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Explaining the U.S. Income Tax Compliance Continuum[+]

Brian Erard[*] and Chih-Chin Ho[†]

Abstract

Within an economy, tax compliance behavior falls along a continuum. At one extreme are households who fully report and

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II. DATA SOURCES

The core elements of our micro-simulation data base are derived from two separate TCMP studies that were conducted for tax year 1988, one for filers and another for nonfilers. Although these data are now some 15 years old, they have the advantage of providing detailed compliance information about both filers and nonfilers for a common tax year. We recognize that the magnitude and composition of tax noncompliance are likely to have changed since these data were collected. Notwithstanding, we believe that the data remain informative about the fundamental nature of the compliance decision and the broad underlying factors associated with noncompliance.

TCMP Filer Data

The data for filers of 1988 federal income tax returns are taken from the IRS TCMP Phase III Survey. This survey contains the results of intensive line-by-line audits of a stratified random sample of approximately 54,000 individual income tax returns for tax year 1988. For most line items both the amount that was reported by the filer and the amount that the examiner determined should have been reported are available. For income items, changes assessed by the examiner to the amount originally reported by the taxpayer are broken down according to whether the change was based on a review of third party information return documents or if it was based on other information. As discussed below in section 3, this distinction is useful for purposes of imputing additional non-detected income to taxpayer returns. A code is also available for the primary filer's occupational category based on the IRS examiner's assessment of the filer's main line of work. A set of sample weights is included to make the data representative of the national return population.[3]

TCMP Nonfiler Data

Our data on nonfilers comes from the examination-based segment of the IRS TCMP Phase IX Nonfiler Survey. The special TCMP study began with a stratified random sample of 23,283 potential nonfilers from a population of 83 million individuals for whom there was no record of a 1988 individual income tax return being filed.[4] Revenue officers set out to locate each of the individuals in this sample to determine whether they should have filed an individual income tax return for tax year 1988.[5] A total of 18,689 of the 23,283 potential nonfilers were successfully located through the search process. The revenue officers had access to information documents and past filing records. Using these records along with the information they collected during an interview or field visit with the individual, the officers made a determination whether the individual was required to file a return; i.e., whether the potential nonfiler was a "true nonfiler". Tax returns were secured from 3,546 individuals who were deemed to have been in violation of their tax filing requirements, and a random sample of 2,195 of these returns were subjected to intensive line-by-line audits, comparable to the audits performed for the TCMP Phase III study of individual return filers. It is the details from these 2,195 examined returns that we include in our micro-simulation data base. As with the filer data, the nonfiler records include the occupation of household head as well as detailed line item information about the sources and levels of household income, deductions, credits, and expenses.

Since not all potential nonfilers in the original sample of 23,283 were located, it is highly likely that a number of true nonfilers went unidentified.[6] We have therefore modified the sample weights for our sample of 2,195 located true nonfilers to make

replaced the TCMP examiner figure with an independent estimate of tip underreporting by the Bureau of Economic Analysis (BEA). For tax year 1988, the BEA estimated that filers reported only $5.9 billion in tips on their returns,

population. We assumed that all of the Schedule C (self-employment) net income reported by these households ($9.5 billion by filers and $9.7 billion by nonfilers) on their tax returns was attributable to informal activities. The aggregate difference between our measures of true and reported informal supplier income for each group represented our estimate of total undeclared income. In the absence of specific information about the relative levels of underreporting by different informal suppliers, we imputed an equal share of the estimated total level of undeclared informal supplier income to each member of the group.

Computation of Additional Tax Liability

The above imputations resulted in the assignment of additional net taxable income for many households beyond that detected during the examination. We applied a simplified tax calculator to translate this additional income into additional tax liability.[10] A more elaborate algorithm was required to estimate the additional self-employment tax associated with our imputations of additional self-employment income to returns.[11]

IV. AGGREGATION OF RESULTS BY OCCUPATION

For each filer in our data base, we have computed our overall measure of tax noncompliance as the difference between our expanded measure of total tax after credits (inclusive of the Earned Income Tax Credit) and the amount originally reported on the return.[12] This measure of noncompliance can be positive, zero, or negative depending on whether the filer has understated, correctly stated, or overstated his tax liability on the return. Often overstatements of tax liability are the result of unintentional errors, as are some understatements.[13] We do not attempt to distinguish between intentional or unintentional errors in our analysis.[14]

In the case of nonfilers, our measure is the difference between our expanded measure of total tax after credits (again, inclusive of the Earned Income Tax Credit) and the total amount of tax that was prepaid (for instance, through withholding and estimated tax payments). As with our filer measure, this noncompliance measure can be positive, zero, or negative depending on whether the nonfiler has made tax prepayments that fall short of, just meet, or exceed his full tax liability.

While our data base therefore contains a measure of tax noncompliance at the household level, we do not perform our analysis at this level, because we feel that our above methodology for imputing undetected income to individual households is not sufficiently refined. In particular, the procedure is likely to understate the amount of unreported income that has gone undetected for some households, while overstating the amount for others. To address this problem, we have aggregated results into 34 distinct occupational groups, thereby canceling out many of the errors made in imputing undetected income at the household level. Below we present the results of our analysis of compliance by occupation.

V. RESULTS

Using our micro-simulation data base, we have developed a preliminary map of where members of 34 distinct occupational groups in the U.S. fall along a continuum ranging from fully compliant to fully noncompliant. With the aid of this map, we have conducted a regression analysis to explore the factors responsible for the variation in compliance among the different occupational groups.

librarians; government officials and administrators; and mathematicians, engineers, computer and natural scientists, and architects.

Compliance by Filing Status

Table 2 breaks down compliance by occupation and filing status. Nonfiling appears to be heavily concentrated within certain occupational groups. Specifically, although individuals employed in the informal suppliers, helpers and handlers, and other service categories account for only an estimated 11 percent of the filer population, we estimate that they account for over 60 percent of the nonfiler population. Together, these three occupational groups account for over one quarter of the overall estimated tax gap (for filers and nonfilers combined). Particularly among these occupational groups, it is important to account for the behavior of nonfilers when drawing inferences about compliance.

Across all occupations, the average estimated level of noncompliance is over twice as large for nonfilers as it is for filers ($1,215 compared to $607). This is consistent with Erard and Ho (2001), who found that the aggregate share of noncompliance attributable to nonfilers was large in relation to their representation in the population.

Table 2 illustrates that compliance is sometimes relatively high among those members of an occupational group who file returns, but relatively low among those members who elect not to file. For instance, mechanics and repairers who file tax returns underreport their taxes by an average of $486, compared to $607 for all filers combined. However, among those mechanics and repairers who do not file returns, noncompliance tends to be much larger than for other nonfilers ($5,373, on average, compared to $1,215 for all nonfilers combined). A similar pattern is observed for the transportation and material moving category.

Regression Analysis

To investigate the reasons underlying the variation in compliance by occupation, we undertook a grouped data regression analysis. In particular, we regressed the average dollar level of noncompliance for each occupational group against the following regressors:[15]

IRP Income Share: the group mean of the ratio of income subject to third party information reporting to total income, multiplied by 100;

Audit Rate: the average group audit rate, computed by assigning the relevant IRS district level audit rate for the prior tax year (multiplied by 100) to each household in a given occupational group and computing the mean of these rates;

AGI: the group mean adjusted gross income divided by $100,000;

Marginal Tax Rate: the group mean marginal tax rate, multiplied by 100;

Time Burden: the group mean time burden (in hours) associated with preparing and filing a return;

Percentage Elderly: the group percentage of taxpayers of age 65 or older, multiplied by 100; and

Percentage Married: the group percentage of taxpayers with a married joint filing status, multiplied by 100.

The first two regressors in our specification relate to the opportunity of successful noncompliance. All else equal, the larger the share of total income that is subject to third party information reporting, the lower the opportunity for evading taxes by not

Results for Filer Sample

Most econometric studies of tax compliance have relied solely on data for filers of tax returns. To investigate whether the exclusion of nonfilers from the sample leads to biased inferences, we have repeated our analysis of the variation in compliance by occupation using only the data from our filer sample. As summarized in Table 4, the filer sample results are qualitatively very similar to the full sample results in Table 3, although the regressor for the percentage of married taxpayers loses its statistical significance in the restricted sample. Thus, restricting attention to filers does not seem to impart much bias on inferences concerning the determinants of noncompliance.

VI. CONCLUSION

In this paper, we have performed a preliminary analysis of noncompliance by occupation using a micro-simulation base that contains information on both filers and nonfilers of U.S. federal individual income tax returns. We began by deriving a map of where 34 distinct occupational groups fall along the compliance continuum. The results show that, for many occupational groups, the relative ranking depends on whether compliance is defined in absolute terms or as a share of taxes owed.

Using a grouped data regression analysis, we have explored what factors are responsible for the variation in compliance along the continuum. The results indicate that opportunity plays a key role in determining which occupations are relatively compliant and which are relatively noncompliant. More specifically, compliance tends to be substantially lower among those occupations with relatively little income subject to third party information reporting. Further, noncompliance tends to increase with the time burden associated with preparing and filing a return. This may be an indication that a large burden discourages

APPENDIX - TABLES

TABLE 1: DISTRIBUTION OF NONCOMPLIANCE BY OCCUPATION, RANKED BY ESTIMATED AVERAGE LEVEL OF NONCOMPLIANCE

Occupation	Avg. level of noncompliance	% of total taxes not paid	Group's share of population	Group's share of total tax gap
Vehicle sales	$6,406	51.1%	0.1%	0.49%
Investors	$4,398	15.0%	0.2%	1.38%
Informal suppliers	$4,011	44.1%	3.0%	18.66%
Lawyers and judges	$2,273	8.9%	0.5%	1.73%
Doctors and dentists	$2,181	7.0%	0.5%	1.78%
Real estate, financial, insurance	$2,165	20.9%	1.4%	4.63%
Farm and agriculture related	$1,465	33.0%	2.0%	4.49%
Non-govt. officials & administrators	$1,132	6.0%	3.4%	5.94%
Construction & extraction	$1,039	22.3%	4.5%	7.11%
Tip earners	$1,010	49.8%	4.0%	6.15%
Other sales occupations	$964	18.9%	6.7%	9.86%
Forestry, logging, fishing, hunting, trapping	$948	23.1%	0.3%	0.47%
Writers, performing artists, editors, announcers	$823	13.7%	1.0%	1.27%
Social and religious workers	$813	23.4%	0.7%	0.83%
Athletes and related workers	$762	10.3%	0.1%	0.13%
Social scientists	$731	7.0%	0.1%	0.08%
Managers, consultants, public relations	$666	9.6%	2.2%	2.22%
Mechanics & repairers	$600	16.0%	3.5%	3.25%
Transportation & material Moving	$577	14.8%	2.8%	2.50%
Mathematicians, engineers, computer & natural scientists, architects	$571	6.6%	2.6%	2.26%
Govt. officials & administrators	$450	7.8%	0.7%	0.51%

Occupation	**Avg. level of noncompliance**	**% of total taxes not paid**	**Group's share of population**	**Group's share of total tax gap**
Post-secondary teachers	$433	6.3%	0.3%	0.19%
Other teachers, counselors, librarians	$416	10.1%	2.1%	1.31%
Helpers and handlers	$409	23.8%	7.1%	4.42%
Accountants, auditors, tax preparers	$386	5.4%	1.1%	0.65%
Other health workers	$372	10.2%	3.1%	1.74%

TABLE 2: DISTRIBUTION OF NONCOMPLIANCE BY OCCUPATION AND WHETHER A RETURN WAS FILED

	Filers	Nonfilers	Filers & nonfilers combined

TABLE 3: RESULTS OF GROUPED DATA REGRESSION TO EXPLAIN VARIATION IN TOTAL NONCOMPLIANCE BY OCCUPATION; COMBINED FILER AND NONFILER SAMPLE

Dependent variable: Mean total noncompliance
Weighted mean value of dependent variable: $655.04
Sample size: 34
R^2 =.8868

Regressor	*Weighted Mean Value*	*Coefficient*	*t-statistic*
Constant Term*	1.000	5640.3	2.40
IRP Income Share*	81.725	-33.81	-5.80
Audit Rate	0.823	-3536.0	-1.31
AGI	0.290	439.1	0.72
Marginal Tax Rate	18.505	-20.39	

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ENDNOTES

[1] Refer to Andreoni, Erard, and Feinstein (1998) and Slemrod and Yitzhaki (2002) for reviews of this literature. Erard and Ho (2001) provide one of the only empirical analyses of nonfilers.

[2] Unfortunately, this data base is not in the public domain, because it contains sensitive individual taxpayer information that cannot be publicly disclosed.

[3] The TCMP filer population excludes returns that were filed late as well as returns filed by non-resident taxpayers.

[4] Non-residents and individuals without valid social security numbers were excluded

Details on the algorithm used to compute the change in self-employment tax are available from the authors.

[12] This measure includes not only income taxes, but also the items classified as "additional taxes" (taxes on distributions from trusts) and "other taxes" (self-employment tax, alternative minimum tax, recapture tax, social security tax on tip income not reported to employer, etc.).

[13] Not all overstatements of tax liability are accidental. In some cases, taxpayers deliberately accelerate the reporting of certain sources of income or postpone claiming expenses or deductions in an improper attempt to reduce their tax liability in another year. This can result in the discovery by an examiner of an overstatement of tax liability in the current year, but a more than offsetting understatement of liability in another tax year.

[14] An econometric approach to distinguish between intentional and unintentional tax reporting errors is deve

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The Interrelation of Scheme and Purpose Under Part IVA

Maurice J Cashmere *

Abstract
The way in which a scheme is defined under Part IVA is emerging as the principal factor which circumscribes the purpose of

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- an amount was deducted from the taxpayer's assessable income where it would not, or might reasonably have been expected not to be deducted otherwise.[2]

THE SCHEME

Scheme Identification

Part IVA is not concerned with any old scheme. It is concerned only with those schemes which produce a tax benefit, where the requisite purpose has been established. This is underscored by observations made by Hill J. in *Hart v FCT*.

> The definition of the scheme is very important. Any tax benefit which is identified must have a relationship to the defined scheme and not some other scheme. The conclusion of dominant purpose must be made by reference to the defined scheme, not some other scheme. Any determination made by the Commissioner must, likewise, be made by reference to the defined scheme and not some other scheme.[5]

As the purposive test has been developed, it has become apparent that the concept of a tax benefit and the test of purpose depend very much on the way in which the scheme is identified.

The importance of identifying the scheme properly was emphasised by the High Court in *FCT v Peabody* [6]- the first Part IVA case to reach the High Court.

> Under S177F(1), the Commissioner's discretion to cancel a tax benefit extends only to a tax benefit obtained in connection with a scheme to which Part IVA applies. The existence of the discretion is not made to depend upon the Commissioner's opinion or satisfaction that there is a tax benefit, or that, if there is a tax benefit, it was obtained in connection with a Part IVA scheme. Those are positioned as objective facts. The erroneous identification by the Commissioner of a scheme as being one to which Part IVA applies or a misconception on his part as to the connection of a tax benefit with such a scheme will result in the wrongful exercise of the discretion conferred by S177F(1).[7]

The point here is that the discretion vested in the Commissioner can only be exercised where it has been established, as a matter of objective fact, that a tax benefit exists and that it arises out of a scheme to which Part IVA applies.

So far, there appears to have been little difficulty in establishing what the tax benefit is. The difficulty has been in identifying the Part IVA scheme.

In identifying the scheme certain elements must be established. The critical elements are:-

- the parties to the scheme, in so far as they are known;[8]
- the terms or content of any agreement, arrangement, understanding, promise or undertaking;[9] and
- the steps or stages of any course of action or proposal in so far as they are relevant.[10]

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[5] Ibid 4618-4619
[6] [1994-95] 181 CLR 359
[7] Ibid 382
[8] Ibid 382, FCT v Spotless Ltd 95 ATC 4775, 4805
[9] FCT v Spotless Services Ltd 95 ATC 4775, 4805

It is critical that the parties to the scheme are identified - particularly the taxpayer who has had a tax benefit cancelled. If the taxpayer is not correctly identified, this will result in the revised assessment being set aside. Further, the terms of the scheme need to be identified with some degree of particularity. It is not sufficient for the whole of the facts to be relied upon. The Commissioner must establish which facts constitute the scheme. If facts less than the whole of the circumstances constitute the scheme, they must be particularised.

The difficulties of identification are illustrated by the lengthy consideration given to this issue by the Full Federal Court in *FCT v Spotless Services Ltd*.[11] (There was no consideration given to this issue by the High Court in this case as by the time the matter reached the High Court, the parties had decided on the identification of the scheme). There, a resident Australian company had invested Australian-based funds in Australian dollars on short-term deposit with a financial institution in the tax haven of the Cook Islands. Because of perceived credit risk on the part of the financial institution, the deposit was supported by credit enhancement documentation. This deposit was made offshore to obtain a better after-tax return than would have been

just the identified tax benefit, or whether it must take into account the substance of the transaction which the taxpayer entered into. It is axiomatic that the more narrowly the scheme is identified as the facts whereby the tax benefit was obtained, the more likely it is that the necessary dominant purpose of obtaining the tax benefit will be found.[12] This was apparent from the very first case to go to the High Court, *FCT v Peabody*.

Peabody's case involved inter-related corporate transactions, being the acquisition of shares with borrowed funds and a corporate reduction in capital which provided the funds whereby the loan could be repaid. The narrowly drawn scheme, which the Commissioner relied upon, was the reduction in capital, because that was the part of the overall transaction which produced the tax benefit. However, at the first instance hearing, the Commissioner had particularised the steps of the scheme more broadly. The High Court concluded that the Commissioner could not single out the reduction of

This is the very issue which is central to *Hart v FCT*, which is currently before the

Court itself in *Peabody* – then Part IVA will be capable of annihilating any transaction, something which no general anti-avoidance provision to date has ever achieved before.

The reason why the identification of the scheme by reference to the substance of the transaction is so important, is that the way the scheme is identified affects the inquiry that needs to be made later regarding the purpose of the scheme. If the Commissioner were able to identify just the part of the facts whereby the taxpayer obtained the tax benefit as the scheme, then few, if any, transactions would survive annihilation. The purpose would be clear even without the need to consider the eight specific factors necessary to establish the dominant purpose of the scheme. The *Peabody* approach is clearly an attempt to limit a very broadly drawn anti-avoidance measure.

The Second Identification Principle

Peabody's case established another principle which is that the Commissioner may rely on alternative schemes and is not necessarily bound by the original identification of the scheme. But how far the Commissioner may go in redefining the scheme, or in relying on a newly identified scheme, is a matter of some uncertainty. The view expressed by the High Court in *Peabody* was that the Commissioner was entitled to redefine the scheme even as late as the initial hearing, if it were originally defined too widely. Specifically, the High Court said:-

> If, within a wider scheme which has been identified, the Commissioner seeks also to rely upon a narrower scheme as meeting the requirements of Part IVA, then in our view there is no reason why the Commissioner should not be permitted to do so provided it causes no undue embarrassment or surprise to the other side. If it does, the situation may be cured by amendment, provided the interests of justice allow such a course.[17]

The High Court in *Peabody* did not go further than that. In the context of the facts in that case it said:-

> In this case (the first instance judge) took the view that the Commissioner had particularised the scheme too widely and that it should be confined…. He was not bound to accept the wider scheme advanced by the Commissioner before him and there was no unfairness to the taxpayer in his reaching the conclusion which he did, notwithstanding the apparent failure of the Commissioner to advance alternative schemes. [18]

It is clear here that there was no unfairness since the determination had been made in relation to the narrow scheme which had originally been identified.

What this observation shows is that the High Court was acknowledging that the Commissioner could redefine a scheme, if he wished to identify a narrower scheme, within a more widely defined scheme. The High Court also appears to have accepted

There are observations to be found which tend to suggest otherwise. In 1999 the Full Federal Court in *FCT v Consolidated Press Holdings Ltd* said that the exercise of the Commissioner's discretion does not depend on the correct identification of a scheme by the Commissioner. The Commissioner's discretion is enlivened so long as there is a Part IVA scheme.[19] The basis of this view must be that the identification of the scheme is posited as one of objective fact and therefore it would follow that so long as a scheme can be identified as a matter of objective fact, Part IVA applies.

But this view is not borne out by what has been said in more recent cases. Nor would it appear to be sustained by the provisions of Part IVA[20] or fundamental principles of due process.

In 2002 in Hart v FCT Hill J. said that if the Commissioner can re-identify schemes it is only initially and only between narrowly and widely defined schemes. The Commissioner may change his mind, but only subject to considerations of fairness.[21] This appears to be directed to his ability to choose between the narrowly and widely defined schemes which he has identified. His Honour's observation simply confirms

taxpayer would have been prejudiced by not being able to call additional evidence relating to this scheme.

That approach accords with the principle established by *Peabody* and is consistent with the thrust of the principles formulated in the Full Federal Court subsequently.

The Third Identification Principle

The third principle is that in identifying schemes, the Commissioner must ensure that they exist in fact and reality, and are not simply figments of the Commissioner's imagination. This was referred to by the Full Federal Court in Spotless in the following way:-

> It is not sufficient to identify a scheme by reference to a hoped for fiscal outcome [Part IVA] requires that a scheme has an existence in fact and reality and is not something based on the Commissioner's view of the facts or their legal effect.[24]

This was illustrated in *Spotless.* When the case was before the Full Federal Court, the fact that the scheme, which the Commissioner had identified, was said to be a scheme

However, unlike the definition of a tax benefit, the definition of a scheme does not encompass some hypothesis. The definition is posited as being of objective fact based in reality, not on the fiscal outcome sought by the Commissioner.

Furthermore, the definition of a scheme, in both limbs, uses words which denote positive action. The fact that commissions were not received by the stockbroker, or that no income by way of salary was paid, does not necessarily denote positive action. It denotes passive acquiescence. That appears to be the situation in Mochkin as there did not appear to be any evidence of any arrangement or unilateral decision whereby the taxpayer forwent commission or salary.

The Fifth Identification Principle

has now been established that by dominant purpose is meant that purpose which is "the ruling, prevailing or most influential purpose."[26]

The legislation refers to the conclusion about purpose being the purpose of the person, or one of the persons, who entered into or carried out the scheme – not the purpose of the scheme.[27]

In so far as the meaning of "entered into or carried out the scheme" is concerned, Hill J. in *Peabody's* case, when it was before the Full Federal Court, equated the expression with the word "participate". His Honour also emphasised that the relevant purpose is that of enabling the taxpayer to obtain the necessary tax benefit. In this context His Honour said that the expression "enabling" carried its ordinary meaning of "make able" or "make possible" and probably also meant "assist in making able or possible" or "contribute to making able or possible".[28]

The legislation refers to the conclusion about purpose being the purpose of the person, or one of the persons, who entered into or carried out the scheme. Therefore, the relevant purpose may be contributed by someone who is not the taxpayer. That does not mean that the purpose of the taxpayer is irrelevant, since the taxpayer may be a person who entered into or carried out the scheme. But, it does mean that anyone connected with the scheme can taint it, even if the taxpayer's purpose is totally untainted, which was the position in *Vincent v FCT*.[29]

It is also apparent that the requisite purpose may be contributed by someone who is not a party to the scheme. This is borne out by the *Peabody* case itself. There, the person whose purpose was relevant was Mr Peabody, yet he was not a party, in any legal sense, to any of the transactions. He was, however, a participant, in the sense of being the controlling mind behind the scheme.

The legislation highlights another problem. The purpose which is relevant is the purpose of the person, or one of the persons, who entered into or carried out, the scheme. As a scheme for Part IVA purposes can only be a stand-alone scheme, this raises the question of whether the inquiry must relate to the purpose of a person concerned with the stand-alone scheme, or whether the purpose of someone connected with part of a stand-alone scheme will suffice.

The High Court in *Peabody's* case held that if a person participates in only part of a stand-alone scheme, the purpose of that person can be taken into account, but that purpose must be ascertained in relation to the whole of the stand-alone scheme, not just that part of it with which the person was associated.[30] Therefore, it would follow that while a person may participate in only part of a scheme (which will be sufficient to provide the physical nexus) the purpose must relate to the whole scheme. The purpose which is relevant to this inquiry, however, is the dominant purpose.

[26] FCT v Spotless Services Ltd [1996] 186 CLR 404 at 416
[27] S177D; Hill J. Peabody v FCT 93 ATC 4104 at 4113
[28] Hill J. Peabody 93 ATC at 4113
[29] 2002 ATC 4490
[30] 181 CLR at 424

Ascertaining Purpose

If it is the dominant purpose which is relevant

It is inherent in what the High Court in *Spotless* said, that a conclusion about what the purpose is, must be determined by having regard to the eight factors set out in S177D. It was highlighted in the Full Federal Court decision in *Peabody*, in a passage from the main judgment delivered by Hill J. (that was not questioned by the High Court on appeal), that regard must be had only to these enumerated factors and no others. Regard must also be had to each of the factors:

> In arriving at his conclusion, the Commissioner must have regard to each and every one of the matters referred to in S177(b). This does not mean that each of those matters must point to th

balancing exercise. All of the factors may not be relevant. The evidence relevant to each factor may not be equally important. But, the more significant factors and the evidence which supports them could be expected to carry more weight in the balancing process. However, what may be underpinning the observations which Hill J. has consistently made is a desire to ensure that a dominant purpose is not determined primarily by reference to the first few criteria. Some flexibility may be a useful tool in such determinations, particularly since the principles for determining dominant purpose are still evolving.

But, even if manner, form and substance and timing are more significant, this still leaves open the question of how an evaluation is to be made once a tax benefit has been identified as arising from the scheme. Tax benefits do not arise in a vacuum. They arise in a commercial or family context. So it is important to determine how a dominant tax purpose is to be determined in a commercial or family context.

The Importance of Context

This is the dilemma which has consistently dogged discussion on tax avoidance. In the past this dilemma was solved by having regard to the predication test laid down by Lord Denning in *Newton v FCT*.[37] The test was formulated as follows:-

> In order to bring the arrangement within the section (the predecessor of Part IVA) you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section.[38]

> entered into or carried out a scheme for the dominant purpose of enabling the taxpayer to obtain a tax benefit.
>
> Much turns upon the identification among various purposes of that which is dominant.[39]

The key to this new formulation of principle appears to lie in the words "dominant purpose" since the High Court underscored this by saying that "much turns upon the identification, among various purposes, of that which is 'dominant' ". As indicated above the High Court has interpreted the word "dominant" as indicating "that purpose which was the ruling, prevailing or most influential purpose" and made it clear that the conclusion to be reached "is the conclusion of a reasonable person".[40] As a result the real inquiry under Part IVA is to see whether getting a tax benefit is the dominant purpose of the taxpayer, not whether it can be explained away by reference to ordinary commercial or family dealings.

And, that purpose has to be tested at the time the scheme was entered into and by reference to the facts and law in existence at that time.

The inquiry is made more complex because, immediately after stating that a dominant tax purpose can be found in an ordinary commercial transaction, the High Court went on to explain that tax considerations may be taken into account in implementing a commercial transaction, without Part IVA coming down on the taxpayer's head like a ton of bricks. This appears clearly from the High Court's approval of the dictum of *Harlan J.* in the United States Supreme Court decision in *Commr of IR v Brown.*

> [The] tax laws exist as an economic realty in the businessman's world much like the existence of a competitor. Businessmen plan their affairs around both, and a tax dollar is just as real as one derived from any other source.[41]

Later, the United States Supreme Court stated that it could not "ignore the reality that the tax laws affect the shape of nearly every business transaction". This statement was again approved in *Spotless* by the High Court, which went on to say:-

> A taxpayer within the meaning of the Act may have a particular objective or requirement which is to be met or pursued by what, in general terms, would be called a transaction. The 'shape' of that transaction need not necessarily take only one form. The adoption of one particular form over another may be influenced by revenue considerations and this, as the Supreme Court of the United States pointed out, is only to be expected. A particular course of action may be, to use a phrase found in the Full Court judgments, both 'tax-driven' and bear the character of a rational commercial decision. The presence of the latter characteristic

the funds in the Cook Islands was accompanied by additional security documents, designed to eliminate the perceived credit risk with the Cook Islands financial institution, should not have been a material factor, since the High Court accepted that the shape of a transaction can take more than one form and the form adopted was explicable on ordinary commercial considerations. Nor should it have mattered that the arrangement produced a better after-tax result, since the High Court approved the approach that a tax dollar saved was as good as any other. Furthermore, the tax dollar which could be saved was provided pursuant to a provision of the ITAA that specifically provided a special tax concession to Australian residents who derived taxed income from overseas.

An assessment of the facts against the criteria adopted by the High Court should have led to a conclusion that the deposit transaction was not one to which Part IVA applied. This was the conclusion of the Full Federal Court in this case. The core of that decision can be seen in the following passage taken from the judgment of Cooper J., who delivered the majority judgment.

> Where all other things are equal the investment offering the highest rate of interest will be chosen. Where taxation rates on particular investments are

the High Court, is equally able, if not better able, to support the Full Federal Court decision.

The Commercial Context

The decision in *Spotless* has raised two difficulties:

1. How can a commercial transaction, in which a tax benefit has been identified, survive on the basis that obtaining the tax benefit was not the dominant purpose?
2. How can any transaction, where it has been structured to obtain a tax benefit, specifically provided by ITAA, survive on the basis that obtaining the tax benefit was not the dominant purpose?

Some assistance regarding the interpretative approach which should be taken by the courts in addressing these two issues, is afforded by the Treasurer's statement in the second reading speech at the time the Bill for introducing Part IVA into ITAA was before Parliament, where the Treasurer said:-

> The proposed provisions – embodied in a new Part IVA of the Income Tax Assessment Act – seek to give effect to a policy that such measures ought to strike down blatant, artificial or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs … Some writers on the subject suggest that tax avoidance involves conduct entered into for the sole or dominant purpose of obtaining a particular tax advantage.

transactions which would not have been entered into, but for the tax benefit, in a manner consistent with the *Spotless* principles, yet maintaining consistency with the approach outlined in the Treasurer's second reading speech.

In *Eastern Nitrogen* the taxpayer had sold plant affixed to the taxpayer's premises to a financier and then leased the plant back at a commercial rental. This has been a familiar method of financing in Australia for decades. The transaction took the form of a lease. The rental payments under the lease gave a higher tax deduction than interest would have done. That was the identified tax benefit. This arrangement was held, by a unanimous decision, not to be a scheme to which Part IVA applied, notwithstanding that the transaction would not have been structured as a lease, but for the tax advantage.

The tax question confronting the Court was clear - whether the financing transaction, which provided a better after-tax return, could be said to have been entered into for the dominant purpose of obtaining the tax advantage.

The judgments in this case clearly show that the inquiry was directed, at least initially, to a consideration of the manner, form and substance of the transaction. In other words, the approach adopted in Spotless was followed. The approach to be adopted was outlined by Lee J. in the following statement:-

> For S177D to apply and a determination made under S177F that Part IVA applies it must be shown that the 'maximised … after-tax return' has been obtained in a manner that speaks of the presence of a purpose above all others to obtain a tax benefit. (FCT v Spotless Services Ltd.[46]

The manner in which the transaction was entered into showed that there had been an exhaustive examination over a lengthy period time about the terms of the deal consistent with the size of the transaction, but the basic transaction was simple and straight-forward, and there was nothing unusual, uncommercial or unexpected about the way in which it had been concluded or carried out.

The form of the transaction was constituted by a lease of equipment which had provided the taxpayer with deductions for the full amount of the rentals that were larger than the deductions for interest, under the pre-existing loan arrangements. The deduction was a tax benefit and it was an important element in the taxpayer's decision to enter into and carry out the transaction. The substance of the transaction was the same.

His Honour then went on to state, in relation to form, that where a transaction is documented and the document creates legally enforceable rights and obligations, an objective assessment of the purpose of the transaction must take into account the rights and obligations undertaken.[47]

And, when considering form and substance the statutory provision does not limit the consideration which needs to be made regarding this factor, simply to a comparison

[46] Ibid 4166
[47] Ibid 4167

between the form and substance of the scheme. Both elements have to be considered separately and together.48

It was emphasised though that although the rights, obligations and duties arising under an agreement may disclose elements of artificiality, whether in the documents or content, they do not determine purpose in favour of the Commissioner under the Spotless principle. Nor do elements of commerciality determine the issue in favour of the taxpayer. They are simply matters to be considered.

The other factors were also considered, but the only one of note was the change in the financial position of the taxpayer. This was significant. The scheme resulted in the taxpayer receiving a large up-front cash payment for its business. Then, instead of being reliant on short-term financing, the taxpayer had a long-term financial facility available which reduced its exposure to interest rate fluctuations. The off-balance sheet nature of the lease financing also had the benefit of enhancing the taxpayer's

In *Eastern Nitrogen*, it was also at the heart of the matter and the Court specifically addressed the *Spotless* principles in relation to tax-driven transactions. Lee J., with whom Sundberg J. concurred, maintained that proper business management requires the net cost of financing to be taken into account. Furthermore, where a business relies on borrowings to provide circulating capital, the net cost of that finance, after taking into account any deductions that are available under ITAA, is a relevant consideration, and to adopt one form of financing over the other on such a basis, does not, by itself, lead to a conclusion that a dominant purpose to obtain that tax advantage exists.

> To show that a business which depends upon financiers to provide the recirculating capital needed for the operation of the business, has obtained

which enabled the tax advantage to be available, nor that the substance of the transaction was a single advance; nor the

the scheme is identified by reference to the practical reality of what the taxpayer did, that the S177D considerations have a role to play and it becomes possible to make a determination about whether tax is the dominant purpose of the taxpayer's actions.

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The Influence of Education on Tax Avoidance and Tax Evasion[2]

Jeyapalan Kasipillai[1], Norhani Aripin

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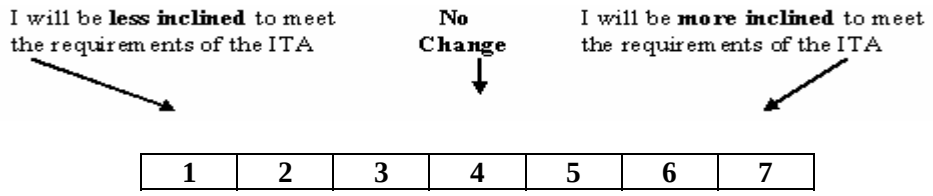
has serious consequences to Governments as it not only cause losses in current revenues but it fosters a threat to voluntary compliance.

Theoretical framework on tax compliance

Achieving tax compliance is costly for both tax authorities and taxpayers. Tax audit and investigation is obviously costly to tax authorities (Allingham and Sandmo, 1972). Compliance is also costly to taxpayers, who must keep records as well as consult tax professionals and this is particularly true under a self-assessment system. Malaysia introduced a self-assessment tax system in stages commencing with companies from year of assessment 2001. In 2004, it would apply to all categories of taxpayers, including individuals. Slemrod and Sorum (1984) suggested that the compliance cost of managing individual income taxes in developed countries is between five and seven percent of revenue raised. According to Henry (1983), perfect compliance to tax law is not a rational objective for public policy.

Most taxation systems in the world reveal that taxation authorities employ a mixture of enforcement activities and penalties in order to enforce tax compliance. Research in the US (Schwartz and Orleans, 1967) and in Sweden (Vogel, 1974) found that taxpayer norms are important in analysing individual behaviour towards tax obligations. Spicer and Lundstedt (1976) found that the internalised norms and role expectations in each taxpayer are the major role elements in taxpayer choice between tax compliance and tax evasion.

moderated such a positive perception, which both contributed indirectly to a less



Out of 560 questionnaires that were distributed at the end of the semester, 551 were returned by the respondents providing a response rate of 98.39%. Five of the questionnaires were rejected due to insufficient data, leaving a total of 546 usable responses.

The Questionnaire

The questionnaire was divided into two parts: Part A and Part B. Part A consisted of four tax case scenarios to measure the behavioural dimension of respondents to tax compliance. After reading each scenario, the respondents were asked to evaluate (on a seven-point "Likert" scale) whether he or she would report their earned income if faced with an identical situation. Part A of the questionnaire comprised of four questions. The first question is structured to gain response to a general public evasion (GE) issue. The second question seeks response to a general public avoidance (GA) issue. The third question relates to a personal evasion (PE) matter and the last question deals with personal avoidance (PA). As mentioned earlier, at the end of the semester, one additional question was added to the same set of questionnaire. The additional question sought from respondents whether their attitude on tax affairs had changed after studying the taxation subject for one semester.

Part B ("demographic information") solicits respondents' background information such as gender, age, ethnic group and work background of parents.

Data Analysis

In Part A, a Likert scale was used for most of the questionnaires and the respondents had to tick the appropriate column. In Part B, the questionnaires required a tick for the correct answer. The responses derived from the questionnaires were coded, entered and analysed by using the SPSS statistical package.

V. FINDINGS

This section reports on the respondent's characteristics, and results of hypotheses introduced for this study.

Respondent's Characteristics

A summary of the characteristics of respondents is reported in Table 1. For both sets of questionnaire, the percentages of sample characteristics are broadly the same. The sample characteristics suggest that about 26% of the respondents were males and 74% were females. Seventy-one percent of the respondents were Malays, 23% were Chinese, four percent were Indians and two percent were others.

Most of the respondents (84%) are between 20 and 30 years of age. This is because the respondents are undergraduate students pursuing a degree program at University Utara Malaysia (UUM). About one-quarter of the student's parents (24%) are

employed with the Government but most of them (48%) are employed with the private sector.

Hypotheses Testing

The research hypotheses were structured to seek answers to the issues raised in the introduction section, that is, the association, if any, between (i) extent of tax compliance and (ii) level of education. As mentioned earlier, the respondents completed the questionnaires at the commencement as well as at the end of the semester. The survey questionnaires for each of groups were coded in relation to the respondent's background data and the mean scores for each survey question were then determined.

TABLE 1 SUMMARY OF SAMPLE CHARACTERISTICS

	Percent
Gender	
Male	25.7
Female	74.3
	100.0
Ethnic Group	
Malay	70.7
Chinese	23.5
Indian	4.0
Others	1.9
	100.0
Age	
Below 20 years	15.4
20 to 30 years	84.4
Over 30 years	0.2
	100.0
Parent's work background	
Sole proprietor/partnership	15.6
Government servant	23.7
Employed in private sector	47.7
Others	13.0
	100.0
Parent's approximate annual income (Year: 2000)	
Below RM18,000	87.4
RM18,001 to RM36,000	9.9
Above RM36,001	2.7
	100.0

* Number of respondents: 546

The first hypothesis was posited in relation to respondents' scores over time (period of tax education).

H-1: There is no difference in the mean scores of students at the commencement of the semester and at the end of the semester.

Data to test hypothesis, H-1, was gathered from students who completed the Taxation 1 program in May 2001. The student's responses to four taxation scenarios were obtained at the commencement of the semester, and student responses to the same questions were gathered at the end of the semester. No student was identified in relation to his or her response in order to make it confidential and to encourage truthful responses. As such, individual

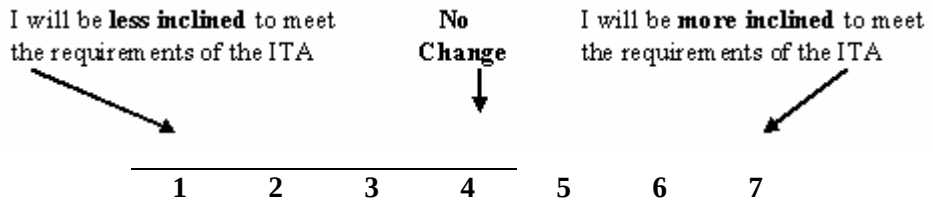

I will be **less inclined** to meet the requirements of the ITA
No Change
I will be **more inclined** to meet the requirements of the ITA
1 2 3 4 5 6 7

TABLE 4: STATISTICALLY DIFFERENT MEAN SCORES AND STANDARD DEVIATION FOR FEMALES ON TAX QUESTIONS

	Mean		Standard Deviation	
Question Number	Commencement of Semester	End of Semester	Commencement of Semester	End of Semester
Q1 GE	4.02	3.99	1.42	1.40
Q2 GA*	4.72	5.25	1.28	1.30
Q3 PE*	4.22	4.44	1.25	1.38
Q4 PA	3.36	3.37	1.25	1.37

* Significant at 5% level
Note: GE: General Evasion GA: General Avoidance PE: Personal Evasion PA: Personal Avoidance

Similar analysis were also undertaken on male attitudes as shown in Table 5. The t-test results revealed that there is a significant difference among male attitudes between the commencement and the end of the semester for only GA ($t=2.91$, $df=270$, $p<0.05$). The findings suggest that male students have shown an improvement in the understanding of the legal provisions pertaining to general tax avoidance under the Act. Indirectly, it has proved that male students' attitudes in respect of general tax avoidance under the Act have changed after undergoing the tax course for one semester.

TABLE 5: MEAN SCORES AND STANDARD DEVIATION FOR MALES ON TAX QUESTIONS

	Mean		Standard Deviation	
Question Number	Commencement of Semester	End of Semester	Commencement of Semester	End of Semester
Q1 GE	4.01	3.97	1.53	1.55
Q2 GA*	4.94	5.45	1.49	1.39
Q3 PE	4.21	4.32	1.46	1.52
Q4 PA	3.48	3.55	1.57	1.48

* Significant at 5% level
Note: GE: General Evasion GA: General Avoidance PE: Personal Evasion PA: Personal Avoidance

The third hypothesis on participant'

Hypothesis H-3 was accepted. It was observed that in both surveys carried out at the commencement and end of the semester, there was no significant difference in attitudes between male and female groups. The fourth hypothesis on participant's ethnic group was proposed as follows:

H-4: There is no difference in the mean scores of attitudes among ethnics groups at the commencement of the semester and at the end of the semester.

Table 7 shows the mean scores for ethnic groups over time (tax education) Results of ANOVA revealed that there are significant differences among ethnic group attitudes for tax education in (General Evasion) GE ($F_{7,1096}$=4.68, $p<0.05$) (General Avoidance) GA ($F_{7,1096}$=7.83,$p<0.05$) and (Personal Evasion) PE ($F_{7,1096}$=3.78, $p<0.05$).

TABLE 7: MEAN SCORES FOR ETHNIC GROUP OVER TIME

	Commencement of Semester				End of Semester
Question Number	Malay	Chinese	Indian	Others	

Furthermore, the findings indicate there is no difference in attitudes between male and females and this is in line with hypothesis 3. The statistical findings of this study confirm the existence of a relationship between education and tax compliance. Therefore, it is suggested that universities offering social science courses as well as

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Scheme New Zealand or An Example of The Operation of Div 165[+]

Justice Graham Hill[*]

Abstract

There is no decided case in Australia yet regarding the application of general anti-avoidance rules to a transaction with respect to GST. However, this has been considered to some extent in a recent case in New Zealand, *TRA No 001/02 v Commissioner of Inland Revenue*. This paper considers the decision made by the New Zealand Taxation Review Authority on that case as a vehicle for speculating on the outcome under the general anti-avoidance rules contained in the Australian GST Act, had a scheme equivalent to the New Zealand scheme been implemented in Australia.

INTRODUCTION

It took 13 years from the introduction of Part IVA into the *Income Tax Assessment Act 1936* until it first engaged the attention of the High Court in *Commissioner of Taxation v Peabody*[1]. It may well take around that time for Division 165 of the *A New Tax System (Goods & Services Tax) Act 1999* ("the GST Act") to receive detailed consideration in the High Court. Perhaps that is to be unduly pessimistic given recent murmurings in the newspapers suggesting the possible application of Division 165 to "joint venture" schemes.

Because there are, as yet, no cases in Australia which have considered Division 165 it is useful to consider the facts of a recent New Zealand case *TRA No 001/02 v Commissioner of Inland Revenue* ("the deferred payment scheme") decided by the New Zealand Taxation Review Authority. This, then, provides a vehicle for speculating on the outcome under Division 165, had the scheme been implemented in Australia (and worked). It also enables us to assess the difficulties (if any) which the transplantation of Part IVA into the GST Act (albeit with some modifications) may have brought with it.

It should, at the outset, be noted that the provisions of the GST Act relating to contracts to acquire property differ from those in New Zealand with the consequence that the scheme could not, at least without modification, work here. As will later be seen the normal provisions in a contract that the deposit would be held by a

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The paper will not set out the legislative scheme of Division 165. That will be assumed. There will, however, be a need to set out some of the provisions of s 76 of the *Goods & Services Tax Act 1985* ("the NZ Act").

THE FACTS

The basic outline of the facts of the deferred payment scheme is quite simple. The taxpayer T contracted to purchase some 114 sections of land in a subdivision from a similar number of companies ("the A group of companies") by separate agreements.

Companies), W Developments Ltd rescinded those contacts and then commenced to sell off the land which the taxpayer had contracted to buy from the various companies

It is far from clear what that qualification means despite an elliptical reference to *Inland Revenue Commissioners v Brebner*[4] in Peabody which presumably was intended to elucidate it. And, as Hely J pointed out in *Hart*;[5]

> The more the scheme can be confined to the essential elements by which the tax benefit is obtained, the more likely it will be that the conclusion will be drawn that the dominant purpose for a person entering into a scheme so defined was to obtain the tax benefit.

Whatever the outcome in *Hart* it will ordinarily not matter whether a wider or narrower definition of the scheme is adopted as the objective facts required to be taken into account in deciding whether the relevant conclusion should be drawn will include all the relevant surrounding circumstances. Naturally these include those elements of the plan or proposal that might be eliminated from the wider scheme in formulating a narrower scheme.

In the present circumstances it is easier to regard the scheme as being the whole of the course of conduct which was set out earlier in this paper under the heading "The Facts". There is no need to narrow the scheme to some narrower scheme.

THE GST BENEFIT

As already noted the relevant scheme must be one from which the "avoider" got a GST benefit. The relevant paragraphs of the definition applicable to the taxpayer will be either s 165 –10(1)(b) [namely that there is an amount payable to the entity (the taxpayer) under the GST Act which is or could reasonably be expected to be larger than it would be apart from the scheme] or s 165-10(1)(d) [namely that all of an amount that is payable to the entity (the taxpayer) is or could reasonably be expected to be payable earlier than it would have been apart from the scheme or a part of the scheme.]

The first of these alternatives is relevantly concerned with a scheme which maximises input tax credits. The latter is relevantly concerned with the timing of the payment of the input tax credits, that is to say advancing the time when refunds are payable. Either could be applicable here.

There is another GST benefit as well here, in that the scheme defers the time at which the vendor companies (the A Group of companies) were required to account for output tax. That other tax benefit would involve a different set of taxpayers. What is perhaps unusual with the deferred payment scheme is that it depended upon both the taxpayer being entitled immediately to the input tax credit and the vendor to the taxpayer not being required to pay GST until a later time. It is not unusual in the income tax context for the Commissioner to issue altTJ15usual 5(t)0.1(woul)(he ST[(that it)-5.5(d6(ac

the benefit "got" from the scheme is one "attributable to the making, by any entity, of a choice or election" expressly provided for by the GST law.

Section 29-40 of the GST Act permits a taxpayer to "choose to account on a cash basis" so long as certain tenets are observed,

v Gulland[9] Dawson J suggested that reconciliation between s 260 and the rest of the

Further, it is an essential element of the scheme that the input tax credit to which the taxpayer is otherwise entitled funds the deposit which the taxpayer is obliged to pay and thus the amount which the various companies in the A group of companies are required to pay to W Investments Ltd. To achieve this it is necessary that the A group companies are so structured that each can chose to account on a cash basis and also that the contracts are so structured that settlement is long delayed thereby maximising the amount of the initial input tax credit and delaying payment of the output tax.

In summary, it may be that a taxpayer who sets up a scheme to avail himself or herself of the making of a choice expressly legislated for does not have a relevant tax benefit if that is all that the scheme involves. For then the tax benefit is attributable solely to the election or choice. However, here the tax benefit obtained, whether by the taxpayer or the companies in the A group of companies, is attributable to other factors such as the structuring of the transaction to avail the taxpayer of the mismatch in manner and time of payment of output tax and receipt of the input tax credits. However it can not be said that the question is free from doubt.

Since, however, it is the taxpayer who is to be denied the input tax credit here, the relevant tax benefit has to be the acceleration of the input tax credit or the obtaining of an input tax credit at all by the taxpayer. No election, choice, application or agreement is exercisable by the taxpayer so as to exclude there being a tax benefit. Obtaining a credit arises from the act itself. Accounting on an invoice basis is an obligation the act itself imposes absent the making of a successful election.

It will be recalled that the relevant definition of GST benefit reads:

> all or part of an amount that is payable to the entity under this Act apart from this Division is, or could reasonably be expected to be, payable earlier than it would have been apart from the scheme or a part of the scheme.

There is no doubt that "*reasonable expectation*" involves more than a possibility. Rather, as the High Court said in *Peabody*[10] reasonable expectation involves:

> Prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out, and the prediction must be sufficiently reliable for it to be regarded as reasonable.

Where the GST benefit involves the payment of output tax it may sometimes be possible for a taxpayer to argue that it is just plain unreasonable to suggest that if the scheme had not been entered into GST would be payable if only because apart from the scheme the taxpayer would do nothing at all and thus have no GST to pay. In the resolution of such an argument the provisions of s 165-10(3) may have some application.

The same argument can not be made where the relevant benefit is the obtaining of an input tax credit. If the taxpayer did not enter into the scheme and did nothing at all no GST credit would be payable to him or her. So the whole of the input tax credit will be the GST benefit "got" by the taxpayer from the scheme.

[10] at 385

tax purpose but motivated by profit to himself or herself. The purpose of an adviser may be attributed to the taxpayer in an appropriate case.[15]

Thirdly, there is no necessary dichotomy between the pursuit of commercial gain in the course of carrying on a business and a finding that the dominant purpose was to obtain a tax benefit.[16]

Fourthly, at least in the operation of Part IVA it is clear that evidence of the actual

The normal provision in the contract that the deposit was to be held as stakeholder was crossed out. This may have been thought necessary to ensure the time of supply was immediately upon the contract being entered into.

The need for 114 separate companies to make the purchases from W Developments Ltd had, despite protestations that the separate companies limited the commercial risks involved, no commercial basis. The separate companies could only be explained by the need for ensuring that each company kept below the threshold so as to permit it to account on a cash basis as a matter of right.

The land agent, although according to the contractual arrangements entitled to commission from W Developments Ltd immediately the contract was entered into with the A group companies, as a result of an understanding entered into informally, not to receive his commission until the GST refund was received. In fact he never received any.

Before the 114 contracts were entered into favourable rulings had been obtained from the Revenue in respect of three unrelated property transactions having a similar mismatch.

No doubt in favour of the taxpayer it would be argued that the taxpayer stood to make a profit from the arrangement. This is somewhat like the argument that, in the income tax context, was made in *Spotless.* There the taxpayer's after tax return was substantial and much better than the after tax return that would have been obtained had the taxpayer left the funds invested at interest with an Australian bank and thus suffered Australia tax upon it. However, th

the taxpayer would, in the event the scheme was successful, have, as a result of the input tax credit, a large fund from which to pay the deposits on the contract with the A group of Companies which in turn would be used by them to fund the deposit obligations to W Developments Ltd. No amounts would be needed to pay GST to the Revenue until the contracts were completed when the A Group of Companies would become liable to pay output tax on the 114 contracts.

There will be the same commercial advantage as discussed above in the context of purpose – an advantage that would exist only so long as the GST advantage was available. Not surprisingly in the New Zealand case, everything collapsed when the revenue refused to pay to the taxpayer the input tax credit.

The conclusion as to principal effect would, thus, be the same as the conclusion as to dominant purpose.

WHAT CONCLUSION SHOULD BE DRAWN ABOUT DIVISION 165

Part IVA has been interpreted, generally, quite favourably to the Commissioner in Australia and it may be expected that Division 165 will likewise be interpreted favourably to him.

The above analysis makes it clear that the only possible difficulty for Division 165 overcoming the Ctavisio070.0 T1u3usiffi70s