



No.43

# Thinking about Tax Avoidance

Ivan Potas

*The Australian taxation system has been designed and implemented to ensure that as many people as possible pay their fair share of taxes. However, this Trends and Issues argues that the taxation rules have become so complicated, that despite the best efforts of the Australian Taxation Office to explain the system, many are obliged to turn to expert advice because they are unable to comprehend the extent of their tax obligations and entitlements. The author suggests that simplification of our tax laws would result in a more efficient and equitable revenue collection system.*

**Duncan Chappell**  
**Director**

As long ago as 1985, the activity of tax avoidance and tax evasion was estimated to cost the Australian revenue about \$3 billion per year (Treasury's Draft White Paper cited in Grabosky & Braithwaite 1987). This offence (really a collection of offences) is generally regarded by criminologists as belonging to the category of "white-collar crime". Traditionally, "white-collar crime" is taken to relate to persons of relatively high social status who commit crimes in the course of their occupation. However, that label does not sit comfortably with "tax cheats". Tax evasion and tax avoidance activities are generally associated with the rich and powerful and involve large companies and big money. Yet the offence can also apply to ordinary people, to almost anyone in fact who derives an income and has an obligation to pay tax.

Naturally, the greater the income or capital that a person (or corporation) derives, the greater is the potential for large scale tax avoidance and fraud. For example, since 1988 the Australian Tax Office has been conducting a large case audit program which has targeted the top 100 Australian companies. When only about half of these audits had been completed, records kept by the Corporate Tax Association revealed that tax adjustments arising from these audits had already exceeded \$1 billion, although some 30 per cent of these adjustments were still in dispute (*The Canberra Times*, 10 May 1993). The fact that such a significant proportion of adjustments were in dispute is but one indication of the uncertainty and complexity of the law.

---

## Tax Avoidance and Tax Evasion

---

At one time the distinction between tax avoidance and tax evasion was relatively clear. The first was legally permissible (the legal escape from tax burdens written into tax codes) and the second

AUSTRALIAN INSTITUTE  
OF CRIMINOLOGY

*trends*

*&*

*issues*

in crime and criminal justice

August 1993

ISSN 0817-8542

ISBN 0 642 19553 6



Australian Institute  
of Criminology  
GPO Box 2944  
Canberra ACT 2601  
Australia

<http://www.aic.gov.au>

was not. In more recent times there has been a blurring of these two concepts. One commentator has coined the term “avoidance” to describe the grey area between avoidance and evasion. Even now the confusion is such that some tax officers prefer the terms “compliance” and “non-compliance”, rather than seek to distinguish between avoidance and evasion.

In the past, the term tax avoidance was used to signify that the taxpayers had employed legitimate methods or “schemes” for reducing their tax liability. It did not imply any conscious wrongdoing, but merely involved paying less tax than normally required (*FCT v. Westgarth* (1950) 81 CLR 396 at 414). This process is sometimes referred to as tax minimisation and is the end product or objective of tax planning. “Tax planning” in its most benign form has been described as the exploitation of tax concessions in accordance with Parliament’s intention (Lehmann & Coleman 1989, p.745). Most investors have probably engaged in some form of tax planning, even though they may not have been aware of it.

In the last decade or so “tax avoidance” has acquired a distinctive pejorative connotation. It no longer guarantees that avoidance arrangements entered into by the taxpayer are free from the taint of illegality. In other words, some forms of tax avoidance are illegal and this has been made crystal clear under the provisions of Part IVA of the *Income Tax Assessment Act 1936* (Cwlth), to be considered shortly.

Unlike tax avoidance, tax evasion is always against the law. It consists of some blameworthy act or omission on the part of the taxpayer: it is fraud (see *Denver Chemical Manufacturing Co v. Commissioner of Taxation* (NSW) (1949) 79 CLR 296 at 313-14). It involves the illegal non-payment of taxes either by under-declaring income or over-declaring deductions or exemptions. People who engage in tax evasion and are caught should expect to be visited

with deterrent penalties. For those prosecuted, this generally means a severe fine, and in serious cases of fraud the penalty can be a custodial sentence.

---

### **Crime Follows Money**

---

Conventional criminological wisdom holds that where there is money to be made there is crime. It therefore follows that where there is an obligation to pay taxes, there will always be people who will strive to avoid meeting their obligation. All other things being equal, the temptation to cheat increases as the amount to be gained from cheating also increases. Similarly, based on the assumption that most people do not wish to pay any more taxes than their obligations permit, legitimate and sometimes questionable tax minimisation schemes or practices are adopted in order to reduce tax liability.

#### *Negative Gearing*

It is well recognised that those who are in the higher income brackets can benefit handsomely by careful investment techniques, such as “negative gearing”. This works extremely effectively where the taxpayer falls into the top marginal tax bracket. Through careful investments some taxpayers are able to legally reduce their assessable income by diverting income which would otherwise be subject to taxation at the highest marginal tax rate (at the time of writing 48.25 per cent including the Medicare levy). The diverted income is placed into a legitimate investment which runs at a loss (that is it has negative income). The net effect is that the taxpayer’s equity in the unprofitable investment is increased while his or her overall income (and therefore tax liability) is reduced.

The object of negative gearing is to make a capital gain or to build up an investment to the point where it is profitable and where full taxes ultimately will be attracted. This

technique enables some taxpayers to offset gains derived from one source of income against losses incurred from another. In many cases the investment will be sold at a profit, and gains made will attract capital gains tax. Thus negative gearing may be a means of deferring tax rather than avoiding it.

The Government would not allow negative gearing arrangements if it did not see some economic benefit (for example encouraging spending, investment, business enterprises, employment) in allowing the practice to continue. It is unfair because only high income earners can take advantage of it. If the sole or dominant purpose of the arrangement is to avoid the payment of tax, negative gearing is legally unacceptable behaviour.

#### *The Tax Avoidance Industry*

Tax avoidance schemes were not widespread until the late 1960s and early 1970s. Thereafter, fuelled by the very restrictive interpretation of tax legislation, virtually any tax avoidance scheme, regardless of its artificiality, appears to have been outside the reach of the Commissioner of Taxation. A number of schemes became notorious devices for getting around the obligation to pay tax.

Limiting exemptions can reduce the opportunities for both avoidance and evasion. Tax avoidance thrives where there is some structural defect (loophole) in the tax legislation. An example of such a loophole enabled the common practice of dividend stripping, where assessable income was converted into non-assessable capital gains. This was achieved where a taxpayer entitled to a large company dividend would instead sell shares in the company to a third party for an amount roughly equal to the potential dividend. This loophole was plugged by s177E of Part IVA.

There are of course many areas where tax avoidance has been practised. These include schemes such as trust stripping (also involving the exploitation of the revenue/capital dichotomy), investing in loss

companies, profit shifting, income splitting, gift schemes, exploitation of trusts and superannuation schemes, just to mention a few.

One scheme involved thousands of university students (*Cridland v. FCT* (1977) 8 ATR 169). The students found that they were able to pass themselves off as primary producers and, by becoming beneficiaries under a trust, could take advantage of the income averaging provisions under the Income Tax Assessment Act. This illustrates the problem of providing concessional benefits for one class of taxpayers only.

During the 1970s the tax avoidance industry mushroomed. "Taxation planning" was actively promoted by professional lawyers and accountants. By the early 1980s, the amount of tax revenue being lost annually from avoidance schemes was variously estimated to be anything from \$3,000m to over \$10,000m (Browne 1985).

---

### A Decade of Tax Reform

---

Alongside the tax avoidance schemes also emerged the so-called "bottom of the harbour" frauds. The 1986-87 *Annual Report of the Australian Taxation Office (ATO)*, stated that these schemes involved some 6,688 companies, and resulted in tax evasion of between \$500m and \$1,000m, the largest instances of fraud committed against the Commonwealth (*see also* Freiberg 1988).

The lessons from the 1970's, as revealed in the Costigan Royal Commission (1984) and McCabe/Lafranchi reports (1983), resulted in specific legislation designed to ameliorate the appalling situation concerning Australian tax law.

"Transfer pricing" legislation was enacted in 1977 to prevent taxpayers taking advantage of lower overseas tax rates by artificially performing inter-national transactions.

In 1980 the *Crimes (Taxation Offences) Act* (Cwlth) made tax evasion a serious criminal act. This

was followed in 1982 by retrospective legislation to enable recovery of taxes which had previously been evaded.

In 1981 the *Income Tax Laws Amendment Act (no 2)* (Cwlth) introduced Pt IVA (the anti-avoidance provisions) and substantially strengthened s 260 of the Income Tax Amendment Act.

At the same time the *Acts Interpretation Act 1901* (Cwlth) was amended by the introduction of s 15AA. The latter ameliorated the overly literal interpretation of Commonwealth legislation which had contributed to the escalation of tax avoidance schemes. Henceforth when interpreting ambiguous provisions the courts could draw upon the purpose and intention of the legislation and so cut down the opportunities for those seeking to exploit the tax system by appealing to a literal interpretation of the legislation.

Very strict secrecy provisions apply to the information gained by the ATO in the course of its work (*see* NCA 1991). In 1982, "declared" Royal Commissions were given access to certain taxation information to assist them in their inquiries. This was a significant step in diminishing the secrecy provisions applying to taxpayers. Thus, for example, tax information can now be communicated to the National Crime Authority (NCA) for the purposes of a tax-related investigation and the NCA may request information which the Commissioner has acquired under the provisions of a tax law relevant to a special investigation of the NCA (*Tax Administration Act 1953* (Cwlth), s 3D). In 1984, following the annual report of Special Prosecutor Redlich, further tax legislation was introduced adding criminal offences and prescribed tax offences to the Act. This meant that fines of up to \$10,000 and imprisonment up to two years could be imposed in certain circumstances.

In the same year the *Crimes Act 1914* (Cwlth) was amended. By section 29D of the Act, it became an offence to defraud the Commonwealth. An original penalty

of \$50,000 or five years imprisonment for this offence was doubled in 1986.

Even so, it is interesting to note that the imposition of gaol terms for tax fraud, in comparison to Social Security fraud, is comparatively rare. One of the long sentences imposed in recent times was that of business-man Abe Saffron. Saffron served 16 months in prison after being convicted in 1987 of conspiring to defraud the Commonwealth of \$1.5m.

The Commonwealth passed fresh legislation in order to impose taxes on previously untouched transactions: the Capital Gains Tax, introduced in 1985, was intended to prevent taxpayers taking advantage of the income/capital dichotomy while the Fringe Benefits Tax, introduced in 1986, partly closed a large loophole that had been exploited mostly by high income earners.

In 1987 the *Proceeds of Crime Act* (Cwlth) was introduced. This further extended the power of the authorities to investigate and prosecute individuals (particularly drug traffickers and those who commit serious fraud on the revenue). The basic aim of the legislation was to ensure that "crime does not pay" and that offenders should not profit from their illegal acts. This was to be achieved by imposing pecuniary penalties and confiscating tainted property (the fruits of crime).

In 1988 the *Cash Transaction Reports Act* (Cwlth) was passed. This was introduced in an effort to counter the underworld cash economy, tax evasion and money laundering. Amongst other things the Act requires cash dealers including banks, financial institutions and certain gambling organisations to report transactions suspected of relating to tax evasion. In the following year the Cash Transaction Reports Agency (now known as AUSTRAC - *see* Horman 1993) was established to examine "suspect transactions".

In 1988, after unsuccessful attempts to introduce the Australia Card, the federal government made compulsory the use of personal tax file numbers to help the Australian Tax

Office maintain its records. These numbers enable the ATO to crosscheck information given to it by the taxpayer against data derived from other sources. Further legislation enacted in 1990 empowered the ATO to match data with that held by other Commonwealth departments.

In 1990, foreign income accruals legislation restricted the use of overseas “tax havens” by attributing tax liability to Australian controlling entities instead of to their offshore “puppets”. The aim of this reform was to catch those who moved assets overseas deliberately to avoid tax, rather than those with legitimate foreign interests.

On 21 October 1991 the Commonwealth Attorney-General announced the establishment of the Law Enforcement Access Network (LEAN), a powerful computer system designed to provide a more efficient and cost-effective method of data exchange and fraud control for federal/state law enforcement and other agencies. Amongst other things it will enable investigators to lift the corporate veil of companies and trace the legal or beneficial ownership in property. It will also enhance the taxation collection function. Like the tax file number, the development of LEAN is subject to the *Privacy Act 1988* (Cwlth) and is being developed in accordance with the Information Privacy Principles set out in the Act (see Roberts 1993).

---

### **Anti-Avoidance Provisions**

---

Part IVA of the Income Tax Assessment Act was introduced in May 1981 to replace the infamous and near ineffectual s 260. The latter section, the key anti-avoidance provision in the Act, had been so restrictively interpreted by the High Court under Sir Garfield Barwick that the most artificial and contrived schemes of tax avoidance were permitted to stand. This was because many of the schemes fell outside the literal meaning of the words contained in the section.

Barwick CJ did not invent literalism (the concern for the meaning of words rather than the substance of what was intended by those words) but was simply applying Lord Tomlin’s dicta that:

*every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be (IRCF v. Duke of Westminster [1936] AC 1)*

If the words in the legislation were ambiguous they would be interpreted in favour of the taxpayer rather than the Commissioner of Taxation. Eventually, the following four particular problems with the way in which the courts interpreted s 260 were identified:

- First, the courts would not invoke s 260 merely because a taxpayer had chosen the most tax-effective legally available type of transaction. They had to find something more than this before they would hold that the taxpayer was cheating.
- Secondly, the courts had no power to look behind and examine the purpose or motive of a taxpayer in choosing a type of transaction. The courts would simply restrict their analysis to the legal effect of the transaction itself.
- Thirdly, s 260 did not allow transactions to be declared partly void. It was an all-or-nothing provision which was not sufficiently flexible to deal with complex tax avoidance schemes.
- Finally, although s 260 empowered a court to annul a dubious transaction the section gave no remedial power to the courts so that they could reconstruct an annulled transaction and make it taxable after all (Explanatory Memorandum to the Income Tax Laws Amendment Bill (no. 2) 1981 (Cwlth), p.2).

In addition to dealing with each of these shortcomings under the old law,

Part IVA was designed to cover tax avoidance schemes that are “blatant, artificial or contrived” (Explanatory Memorandum 1981). However, the terms of the legislation give it an even wider operation than this. It applies to

1. any scheme
2. entered into after 27 May 1981
3. for the sole or dominant purpose of obtaining a tax benefit
4. which does in fact yield a tax benefit.

The word “scheme” is very widely defined, although the recent Federal Court decision in *Peabody*, discussed below, seems to have limited the scope of the concept to a significant degree. In summary, therefore, the provisions of Part IVA are intended to allow the Commissioner of Taxation to set aside certain financial transactions if satisfied that they were made with a view to avoiding tax.

---

### **Peabody and the Dominant Purpose Rule**

---

Unfortunately it is not always clear when the taxpayer has overstepped the mark between acceptable and unacceptable behaviour. For example, in *Peabody v. The Commissioner for Taxation* 93 ATC 4104, the Full Bench of the Federal Court of Australia overturned a lower court decision which had agreed with the Commissioner that the taxpayer had engaged in tax avoidance in breach of Part IVA.

In that case, the Full Bench of the Federal Court held that the Commissioner had erred in assessing tax in relation to a fairly complicated series of transactions which had added \$8.6m to the value of shares owned by the Peabody family trust. The scheme related back to a time when Mr Kleinschmidt, a director of the trust’s operating company, agreed to sell for \$8.6m his 38 per cent stake in the trust to the Peabodys. However, instead of buying the shares directly for Mr Kleinschmidt, the shares were

transferred to a holding company which had borrowed the money from a bank. These shares were then converted into non-voting Z-class shares and so were effectively rendered worthless. The tax advantage which was obtained as a result of this manoeuvre can be explained as follows.

If the Peabodys had simply sold the shares acquired from Kleinschmidt to the public at their market value, they would have been liable to pay income tax on the large profit that sale would have yielded. Instead, by making the Kleinschmidt shares effectively disappear, the Peabody trust greatly increased the value of its own holdings and became the sole owner of the group. The group was then floated and half was sold to the public at a much higher price than under the Kleinschmidt transaction, without there being any legal "profit" for the Commissioner to tax. The money borrowed from the bank was repaid by way of rebatable company dividends out of the money obtained from the float.

The Peabodys argued that the main reason for the scheme was to avoid having to declare in the prospectus the amount of money which had been paid for the Kleinschmidt shares as this might have reduced the amount which was obtained for the shares when they were offered to the public. The basis of the decision rested on the finding that the tax benefit was only an incidental result of a larger scheme whose primary objective was not to avoid tax.

Peabody's case opened a chink in the Tax Commissioner's anti-avoidance armour. If it is allowed to go unchecked it is likely to generate new schemes reminiscent of the flourishing tax avoidance industry of the 1970's. At the time of writing application for special leave to appeal against this decision has been lodged in the High Court of Australia. The outcome of that appeal may determine whether the Government will have to return to the legislative drawing boards.

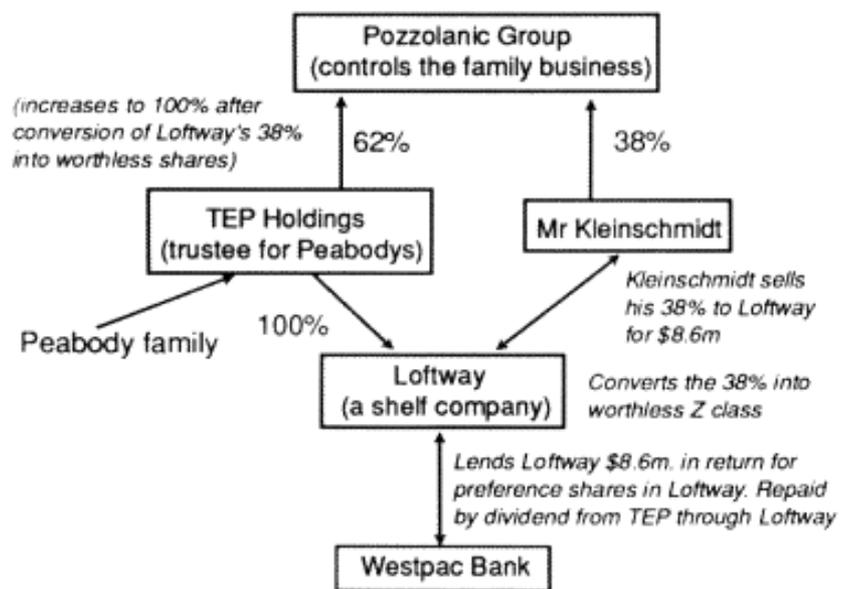
### Is Compliance Becoming More Difficult?

The changes to the Australian taxation system have been so significant and far reaching, that the ordinary citizen has increasing difficulty in understanding (and therefore complying with) his or her tax obligations. The complexity is such that only the

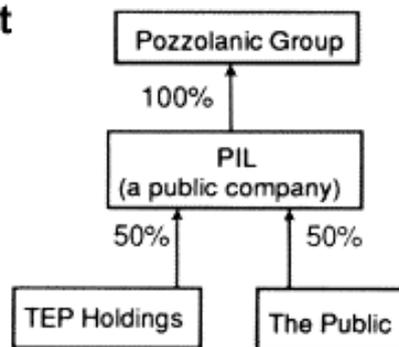
negotiation of law and legal institutions". Ultimately, they argue, the notion of compliance is a political one so that what is perceived as an acceptable level of compliance at one time may not be acceptable at another (Tomasic & Pentony 1990, p.1). This may help to explain why at the height of the tax avoidance industry, there appeared to be such little resistance to what in hindsight can now be seen as

Figure 1: The Peabody Scheme

#### A. The Acquisition



#### B. The Float



simplest tax returns can now be confidently completed without the assistance of expert advice.

Tomasic and Pentony (1990) suggest that the whole notion of tax compliance is a social construct, that there is no objective standard of the appropriate level of compliance and that the level "is a product of the

a situation that had been allowed to get out of hand.

#### The Penalties

As most Australian taxpayers are aware, the Australian Taxation Office has undergone significant operational

Table 1

Nature of Understatement	Penalty
Deliberate evasion	75% of tax avoided
Under Anti-avoidance provisions	50% of tax avoided
Lack of reasonable care	25% of tax avoided
No reasonably arguable position	25% of tax avoided
Ignoring a Private Ruling	25% of tax avoided

and structural changes including the adoption of a policy of voluntary compliance through self-assessment. This means that despite the quantity, complexity, and vagueness of the law, taxpayers are obliged to pay the correct amount of tax or be penalised under the Act. However, a new system of Private and Public Rulings, which are binding on the Commissioner, has been introduced under the *Taxation Law Amendment (Self-Assessment) Act 1992* (Cwlth). Taxpayers who are uncertain of their rights can now obtain information from the ATO which will inform them of their obligations and, if the advice is followed, it will protect them against the possibility of being penalised for non-compliance.

Until recently, if the taxpayer's conduct resulted in a breach of the anti-avoidance provisions of Part IVA of the Income Tax Assessment Act 1936, the prescribed penalty was automatically double the amount to tax avoided (s 226 of the Act, now repealed). This meant that even innocent mistakes were automatically penalised at that rate, unless the Commissioner exercised his discretion to wholly or partially remit the penalty.

The most recent amendments, however, implicitly acknowledge the complexity and uncertainty of the tax laws, the likelihood that in the course of self-assessment taxpayers and their agents sometimes make inadvertent errors or honest mistakes and that the

“double the tax avoided” formula is unfair. Indeed under the Taxation Laws Amendment (Self-Assessment) Act 1992 there is a most elaborate penalty regime (see Table 1).

Where a taxpayer has exercised reasonable care there is no penalty even though there may not have been an inadvertent error or honest mistake. Thus this revised penalty structure is much fairer and now takes into account the culpability of a person for failing to comply with the requirements of the law (but see Fisse 1981). In addition, where the imposition of penalties are appropriate there are provisions for increasing or reducing them by 20 per cent of the guidelines, depending on whether there are aggravating circumstances or positive cooperation with Tax Office inquiries.

The discretion to impose a penalty is more structured than previously, and so should introduce a degree of consistency into the process. The power of the Commissioner to remit penalties is retained and may be exercised where it would be fair and reasonable to do so. In addition, there are penalties for late payment of taxes and interest accrues on amounts outstanding.

Similarly, the system of Public and Private Tax Rulings already referred to are designed to clarify and explain to taxpayers the ATO's interpretation of particular nuances in tax legislation and hence assist taxpayers (and their advisers) to comply with the requirements of the law. Given the complexity of the current system and the shift to self-assessment, one might well wonder how the system could operate without such rulings.

Further, the introduction of the *Tax Pack* in 1990 was a significant step forward by the ATO in assisting ordinary taxpayers grapple with their tax returns. Unfortunately, however, what was once a relatively straightforward task of filling in a form, now involves reference to a second document for instructions on each item. While on balance the *Tax Pack* is a most helpful document, there must be many who throw their hands up in

horror when they are faced with the task of completing their returns. Consider item 5 of the 1993 *Tax Pack* which deals with the calculation of eligible termination payments. Under this head there are four pages of instructions and in some cases up to 70 separate calculations may be needed to satisfy the requirement of the law.

### Overreach of the Law

In seeking to redress the problems of the 1970s have the authorities overreacted? Certainly changes to the tax laws have also been accompanied by legislation directed towards the control of organised crime, large scale fraud and drug trafficking. The situation has reached a point where a number of commentators have begun to voice serious concerns about the fairness, necessity and scope of such powers.

The most vociferous of the critics has been Professor Brent Fisse who has attacked, not so much the tax laws but the emergence of law enforcement bodies, such as the National Crimes Authority and the scope of the Proceeds of Crime Act, particularly as these apply to areas of money-laundering, possessing money/property suspected of being the proceeds of crime and organised fraud (Fisse et al. 1992, p.1).

Similarly, Professor Arie Freiberg has cautioned against the use of overzealous legislation in the fight against organised crime. He says that “almost no member of the population has been, or will be, untouched by what has surfaced from the bottom of the harbour” and has reminded us that the fundamental concepts of criminal responsibility are not seasonal and should not be changed to suit a particular trend of the day (Freiberg 1988, p.192).

These and similar warnings suggests that it is time to review the reforms of the past decade and consider the progress that has been made, and whether our tax laws are comprehensible to all those who are

expected to comply with them. The trend has been to attempt to match the complexity of the laws with ever increasing reliance on surveillance, auditing, policing, prosecutorial powers and punitive powers. Such reliance does not come without cost to civil liberties. It is possible to simplify the law in a way which might help reduce the opportunities for tax avoidance without continually having to extend the arm of intelligence and law enforcement mechanisms?

So far as fairness to the taxpayer goes, serious attempts have been made to remove the concept of strict responsibility in tax compliance, and significant reforms have been made on the self-assessment scheme. However, it is somewhat ironic that the very attempt to simplify the law has merely added to the vast labyrinth of legislation that already exists. As Senator Bishop pointed out in the debates on the Taxation Laws Amendment (Self-Assessment) Act 1992, the Act is 68 pages long but the Explanatory Memorandum is 142 pages long (Senate Hansard, 17 June 1992, p.3852).

Nevertheless, given the complexity of this comparatively recent addition to tax law, the ATO is to be commended for producing such a detailed explanatory memorandum. It contains numerous charts and summaries which assist the reader in understanding the key provisions of the legislation, and simplifies the task of navigating through the Act. However, it is unrealistic to expect that the average taxpayer will read, let alone fully comprehend, these provisions. And this is but one on many areas of tax law with which taxpayers are expected to comply. The fact remains that complexity and compliance are unhappy bedfellows.

### **Avoidance or Minimisation?**

Even where tax avoidance is regarded as falling within the permissible limits of the law, the conduct itself may sometimes be viewed as immoral or otherwise unacceptable behaviour.

Such a criticism is sometimes levelled at the practice of “negative gearing” (described above). Yet is such a practice any different from selecting investments which yield a low rate of tax rather than a high one? Indeed, prudence and good business practice dictates that a careful examination is undertaken of the taxation implication of any potential investment.

“Shopping around” for the best return on investments inevitably means that consideration is given to the issue of tax minimisation. Consider, for example, the following list of tax planning strategies which are generally regarded as legitimate:

- diverting income to a spouse with a lower tax rate
- investing in 10-year friendly society bonds
- investing in companies which pay franked dividends
- purchasing property or shares with a view to negative gearing
- letting part of a residence on an arms length basis
- maximising a capital gains cost base
- considering investment which have most tax-effective income payments dates
- mortgage interest offset accounts (if allowed) (PSU 1993).

Nevertheless some forms of tax minimisation are legally acceptable and other are not. As Peabody’s case illustrates, there may be legitimate differences of opinion as to whether a trans-action is artificial and contrived, or is a normal commercial or family dealing, and also, whether the dominant purpose is one of tax avoidance (PSU 1993, chapter 9).

### **Promoting Tax Compliance**

The structure of the tax system is of critical importance in developing a workable environment capable of diminishing both the extent and the opportunities for tax avoidance and evasion. Our progressive system of taxation seems to have failed to eliminate abuse, and allowed many of the most affluent amongst us to pay less tax than the ordinary taxpayer.

However, one must acknowledge the desirable incentives that our system of taxation provides (for those with means) to spread their wealth into areas which benefit the community, such as donations to charitable institutions as well as investments into legitimate business enterprises. Indeed one may speculate about the extent to which these institutions would flourish but for the promise of tax concessions to the donor. In some respects, therefore, a progressive system of taxation has desirable features.

There is evidence to suggest that higher marginal tax rates lead to a higher incidence of tax evasion and that marginal tax rates positively influence the proportion of under-reporting of true income (Crane & Nourzad 1990). It follows, therefore, that a flatter system of taxation, where the top marginal tax rate is not very high, and where the number of incremental steps are fewer and the steps between them are not too large, is likely to reduce the incentive to cheat.

Similarly, it is important that taxpayers should not be able to slide from one type of tax to another, or slip from a higher to a lower marginal tax rate in order solely to reduce tax liability. For example, if the top personal income tax rate were equal to or lower than the corporate tax rate, there would be no incentive on the part of a taxpayer to form a company in order to reduce his or her tax liability. Similarly, as the Government has recognised recently, if fringe benefit tax is levied on fringe benefits at a rate which is similar to the tax that the employee would have

paid had the benefit been paid in a monetary form (for example included in the salary of the employee), then again, the opportunity to minimise tax is eliminated.

Of primary concern, however, is the fact that in many areas taxation has become so complicated that many ordinary people have difficulty in understanding the extent of their obligations. The well-meaning may be paying too little or too much tax because of the uncertainty and vagueness surrounding the law. Despite the best efforts of the ATO to explain in plain English the requirements of the law, even the experts sometimes have difficulty in comprehending it. Furthermore, it is not unknown for the *Tax Pack* itself to provide inaccurate (and therefore misleading) information (*see* ATO media release no. 93-25, 27 June 1993). Again, this is not so much a criticism of the ATO, but rather a reflection of the complexity of the legislation which it must administer.

Uncertainty, complexity and confusion provide the breeding-ground for tax avoidance and evasion. The draftperson's task is made more difficult and prone to error, and the unscrupulous are able to take advantage of loop-holes that inevitably emerge.

Perhaps most importantly, it provides unnecessary hardship for the majority of honest people who wish to comply with their obligations but are unable to do so without the assistance of tax agents and accountants, who are fast becoming the gatekeepers of the taxation system. Unless they conduct their business with integrity and with high ethical standards, tax avoidance and evasion will continue to flourish.

It is difficult to legislate for honesty, and there is no guarantee that understanding the rules means that they will be followed and applied. However, unless the rules are understood they cannot be followed and applied.

What we have witnessed in the past decade or so are: increasing emphasis on auditing, policing,

prosecutorial and punitive powers, and a new tax regime which, some might say, often places unreasonable expectations upon ordinary citizens.

While the tangled forest of tax rules and regulations remain in force, so too do the hiding places of tax cheats. A concerted effort at simplification of the tax laws may remove some of the camouflage and, at the same time, reduce both the opportunity to cheat and the need to develop more sophisticated and intrusive surveillance and compliance measures.

Roberts, P. 1993, "Law enforcement access network", vol.4, no.4, *Criminology Australia*, April/May.

Tomasic, R. & Pentony, B. 1990, *Defining Acceptable Tax Conduct*, Discussion Paper No.2, Centre for National Corporate Law Research, University of Canberra.

#### Acknowledgments

Jonathan Woodger for research assistance; Stefan Kovic, Nadia Potas, and Andrew Wirth from the ATO for advice and assistance; Boronia Halstead from the Institute for her comments.

The views expressed, including any errors or omissions, are however, totally the responsibility of the author.

### References

- Costigan, F.C. (Chairman) 1984, Royal Commission on the Activities of the Federated Ship, Painters and Dockers Union, *Final Report*, AGPS, Canberra.
- Braithwaite, J. 1992, "Penalties of white-collar crime", in *Complex Commercial Fraud*, Conference Proceedings No. 10, ed. P. Grabosky, Australian Institute of Criminology, Canberra.
- Browne, P. 1985, "Fair shares", *Legal Services Bulletin*, no.52.
- Crane, S.E. and Nourzad, F. 1992, "Tax rates and tax evasion: evidence from California Amnesty data", *National Tax Journal*, vol.XLIII.
- Fisse, B. 1981, "Community service as a sanction against corporations", *Wisconsin Law Review*, vol.970.
- Fisse, B., Fraser, D. & Coss, G. 1992, *The Money Trail: Confiscation of Proceeds of Crime, Money Laundering and Cash Transaction Reporting*, Law Book Co Ltd, Sydney.
- Freiberg, A. 1988, "Ripples from the bottom of the harbour: some social ramifications of taxation fraud", *Criminal Law Journal*, vol.12, no.136.
- Grabosky, P. & Braithwaite, J. 1987, *Corporate Crime in Australia*, Trends and Issues No.5, Australian Institute of Criminology, Canberra.
- Hepburn, G. 1992, "New estimates of Cash-based income tax evasion in Australia", *Research Paper 323*, Department of Economics, University of Melbourne, Victoria.
- Horman, W.J. 1993, "Countering organised crime through strategic planning and effective coordination", paper given at Australian Institute of Criminology Criminal Justice Planning and Coordination Conference, April.
- Lehman, G. & Coleman, C. 1989, *Taxation Law in Australia*, Butterworths, Sydney.
- McCabe, P.W. & Lafranchi, D.J. 1983, *Report of Inspectors appointed to investigate the particular affairs of Navillus Pty Ltd and 922 other companies*, Government Printer, Melbourne.
- NCA 1991, *Taken to the cleaners: money laundering in Australia*, vol.1, Dec.
- PSU (Public Sector Union) 1993, *Professional Division, Tax Guide 1992/1993*



Inquiries about the Trends and Issues series should be forwarded to:  
The Director  
Australian Institute of Criminology  
GPO Box 2944  
Canberra ACT 2601 Australia