

eJournal of Tax Research

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EDITOR'S NOTE

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

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The Effect of the Human Rights Act 1998 on Taxation Policy and Administration

Natalie Lee*

In her paper, Natalie Lee considers the im

uniting Europe, which had been promoted from the 1920s onwards, was revived at the onset of the Second World War. Indeed, in 1939, Clement Attlee, then leader of the British Labour Party, declared, “Europe must federate or perish.”⁵

That the Council of Europe and the Convention were both aimed at securing the most fundamental of values can be concluded from surrounding circumstances, the Preamble to the Convention itself and modern-day pronouncements. Thus, the Council was established, and the Convention came into being, four and five years respectively after the end of the Second World War, and one and two years respectively after the adoption and proclamation by the General Assembly of the United Nations of the Universal Declaration of Human Rights⁶. The Preamble to the Convention specifically reaffirms the “profound belief” of the members of the Council “in those fundamental freedoms which are the foundation of justice and peace in the world” The first four of the Convention rights and freedoms are the right to life, the prohibition of torture, the prohibition of slavery and forced labour and the right to liberty and security. More recently, it was said:

The Europe we foresee in our Presidency priorities is one which is anchored in the values of the Council of Europe and the European Convention on Human Rights. ... We will give a focus to issues such as fair wages, good job opportunities, civil and political rights, greater security and better co-operation between Governments in Europe and beyond.⁷

The aim of this paper is to determine the effect to date of, and any likely future impact from, the incorporation of Convention rights into UK law by the Human Rights Act 1998 (HRA) on the formation of tax policy and tax administration. This will, however, necessitate the consideration of three preliminary issues. First, since UK citizens have enjoyed the right to take a case to Strasbourg since 1953⁸ and, more recently, the protection by the common law through judicial review against interference with a fundamental right through the exercise by a public body of a very wide discretion conferred by statute,⁹ why should the HRA make any significant difference? Secondly, what are the main principles of the HRA? Finally, given the fundamental values behind both the Council of Europe and the Convention, what have the Convention and the HRA to do with taxation at all?

COMPARING RIGHTS BEFORE AND AFTER INCORPORATION

The effect of the Convention is to guarantee a number of basic human rights by allowing an individual to complain about the behaviour of his own government.¹⁰

⁵ In a speech, later circulated in pamphlet form, on November 8, 1939 that sought to define the Labour Party’s war objectives, in Cole, GDH, *A History of the Labour Party from 1914* (Routledge & Kegan Paul Ltd, London 1948) at p 379.

⁶ On 10 December 1948.

⁷ Dick Roche, Irish Minister of State for European Affairs in a presentation to the Committee of Ministers of the Council of Europe of the priorities of the Irish Presidency of the European Union, January 2004.

⁸ Although the UK was the first state to ratify the Convention in 1951, it only came into force in 1953.

⁹ See, for example, *R v Ministry of Defence, ex p. Smith* [1996] QB 517; *R v Secretary of State for the Home Department, ex p. McQuillan* [1995] 4 All ER 400.

¹⁰ Before the adoption of the Convention in 1953 by the UK, individuals enjoyed few opportunities to assert rights under international law.

Government, were no longer perceived as British rights.¹⁶ Indeed, it was pointed out with some force that the United Kingdom lagged some way behind the international human rights movement, with Britain remaining “in a slightly insular condition of satisfaction with its own legal institutions.”¹⁷ Secondlyons.”c00041.6(ctak Tc5t6044 ofg041.6(ca041.6(cc

Kingdom” in the same way that administrative law had grown exponentially in the latter half of the twentieth century.²⁶

THE MAIN PRINCIPLES OF THE HUMAN RIGHTS ACT 1998

Three Main Principles

Convention rights have been incorporated into UK law by the HRA only insofar as this is consistent with parliamentary sovereignty. So, the Act, which itself can be

Parliament. However, as Lord Hope has observed, section 3(1) must be read so as to preserve the sovereignty of Parliament:

... the interpretation of the statute by reading words in to give effect to the presumed intention should always be distinguished carefully from amendment. Amendment is a legislative act. It is an exercise which must be reserved to Parliament.³¹

Secondly, although it has already been stated that no court is able to strike down or disregard legislation that conflicts with Convention rights, the High Court and above³² may make a 'declaration of incompatibility',³³

invalid and that it sought specifically to limit their access to justice. The European Court of Human Rights rejected the argument that there had been double taxation, and concluded that, despite the fact that the legislation did constitute an interference with

The question that needed to be answered in the case of the windfall tax was not whether it interfered with the taxpayers' enjoyment of their property (for it obviously did since they would have rather less after the imposition of the tax than before) but, rather, whether it was disproportionate to the needs of the society for whose benefit it was being levied. Opinions on the matter differed and, in the event, no challenge was ever made, possibly for the reason that the directors of the companies' concerned could not justify to their shareholders the expense of a petition to Strasbourg when compared with the actual tax owed. As a matter of conjecture, it is submitted that a challenge would not have been successful. Although in *Wasa Liv v Omsesidigt v Sweden* the Strasbourg Court held that the protection afforded by Article 1 of Protocol No 1 and other relevant provisions of the Convention is not excluded by the fact that a legislative provision involved the payment of tax, so theoretically a challenge *could* be successful, sd6c.57857 Tw[(chalc1.harh.588(o)7(f)-517u17(e -517uP)5.3-g-14)]TJ/,ed4()-n hjrr relevdfor th

competence of the Contracting States. The power of appreciation of the Contracting States is therefore a wide one.⁶⁷

been the subject of two challenges under the Convention. In the first case, in order to avoid setting a precedent, the UK Government conceded the point and reached a 'friendly settlement' whereby the same amount was paid to Mr Crossland, the claimant widower, as would have been given to a widow.⁷² The second challenge arose in the wake of the Revenue's refusal to provide the same treatment for other widowers in the same position as Mr Crossland. In the High Court, Moses J held that it was clear that the difference between widows and widowers in relation to the widow's bereavement allowance constituted discrimination under Article 14 read with Article 1 of Protocol No 1 *in the absence of any objective justification advanced for such discrimination*.⁷³

The important issue of the margin of discretion (or appreciation) was discussed fully in another case concerning challenges in respect of certain types of widow's benefit and raising similar issues in relation to discrimination.⁷⁴ In that case, Moses J. sought to strike a

legislator's judgment as to what is in the general interest unless that judgment be manifestly without reasonable foundation.⁷⁶

Moses J also drew attention to the decision in *Petrovich v Austria*,⁷⁷ a case concerning parental leave payments to a man, where it was explained that a factor relevant to the scope of the margin of appreciation is the existence of common ground between the laws of the contracting states. Thus, the greater the disparity that exists between such states, the broader is the margin of appreciation.⁷⁸ In the end, however, Moses J concluded that:

it is neither possible nor productive to determine with any precision the degree of deference to be paid to the legislature when the issues concern social and economic policy and the constitutionally important right not to be discriminated against on the ground of gender.⁷⁹

and felt that his task was simply the ordinary judicial one of subjecting the reasons advanced by the Government for the discrimination. He continued:

If the reasons advanced by the Defendant are insubstantial or, even if they are substantial, they do not persuade me, I shall decline to find any objective justification.⁸⁰

Using that reasoning, Moses J found that there was no objective justification for the discrimination resulting from the widow's bereavement allowance, and made a declaration of incompatibility, seemingly

As to the scope of Article 14 as it might affect tax policy, it is possible that challenges could also be made on the grounds of the favourable tax treatment afforded to married couples, discrimination between similarly situated taxpayers and discrimination between employees and self-employed persons. As far as marriage is concerned, whilst UK legislation that provided for allowances discriminating between single and married people has been held not to be an infringement of the Convention on the grounds that it was within the discretion allowed to contracting states and that the distinction was objectively justifiable,⁸³ it remains to be seen whether the distinction will remain justifiable with the changing attitudes of society to marriage.

The issue has been recently tested in the context of Inheritance Tax (IHT), which allows for an exemption between spouses.⁸⁴ In *Holland v IRC*,⁸⁵ the Revenue accepted that marriage was a question of status within Article 14, and that the facts of the appeal fell within both Article 1 of Protocol No. 1 and Article 8 (right to respect for family and private life, discussed below), but the Special Commissioner dismissed the claimant's argument that, although she and the deceased were not legally married, they had lived together as husband and wife for thirty-one years before his death and so she should be treated as his spouse for IHT purposes. He held (*obiter*, since the HRA was not in force at the time of death) that it was permissible for Parliament to legislate for different tax provisions to apply to married persons, since this reflected the fact that marriage is accompanied by mutual rights and obligations between the spouses relating to maintenance both during their lives and after their deaths. That the claimant and her partner chose not to marry was entirely their decision; having made that decision, they had to accept the consequences.

It is, of course, quite possible that a single sex couple, living as though married, may seek to challenge the same legislation and may be successful since, in the UK in such a case, they would have no choice in the matter of marrying. Other legislation that could be the subject of a similar challenge is the Tax Credits Act 2002 which, whilst drawing no distinction between those who are married and those who are not, does not recognise single sex partnerships. It was to be hoped that this particular form of discrimination might soon be removed if the proposals which aim to permit the civil registration of single sex partnerships are carried into fruition.⁸⁶ Under these proposals, once a couple has registered its partnership, then certain rights that are currently afforded only to married couples, will also be available to single sex couples. Unfortunately, despite the fact that exemption from IHT is a key issue for many same-sex couples, the consultation document failed to address it (or, indeed, the further issue of tax credits). In its response, the Government merely paid lip-service to the problem, saying that the Budget process would take full account of the comments that had been received as part of the consultation process and their implications for the tax system.

It is possible that discrimination between similarly placed taxpayers could be the basis of a further challenge in respect of a windfall tax (already considered above in the

⁸³ *Lindsay v United Kingdom* (1997) 23 EHRR 199

⁸⁴ Inheritance Tax Act (IHTA) 1984, s 18.

⁸⁵ (2003) Sp C 350; (2003) Simons Tax Intelligence 62.

⁸⁶ The proposals were published in a consultation document, *Civil Partnership: a framework for the legal recognition of same-sex couples* DTI, June 2003. The Government's response to the proposals was published in November 2003.

context of Article 1 of Protocol No 1). If such a tax fell on one, or only some, of a number of companies in the same sector, it could be argued that it draws an arbitrary distinction between a similar group of taxpayers. It would, of course, be necessary for the claimant to prove such a similarity.

It is unlikely that the different tax provisions that apply to the employed⁸⁷ and to the self-employed⁸⁸ will ever be successfully challenged. One such provision permits employers to obtain a deduction for childcare expenses for employees as the provision of a benefit to its employees. Subject to certain conditions, an employee is not taxed on that benefit.⁸⁹ In contrast, self-employed persons can make no deduction for expenses incurred in respect of childcare. The taxpayer, a self-employed person, argued in *Carney v Nathan*⁹⁰ that the disallowance of such expenditure constituted discrimination within Article 14 in relation to Article 1 of Protocol No 1. Her argument was dismissed by the Special Comm 6.6oun2r.6ounrn2 Tc2 T,6 a Tc0-5..xr.01.068dt i-5.1(rn.6(it

event, this proved unnecessary, but Lord Hoffman took the opportunity to pronounce on the human rights issue. Citing the European Court of Human Rights case of *Foxley v UK*,⁹² he confirmed that legal professional privilege is a fundamental human right, which can be derogated from only in exceptional circumstances, and he doubted that these exceptional circumstances would include the public interest in the collection of financial information by the Revenue. He concluded by saying that if new information-gathering legislation were to be passed, then any interference with privilege would have to be shown to have a legitimate aim which is necessary in a democratic society.⁹³ It should be noted that Lord Hoffman's words of caution are limited to an 'interference with privilege' and, as vitally important as that may be, would not have a more general ef7(d that f- h)-4(93)Teuw54 -1. f-4.9(e)-7.3(f7(d t5e)-272 Twc6(uailssi)-6.m

No judicial countenance can or ought to be given in matters of taxation to any system of extra-legal concessions.⁹⁹

Although there has been a move to incorporate some of the published concessions into the legislation,¹⁰⁰

It is quite clear that despite the elation from commentators following the decision of the Strasbourg Court in *Willis v The United Kingdom*,¹⁰⁸ decided after the *Wilkinson* case, in which it was held that the difference in treatment between men and women regarding entitlement to the Widow's Payment and Widowed Mother's Allowance (both social security payments) was not based on any objective and reasonable justification, and was therefore in violation of Article 14 of the Convention taken in conjunction with Article 1 of Protocol No 1, this case will have little bearing on the issue under discussion. Whilstle n re qation

a public authority has acted in a way which is incompatible with a Convention right must be a *victim* of that unlawful act. It is suggested that this requirement is even stricter than that of *locus standi*, and that it would be difficult for A to argue that he

That such a penalty could be criminal in nature was confirmed by the Strasbourg Court in *Georgiou v United Kingdom*,¹²⁷ and was applied in the High Court in *King v Walden*¹²⁸ where it was held that the system for imposing penalties for fraudulent or negligent delivery of incorrect tax returns was criminal for the purpose of Article 6(1) because the system was punitive. In *Han v Customs and Excise Commissioners*,¹²⁹ the Court of Appeal, in deciding that appeals against civil evasion penalties¹³⁰ were criminal proceedings for the purpose of the Convention, agreed that the concept of a 'criminal charge' within the meaning of Article 6 is an autonomous one, and applied three criteria previously enunciated by the Strasbourg Court for determining whether a criminal charge has been imposed.¹³¹ These are, first, the classification of the proceedings in domestic law, secondly, the nature of the offence and, thirdly, the nature and degree of severity of the penalty that the person concerned risked incurring. In applying these criteria, Potter LJ said that they should not be considered separately, but as factors weighed together to decide whether, taken cumulatively, the relevant measures should be treated as criminal, and he concluded that, when coming to such a decision the second and third factors should weigh heavier than the first.¹³²

In slight distinction, two more recent decisions of the Strasbourg Court have treated the three criteria as alternatives and not cumulative, unless an analysis of each did not make it possible to reach a conclusion as to the existence of a 'criminal charge'.¹³³ In any event, our own courts are of the view that categorisation of the proceedings in domestic law is not decisive of their nature, and provides only a starting point for the classification. Applying the criteria to the facts before them, the Court of Appeal was of the opinion that the national classification of the penalties as 'civil'¹³⁴ did not represent a decision on the part of the legislature to de-criminalise dishonest evasion of VAT. The relevant provisions applied in principle to all taxpayers and sought to punish, rather than compensate, Customs and Excise. Finally, it was sufficient that the penalty was substantial and its purpose was punitive and deterrent, and there was no requirement that it should involve imprisonment. Accordingly, looking at the substance rather than merely the form of the penalty, it was evident that it amounted to a criminal charge to which Article 6 applied. For its part, the Strasbourg Court has also taken the view that so-called 'civil' surcharges amounting to 20% and 40% of the increased tax liability were criminal for the purposes of Article 6.¹³⁵

It has already been noted that the importance of the question at issue in cases such as *Han* lies in the protection afforded to taxpayers by the various minimum rights provided for by Article 6(2) and (3). It is critical, then, to have some certainty on the matter, and yet there is none. In *N Ali and S Begum & Ors v Customs and Excise*¹³⁶

¹²⁷ [2001] STC 80. The penalty in question was for dishonest evasion in respect of undeclared output VAT, but it was decided that there had been no infringement of Article 6 rights.

¹²⁸ [2001] STC 822.

¹²⁹ [2001] STC 1188.

¹³⁰ Imposed pursuant to the Value Added Tax Act 1994, s 60(1).

¹³¹ In *Engel v The Netherlands*(1976) 1 EHRR 647.

¹³² *Op. cit.* n 129 at pp 1208-1209.

¹³³ See

the VAT Tribunal concluded that serious misdeclaration penalties, default surcharges and late registration penalties were not criminal for the purposes of Article 6, a decision seemingly at odds with both the Strasbourg jurisprudence and the Court of Appeal. The Tribunal said that the penalties and surcharges in question had none of the characteristics of a criminal penalty, despite the fact that the 15% default surcharge appeared severe where the delay on payment was small,¹³⁷ and that the operation of the penalty regime under UK law adequately protected the rights of alleged defaulters, with no need for further safeguards.¹³⁸

procedure, no undertaking was given that such a settlement would be accepted even if the taxpayer had made a full confession, and the Revenue's decision to exercise its discretion in favour of the taxpayer would have been influenced by the amount of cooperation given by him. In these circumstances, the taxpayer may well argue that his right to a fair trial has been breached because, by providing sensitive information under threat of a penalty, he has been forced to incriminate himself.

In *R v Allen*,¹⁴² a taxpayer charged with cheating the Revenue sought to have certain evidence, provided during a Hansard interview, excluded by relying on the privilege against self-incrimination. Although the House of Lords held that it was not necessary to consider the alleged breach of Article 6 because the HRA was not in force at the relevant time and it did not have retrospective effect, it nonetheless considered the

process, designed to gather in money, and was not a criminal investigation. However, in *R v Gill and Gill*,¹⁴⁵

margin of appreciation afforded to the Government, and argue that the measure is in proportion to the needs of a democratic society. Only in very exceptional cases will the courts be willing to hold that a measure is not proportionate.¹⁵⁰

Challenging discretionary actions taken by the Revenue may also prove to be either difficult or impossible as an analysis of *R (on the application of Wilkinson) v IRC*¹⁵¹ has revealed. And perhaps that is all justifiable for, in the end, what is trying to be secured is a balance between the interests of the whole community and the protection of individual fundamental rights. It is all too easy to support the 'little' taxpayer against the might of the Revenue and Customs and Excise, departments universally loathed and vilified, sometimes without justification. The courts and tribunals, on the other hand, can look at the matter with dispassion, and can identify with relative ease those cases in which the taxpayer is simply jumping upon the 'human rights bandwagon.' However, when it comes to matters that are more in line with the original aims of the European Convention on Human Rights, for example, the presumption of innocence and the right to a fair trial, it has been shown that the domestic courts are more willing to consider holding both the Revenue and Customs and Excise to account, even to the extent of departing from the Strasbourg jurisprudence in holding that tax matters are not purely 'public' but are 'civil' for the purposes of Article 6(1). It is to be hoped that the courts will be rigorous in continuing to ensure that a taxpayer is treated as fairly as an ordinary criminal when being investigated in relation to serious fraud, and that any further attempt to infringe professional privilege will be held to be totally incompatible with Convention rights.

¹⁵⁰ As did the Strasbourg Court in *Darby v Sweden* (1991) 13 EHRR 774.

¹⁵¹ [2003] EWCA Civ 814; [2003] 1 WLR 2683.

Philip Moss*

Abstract

1936

Ombudsman Act 1976

Decisions (Judicial Review) Act

Information Act 1982

Administrative

Freedom of

MORE RECENT DEVELOPMENTS

Parliamentary Scrutiny

An Assessment of Tax

INTERNATIONAL COMPARISONS

Internal Revenue Service Restructuring and Reform Act 1998

Trusts and Double Taxation Agreements

John Prebble

Abstract

This paper considers the correct interpretation of double tax agreements in the context of locally resident accumulation trusts established in New Zealand or Australia, that have foreign settlors and foreign-source income

practice, although the answers to the questions are the same in both countries there are significant second-order differences. The

for purposes of this paper to call the clause beginning “But this term ...” the “proviso” to Article 4(1).]

Most of New Zealand’s treaties follow Article 4(1) of the OECD Model or a simplified version of it: Belgium, China, Denmark, Finland, France, Germany, India, Ireland, Italy, the Netherlands, Norway, the Philippines, and Switzerland. The treaty with Indonesia omits the proviso or any counterpart of it. The Swedish treaty and most treaties with British Commonwealth countries have a much simpler format, but a format that, like the Indonesian treaty, contains no proviso: Australia, Canada, Fiji, Malaysia, Singapore, Sweden, and the United Kingdom. The New Zealand-United Kingdom Article 4(1), for example, reads:

For the purposes of this Convention, the term “resident of a Contracting

probably be a resident of a state for treaty purposes.”⁶ Avery Jones points out that this conclusion fits awkwardly with treaty rules that apply to resolve dual residence issues that arise for trustees, because the criteria by which treaties determine the residence of individuals (availability of a permanent home, centre of vital interests, an habitual abode, and nationality)⁷ are not appropriately applied to persons in their capacity as trustees. Referring initially to Canadian law, Avery Jones explains:⁸

It is arguable that because a trustee in his capacity as such does not have a permanent home, a centre of vital interests, an habitual abode or a nationality (particularly in the case of a corporate trustee), the tests set out in article 4(2) are inappropriate and therefore inapplicable. If this argument prevails, article 4(3) applying the place of effective management to persons other than individuals, would presumably apply. ... Article 4(3) would apply in the United Kingdom, where a trustee is not treated as an individual, and the United States, and Australia.

Avery Jones’s argument appears to be that although, as explained in the previous paragraph, a trustee is a *person*, and therefore can be resident somewhere for treaty purposes, it is not appropriate to determine the residence of a trustee by tests that apply to *individuals*. The need to make this argument gives rise to the question as to whether Avery Jones’s basic premise can be correct. If a trustee is a “person” for treaty purposes, but if trustees who are individuals are not to be treated as such, the text of Article 4(2) and (3) does not aptly apply to them. But if this is so, why should we assume that Article 4(1) is meant to apply to trustees as well? That is, one could argue that a state that adopts Article 4(2) and (3) is perhaps assuming that none of Article 4 (in particular, not Article 4(1)) applies to taxpayers in their capacity as trustees. This conclusion leads back to the argument of Robert Venables, discussed above, that the personal residence of individuals does not determine their residence as trustees if they happen to be trustees. Nevertheless, it is worth examining particular treaty drafts to determine whether there are possible contrary views, at least in respect of some versions of Article 4(1). One thesis of this paper is that, all things considered, these contrary views must command considerable respect.

INTERPRETING DIFFERENT FORMS OF R

reasonably make an attempt to identify the relevant questions and sometimes to answer them.

taxed as an ordinary corporate taxpayer. The second is the company in its capacity as a trustee. Qualification for or disqualification from treaty protection of someone in the company's second (trustee) capacity has no effect on the company's treaty rights as an ordinary corporate taxpayer.

This response is attractive from a policy point of view. No doubt, that is how treaties *should* work.¹² The problem is that the text of a double tax convention that is drafted in terms of the New Zealand-France treaty offers no support for this interpretation. One can argue that a taxpayer who is a trustee cannot be resident in respect of trust income, but the text contains no basis for saying that a taxpayer can be resident for some fiscal purposes and not for others. More so, if a taxpayer that is a trustee is excluded from treaty benefit, why stop at that point? What about taxpayers who might one day be trustees? Such a result seems to be compelled by the logic of the "nothing" alternative, but it would be absurd to exclude taxpayers from treaty benefits on the basis that they might one day become trustees. As argued above, it seems to follow that trustees may take treaty benefits, both as trustees and in their own capacities as taxpayers.

SUBSTANTIVE INTERPRETATION NOT COMPELLING

A more substantive interpretation might suggest that the focus should be neither on the taxpayer, nor on whether the taxpayer is potentially liable to tax on some foreign source income, but on items of foreign source income, on a case-by-case basis. Is the New Zealand taxpayer assessable to New Zealand tax on this particular income from France, being trustee income? If not, the argument runs, the treaty should not protect the income. The answer to this argument is that the proviso deals with persons, not items of income. A person either is, or is not, entitled to treaty protection. Article 4(1)(b) of the New Zealand-United States treaty, on the other hand, considers income on an item-by-item basis, as already explained. When New Zealand's treaties were drafted, income on an item-by-item basis could have been added to the treaty text to the effect of the New Zealand-United States Article 4(1)(b). The omission arguably shows an intention to retain the taxpayer-by-taxpayer approach that is mandated by a literal interpretation of the proviso. The better view, therefore, is that the French treaty, and others like it, protect income derived by New Zealand resident trustees even where the receipts are trustee income and not subject to New Zealand tax.

It follows with greater force that where the corresponding article takes the simplified form that is found in the United Kingdom treaty,¹³ foreign source trustee income derived by New Zealand resident trustees enjoys treaty protection in the same manner. This conclusion, and the conclusion in the previous paragraph, may be modified by consideration of the second question raised by double tax agreements that is relevant in the present context. This question is whether a trustee can be said to derive income as a "beneficial owner", which is commonly a pre-requisite for treaty protection, at least in respect of passive income. That question is considered next.

See also the view of Robert Venable QC, discussed above under heading 3.
Convention between New Zealand and the United Kingdom for the Avoidance of Double Taxation (1983) Article 4 (1): "For the purposes of this Convention, the term 'resident of a Contracting State'

DOUBLE TAX AGREEMENTS AND LIMITS ON WITHHOLDING TAX

Apart from the treaty with Japan, all New Zealand's double tax agreements provide for a reduction in withholding tax on interest, dividends, and royalties that flow between parties resident in New Zealand and th

THE REQUIREMENT OF BENEFICIAL OWNERSHIP

If a New Zealand resident trustee were to receive, say, royalties, from someone in the United Kingdom, would the trust be able to take advantage of the ten per cent limitation on withholding tax on royalties that is imposed in the United Kingdom-New Zealand Treaty? The answer to this question is a matter for the law of the United Kingdom, rather than for New Zealand law; the answer depends on how United Kingdom courts would interpret the double tax agreement. Similarly, in respect of interest, dividends, or royalties received by the trustee from any other jurisdiction with which New Zealand has a double tax agreement, the effect of the beneficial ownership requirement is a question for the courts of that jurisdiction.

Having said that, one should note that in a number of countries the beneficial ownership condition is thought to have relatively little effect in practice. That is, taxpayers pay out dividends, interest, and royalties to people or companies that are residents of treaty partner countries, and, reputedly more often than not, deduct withholding tax at only the reduced treaty rate without questioning whether the recipient is the beneficial owner of the income. This is said to happen without adverse reaction by the revenue authorities in the source country, though some fiscal

the Commentary shed no light on this question. The Commentary changed again in the 2003 edition of the Model, to read in respect of Article 12:¹⁷

The requirement of beneficial ownership was introduced in paragraph 1 of Article 12 to clarify how the Article applies in relation to payments made to intermediaries. It makes plain that the state of source is not obliged to give up taxing rights over royalty income merely because that income was immediately received by a resident of a State with which the State of source

who wrote the Commentary, at least some trustees may be “beneficial owners” for purposes of the relevant treaty articles. That is, at least some trustees are not disqualified from treaty benefits by a narrow, technical interpretation of “beneficial owner”.

“BENEFICIAL OWNERSHIP” AND THE NEW ZEALAND OBSERVATION

A number of New Zealand’s treaties address the question of the interpretation of “beneficial owner” or “beneficial entitlement” by provisions in the interpretation article, which is ordinarily Article 3. There is a typical example in the agreement with Canada:

In determining, for the purposes of Articles 10, 11, or 12, whether dividends, interest, or royalties are beneficially owned by a resident of a contracting state, dividends, interest, or royalties in respect of which a trustee is subject to tax in that Contracting State shall be treated as being beneficially owned by that trustee.

Such provisions in treaties to which New Zealand is a party have their origin in a New Zealand observation to Article 3 (General Definitions) of the OECD Model:

For the purposes of Articles 10, 11, and 12, New Zealand would wish to treat dividends, interest, and royalties in respect of which a trustee is subject to tax in the State of which he is a resident as being beneficially owned by that trustee.

The New Zealand observation and provisions in treaties that reflect it are relevant to cases where trustees *are* subject to tax in the state of residence. They do not directly address the question that is at issue in this paper: whether trustees who derive passive income can be described as “beneficial owners” of that income even though they are *not* subject to tax on the income in their state of residence. Indirectly, however, the New Zealand-Canadian provision and others like it suggest that trustees are not “beneficial owners” as the expression is used in treaties, (otherwise there would be no need for the provision) and, if they are to be treated as beneficial owners when they bear tax on the income in question, there must be a special rule to enable that to happen.

“BENEFICIAL OWNERSHIP”

possible beneficial owners it could have done so. Moreover, there was no change in the ambulatory draft of the Model that was promulgated in 1995.

The 2003 amendments to the Commentary that have been discussed²³ reinforce the argument. If the question of whether “beneficial owner” can include some trustees was a live issue in 1977, by 2003 the OECD Committee on Fiscal Affairs can have been in no doubt that this question was a major, perhaps the major, issue in the interpretation of relevant articles in the model. The fact that, in these circumstances, the Committee said that “the term ‘beneficial owner’ is not used in a narrow, technical sense” is most significant. Until publication of the 2003 edition of the Model, du Toit’s arguments that “beneficial owner” should be interpreted according to trustee law in common law countries had a good deal of traction. From 2003, the prohibition on interpreting the

rules that provide a definite answer to the question of whether trustees can be classified as beneficial owners. Such treaties are the paradigm cases for this paper. An example is the New Zealand-United Kingdom treaty. To quote again from Article 12:

Interest arising in a Contracting state which is derived by a resident of the other Contracting State may be taxed in that other State may ... be taxed in the Contracting State in which it arises ... but where the beneficial owner of such interest is a resident of the other Contracting State the tax so charged shall not exceed 10 per cent of the gross amount of the interest.

Consider first a New Zealand resident trustee who derives and accumulates interest from the United Kingdom, but who is not taxable on the interest because there is no New Zealand resident settlor. One argument is that the trustee should not be entitled to treaty benefits because New Zealand will not tax the income.³¹ But suppose that the same trustee distributes the income to a New Zealand resident beneficiary in a later year. New Zealand will tax this beneficiary. Indeed, New Zealand will impose tax at a penal rate in response to the deferral that the income has enjoyed since the trustee derived it.³² In these circumstances, it would not seem unreasonable for the trustee to enjoy a treaty benefit. Whichever set of facts obtains the New Zealand-United Kingdom treaty must be interpreted in the same way: either “beneficial owner” includes a trustee who accumulates or it does not. Those who advance the argument now under discussion say that only a positive answer is consistent with the general policy of double tax conventions.

FRENCH TEXT AND CONCLUSION

A third argument is that the French text of the OECD Model, supports the proposition that “beneficial ownership” included ownership by a trustee. The French expression is “*bénéficiaire effectif*”. Because French law does not recognise trusteeship “*bénéficiaire effectif*” includes both full owners and trustees. Since the French and English texts of the Model are equally authoritative it follows that the English text must have the same meaning. Admittedly, this meaning does not necessarily travel the long route from the French version of the Model to a New Zealand treaty. However, the broad adherence to the OECD Model that is apparent in all bilateral tax conventions indicates a strong international commitment to consistency of interpretation.

The matters discussed in the foregoing paragraphs may offer some comfort to trustees who receive passive income from foreign countries that are treaty partners of the trustees’ jurisdictions of residence. There is much to be said for the point of view that “beneficial owner” should be interpreted in the same manner in all treaties, and for the argument that Vogel’s civil law meaning of the expression should be considered as some kind of lowest common denominator. Although it would be rash to claim that this lowest denominator is established as the law, the 2003 amendments to the Commentary³³ add a good deal of force to Professor Vogel’s arguments.

C

respect of financial arrangements. For example, discounts on bonds and foreign exchange gains or losses are treated as revenue items.³⁴ A second example is gains that result from profit-making schemes, or gains from the sale of property that was acquired with the intention of sale.³⁵ The tax bite is more comprehensive when the property in question is land.³⁶ Thirdly, the principle in *Californian Copper Syndicate*

There is no alienation of property article in New Zealand's treaties with Fiji, Japan, Malaysia, or Singapore. The relevant articles in the treaties with Australia, Sweden and Canada do not contain residual property exemption provisions like the New Zealand-United States rule. New Zealand's treaty with Norway has a residual property exemption provision, but there are certain limitations in respect of property that comprises substantial participatory shareholdings.

The New Zealand-Ireland treaty has a residual property exemption provision, but it is followed by a proviso of uncertain scope:

Provided that where under the law of that Contracting State [the state of residence of the alienator] an individual, in respect of such gains, is subject to tax thereon by reference only to the amount thereof which is received in that Contracting State, the foregoing provisions of this paragraph shall not operate in relation to so much of such gains as is not received in that Contracting State.

In spirit, this proviso is presumably meant to withhold the benefits of the New Zealand-Ireland residual property exemption provision from taxpayers who are not

Income or gains from the alienation of any property other than that referred to in paragraphs (1), (2), and (3) of this Article, shall be taxable [“only” omitted] in the Contracting state of which the alienator is resident.

It is probable that the omission from the New Zealand-United Kingdom convention is inadvertent, and the treaty should be read as if it included “only”. Perhaps the main argument is that otherwise Article 14(4) is pointless, because the country of residence does not need the authority of the treaty to tax the gains in question.

Whether this argument should be accepted is a matter for the United Kingdom courts. If it is accepted, the result appears to be that a New Zealand trustee who derives a gain from the sale of movable property in the United Kingdom (apart, mainly, from property that forms part of a permanent establishment of the taxpayer) is not taxable on that gain.

Tax Reform in the China Context: The corporate tax unit & Chinese enterprise

Nolan Sharkey

Research into the relationships between people and organizations that drive social behaviour and institutions in China has produced some profound findings on the structure of society in China. The network structure of private enterprise and the importance of Guanxi are often highlighted. While some scholars of comparative law have investigated the implications these issues have for legal reform/ development in China, too many projects assume that emulation of the laws in developed legal systems is the way forward for China. This ignores the importance of tailoring China's laws to the structure of Chinese society. The debate surrounding the reform of income tax laws in China is no exception with many commentators looking to Western tax laws to solve such severe problems as tax avoidance and low revenue yields. This paper seeks to address some of the issues that arise in applying income tax laws based on those of developed countries to private enterprise in China with a particular focus on the legal design of the income tax unit.

INTRODUCTION

China's income tax laws have developed rapidly over the course of the past quarter century in conjunction with the opening of China and its transition to a (socialist) market economy. During this time there have already been two major reform efforts and numerous other changes that have attempted to create an effective and efficient income tax law. At present, major income tax changes are again being debated. The reform efforts are all predicated on the shortcomings of the current income tax laws. These shortcomings include low tax yield relative to national income, lack of clarity in the law, distortionary tax effects and high levels of tax avoidance¹. For many commentators the problem with China's income tax laws is that they are not yet fully developed along the lines of the income tax laws in place in countries with developed market economies² that do not suffer from the serious tax problems that China does³. The solution to the problem therefore lies in further reforms aimed at developing a law that mirrors those in place in these countries. This entails, amongst other actions, the refinement of legal definitions and an increase in the detail of the laws to clearly articulate who the taxpayer is and what income they have earned during the tax period.

The income tax unit is one of the key foci of the contemporary debate on income tax reform in China. The tax unit or taxpayer is a fundamental building block of any tax and its definition is critical to the scope of the tax. This is the case with any income

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¹ For an excellent summary of tax revenue problems in China see: OECD (2002). *The Current Tax System and Priorities for Reform. China in the World Economy: The Domestic Policy Challenges*. Paris, OECD: 623 - 644.

² including the USA, UK, Germany, Australia and Canada

³ For a major recent study looking to foreign tax laws for solutions in China see: China International Taxation Research Institute and IBFD (2004). *China Tax Reform and the WTO Accession Project*. Amsterdam, IBFD Publications BV.

tax where the law needs to define “whose” income is to be calculated for the relevant period and “who” is liable to pay the tax. In most developed income taxes, the tax unit is defined as both the individual and a company/ body corporate. Most of these taxes also develop rules to deal with other forms of business such as partnerships, trusts and joint ventures. These are sometimes treated as taxpayers in their own right but are more usually treated as transparent vehicles with only the underlying individuals and companies viewed as taxpayers. The essential rationale for the individual/ company tax unit is the concept of legal person where companies are viewed as persons in their own right at law. They have the right to sue and can be sued. More importantly the property of the company is its property and not that of the shareholders. The shareholder’s property is shares in the company. The company management has the day to day power to determine the comp

unit and define all the various forms of activities sanctioned by law as “enterprises” thereby creating a uniformity of income tax treatment. The only distinction that remained was that between the domestic and foreign which were covered by the two different enterprise income tax laws. However within these two laws the various business forms were branded as “enterprises” allowing for a single tax unit and uniform treatment. The foreign sector reform was completed in 1991 with the introduction of the FIET Law while the domestic sector reform was finalised in 1993 with the introduction of the DEIT Regulations

generated by the enterprise as opposed to a gain in the private property of a person. In reality, the two concepts will often yield the same results but they are quite distinct and can lead to very different results. When a pure “enterprise” tax unit is used in China’s tax laws (in the sense of an activity as opposed to a person), the laws are operating in an internationally innovative manner. There is little doubt that this

single director/ shareholder company. Here, the same individual is the company management as well as the investor. This company cannot be viewed as independent of this individual and the individual has de-facto control of the company property. At the other extreme a listed company with widely dispersed shareholders is a clear example of a “real” independent body. The shareholders here have very little control of the company’s property and genuinely own only their shares.

Serious tax problems can arise when non-independent companies that are mere legal

neoclassical economics in explaining Western economies and markets results from this assumption generally holding true²⁵

is done socially through gift-giving, banquets etc. Through the successful pursuit of Guanxi, persons can become part of extensive networks that go well beyond the extended family and friends. The networks are employed to pool resources in the pursuit of business enterprises³¹. The essential point about these network bonds is that they have very real enforceable value in terms of mutual obligation. There is however no written contract or record to show the connection as it is socially and not legally reinforced. There is no need to rely upon legal reinforcement due to the values of Chinese society which, in themselves, provide effective sanctions against those that violate social obligations. The reason for this is the non-presumption of independence and autonomy with instead a presumption of connectivity with the appropriate

In addition to the above factors, the commodification process during the reform period in China has further strengthened the development and use of Guanxi networks. Extensive field and theoretical work by David Wank³³ has considered the role of commodification in developing China's business modalities. The term commodification refers to the conversion of state assets into commodities in China's market economy. There are no clear property rights in relation many valuable State (or former State) assets in China. They are, however, under the control of local government. These assets include resources as critical to enterprise as land and buildings. Control of these assets and the ability to let others use them, has led to the absorption of local officials into Guanxi networks that dominate much of China's economy. In most cases successful private entrepreneurs have strong Guanxi links to local officials if they are not officials themselves. The ability to use these assets subject to "fuzzy" property rights in Guanxi based business networks incorporating local officials as well as entrepreneurs has proven effective and efficient in China. It allows assets to be moved quickly through the network to where they can be effectively used³⁴. It has been strongly argued by Hendrischke³⁵ that the success of this modality of business leads to a demand for "fuzzy" property rights in China. It is worth contrasting this with the politics of democracy in the West where there was a clear drive for clear property rights³⁶.

In summary the nature of Chinese society in combination with the formerly hostile and current weak institutional environment and the process of commodification of State assets have resulted in a situation in contemporary China where the primary actors are business networks rather than independent companies and individuals³⁷. Business is conducted by and through networks held together by strong Guanxi –

entrepreneurship. Richmond, Surrey, Curzon, McKeown, A. (2001). Chinese migrant networks and

social bonds. The entrenched economic and political strength of these networks and their desire for “fuzzy” property rights as well as the nature of Chinese society mean that there is unlikely to be a change in this situation despite Government attempts to strengthen the institutional environment. More to the point, in many respects, these factors push for the weaker institutional environment.

Commentators such as Biggart and Hamilton³⁸ concluded that Asian capitalism and

social sanctions as an enforcement. The preference for “fuzzy” property rights adds further reinforcement to this.

Another critical factor to consider is the private sector’s aversion to paying income tax. Having considered the rationale for reliance on social networks rather than legal agreements in China, it can be seen that the ability to avoid taxation only adds to this. Business networks have had a new reason to remain invisible in China in the Nineties. During the Eighties they feared a Central Government backlash, now they fear that the Central Government will gather revenue from them. Governmental attempts to strengthen the institutional environment and property rights through initiatives such as the introduction of the Company Law can be counterproductive when social bonds are stronger than legal rights. This is because instead of simply being invisible, networks can make use of the new laws to create legal rights that they are able to readily circumvent. Regulators on the other hand will treat the legal rights as a correct representation of the situation. There is evidence that assets are simply placed into companies and removed at will by networks and that legal entitlements to dividends are simply ignored when profits are shared⁴⁰.

In summary, it may be concluded that the adoption of a corporate tax unit in China’s income tax will not result in the benefits anticipated based solely upon its successful adoption in Western taxes. The possibilities for tax avoidance and arbitrage are far greater than in Western economies due to the use of social Guanxi connections and networks and the preference for “fuzzy” property rights in China. This stands in stark contrast to the preference for legal agreements and records and clear property rights in the West. It can also be concluded that the benefits of tax avoidance for the private sector may reinforce the desire to rely upon Guanxi rather than contracts.

The above conclusions do not, however, lessen the need for reform of China’s income tax unit as considered above. A different solution needs to be found. One possible answer lies in the innovative use of “enterprise” as discussed earlier. The concept of an enterprise as an activity as opposed to a person was adopted in a socialist situation where use of increments in private property to define income was inappropriate. The income of an enterprise in these situations referred instead to profits generated by a commercial activity. This subtle conceptual difference may be a suitable starting point in the development of China’s contemporary income tax unit. This is because it does not rely upon the accurate identification of a person’s property rights. Another theoretical possibility is to identify and tax the business network itself. This is appropriate conceptually but unlikely from a practical perspective due to the difficulty of identifying the network.

A final issue relevant to China’s reform of its tax unit is the need to fit into the international system. As discussed earlier, there are real pressures towards convergence and harmonisation of income tax laws due to the internationalisation of business. Attempts to make use of a radical concept when designing a tax system are therefore likely to be criticized and objected to by international business and organizations. This is because variation creates compliance costs and inefficiencies. However, against this China’s effective revenue collection needs to be considered and

⁴⁰ Hendrischke, H. (2002). *The Role of Social Capital, Networks and Property Rights in China’s Privatization Process*. Chinese Enterprise Models, University of New South Wales, Sydney, UNSW Centre for Chinese Studies.

it cannot be simply ignored to benefit international interests. China does, after all, represent a significant portion of the world and what it does should therefore be considered a variation of international standards as opposed to a departure from them. Any new concept will therefore need to be reconciled to the internationally standard corporate tax unit.

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Perceptions of Tax Evasion as a Crime

Stewart Karlinsky^{*}, Hughlene Burton[†], Cindy Blanthorne[‡]

Abstract

This paper considers one aspect of the deficit faced by the U. S. economy. It considers the contribution to this deficit made by the taxpayers that do not fully report taxable income and/or do not pay taxes on their income. The gap between what is owed in tax and the amount of tax actually paid is estimated at \$310 billion. What portion can be attributed to underreporting and non filing? The study reported in this paper attempted to measure the perceptions of US citizens as to the seriousness of tax evasions relative to other crimes and violations. The results show that tax evasion ranked 11th among the twenty-one offences surveyed. This means that the average person views tax evasion as only somewhat serious. Compared to other white collar crimes it ranked below accounting fraud, violation of child labour laws and insider trading, and equal to welfare fraud and higher than violation of occupational safety and health laws.

This study was designed to measure the perceptions of U.S. citizens as to the severity of tax evasion relative to other offences (crimes and violations). If tax evasion is not viewed as a serious offence, it may somewhat explain the degree of non-compliance with the tax laws. The current study investigated people's perceptions of the severity of tax evasion as a crime when compared to twenty other offences. The results of the study show that tax evasion ranked 11th among the twenty-one offences surveyed. The results indicate that the average person view

The perceived seriousness of crimes may be measured across countries and cultures³. IVCS Survey polled individuals in 17 countries (including Australia, England, Netherlands, Sweden, Canada, USA, France, Japan and Switzerland) and found that Unrecovered Car Thefts was the most serious offence of those crimes surveyed followed by sexual assault, recovered car thefts and then robbery involving a weapon. The least serious crime was bicycle theft. We included several of these offences in our survey instrument, namely carjacking, robbery and bicycle theft.

In a February 2001 Criminal Intelligence Service Alberta telephone interview study⁴ examined 26 different crimes (but no violations) of which seven (7) overlapped with the current study's focus. Using a 10 point scale (10 being the most serious) the interviewees were asked to rate the seriousness of various crimes. Sexual exploitation of children was ranked the most serious crime (9.53) with murder being slightly less serious (9.39) followed by robbery (8.66). Interestingly, prostitution was viewed as more serious (7.38) than car theft (6.92) or insider trading (6.61). Demographic factors solicited were gender, marital status and age.

In one of the few studies that examined the perception of the seriousness of tax evasion, Song and Yarbrough (1978) investigated taxpayers' perceptions of tax ethics

they prepared their own tax returns and/or if they had ever been audited by the IRS. This study also extends the work of Song and Yarborough (1978) by examining the relative perceived severity of white collar offences such as insider trading, accounting fraud and tax evasion. Another study (Eicher 2002), tested peoples' perception of various crimes, including cheating on their tax return, focusing on potential difference between men and women respondents. When asked "How much, if any, do you think is an acceptable amount to cheat on your income taxes?", roughly 1/3 of both the male and female subjects responded that they cheated a little here or there. 18% of men and 9% of the women said as much as possible, while 49% of men and 59% of women said it is not at all acceptable to cheat on your income taxes. The study found that overstating tax deductions was acceptable to 44% of the males and 36% of the females.

The Eicher study also examined six behaviours of which five have the roughly equivalent offence in our study (speeding, tax cheating, DUI, running a red light, shoplifting). The study found that driving 10 miles over the speed limit was somewhat or very acceptable for 82% of women and 78% of men. Overstating tax deductions was somewhat or very acceptable to 44% of the males and 36% of the females. Shop lifting was viewed as not at all acceptable by 44% of men and 54% of women. This is

METHODOLOGY

the Speeding at a safe speed or out of control. One subject did not know what jaywalking was and left it blank, and another person did not know what DUI/DWI was and left that factor blank.

In exit interviews with several people, we were complimented for the simplicity of the test instrument. Comments like 'it was easy to use', 'it was quick and simple' and 'other surveys should take lessons from this instrument' were expressed by test subjects.

Sample

The sample included surveys from 364 respondents. The respondents came primarily from California and North Carolina. The sample was made up of 144 from California and 202 from North Carolina. Fifty-eight percent of the sample was male.

RESULTS OF THE SURVEY

Table 1 shows the overall rating of all 21 offences. The rating is the average of all response in the survey. The most serious offences rated by the sample were not surprisingly, Murder, Rape and Child Molestation, while Jaywalking, Illegal Parking and Ticket Scalping were rated as the least serious offences. The average rating for tax evasion was 3.3, which was the eleventh most serious or least serious offence in the survey depending upon your point of view.

TABLE 1: AVERAGE SCORES OF CRIMES SURVEYED

Crime	Overall rating	Ranking
Murder	5.0	1
Rape	4.9	2
Child Molestation	4.8	3
Robbery	4.0	4
DWI	3.9	5
Carjacking	3.8	6
Child Labour	3.8	7
Accounting Fraud	3.7	8
Insider Trading	3.3	9
Welfare Fraud	3.3	10
Tax Evasion	3.3	11
Minimum Wage	3.3	12
Shoplifting	2.8	13
Prostitution	2.8	14
Running a Red Light	2.6	15
Bike Theft	2.3	16
Smoking Marijuana	2.3	17
Speeding	2.1	18
Ticket Scalping	1.8	19
Illegal Parking	1.5	20
Jaywalking	1.3	21

The average rating for tax evasion (3.3) was compared to the three violent crimes in

(2001) and Warr (1989) that white collar offences were rated as less serious than violent offences.

In previous studies white-collar offences as a whole have been compared to violent offences or to property offences. The prior studies have not broken white-collar offences out to various types. In our survey there are six white-collar offences: tax evasion, accounting fraud, violation of child labour laws, insider trading, violation of welfare laws and violation of minimum wage laws. The ranking of tax evasion was compared to the rankings for the other five white collar offences in the survey. Based on the results of the paired t-tests, there was a significant difference in peoples' perception of the seriousness of tax evasion and accounting fraud and violation of child labour laws, but there was no difference between tax evasion and insider trading, violation of welfare laws or the violation of minimum wage laws (See Table 2).

TABLE 2: COMPARISON OF TAX EVASION TO OTHER CRIMES

Tax evasion	Violent crimes	Accounting fraud	Violation of child labour laws	Insider trading	Violation of welfare laws	Violation of minimum wage laws
3.3	4.9*	3.7*	3.8*	3.3	3.3	3.3

* Significant at the .01 level

Of the six white collar offences, violation of child labour laws and accounting fraud were rated as the most serious. However, the rankings of all six white collar offences

TABLE 4: RELATIVE SEVERITY OF VICTIM/VICTIMLESS OFFENCES

Crime/Victim		Crime/Victimless	
Murder	5.0	DWI	3.9
Rape	4.9	Welfare Fraud	3.3
Child Molestation	4.8	Tax Evasion	3.3

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APPENDIX A

Survey Document

We are three professors doing a study on people's perceptions of the seriousness of selected offences. Thank you in advance for taking five or ten minutes out of your busy schedule to share your opinions with us.

Since we are only interested in your opinion, there are no right or wrong answers. So,

1. In your opinion, how serious is each offence listed below?

Item	Description of offence	Not serious	Somewhat serious	Serious	Very serious	Extremely serious
1	Bicycle theft					
2	Welfare fraud					
3	Speeding					
4	Carjacking					
5	Prostitution					

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- | | | |
|---|------------|--------------|
| 12. Are you married? |Yes |No |
| 13. Do you attend church regularly
(at least once a month)? |Yes |No |
| 14. Do you hire someone to prepare
your income tax return? |Yes |No |
| 15. Are you a tax professional
(tax preparer, IRS agent, etc.) |Yes |No |
| 16. Has your income tax return been
audited (by IRS or state)? |Yes |No |
| 17. Have you or someone close to you had
personal experience
with any of the offences listed? |Yes |No |
| 18. Are you male or female? | Male | Female |
| 19. Please indicate the state in which you live? | | |

THANK YOU. Your contribution is greatly appreciated!

Globalisation, Innovation and Information Sharing in Tax Systems: The Australian experience of the diffusion and adoption of electronic lodgement

Liane Turner and Christina Apelt[†]

Abstract

The aim of this research was to apply a new conceptual framework to describe and explain the factors that have enabled the diffusion, adoption and operationalisation of electronic lodgement within the Australian tax system. The uptake of electronic lodgement of tax returns by both tax agents and taxpayers has increased significantly since introduction. Electronic lodgement of tax returns is part of a burgeoning global trend by OECD members to engage in and broaden the implementation of e-government applications.

This research applied an eight factor framework to analyse the diffusion and adoption of electronic lodgement of tax returns within Australia. These eight factors were the circulation of ideas, national context, tax policy context, technological context,

as objectively measured by the duration of time since it was initially discovered or used. Building on the work of Rogers (1962), Kimberly and de Pouvourville (1993b) constructed a six factor framework to analyse the diffusion of DRGs in Western Europe. These factors were the health policy context, technical context, path of entry, role of champions, roles of key constituents and internal and external networks of support (Kimberly & de Pouvourville, 1993b). Each factor was found to have influenced the outcome of the DRG diffusion and adoption process by both governments and key stakeholders in ninetsovergm8- -1a194g6es oeivotrnaoei.8e rlyadgm8- -(u).9

Callon (1991) highlights the importance of the roles played by specific non-human actors, termed 'intermediaries', in enabling the diffusion of an innovation. Examples of intermediaries are texts, technical objects, skills and money.

that time. Data from income tax returns was entered into the computer network and the edit programs eliminated a high proportion of taxpayer, assessor and keying errors. The corrected data was then transferred to a central computer complex in Canberra for further processing. The first stage of the national roll-out commenced in June 1976 when the system began processing the returns of taxpayers in New South Wales (NSW) and the Australian Capital Territory (ACT) (Interviewee 2, 2004; ATO Story, 2001).

In 1984, Trevor Boucher replaced William O'Reilly as Commissioni

returns could be lodged. This trial was given support by Adelaide's Deputy Commissioner, Ron Kelton (Interviewee 10, 2004; ATO, 1993).

Internally, the ATO had some very clear business pressures to drive the development of an electronic lodgement system. ELS was the first Modernisation project and was seen to have a central role in the push towards modernising ATO business systems and achieving the increased efficiencies and improved job design promised by the Program (Interviewee 12, 2004; Interviewee 6, 2004; Deuchar, 1989; ATO, 1990b). Electronic lodgement by tax agents was central to the ATO shift away from being a paper processing organization with all of the associated job design benefits for staff and clients (Interviewee 1, 2004).

ELS involved the lodgement of income tax return information through the use of tax preparation software on the tax agent's own computer equipment. The transfer of the information from the tax agent to the ATO occurred electronically via telephone lines on the Telecom (now known as Telstra) Auspac network or on a floppy disk (Interviewee 7, 2004). It is

tax agent to buy a dedicated line service from Telecom to connect to the ATO. The emergence of this technology made it much cheaper for tax agents to link to the ATO and adopt ELS (Interviewee 5, 2004).

At the same time, the PC revolution was putting personal and business computers within easy reach (Interviewee 5, 2004). The computerisation of business was happening rapidly and some tax agents had already recognised the growing business imperative to increase their familiarity with this technology and were using computers to assist them in preparing tax returns. The information on these forms was then re-keyed into ATO systems (ATO, 1993; Jones, 1998). Supporting this trend, software producers had begun developing and marketing programs designed specifically for tax return preparation and tax agents found these very attractive (Interviewee 6, 2004).

The ATO also needed to improve the quality of data gathered from income tax returns. The period for issue of assessment notices had extended up to 16 weeks and tax agents were under increasing pressure from their clients for faster refunds, and were in turn, putting pressure on the ATO to meet demand for a faster turnaround (Interviewee 1, 2004; James, 1998). Electronic lodgement dealt with this by 'error checking' at the point of transmission, that is, where it was lodged by the tax agent (Interviewee 1, 2004). ELS passed data keying and initial error management to the tax agent. Checks were at lodgement or at the ATO gateway and tax returns were able to be immediately corrected by the tax agent (Interviewee 7, 2004; Interviewee 1, 2004).

At a broader level, the ATO believed that the future business of banks, government agencies and tax agents would depend on electronic document interchange (ATO, 1990b). There was a sense of urgency about the ATO being at the cutting edge of this technological wave and utilising it to ensure the organisation was at the forefront of gaining the benefits (Interviewee 6, 2004). Self assessment, introduced the previous year, the Modernisation Program and the development and implementation of ELS in Australia produced a 'convergence of the planets' in relation to technology and policy going hand in hand and the ATO was in a position to ride the crest of the wave of the opportunities that this provided (Interviewee 2, 2004). ELS encouraged tax agents to purchase computers for their business and modernise their systems ready for the sea change in the way they communicated with the ATO (Interviewee 12, 2004).

The project team that so successfully developed, piloted and implemented ELS existed separately from the mainstream office structure (Interviewee 2, 2004). In the development phase approximately twenty to thirty people worked in the ELS project team directly under Michael Carmody and headed by Project Manager Mike Cebalo (Interviewee 1, 2004; Interviewee 2, 2004).

The ELS acronym originally stood for Electronic Lodgement System and was renamed to Electronic Lodgement Service when Cebalo's son, then aged nine years, suggested the 's' for system should stand for service (Interviewee 2, 2004; Interviewee 13, 2004; Interviewee 3, 2004). The emphasis on 'service', suggested by Cebalo junior was fundamentally embedded in this innovation.

Staff numbers increased as the project progressed into national implementation. The team consisted of technical people, Client Relations Officers (CROs), Business Implementation Managers (BIMs) and administration staff. There were many technical issues to overcome and the ELS project team was working from scratch,

with no useful precedents internally or externally (nationally or internationally) on which to call for examples or experience (Interviewee 6, 2004).

They worked closely with the Privacy Commissioner (Kevin O'Connor), Attorney-General's Department and the Defence Signals Directorate to establish the protocols and standards (encryptions and privacy keys) needed to operationalise ELS (Interviewee 2, 2004). The result of cooperation with external parties was the establishment of security measures for direct data transmission, which included a physical break between the Data Take-On machine, used to accept tax agent data, and the internal ATO processing machine, measures involving the use of passwords, network identifiers, tax agent registration and log-on codes and addresses (Deuchar,

national implementation project was initiated in January 1989. Their task was to have ELS fully operational in all sixteen Branch Offices by July 1990 (ATO, 1990b).

In July 1990 the ATO officially announced the national release of the system. This represented several firsts for the ATO. These, included:

The ATO objective was that 80% of electronically lodged returns would be processed and assessments issued within 14 days. The result after the first year of operation was that 87% of electronically lodged returns were turned around in fewer than 14 days,

In 1997, the Prime Minister introduced the establishment of electronic service delivery (ESD) targets as part of the strategic plans for Information Age Government. Australia's ESD target was to have all appropriate Federal government services capable of being delivered electronically via the Internet by 2001 (United Kingdom Cabinet Office, 2000).

The Commissioner Michael Carmody had an interest in making electronic lodgement directly available to self-preparers

The technology allowed individuals to download the free software from the website, eliminating the use of a floppy disk or paper. This provided a faster, simpler and easier tax return solution for self-preparers (Interviewee 9, 2004).

The e-tax product delivers the data to the ATO in a form that feeds directly into the ELS. Error checks are performed at lodgement, that is, at the taxpayer's PC, before the data is sent, improving the quality of the data in self-preparers' tax returns (Interviewee 10, 2004). E-tax also introduced calculations embedded in the software to help taxpayers to understand what they needed to do and help them in a practical way to get it right, improving compliance (Interviewee 8, 2004; Interviewee 14, 2004). There is a major system update in June/July each year to incorporate legislative and functional changes. (Meeting of International Tax Agencies, 2002).

E-tax was developed by a relatively small team of people. The Project Manager was John McCarthy and Chris Mobbs was then Assistant Commissioner for Individuals – Non Business (INB), now called PTax, in charge of TaxPack, TaxTime marketing and telephone services (Interviewee 10, 2004; Interviewee 9, 2004). Around a dozen people developed the technical side of e-tax (Interviewee 9, 2004). A contract for the PC software was awarded to the successful tenderer, a consortium formed for this purpose. Interface specifications were borrowed from ELS (Interviewee 12, 2004; Interviewee 10, 2004).

E-tax was released nationally in 1999 with little or no advertising (Interviewee 14, 2004). Word of mouth and publicity in national newspapers and journals such as Australian Personal Computer and Business Review Weekly raised public awareness for the service (Interviewee 14, 2004). This alone was sufficient to generate initial taxpayer enthusiasm for the product (Interviewee 14, 2004).

The ATO was proactive in marketing e-tax in the media from 2000 onwards. (Interviewee 14, 2004). One of the marketing strategies implemented to raise

Organisation for Economic and Cooperation Development (OECD).

(ATO, 2003; United Kingdom Cabinet Office, 2000).

Experience with electronic lodgement globally includes the following country examples:

United States of America

The Inland Revenue Service (IRS) in the US began trials of electronic lodgement prior to the development of the innovation in Australia (Deuchar, 1989). Adoption of electronic lodgement has been slowly and steadily increasing since trials in 1986. Taxpayers in 35 states and the District of Columbia can file federal and state taxes electronically. In 1997, nearly 16% of i3e1n 0 TD0.02is0--7nb(been)}werefederd-17.7497 - TD0TD0.

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the data evidences that Commissioner Carmody acted as the path of entry, championing the introduction of this innovation to honour a commitment to have an electronic version of TaxPack.

The evidence is now considered in relation to the factor, the

. Interview and textual material highlighted the presence of a number of effective champions. Most notably, these were the successive Commissioners Boucher and Carmody and senior members of the Office who championed the operationalisation of ELS and e-tax, including Cebalo, Kelton, Mobbs and McCarthy. Together, these champions were pivotal in driving the diffusion and implementation of electronic lodgement innovations in the ATO. The personal commitment, credibility, standing, ability and 'can-do attitude' of these champions were critical in mobilising the requisite resources of people, skills, funds and hardware to build the momentum to effect the spread of electronic lodgement innovations in the Australian tax policy domain.

The is now examined. There is considerable textual and interview material highlighting that this factor was critical in influencing the diffusion and adoption of electronic lodgement services within Australia. In terms of its basic contours, the Commonwealth Government was able to drive the national diffusion of electronic lodgement services of tax returns for Individuals as a consequence of the prior exclusion of the states from levying personal income tax. This occurred due to World War II, initially on a trial basis in September 1942, then permanently by 1946, with resultant amendments in those years to the

TABLE 2: FACTORS INFLUENCING ELS DIFFUSION, ADOPTION AND IMPLEMENTATION

TABLE 3 FACTORS INFLUENCING E-TAX DIFFUSION, ADOPTION AND IMPLEMENTATION WITHIN AUSTRALIA

Tax policy context

- To fulfil the Commissioner's undertaking to develop an electronic TaxPack
- To ensure electronic lodgement was available to all taxpayers, not just tax agent clients
- To simplify the process of completing and lodging tax returns
- To encourage use of electronic lodgement

namely the Privacy Commissioner, Attorney-General's Department and Defence Signals Directorate.

With regard to e-tax, human actors included ATO officers — Commissioners, senior management, the e-tax team, software developers and taxpayers. Non-human actors included ELS, Internet, ATO web site, e-tax software program, computer hardware,

innovation. Each study found that the uptake rate of an innovation by other potential users was advanced by the presence of early adopters in key constituent communities who took on the role of champions in advocating the invention's adoption.

The importance of the [redacted] is now considered. This study found that Government's pursuit of broader public sector reform aimed at achieving efficiency influenced the adoption and diffusion of ELS. Further, this research revealed that the presence of other electronic innovations in the broader community such as e-banking, e-commerce and e-government raised taxpayers' familiarity with computer literacy, Internet and electronic transaction services, which in turn facilitated the uptake of e-tax by taxpayers. These findings are supportive of prior research (Kimberly, 1993; Turner, 2002) highlighting the need to examine the national context for its role in influencing the diffusion and adoption of innovations by governments and key constituents.

Similarly to the findings of Kimberly (1993) and Turner (2002), the current study highlights that [redacted] furthered the global diffusion and local adoption by specific countries of innovations. These ideas are circulated primarily through international forums, visits to other countries and texts.

This study substantiates research undertaken by sociologists of translation, finding that an inadequate explanation of an innovation's spread and adoption will result unless equal attention is given to the roles of both [redacted] and non-human actors (Callon, 1986, 1991; Chua, 1995; Law, 1992; Latour, 1988, 1991; Turner, 2002). This study found the diffusion and adoption of electronic lodgement innovations were contingent on the presence of human and non-human actors. Human actors included ATO officers — Commissioners, seni

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