrangements should be aware we will take a close look at the tax affairs of anyone taking part.'[110] The ATO takes the view that such practices tend to undermine the spirit of the law, and thus may fall under the auspices of unacceptable tax avoidance. What this has highlighted is a challenge for all stakeholders in the taxation game; the government, the courts, the ATO and taxpayers now must consider where 'planning' ends and 'avoidance' begins.

Tax avoidance and tax evasion

Tax evasion is observed to encompass illegal activities where taxpayers engage in 'wilful attempts to evade their tax liability by submitting false information and records or by omitting any material or details that should have been disclosed'.[111] For example, where taxpayers intentionally under declare income, profit, or gains, and overstate deductions. On the face of it, the 'distinction between tax avoidance and tax evasion has been well established'[112] where 'tax avoidance lacks the criminal intent required for an arrangement to breach the tax evasion provisions.'[113] However the ATO, in recent times, has significantly blurred 'the distinction between tax avoidance and tax evasion,'[114] in particular when dealing with the problematic cash economy as well as with those taxpayers who employ foreign tax havens to avoid their tax obligations.

The cash economy

One challenging area where tax evasion has been and still is prevalent is the cash economy. Around the same time as the tax avoidance economy was evolving in the mid-1970s, tax evasion in the cash economy also experienced a boom. Taxpayers, driven by the aforementioned inequity in the tax system, gross increases in tax liability, as well as problematic complexity issues contained within the tax system itself, were evading their tax liabilities to varying degrees by accepting cash payments for work performed, and not declaring the cash payments as income. The practice grew, especially in certain industries where cash payments were commonplace, and the provisions in the *ITAA36* that existed prior to 1981 were simply inadequate to prevent such blatant evasions.[115]

---

110 Australian Taxation Office, *ATO Examining Takeover Arrangements* (2010), above n 107.

111 See *Denver Chemical Manufacturing Co v Commissioner of Taxation* (NSW) (1949) 79 CLR 296 313-14, where it was noted that this requires the taxpayer to have possessed a fraudulent intention to deceive at the time of withholding important information.

112 McLaren, above n 15, 141.

113 J Cleary, 'The Evolution of Tax Avoidance' (1995) 5(2) *Revenue Law Journal* 223.

114 McLaren, above n 15, 141.

115 Ibid.

Over time, the Australian government has put a number of legislative and regulatory measures in place in an attempt to quell the growth of the cash economy, starting in the 1980s. In 1983, the government introduced the Prescribed Payments System (PPS).[116] Whilst the system was successful in decreasing tax evasion within the particular industries to which the PPS provisions applied, it was found that there were still a great number of traders who only dealt in cash, but who did not fall within the PPS parameters. As such, the Reportable Payments System was introduced in 1994 to 'fill the gaps' and to cover even more cash transactions.[117] In addition, in 1989, to further reduce the level of tax evasion for cash transactions, a system of identification using Tax File Numbers (TFN) was introduced. This allowed efficient comparison of information in a taxpayer's tax return with information provided to the ATO by the taxpayer and other parties such as employers, banks, and superannuation funds. This TFN system together with the introduction of further legislation in 1990, the *Data Matching Program Act 1990* (Cth) has addressed tax evasion activities by certain taxpayers dealing in the cash economy for example, by making it more difficult for taxpayers to earn income under an assumed name.[118] In July 2000, the Australian Business Number[119] (ABN) system was also introduced to further enhance the ATO's power to trace and data match transactions and taxpayers activities.[120] The Australian government also introduced its version of a value added tax, the Goods and Services Tax, which in part was also to address the problematic cash economy.[121] Today, education plays a great part in dealing with those taxpayers who deal in cash transactions. For example, in 2010 and 2011 the ATO has committed

---

116 See Part IV Div 3A, *Income Tax Assessment Act 1936* (Cth) (ss 221 YHA – 221 YHZ) which requires taxpayers who receive cash payments in prescribed industries to register with the ATO. Under the system, the payers of cash amounts, in respect of specified work which is carried out within specified industries, must register the payments with the ATO, and deduct the appropriate amount of tax from the amount, forwarding it to the ATO in accordance with their guidelines.

117 Cleary, above n 112, 223-4.

118 The Australian Taxation Office uses powers given to it under the *Data Matching Program Act* 1990 to match data concerning a person's income and family structure with the taxpayer's TFN.

119 The Australian Business Number (ABN) is a unique number which identifies businesses in their dealings with the ATO. Entities who can obtain an ABN include: entities carrying on business in Australia; Commonwealth and State departments which are deemed to be carrying on a business; companies registered under Corporations Law and certain charitable organisations registered to enable tax deductibility of donations.

120 The Australian Business Number (ABN) arguably makes tax avoidance more difficult by requiring payers to deduct tax unless an ABN number is quoted where required.

121 *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

to send out letters to those taxpayers identified as participating in the cash economy to,

> inform taxpayers that they have been identified as a result of one of our cash economy indicators (and) … encourage taxpayers to review their records to ensure they have correctly reported all income, especially cash transactions.[122]

These letters are part of the voluntary compliance program by the ATO, whose stated purpose is to 'alert those taxpayers at risk on how to correct mistakes and how to make voluntary disclosures'.[123] The ATO, through education, is seeking to further manage the compliance risk of taxpayers who are dealing in the cash economy.

Foreign Tax Havens

The ATO's current focus is also on arrangements which are 'uncommercial' in nature and have an aggressive flavour. They typify taxpayers using foreign tax havens to minimise their tax obligations as 'blurring ... the distinction between tax avoidance and tax evasion'.[124] This has been most evident when dealing with tax schemes that have caught the attention of 'Project Wickenby'.[125] The government has insisted on ignoring the distinction between tax avoidance and tax evasion activities undertaken by certain taxpayers in order to curtail the use and promotion of such foreign tax schemes by taxpayers. As McLaren notes, under 'Division 290 of the *Taxation Administration Act 1953* (Cth), the legislation does not refer to tax avoidance or tax evasion but instead deals with "tax exploitation schemes"'.[126] In addition, both the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth)[127] and the *Tax*

---

122 See Australian Taxation Office, *Cash Economy Letter Program*, (2010) <http://www.ato.gov.au/businesses/content.asp?doc=/content/00251723.htm&pc=001/003/070/007/001&mnu=&mfp=&st=&cy=1>, where it is noted that 'as part of our approach to managing risks in the cash economy, this financial year, we will send around 110,000 letters to taxpayers who may be participating in the cash economy.'

123 Ibid.

124 McLaren, above n 15, 141.

125 See Australian Taxation Office, *Project Wickenby*, <http://www.ato.gov.au/corporate/content.asp?doc=/content/00220075.htm>, where it is noted that the multi-agency task force 'Project Wickenby' was set up in early 2006. Its objective is to 'prevent promotion and participation in the abuse of tax havens'. Project Wickenby evolved from Operation Wickenby, an Australian Crime Commission led operation set up in 2004. Its purpose was to 'investigate serious tax fraud, tax evasion and money laundering offences against the Commonwealth.'

126 McLaren, above n 15, 141.

127 Section 41, *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth).

Laws Amendment Act (2006 Measures No 1) Act 2006 (Cth)[128] refer to 'suspicious matters' and 'tax exploitation schemes', respectively. The use of such terminology can allow the government to categorise any attempt by taxpayers to minimise the amount of tax payable via the use of foreign tax havens as illegal activity and not just as aggressive tax planning or even unacceptable tax avoidance. In other words, such activity is characterised as tax evasion, with not just administrative but also criminal sanctions attached.[129] The overall goal of Project Wickenby has been to address and reduce,

> international tax avoidance and evasion in the Australian tax system and enhancing community confidence in Australian regulatory systems, particularly confidence that the Australian government addresses serious non compliance with tax laws.'[130]

The first conviction under Project Wickenby was in July 2007 when Mr Glen Wheatley was jailed for two and a half years after pleading guilty to charges under the *Crimes Act 1914* (Cth), *Bankruptcy Act 1966* (Cth) and the *Criminal Code Act 1995* (Cth).[131] By August 2010, 58 people 'had been charged with serious offences'[132] under Project Wickenby, with 12 convictions.[133] The sentencing comments in the cases of *R v Anthony Joseph Luis HILI* [2009] and *R v Glyn Morgan JONES* [2009][134] illustrates the Government's and the courts' view that such activities are serious crimes:

> With respect to both offenders that is Mr Hili and Mr Jones, the offences to which each have pleaded are extremely serious…their acts involved a deliberate course of conduct committed to evade paying the taxation which they were

---

128 See Schedule 3, Promotion and Implementation of Schemes, *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth).

129 The largest fine for tax evasion in Australian legal history was imposed in the Victorian Supreme Court case of *Commissioner of Taxation v Australian Petroleum Suppliers Pty Ltd* [2003] VSC 240, where a company was fined a total of $53 million after evading its obligation to pay excise duty. See also ABC Radio National, 'Record Fines for Company Tax Evasion', *PM Report*, 27 June 2003 (Ben Knight) <http://www.abc.net.au/pm/content/2003/s890095.htm>.

130 Transcript of sentence handed down by Morgan J in *R v Hili & Jones (*unreported NSWDC) 13 Nov 2009, 8.

131 Melissa Jenkins and Mariza O'Keefe, 'Wheatley sent to jail over tax fraud', *The Sydney Morning Herald, (*Sydney), 20 July 2007, also available at <http://www.smh.com.au/news/national/wheatley-sent-to-jail-over-tax-fraud/2007/07/19/1184559956966.html>.

132 Australian Taxation Office, Project Wickenby, <http://www.ato.gov.au/print.asp?doc=/content/00220075.htm&page=9>.

133 Ibid.

134 Transcript of sentence handed down by Morgan J in *R v Hili & Jones (*unreported NSWDC) 13 Nov 2009, 35.

> liable to pay to the Commonwealth of Australia. Both knew from the outset they were involving themselves in a completely blatantly dishonest scheme of tax evasion. They also frankly conceded the motivation for their participation was for financial gain… Taxation fraud has been likened to Social Security fraud and in those cases the courts have said that the rationale stated for the rule that a custodial sentence is to be imposed except in very special circumstances is that the offence is easy to commit but difficult to detect, Regina v Purden unreported Court of Criminal Appeal decision 27 March 1997. These words are apposite in this case, indeed it was because of the difficulty in detecting and investigating such offences that Project Wickenby was established.[135]

In this case the taxpayers, Mr Hili and Mr Jones, had been involved in a 'Vanuatu based "round robin" scheme that operated to enable its participants to evade payment of company income tax and personal income tax in Australia'.[136] The court noted that Mr Hili's and Mr Jones' tax evasive activities resulted in a total liability to the Australian Taxation office, personally and that of their companies, in the vicinity of $1.1M each having regard to penalties and interest to be imposed. Despite both men pleading guilty, and showing great remorse, Judge Morgan of the New South Wales District Court convicted them and sentenced both to 18 months imprisonment to be released on recognisance after seven months, for a number of offences, including:

> defrauding the Commonwealth contrary to s 29D of the *Crimes Act 1914* (Cth) … dishonestly obtaining a financial advantage from the Commissioner of Taxation contrary to s 134.2(1) of the *Criminal Code* and … dealing with money to the value of $100,000 or more intending that the money would become an instrument of crime contrary to s 400.4(1) of the *Criminal Code*.[137]

---

135 Ibid.

136 Ibid.

137 Section 29D of the *Crimes Act 1914* (Cth) provided that a person who defrauds the Commonwealth was guilty of an indictable offence and liable if convicted to be fined $100.000, imprisoned for 10 years or both, however it was repealed and replaced with the provisions in the *Criminal Code Act 1995* (Cth) which commenced on 24 May 2001. Section 134.2(1) of the *Criminal Code Act 1995* (Cth) provides '(1) A person is guilty of an offence if: (a) the person, by a deception, dishonestly obtains property belonging to another with the intention of permanently depriving the other of the property; and (b) the property belongs to a Commonwealth entity. Penalty: Imprisonment for 10 years. (2) Absolute liability applies to the paragraph (1)(b) element of the offence'. Section 400.4(1) of the *Criminal Code Act 1995* (Cth) provides that '(1) A person is guilty of an offence if: (a) the person deals with money or other property; and (b) either: (i) the money or property is, and the person believes it to be, proceeds of crime; or (ii) the person intends that the money or property will become an instrument of crime; and (c) at the time of the dealing, the value of the money and other property is $100,000 or more. Penalty: Imprisonment for 20 years, or 1200 penalty units, or both.'

The Crown appealed against their sentences in the Court of Appeal of New South Wales,[138] on the ground of manifest inadequacy. The taxpayers' sentences were increased to three years imprisonment with recognisance after 18 months. Mr Hili's and Mr Jones' appeals to the High Court were dismissed.[139] The High Court, despite agreeing that the 'Court of Appeal of New South Wales was wrong to have regard to a mathematical percentage as the "norm" for setting a non-parole period',[140] found that the Appeal Court was nevertheless correct to increase the sentences. To this end, their Honours expressly noted the importance of general deterrence, the motivation for the offence and the offenders' prior convictions.[141]

The seriousness of tax evasion activities, and the subsequent consequences for taxpayers caught under the radar of Project Wickenby was again illustrated in the 2010 case of *R v Hargraves and Stoten* [2010][142] where tax evasion was regarded by the Supreme Court of Queensland as 'theft and corruption'.[143] In that case, the taxpayers were two of the three shareholders of a Broadbeach (Qld) based Phone Directories Company (PDC). They were found guilty of conspiring to dishonestly cause a loss to the Commonwealth, between May 2001 and June 2005, by inflating tax invoices for their business expenses and hiding money in offshore bank accounts to avoid paying tax.[144] Neither of the taxpayers showed any signs of remorse during their trial, and Justice Fryberg at sentencing commented that it was to be inferred that:

---

138 *R v Glyn Morgan JONES; R v Anthony Joseph Luis HILI* [2010] NSWCCA 108 and *R v Glyn Morgan JONES; R v Anthony Joseph Luis HILI* (No 2) [2010] NSWCCA 195.

139 *Hili v The Queen; Jones v The Queen* [2010] HCA 45.

140 *Hili v The Queen; Jones v The Queen* [2010] HCA 45 [18].

141 *Hili v The Queen; Jones v The Queen* [2010] HCA 45 [18].

142 *R v Hargraves and Stoten* [2010] QSC 188. Available at <http://archive.sclqld.org.au/qjudgment/2010/QSC10-188.pdf>.

143 *R v Hargraves and Stoten* [2010] QSC 188 [41]. Available at <http://archive.sclqld.org.au/qjudgment/2010/QSC10-188.pdf>.
Justice Fryberg agreed with the Victorian and Western Australian CA cases of *Director of Public Prosecutions (Cth) v Goldberg* (2001) 184 ALR 387 and *Pearce v R* (2005) 216 ALR 690 on tax evasion as theft and corruption. In *Pearce v R* (2005) 216 ALR 690, 763 the court characterised tax evasion: 'Tax evasion is not a game, or a victimless crime. It is a form of corruption and is, therefore, insidious. In the face of brazen tax evasion, honest citizens begin to doubt their own values and are tempted to do what they see others do with apparent impunity. At the very least, they are left with a legitimate sense of grievance, which is itself divisive. Tax evasion is not simply a matter of failing to pay one's debt to government. It is theft, and tax evaders are thieves.'
On appeal, the sentences were reduced to imprisonment for 5 years with a non-parole period of 2 years and 6 months: *R v Hargreaves and Stoten* [2010] QCA 328.

144 *R v Hargraves and Stoten* [2010] QSC 188 [41]. Available at <http://archive.sclqld.org.au/qjudgment/2010/QSC10-188.pdf>.

> They appreciated the very real possibility that the scheme was illegal, and that they were at least indifferent to that possibility. I am well satisfied that from that point forward their behaviour was dishonest. There is no suggestion in the evidence that any subsequent event occurred which might have restored their belief in the legality of the scheme. [145]

Fryberg J stressed that defrauding through tax evasion was unacceptable and that an example should be set:

> one of the most important factors affecting sentence in this case is the need to impose a sentence which will deter others from similar conduct … [sentencing both taxpayers for a] … term of imprisonment of 6½ years with a non-parole period of 3 years and 9 months … [as it was] necessary to deter such conduct by the imposition of penalties that those minded to defraud governmental departments will find an unacceptable risk. … This is especially so where they are offences which are not easily detected.[146]

The continued activities of Project Wickenby have arguably been a success for the government. In May 2010, the Commissioner Michael D'Ascenzo commented: 'Our ability to trace fund flows around the world is constantly expanding and we are identifying transactions and participants in abusive secrecy haven schemes,'[147] lending justification for the enormous amounts of money expended on this initiative.[148] The Assistant Treasurer, Senator Nick Sherry, in October 2009

---

[145] *R v Hargraves and Stoten* [2010] QSC 188 [18]. Available at <http://archive.sclqld.org.au/qjudgment/2010/QSC10-188.pdf>.

[146] *R v Hargraves and Stoten* [2010] QSC 188 [38]. Available at <http://archive.sclqld.org.au/qjudgment/2010/QSC10-188.pdf>.
Also refer to *R v To; ex parte Director of Public Prosecutions* [1998] 2 Qd R 166 and *Director of Public Prosecutions (Cth) v El Karhani* (1990) 21 NSWLR 370, 377 where it is noted that 'whilst deterrence is absent as a factor to be considered in sentencing under s 16A(2) *Crimes Act 1914* (Cth), it is nevertheless a relevant factor.'

[147] Australian Taxation Office, *Operation Wickenby-Tax fraud jails Perth accountant for 13 months* (2010) <http://www.ato.gov.au/corporate/content.asp?doc=/content/00241119.htm>.

[148] See Australian Taxation Office, *Project Wickenby – is it worth the risk? Funding* (8 November 2010) <http://www.ato.gov.au/businesses/content.asp?doc=/content/00220075.htm&page=16&H16>, where it is noted that a measure of the importance which the Government attributes to the collection of revenue and prevention of abusive tax planning is the amount of money expended on the initiative. 'Government additional resourcing for Project Wickenby is $430.9 million set out as follows: Phase 1 – $308.8 million from February 2006 to June 2010, with the period of funding for the Commonwealth Director of Public Prosecutions extending to 30 June 2012 and Phase 2 – $122.1 million over four years 2009–13.'
Also refer to Australian Crime Commission, *Project Wickenby,* (26 November 2010) <http://www.crimecommission.gov.au/media/faq/wickenby.htm> where the results of

commented in his press release 'that for every $1 spent, Wickenby had brought in $2 in tax liabilities or $1.50 in tax collections which he believed was a good return on the funds invested in combating evasion'.[149] Arguably, this expenditure seems justified when measured against relevant revenue returns and its use as a deterrent, particularly when coupled with widely publicised prosecutions.

PART 2 - REGULATORY THEORY AND COMPLIANCE ISSUES

Taxpayers' attitudes to compliance

Why people chose to comply or not to comply with their tax obligations is the major factor of the regulatory framework which underpins the ATO's current compliance program. Two major drivers that influence taxpayers' attitudes to compliance include the notions of ownership of the tax system itself and tax complexity, both of the tax system and in its administration.

Tax system ownership

The notion of ownership of the tax system by taxpayers is one major factor which influences taxpayers' attitudes to compliance:

> Research undertaken by the ATO in 1996 had identified a perception that ... the ownership of the tax system is associated with the Government or the ATO. When taxpayers choose to avoid their obligations they do not connect this with cheating the community, or the system that is there for the benefit of the entire Australian community.[150]

It is this perception of ownership or non-ownership of the tax system that has created much discussion amongst scholars, professionals and the ATO. Kristina Murphy notes that the management of tax evasion and tax avoidance by taxpayers for regulatory agencies such as the ATO has become increasingly difficult in the past few decades.[151] She explains that different theories have been proposed that attempt to

---

Project Wickenby at 31 October 2010 encompassed the 'completion of 1664 reviews and audits, raising liabilities of approximately $951.61 million; a total of 27 criminal investigations underway, with 60 people charged and 14 people convicted of serious offences; recouped $229.52 million in tax; achieved a compliance dividend of $301.70 million and collected $2.1 million in other moneys.'

149 Senator Nick Sherry, Australian Taxation Office, 'Anti Tax Evasion Strategy Paying Major Dividends' (Media Release, 20 October 2009) <http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/073.htm&pageID=003&min=njsa&Year=&DocType= >.

150 Australian Taxation Office, *Stepping into the Shoes of Small Business - A Review of the Small Business Market* (1996), < http://www.ato.gov.au>.

151 Murphy, above n 8.

'explain the "compliance behaviour" of people concerning their tax obligations.'[152] She rejects the rational choice model, which previously dominated public policy formulation in areas such as criminal justice, welfare policy and tax,[153] which 'propounds that people are motivated entirely by economic welfare where they calculate all associated risks and opportunities and disobey the law when they anticipate that the probability (and the monetary fine) of being caught are lower than the economic gain that would result from noncompliance.'[154] Murphy further notes that because the 'rational choice model fails to recognise people's perceptions of justice, fairness of the regulatory system and loss of reputation if caught contravening tax regulations, the most productive way of achieving complete acceptance of and adherence to regulations is through strategies appealing to a citizen's law abiding self', rather than 'reliance upon sanctions and legal coercion.'[155] Murphy argues that 'the ability of taxpayers to trust the regulating body, and their perception of the fairness with which they are treated, has a greater influence on a person's choice to contravene tax rules than simple economic self interest does.'[156] This sentiment was also noted by Vogel who had said 'public perception that the tax system is fair is critical if it is to rely for its success on a significant degree of voluntary compliance.'[157] Vogel suggested that a 'tax system may be less successful to the extent that it is perceived by members of a society to be unfair and inequitable'[158] and Spicer and Becker further added that it 'may generate feelings by taxpayers to evade paying taxes.'[159] According to these commentators, the concept of fairness thus has a positive role to play in the voluntary compliance attitudes of taxpayers.

Nevertheless, whilst the concept of fairness is arguably important, it is only one of many factors that are also relevant. For example, in 2003, a study was undertaken at an Australian University (105 post graduate business students) which looked at the impact of tax fairness on tax compliance. The study looked at a number of variables, including general fairness of the tax system, tax rate structure, exchange with the government, self-interest and fairness of special provisions.[160] Interestingly, with

---

152 Ibid.

153 Ibid.

154 Ibid 188.

155 Ibid.

156 Ibid 201.

157 J Vogel, 'Taxation and public opinion in Sweden: an interpretation of recent survey data' (1974) 27 *National Tax Journal* 499-513.

158 Ibid.

159 M W Spicer and L A Becker, 'Fiscal inequity and tax evasion: an experimental approach' (1980) 33 *National Tax Journal*, 171-5.

160 G Richardson, 'A Preliminary Study of the Impact of Tax Fairness perception Dimensions on Tax Compliance Behaviour in Australia' (2005) *Australian Tax Forum* 407.

respect to the tax rate structure and self-interest, the results showed that these variables were significant, however none of the others were. The study concluded that while tax fairness was a 'multidimensional concept, it only has varying effects on tax compliance in Australia.'[161] With this in mind, it is important to look at other factors which may also influence taxpayer compliance.

Conditional cooperation and taxpayer moral are also relevant issues that influence taxpayer compliance. People typically do not cooperate unconditionally. Fischbacher et al note that in a 'public goods dilemma most people will make a personal contribution provided others do the same, but if some free ride then cooperation will stop.'[162] International studies also indicate that compliance tends to be higher than rational models predict, given monitoring and penalty levels, even if people are significantly risk averse.[163] Taxpayer morale, which relates back to fairness concepts, which is people's intrinsic motivation to pay taxes, is also important, and this also relates to conditional cooperation. Just as in public-goods experiments, people will be more willing to pay tax if they perceive that other people are also paying their fair share. An empirical study across 30 countries has shown a strong correlation between tax morale and perceived levels of tax evasion by others.[164] Braithwaite expanded on this view and suggested that 'moral obligations and attitudes – in addition to the pure economic calculation of fear and punishment – are important influencers of compliance behaviour, and should therefore be considered in managing the non compliance of tax laws.'[165]

Generally taxpayers' attitudes to fairness, trust and morale are important factors, however it must also be noted that the complexities of the taxation system, its administration and the legislation itself also have a significant impact on the issue of taxpayer compliance.

Complexity

The Australian taxation system is complex. There are many tax laws, with many of them confusing and unclear. These concerns have a significant impact on taxpayer compliance. There are currently over 125 different types of taxes that may apply to

---

161 Ibid 428.

162 U Fischbacher, S Gächter and E Fehr, 'Are People Conditionally Cooperative? Evidence from a Public Goods Experiment' (2001) *Economic Letters* 71, 397–404.

163 Frey and Torgler, 'Tax morale and conditional cooperation' (2007) 35 *Journal of Comparative Economics,* 136–159 < http://www.bsfrey.ch/articles/453_07.pdf>.

164 Ibid.

165 Valerie Braithwaite, 'Perceptions of who's not paying their fair share' (2003) 38 *Australian Journal of Social Issues* 335-362.

Australian taxpayers,[166] where current tax laws allow taxpayers to 'slide from one type of tax to another, or slip from a higher to a lower marginal tax rate solely to reduce tax liability'.[167] This has added to complexity in the tax system, and in this regard, it has been noted, 'our progressive system of taxation seems to have failed to eliminate abuse, and allowed many of the affluent among us to pay less tax than the ordinary taxpayer'.[168]

The Australian Government's latest review of the tax system released in May 2010, 'Australia's Future Tax System Review' (*Henry Review*),[169] also recognised that 'Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax system,'[170] where 'years of incremental policy change have eroded the bases of even potentially efficient taxes'.[171] It was also highlighted by the *Henry Review* that the effect of having so many taxes, where only a few operate efficiently, arguably can lead to people paying the 'wrong amount of tax, or claim more or less than they are entitled in transfer payments.'[172] The *Henry Review* noted too that the myriad of taxes may well allow taxpayers to make economic based and self interest choices when determining their tax liability where 'the provision of choice in determining a tax liability can increase complexity and result in higher compliance costs where taxpayers seek to discover the best tax outcome.'[173] It is these 'choices' and the corresponding inefficiencies in the current tax system, which further add to its complexity.

Additionally, not only are there many tax laws, but many of them are inordinately difficult for taxpayers to understand and apply. The complexity contained within some of the Australian tax laws was noted in the 1990 case of *FCT v Cooling* (1990)[174] where Hill J in observing the application of some of the Capital Gains Tax provisions

---

166 Robert Jeremenko, 'Simplicity, Equity And Fairness Key To Tax Reform' *The Australian, 18* January 2011 12:00am, <http://www.theaustralian.com.au/business/opinion/simplicity-equity-and-fairnesss-key-to-tax-reform/story-e6frg9if-1225989836647>. The author notes 'Henry identified 125 taxes paid by Australians, yet 90 per cent of national revenue comes from just 10 per cent of them. That means there are more than 100 taxes that are doing very little other than adding huge complexity.'

167 Potas, n 13, 8.

168 Ibid 7.

169 Ken Henry et al, 'Australia's Future Tax System Review, Final Report' (*Henry Review*) (Australian Government, Treasury, 2 May 2010) Parts 1 and 2, Also available at <http://www.taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm>.

170 Ibid, 11.

171 Ibid.

172 Ibid, 21.

173 Ibid.

174 *FCT v Cooling* (1990) 90 ATC 4472.

of the *ITAA36*, commented that they were '… 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.'[175] In 1993, Potas also noted that:

> in many areas taxation has become so complicated that many ordinary people have difficulty in understanding the extent of their obligations. The well-meaning may be paying too little or too much tax because of the uncertainty and vagueness surrounding the law. … Uncertainty, complexity and confusion provide the breeding-ground for tax avoidance and evasion.[176]

In this regard, the *Henry Review* in May 2010 also identified that 'personal income tax compliance has become inordinately complex. This complexity hides its policy intent from citizens.'[177] For individual taxpayers,

> the personal tax system is complex not only because of the rates scale and the lack of a coherent definition of taxable income, but also because they must deal with a large suite of complex deduction rules, numerous tax offsets and a variety of exempt forms of income. Seventy-two per cent of taxfilers now seek advice from a tax agent, even though 86 per cent either claim no deductions at all or only claim work-related expenses, gifts and the costs of managing tax affairs. Australia's use of tax agents is high by international standards.[178]

These compound complexities can have a significant impact on taxpayers' choices and abilities to comply with their tax obligations. It may be just too hard to comply with so many different taxes, and even if one or more are chosen, then the laws themselves may well be difficult to understand and apply. The effect is that the Australian taxation system's compound complexities will continue to have an impact on taxpayers' decisions when making a choice as to how far they will and can comply with their tax obligations. Complexity like this can be so oppressive as to be contrary to the rule of law, and this point has been argued by the *Revenue Law Journal*.

It will be argued that considerations of fairness, conditional cooperation, moral obligations and taxpayer attitudes as well as tax complexity issues extensively underpin the ATO's approach in its taxpayer compliance programs today.

Tax regulatory theory and the ATO's approach

Regulation of a person's actions or behaviour in a society can cover a number of aspects including the 'controlling, governing or directing, facilitating or influencing

---

175 Ibid, 4488. These sentiments were also echoed by the High Court in *Hepples v FCT* (1991-1992) 173 CLR 492, 521; 91 ATC 4808, 4824, where Toohey J commented, 'these provisions are unduly labyrinthine.'

176 Potas, above n 13, 8.

177 Henry Review, above n 169, 30.

178 Ibid.

behaviour towards some purpose'.[179] Several regulatory approaches or techniques can be taken with respect to any one or number of behaviours of people in a society to 'influence industrial, economic, or social activity'.[180] Under the command-and-control regulatory approach of the past, the full force of the law with regard to taxation was utilized up until the mid 1980s to control and monitor certain tax avoidance and tax evasion behaviours with sanctions (penal and criminal) to ensure that certain conduct of some taxpayers was discouraged or even prohibited. The adoption of the command-and-control approach at this time was arguably a knee jerk reaction by the Australian government and was implemented so that the force of the law 'could be used to impose fixed standards with immediacy and to prohibit activity not conforming to such standards'.[181] In addition, the government was seen to be taking a firm political stance in controlling such activity and unfavourable behaviours with the '… public … assured that the might of the law is being used both practically and symbolically in their aid.'[182]

This type of regulatory approach began to change by the mid 1980s when it became apparent that there was considerable disquiet amongst taxpayers. The negative reaction to the retrospective legislation enacted to deal with schemes such as the 'Bottom of the Harbour' signalled to the government that such command-and-control approaches on their own were unsavoury and unacceptable to many taxpayers. Such an approach could not continue to be effective in dealing with the complexity of the tax system and its administration. As Valerie Braithwaite said:

> taxpaying is contestable, in terms of how much should be paid, how it should be collected, how it should be enforced, and how well it serves the public interest. Command-and-control systems of regulation are not built to deal with contestation.[183]

The ATO recognised that, to improve taxpayer compliance, they needed to develop their Compliance Model to bridge the 'growing gap between the actions that the tax authority could prohibit and punish and the actions that they wanted the taxpaying community to pursue in order to ensure the sustainability of the tax system'.[184] From the 1990s, the government's regulatory approach in dealing with unacceptable tax avoidance and illegal tax evasion began to 'move beyond the command-and-control

---

179 J Black, 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1.

180 Baldwin and Cave, above n 3, 34.

181 Ibid 35.

182 Ibid 35.

183 Braithwaite V, 'Responsive Regulation and Taxation: Introduction' (2007) 29 *Law and Policy* 1.

184 Ibid.

framework that typified the 1970s and 1980s to one of "responsive regulation" and "meta risk management".'[185]

Drawing from regulatory theory, the approach of the OECD,[186] and changing taxpayer attitudes over the last 40 years, the ATO has significantly modified its adoption of tax regulatory strategies. They acknowledged that they risk 'discouraging civic virtue if they engage in aggressive prosecution for relatively minor offenses, because those being regulated are likely to feel that their past good faith efforts at compliance have not been acknowledged'.[187] The introduction of the income tax self-assessment model in 1986 marked the beginning of a process towards what Ayres and Braithwaite called a 'responsive regulatory strategy',[188] a process that gathered pace during the 1990s. The embracing of this regulatory strategy came at a time when the protection of Australia's tax revenue was a priority. There was 'the anticipated introduction of a national goods-and-services tax, and concerns about increases of the size of the cash economy and aggressive tax planning'.[189] The Australian government by the mid 1990s recognised that in order to implement major tax reform, it required cooperation from its taxpayers. This regulatory strategy has gained even further momentum, and as recently as May 2010 the Australian Government acknowledged that whilst '[r]esponsive regulation was not a clearly defined program [it nevertheless] … enabled the blossoming of a wide variety of regulatory approaches'.[190]

Voluntary compliance

Today, the ATO focuses on an interactive and responsive relationship with its taxpayers. It bases it compliance program on the model in *Figure 1* below. The ATO has come to recognise that there are a number of factors that motivate taxpayers to comply or not to comply with their tax obligations, and based on this model, they use 'a different mix of responses and interventions in order to influence taxpayer behaviour in a positive way,'[191] including education, guidance, taxpayer advice,

---

185 Braithwaite J, above n 7.

186 See the standards contained in AS/NZS 4360:2004 Risk Management and OECD 2004 Guidance Note *Compliance Risk Management: Managing and Improving Tax Compliance* <http://www.oecd.org/dataoecd/44/19/33818656.pdf>.

187 Ayres and Braithwaite, above n 6.

188 Ibid.

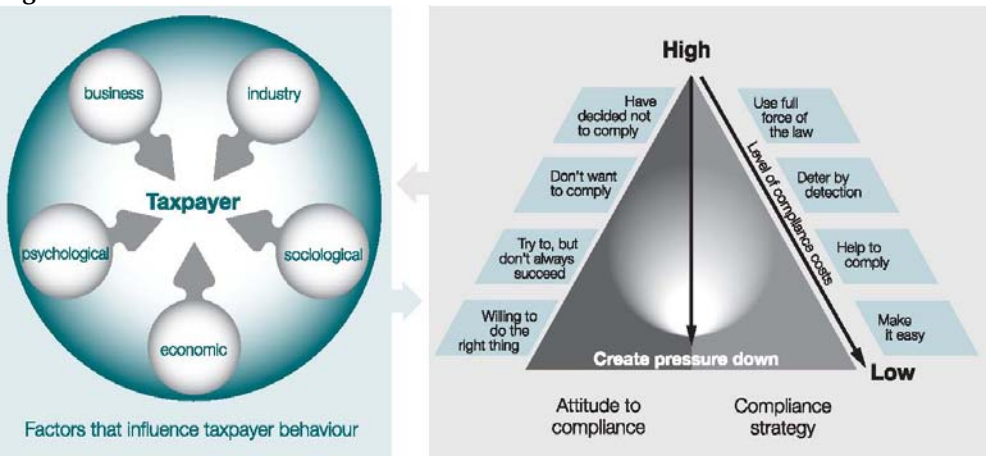
189 Braithwaite V, above n 183. Also note that the Goods and Services Tax was introduced on the 1 July 2000; see *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

190 Ayres and Braithwaite, above n 6, 5.

191 Australian Taxation Office, *Compliance Program 2009-2010*, (2010) <http://www.ato.gov.au/corporate/content.asp?doc=/content/00205435.htm&mnu=47063&mfp=00>.

taxpayer alerts, audits, penalties and prosecutions where appropriate. The ATO's ultimate aim is to 'influence as many taxpayers as possible to move down the pyramid into the "willing to do the right thing" zone',[192] whilst optimising voluntary compliance.

Figure 1:



Source: Australian Taxation Office, *Compliance program 2009-2010* (2010), <http://www.ato.gov.au/corporate/content.asp?doc=/content/00205435.htm&mnu=47063&mfp=001>.

The ATO's focus on compliance behaviour based on this model allows them to address many of the causes of non compliance, where the 'compliance approach will continue to emphasise prevention over cure, coupled with firm but fair action where necessary'.[193] For example, '[t]he ATO has come to believe that it is essential to address what appears to be a widespread acceptance in some sections of the community that "not paying tax on cash is OK" by developing a community awareness campaign that explains the costs to the community of tax evasion and that tax evasion is a crime'.[194] It has also recognised that the majority of aggressive tax planning measures are carried out by High Wealth Individuals (HWIs) and large taxpayers, for these two groups have the 'necessary motives and asset backing to make complex structuring worthwhile'.[195] In response, the ATO has undertaken meta-risk management of these taxpayers by focusing on 'building a better

---

192 Ibid.

193 Ibid.

194 Australian Taxation Office, *ATO Cash Economy Task Force, Improving Tax Compliance in the Cash economy*, AGPS, (1997) <http://www.ato.gov.au/content/downloads/SB39065.pdf>.

195 Michael D'Ascenzo, Commissioner of Taxation, 'Did you know? Not a penny more' (Speech delivered at Deloitte Touche Tohmatsu, Tax Perspectives Breakfast, Sydney Australia, 30 June 2009).

relationship between the tax administration and these large taxpayers so that each respects and understands the other's position'.[196] The rationale of this approach has been to level the playing field, that is, to educate large taxpayers so that they will be less likely to seek out ways of paying less tax if they know that their competitors are all competing on a level playing field and paying what they reasonably should in tax. Again, this focus draws from fairness issues. From the tax administration perspective it is also useful to let 'these corporations know what to expect from the regulators and how they can co operate with each other'.[197]

Measured success?

How successful the ATO and the Australian government have been to date in addressing voluntary compliance issues is difficult to assess, agrees the ATO itself:

> Active compliance results are only the direct outcome flowing from our strategies; the more important impact is on the general level of voluntary compliance; although this is difficult to measure.[198]

However, after examining data released by the ATO concerning compliance in 2009 it was noted that 'when examining net cash collections for the 2009 period, they were 1.2% above the 2009 Budget forecast, suggesting that compliance levels remained relatively high'.[199] The 2009 year also saw a marked increase in lodgements as well as an increase in GST collections as well and an increase in large businesses voluntarily disclosing tax issues.[200] When looking at the 2010 outcomes, a number of measures used to indicate the levels of voluntary compliance also show favorable results. In 2010, ATO commented:

> [For individuals and information matching] … the trending of compliance behaviour showed that once we make an information matching adjustment to a taxpayer's taxable income, in the following year 84% of these taxpayers either partially or fully comply …. [In relation to micro enterprises and their

---

196 Australian Taxation Office, *Introduction to the High Wealth Individuals Taskforce* (2008) 6. <http://www.ato.gov.au/businesses/content.asp?doc=/content/00124820.htm>.

197 Michael D'Ascenzo, Commissioner of Taxation, 'Two to Tango' (Speech delivered to the G100, Sydney Australia, 9 December 2009).

198 Australian Taxation Office, Commissioner of Taxation, Annual Report, 2009-10, Effectiveness of our compliance strategies, <http://www.ato.gov.au/corporate/content.asp?doc=/content/00258543.htm&page=46&H46=&pc=001/001/009/001&mnu=49806&mfp=001/001&st=&cy=1>.

199 Australian Taxation Office, *Compliance program 2009-2010, Snap shot of 2008-2009 results* (2010), <http://www.ato.gov.au/corporate/content.asp?doc=/content/00205435.htm&page=42&H42=&pc=&mnu=47060&mfp=001&st=&cy= >.

200 Ibid.

> involvement in the cash economy the ATO noted] … taxpayers we wrote to, highlighting potential under-reporting of income, responded by increasing the average net GST they reported over 12 months. … [In relation to larger enterprises and compliance, the ATO also noted that] … the aggregated turnover of corporate groups engaged in compliance arrangements increased from $101 billion to $152 billion throughout the year.[201]

Most importantly, the ATO in the 2010 year observed a significant positive impact on compliance in relation to Project Wickenby and tax havens:

> By comparing the financial years 2007-08 to 2008-09 and 2009-10 AUSTRAC has shown a decline in the level of annual flows, between a range of 18-45% and 12-40% respectively from Australia to Switzerland, Vanuatu and Liechtenstein where Project Wickenby has had a focus. This is in comparison to a decline of only 5% in other tax-secrecy havens.[202]

The ATO's overall 'compliance strategies are aimed at supporting the high levels of voluntary compliance'.[203] The achievement of high levels of voluntary compliance are arguably indicative of a tax system that is ultimately underpinned by the concepts of fairness and integrity. This sentiment was echoed by the Henry Review, which observed in Part 1 of its Overview:

> The operation of Australia's tax system is fundamentally sound and there is general confidence in the system. The level of voluntary compliance is high, reflecting positive perceptions about the fairness and integrity of the system and how it is administered.[204]

The push forward - 2010 and beyond

The administrators' push today is to continue to focus on Project Wickenby, to increase data matching activities, make ease of compliance for taxpayers a priority, as well as providing advice and alerts to those taxpayers involved in high risk arrangements, all the while emphasising 'prevention over cure, coupled with firm but fair action where necessary'.[205] In May 2010, the Henry Review recommended that 'a more transparent and accountable [taxation] system be adopted [and] governments should further develop open and inclusive processes by which the community can raise issues and have them considered by government.'[206] In particular, the Henry Review in examining taxpayers' interactions with the ATO,

---

201 Australian Taxation Office, above n 198.
202 Ibid.
203 Ibid.
204 Henry Review, above n 169, 69.
205 Australian Taxation Office, above n 199.
206 Henry Review, above n 169, 69.

commented that they were 'complex and fragmented.'[207] It was recommended that this be improved through, for example:

> use of technology, improved coordination, and management of information, plus better design and integration of processes [and continuing] … with current government strategies such as the 'Standard Business Reporting Program' [will] to improve businesses experiences of the system, including through reduction in the compliance costs of interacting with government.[208]

To date, the Australian Government has indicated that it will action many of the recommendations of the Henry Review, to ensure that they provide a 'stronger economy, and a fairer and simpler tax system'.[209] In May 2010, the Australian government announced a number of tax reforms that were to be implemented, including the introduction of standard deductions for many Australians i.e. 'a 'tick and flick' system of pre filled tax returns that will make life easier for working families at tax time.'[210] They also announced the introduction of a new 'super profits tax, to be implemented in the mining sector.[211] The government at the time put forward this plan by arguing that 'Australians [should] get a fair share from our valuable non-renewable resources'[212] and at the same time encourage further investment in the non-renewable resources sector. Of course, taxpayers will always be resistant to change, especially where it impacts on their wealth maximisation, and this was evident by the amount of resistance that the non-renewable resources tax proposal received in the second half of 2010.[213] Nevertheless with the appointment of the new Prime Minister Julia Gillard in June 2010,[214] the ATO's approach of

---

207 Ibid, 71.

208 Ibid.

209 See generally Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future* (2010), < http://www.futuretax.gov.au/pages/default.aspx>. This initiative outlines the Australian government's tax plans for the future.

210 Treasurer, Wayne Swan MP and Senator Nick Sherry Assistant Treasurer, 'Standard deduction to increase tax returns for 6.4 million Australians', (Joint Media Release, 5 May 2010) <http://www.futuertax.gov.au/pages/MediaCenter.aspx> , where it was noted that the then Rudd Government was to make filling out tax returns easier for many taxpayers by 'offering a standard tax deduction.'

211 Minister for Resources and Energy The Hon Martin Ferguson MP 'Reform for a fair return to the Nation from our resources', (Media Release 2 May 2010) <http://www.futuertax.gov.au/pages/MediaCenter.aspx>.

212 Ibid.

213 See '*Keep Mining Strong*' <http://www.keepminingstrong.com.au>. The non renewable resources industry sector launched a campaign highlighting their disapproval of the new tax strategy after the release of the Henry Review and its recommendations in May 2010.

214 Julia Gillard was appointed as Prime Minister of Australia on 24 June 2010, when the elected Prime Minister Kevin Rudd was forced to step down after a show of no confidence

consultation and education may be further implemented. This approach will address taxpayers concerns and at the same time ensure that taxpayers, even large ones, will come to an understanding concerning compliance with their tax obligations.[215]

CONCLUSION

The system has been relatively successful in achieving clearer distinctions between acceptable tax planning, illegitimate tax avoidance, and illegal tax evasion, after the need for a drastic change in its regulatory approach became evident in the 1970s. This clearer distinction today between acceptable and unacceptable measures for tax minimization, and a more satisfied and purpose-focused judiciary, have challenged the taxpayer's defiance of tax liability of the 1970s and early 1980s.

There will always be those taxpayers who will attempt to evade all tax,[216] and Australia still has a long way to go to convince taxpayers they should all pay their fair share of tax. But the inroads of the last four decades which has seen shift from a predominantly command-and-control regulatory framework to one of 'responsive regulation and meta risk management'[217] has attracted more respect for the tax system. The Tax Office claims these attitudes go a long way in 'underpin[ing] a respect for the rule of law and a stable culture that supports our civilised society'.[218] Australian citizens are increasingly prepared to recognise that:

> evasion and avoidance are not victimless activities … [that] the tax system belongs to the people and [that] the whole community suffers when some members wrongfully or artfully dodge making their fair contribution to the upkeep of a decent, civilised society.[219]

This has set the stage for the Australian government to argue that the attainment of a fair and community-subscribed tax system will ultimately provide for a higher standard of living across the board. This ultimate driver underpins the current stance of the ATO - that parity for all Australian taxpayers is ultimately achievable.

---

from his ministers. See Phillip Coorey and Tim Lester, 'Gillard becomes Australia's first female prime minister as tearful Rudd stands aside', *The Sydney Morning Herald*, (Sydney) 24 June 2010 <http://www.smh.com.au/national/gillard--becomes-australias-first-female-prime-minister-as-tearful-rudd-stands-aside-20100624-yzvw.html >.

215 'Gillard cancels mining tax campaign', *The Age Newspaper*, (Melbourne) 24 June 2010, <http://www.theage.com.au/national/gillard-cancels-mining-tax-ad-campaign-20100624-z0pa.html >.

216 Kasipillai et al, 'The Influence of Education on Tax Avoidance and Tax Evasion' (2003) 7 *eJournal of Tax Research* 1. <http://www.austlii.edu.au/au/journals/eJTR/2003/7.html >.

217 Braithwaite J, above n 7.

218 Australian Taxation Office, *Compliance Program* 2009-2010 (2010), above n 191.

219 Potas, above n 13, 8.