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EDITORIAL

The 2024 issue of the *Journal of Australian Taxation* is contained in Volume 26. The editors are very pleased that there are three groups of authors living in South Africa, Indonesia and India. Two of the papers provide a comparative study of non-compliance regulations and consumption taxes which include Australia in the study. The paper from the Indonesian authors examines the voluntary disclosure program in Indonesia. It is important that this journal publishes articles relating to other nations and their taxation systems along with articles focused on Australia and New Zealand.

The first article by Celeste Black examines the new Safeguard Mechanism rules, which came into effect on 1 July 2023, that give rise to a new emissions unit called the Safeguard Mechanism Credit unit (SMC), a new type of personal property which is bankable and tradeable. The reforms to the Safeguard Mechanism will also increase demand for Australia's other emissions unit, the Australian Carbon Credit Unit (ACCU). This important step is designed to control and reduce the emissions of large industrial facilities. The specific tax rules for ACCUs that are found in Division 420 of the ITAA 1997 have been amended to extend to transactions involving the new SMCs, but the tax treatment diverges in some significant ways from the tax treatment of ACCUs. In this article, the tax treatment of ACCUs and SMCs are compared and contrasted with a focus on Safeguard Facilities and participants in the ACCU Scheme. Celeste also comments on the separate 2023 amendments to Division 420 that established concessional tax treatment for ACCUs issued to eligible primary producers. Division 420 was introduced to avoid the complexities and uncertainties that could otherwise have resulted from the application of the pre-existing tax rules to transactions involving emissions units. However, this goal of simplicity is being undermined by the 2023 amendments that have the effect of creating three tax approaches to units within Division 420. Although these variations may be justifiable on policy grounds, the added cost of complexity within the tax system should be recognised as well as the potential impact of differential tax treatment on the efficiency of the emissions unit market.

The second article is written by Jane Ndlovu and Luvuyo Poyana and provides a comparative cross-sectional study that analyses tax compliance frameworks across South Africa, Australia, and the United States. Despite amendments to the South African Tax Administration Act, subjective taxpayer behaviour remains a major factor in non-compliance. The primary goal of the paper is to suggest changes to South Africa's tax penalty system by evaluating its effectiveness against those in Australia and the US. The article delves into the administration of tax non-compliance and understatement penalties, highlighting key similarities and differences. It identifies challenges from past litigations and provides policymakers with actionable insights. This nuanced comparison illuminates global tax penalty structures and informs future regulatory improvements.

The third article is written by John Tretola, and it examines in detail the psychological trait associated with Machiavelli and tax avoidance. Tax avoidance involves manipulating the tax system to achieve, usually by artificial non-commercial arrangements, a tax related outcome that is not intended by Parliament. The connection between Machiavellianism and tax

avoidance lies in the strategic and manipulative nature of both concepts. However, whilst it is true that not all individuals who engage in tax avoidance are necessarily Machiavellian, it is very likely that nearly all Machiavellians will engage in tax avoidance due to their manipulative self-serving natures. This article compares the outcome of five known recent studies that explored the link between Machiavellianism and tax avoidance. These five studies took place in different countries but lead to the same ultimate conclusion that Machiavellianism behaviour leads to tax avoidance behaviour.

The fourth article is written by five authors including I Nyoman Yasa, Nyoman Herawati et al. The article investigates the role of fairness in voluntary disclosure programs (VDP) and its impact on taxpayer compliance behavior. It emphasises the need for aligned taxation regulations to enhance state revenue and tax equity. Using qualitative methods, the authors conducted interviews with regulators, academics, practitioners, and tax administrators from the Bali Tax Regional Office. Their findings indicated that VDP reflects fairness through higher tax rates and penalties, but fairness also requires consideration of legal certainty and economic factors to build public trust.

The fifth article is written by Matt Nichol and he examines the not-for-profit tax exemption for Australian Football League clubs in Australia. Sport holds a unique place in Australian society. Underlying this position is the tax exemption given to sport under s 50-45 of the *Income Tax Assessment Act 1997* (Cth). This exemption does not differentiate between community and professional sport. The Australian Football League ('AFL') and its 18 clubs all enjoy not-for-profit status under the s 50-45 sports exemption and do not pay income tax. This article will argue that the AFL and its clubs should not be tax exempt. This article suggests reforms such as amending the s 50-45 exemption to only cover community clubs and leagues, taxing the commercial income of sports that relate to ordinary business income and treating sports as charities and requiring them to benefit the public.

The six and final article is written by Shivani Badola and Sacchidananda Mukherjee and where they explores VAT compliance costs and associated burdens, a topic of paramount importance in tax policy evaluation and reform. Tax compliance costs, which encompass the financial and non-financial burdens taxpayers face in meeting their tax obligations, present significant challenges, particularly in developing countries. Their analysis of the literature on the VAT compliance cost burden and the issues related to complying with the VAT regime in India, compared with developed nations (especially Australia), provides a foundation for understanding the tax landscape. With the advent of the Goods and Service Tax (GST) in India, comprehending the compliance burden faced by taxpayers has become even more critical. In this article they have evaluated the performance of the Indian VAT system compared to other nations, considering factors such as tax law complexity, administrative requirements, the capabilities of the tax departments in meeting taxpayers' services and compliance needs, and monetary costs.

John McLaren and John Minas

Editors 2024

REVIVING CARBON MARKETS UNDER A REFORMED SAFEGUARD MECHANISM: TAXATION PERSPECTIVE

CELESTE BLACK*

Abstract

The Commonwealth Government is taking more ambitious action to reduce Australia's greenhouse gas emissions. This reflects Australia's updated National Determined Contribution under Article 4 of the Paris Agreement, which is to reduce emissions 43% below 2005 levels by 2030 and to achieve net zero by 2050. An important step has been the substantial reform of the Safeguard Mechanism, which is designed to control and reduce the emissions of large industrial facilities. The new Safeguard Mechanism rules, which came into effect on 1 July 2023, will give rise to a new emissions unit called the Safeguard Mechanism Credit unit (SMC), a new type of personal property which is bankable and tradeable. The reforms to the Safeguard Mechanism will also increase demand for Australia's other emissions unit, the Australian Carbon Credit Unit (ACCU).

The specific tax rules for ACCUs that are found in Division 420 of the ITAA 1997 have been amended to extend to transactions involving the new SMCs, but the tax treatment diverges in some significant ways from the tax treatment of ACCUs. In this article, the tax treatment of ACCUs and SMCs will be compared and contrasted with a focus on Safeguard Facilities and participants in the ACCU Scheme. Comment will also be made on separate 2023 amendments to Division 420 that established concessional tax treatment for ACCUs issued to eligible primary producers. Division 420 was introduced to avoid the complexities and uncertainties that could otherwise have resulted from the application of the pre-existing tax rules to transactions involving emissions units. However, this goal of simplicity is being undermined by the 2023 amendments that have the effect of creating three tax approaches to units within Division 420. Although these variations may be justifiable on policy grounds, the added cost of complexity within the tax system should be recognised as well as the potential impact of differential tax treatment on the efficiency of the emissions unit market.

I INTRODUCTION

The change to a Labor government at the Commonwealth level in 2022 has seen a renewed focus on issues related to the environment and climate change. As one of its first steps in this regard, in June 2022, the Australian Government lodged a new and more ambitious National Determined Contribution (NDC) with the United Nations under the Paris Agreement.[1]

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* Associate Professor, University of Sydney. The figures are current for April 2024.

[1] *Paris Agreement to the United Nations Framework Convention on Climate Change*, adopted 12 December 2015, signed by Australia 22 April 2016, [2016] ATS 24 (entered into force in Australia 9 December 2016).

Australia's former NDC set a target of greenhouse gas emissions 26-28% below 2005 levels by 2030 and the new target is 43% below 2005 levels by 2030 and net zero emissions by 2050.[2] This commitment has been legislated in section 10 of the *Climate Change Act 2022* (Cth). For this 15% increase in the target to be met, various government interventions will be necessary. The most recent figures available from the Department of Climate Change, Energy, Environment and Water (DCCEEW) show that emissions in the year to June 2023 were 24.5% below the 2005 baseline year,[3] revealing the challenge ahead to meet the 43% target by 2030.

In Australia's reporting to the UN, a variety of measures have been identified as forming the climate policy mix and a key element is the reform of the Safeguard Mechanism, which is the subject of this article.[4] The 2023 Climate Change statement, released in December 2023, further evidences a reliance on the reformed Safeguard Mechanism to contribute to the emissions reduction projected under the baseline scenario.[5]

A detailed account of the history of climate change law in Australia has been provided by others[6] so this article will provide a high-level summary of the development carbon unit markets in Australia and the Safeguard Mechanism, the focus of this article. Some detail is provided regarding the circumstance under which carbon units are issued, sold and surrendered by way of context for the discussion of income tax implications. The discussion then turns to the application of the special purpose tax rules found in Div 420 of the *Income*

[2] The United Nations Framework Convention on Climate Change Secretariat maintains the official NDC Registry which records the communications to the Secretariat of all Parties to the Convention as required by Art 4, para 2 of the *Paris Agreement*. This Registry is available at https://unfccc.int/NDCREG. Australia's updated targets were included in Commonwealth of Australia, *Communication 2022* (2022) https://unfccc.int/sites/default/files/NDC/2022-06/Australias%20NDC%20June%202022%20Update%20%283%29.pdf.

[3] DCCEEW, *Quarterly Update of Australia's National Greenhouse Gas Inventory: June 2023* (2023) https://www.dcceew.gov.au/climate-change/publications/national-greenhouse-gas-inventory-quarterly-update-june-2023.

[4] A high-level summary of these initiatives is provided in Australia's NDC *Communication 2022* (n 2). Another significant government program directed towards industrial facilities and processes is the new $1.9 billion Powering the Regions Fund, which includes a $600 million Safeguard Transformation Stream to fund the transition for trade-exposed facilities, a $400 million Industrial Transformation Stream that specifically targets activities in regional Australia, and the $400 million Critical Inputs to Clean Energy Industries program. Department of Climate Change, Energy, the Environment and Water, 'Powering Australia' (updated 12 February 2024) https://www.dcceew.gov.au/energy/strategies-and-frameworks/powering-australia. Details regarding the first round of grants under the Safeguard Transformation Stream are available here: Australian Government, 'Funding for trade exposed Safeguard facilities to reduce emissions' (updated 18 January 2024): https://business.gov.au/grants-and-programs/powering-the-regions-fund-safeguard-transformation-stream-round-1. The Industrial Transformation Stream also provides support for industrial facilities to reduce emissions. Although it is not limited to trade exposed facilities, the funding rounds are targeted to specific focus areas: Australian Renewable Energy Agency, 'Powering the Regions Industrial Transformation Stream' (2024) https://arena.gov.au/funding/powering-the-regions-industrial-transformation-stream/ .

[5] Department of Climate Change, Energy, the Environment and Water, *Annual Climate Change Statement 2023* (2023) at 45. Under the baseline scenario, emissions are projected to be only 37% below 2005 levels by 2030 so the government is relying on a 'with additional measures' scenario to reach 42% below 2005 levels by 2030, just short of the legislated 43% target. Ibid at 41. The most critical of these additional measures are the ambitious 82% renewable electricity target and the National Electric Vehicle Strategy to reduce transportation emissions. Ibid. The requirement to make annual climate change statements was also introduced as part of the *Climate Change Act 2022* (Cth) s 12.

[6] See Ilona Millar and Sophie Whitehead, 'Climate Change Law in Australia – A History and the Current State of Play' (2018) 92 *Aus Law Journal* 756 and Elia de Wit and Amy Quinton, 'Creating Buying and Safeguarding Emissions Reductions under the Emissions Reduction Fund' (2018) 92 *Aus Law Journal* 766.

Tax Assessment Act 1997 (Cth) (ITAA 1997) to transactions involving the two types of Australian carbon units: Australian Carbon Credit Units (ACCUs) and Safeguard Mechanism Credit units (SMCs). The Australian government is relying on carbon markets to identify the lowest cost abatement and sequestration opportunities, so this article highlights circumstances where the design of the Div 420 tax rules have the potential to influence unit holder decisions and therefore impact the efficiency of the markets.

II CLIMATE POLICY CONTEXT

This Part provides an overview of the development of carbon pricing and carbon markets at the national level as well as details of the operation of the current schemes. The 2023 reforms to the Safeguard Mechanism are highlighted.

A *Early efforts to create carbon markets at a national level*

Australia's first efforts to put a price on carbon emissions and abatement came in the form of the short-live Carbon Pricing Mechanism and the companion Carbon Farming Initiative. The Carbon Pricing Mechanism (CPM) commenced operation on 1 July 2012 as a cap-and-trade emissions trading system with an initial fixed price phase.[7] The CPM applied to facilities annually generating direct emissions of at least 25,000 tonnes CO_2-equivalent (CO_2-e) scope 1 emissions and was estimated to capture approximately 500 facilities when originally introduced.[8]

Emissions from agriculture and other land uses were not covered by the CPM but rather became the subject of an offsets regime under the so-called Carbon Farming Initiative, introduced at the same time as the CPM.[9] In general terms, the Carbon Farming Initiative created a scheme whereby carbon emissions abatement and sequestration projects that comply with an approved method can be registered with the government. Once the project is in operation, through regular reporting mechanisms, the volume of emissions avoided or sequestered is determined and, for each tonne of CO_2-e, the project proponent is issued with an Australian Carbon Credit Unit (ACCU). Demand for ACCUs was to come largely from facilities covered by the CPM, as ACCUs could be used to meet compliance obligations, as well as from entities wishing to voluntarily offset emissions and therefore be 'carbon neutral'.

The CPM proved to be unpopular with the electorate and was promptly repeal with effect from 1 July 2014 with a change in government. However, the Carbon Farming Initiative was retained and linked to the newly established Emissions Reduction Fund under which ACCUs would be purchased by the government, thereby creating demand for ACCUs and providing funding for registered projects. The Fund, recently re-named the ACCU Scheme, had been

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[7] *Clean Energy Act 2011* (Cth) (repealed).

[8] Explanatory Memorandum, Clean Energy Bill 2011 (Cth) 11.

[9] *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth) and *Carbon Credits (Carbon Farming Initiative) Rule 2015* (Cth).

seen as the 'centrepiece' of the previous Coalition Government's Direct Action climate policies,[10] with funding to date of $4.55b, including a 2019 top up by the $2b Climate Solutions Fund.[11] Over time, the available abatement methods eligible for the Emissions Reduction Fund have been expanded to provide incentives for a suite of activities connected with industrial activities.

B *The introduction of the Safeguard Mechanism*

Since the ACCU Scheme is a voluntary, incentives scheme, the main measure designed to control emissions from industrial activities after the repeal of the Carbon Pricing Mechanism has been the Safeguard Mechanism, which in its original form commenced operation on 1 July 2016.[12] The Safeguard Mechanism applies to facilities that emit more than 100,000 tonnes of CO_2-e scope 1 emissions (a 'Safeguard Facility').[13] According to Government statements, there are currently around 215 Safeguard Facilities across sectors including mining, oil, gas, manufacturing, transport and waste, and these facilities emit approximately 28% of Australia's greenhouse gas emissions.[14] Emissions from electricity generation are subject to a separate scheme.[15]

As originally envisioned, the Safeguard Mechanism appears to have been designed to limit increases in emissions from Safeguard Facilities rather than actively reduce them. The Safeguard Mechanism operates to set a cap on emissions produced by a Safeguard Facility, where this cap is referred to as the facility's 'baseline', and if the baseline is exceeded an obligation arises which can be met by the surrender of ACCUs (one unit for each tonne of excess emissions) or by entering into a multi-year monitoring period to allow further time to reduce emissions. The Clean Energy Regulator states that prior to the 2023 reforms, baselines allowed for business-as-usual levels of emissions and, because they were based on emissions intensity and adjusted to reflect production levels, overall limits 'remained relatively consistent over time'.[16] Reports published by the Clean Energy Regulator indicate that only 12 Safeguard Facilities were subject to a surrender obligation in the 2021-22 reporting period

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[10] Department of Climate Change, Energy, the Environment and Water, *Climate Solutions Package* (2019) 3 https://www.dcceew.gov.au/sites/default/files/documents/climate-solutions-package.pdf. The Emissions Reduction Fund was the key component of the Direct-Action Plan. Including the most recent March 2023 auction, $2.7b has cumulatively been committed to purchasing ACCUs. Clean Energy Regulator, 'Auction Results: March 2023' https://www.cleanenergyregulator.gov.au/ERF/auctions-results/march-2023.

[11] When originally introduced, the Emissions Reduction Fund was given a budget of $2.55b for the period 2015-2020. Millar and Whitehead (n 6) at 763. The top-up funding is part of the *Climate Solutions Package*: (n 10) at 6.

[12] The Safeguard Mechanism was created though inclusion as a new Part 3H in the *National Greenhouse and Energy Reporting Act 2007* (Cth) (the *NGER Act*) and the details of the scheme are provided in the *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (Cth) (the *Safeguard Rules*).

[13] *Safeguard Rules* s 7 (covered emissions) and s 8 (designated large facility threshold).

[14] Department of Climate Change, Energy, the Environment and Water, 'Safeguard Mechanism Reforms' (May 2023).

[15] The Renewable Energy Target is the Federal Government scheme to reduce emissions from electricity generation and to incentivise the shift to cleaner renewable energy generation. *Renewable Energy (Electricity) Act 2000* (Cth).

[16] Clean Energy Regulator, 'The Safeguard Mechanism' (28 July 2023) https://www.cleanenergyregulator.gov.au/NGER/The-Safeguard-Mechanism.

(the most recent period for which this information is available), with a total of only 738,862 ACCUs surrendered in comparison to total combined emissions of Safeguard Facilities of 137,500,000 tonnes.[17]

C *The role of Carbon Abatement Contracts*

The Carbon Farming Initiative provided for a reverse auction system that was adopted as the mechanism to identify lowest cost emissions reduction and storage projects that would be granted government funding under the Emissions Reduction Fund. This system has been maintained to date but there have been some changes to management of the abatement contracts.[18]

These ACCU auctions have been described as 'an opaque market'.[19] Based on the offer prices specified by willing project proponents, the Clean Energy Regulator accepts a number of contract offers such that the total intended volume of abatement is obtained in that round, taking up the offers from lowest offer price and rising (a reverse auction) up to a level dictated by both a confidential maximum benchmark price and a commitment to purchase a minimum percentage of ACCUs under that benchmark price.[20] Through the reverse auction process, a range of prices for ACCUs is determined. The auction results are regularly publicly reported by the Clean Energy Regulator on its website.

A carbon abatement contract arises between the successful project proponent and the government such that the specified number of ACCUs (the 'agreed quantity'), which are anticipated to be generated by the project, will be sold to the government according to the delivery schedule for the contracted price (this is the 'fixed delivery' element of the contracts). The units must be delivered so, if there is a shortfall in units generated by the project, the project proponent will need to acquire ACCUs on the secondary market to meet the contract shortfall or pay a penalty.

The auction system was originally designed to provide (only) for 'fixed delivery' contracts but since 2020 'optional delivery' contracts have been available for new projects or existing projects which have 'not previously been contracted'.[21] Under the optional delivery contract, the seller has the right but not the obligation to sell the ACCUs to the Commonwealth at the

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[17] The Clean Energy Regulator provides summary figures on the webpage and the specific facility data can be accessed via a downloadable Excel spreadsheet: https://www.cleanenergyregulator.gov.au/NGER/The-Safeguard-Mechanism/safeguard-data/safeguard-facility-reported-emissions/safeguard-facility-reported-emissions-2021-22. The data for the 2022-23 year will be made available by April 2024.
[18] Division 3 of the *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth), as amended, provides for mechanisms including reverse auctions whereby the Commonwealth may purchase ACCUs (see esp s 20F) and some further details are provided in Part 2A of the *Carbon Credits (Carbon Farming Initiative) Rule 2015* (Cth). However, most of the detail around these processes are by way of guidelines produced by the Clean Energy Regulator under the authority of s 11 of the *Carbon Credits (Carbon Farming Initiative) Rule 2015* (Cth).
[19] De Wit and Quinton (n 6) at 772.
[20] Ibid.
[21] Clear Energy Regulator, 'Auction FAQs' (11 August 2023) https://www.cleanenergyregulator.gov.au/ERF/Forms-and-resources/auctions-and-contracts/contracts-frequently-asked-questions#2.

specified price. This in effect creates a series of put options and provides a minimum guaranteed income stream from the project.

In March 2022 a further feature was introduced by the then Coalition Government on a pilot basis to allow proponents to avoid the fixed delivery contract obligations by instead paying an exit fee equal to the contract price (referred to as a 'Buyer's Market Damages' in the standard carbon abatement contract terms).[22] This allows the project proponent to retain the ACCUs what would otherwise be subject to the delivery schedule, which would be commercially advantageous if the market price via the secondary market has increased to a level above twice the contract price. By way of illustration, the Clean Energy Regulator's auction reports show that the weighted average fixed delivery contract price under the seventh auction in June 2018 was $13.52[23] whereas the generic spot price for ACCUs in 2023 Q3 (approximately five years later) was between $30.50 and $32,[24] thereby offering a margin of profit to exit the delivery contract. If the contracted party paid the exit fee of $13.52 per ACCU but then sold the units for $30.50, this would produce net proceeds of $16.98, compared to the proceeds that would otherwise have been received under the carbon abatement contract of $13.52. Overall, this produces an increase in net proceeds of $3.46 per ACCU. The 2023 Q3 Carbon Market Report shows that 9.3m ACCUs due for delivery under fixed delivery contracts in the third pilot exit window were eligible and 4.1m were released, and a total of 8.4m ACCUs have been released from fixed delivery contracts over the three pilot exit windows to date.[25] The Government is considering making these exiting arrangements a permanent feature of the scheme.[26] However, a report by the Institute for Energy Economics and Financial Analysis shows that the government's facilitation of contract exits creates both winners and losers, a notable potential loser being the Australian taxpayer since the ACCUs contracted to be purchased by the Clean Energy Regulator under the ACCU scheme, which would have counted towards the official emissions target, will no longer be acquired at those lower prices, leaving the government behind its target and facing a higher cost to achieve the target.[27]

The government has recognised that the facilitation of exit arrangements by the Clean Energy Regulator has had the effect of generating windfall gains to certain the ACCU sellers where the seller may be only one of a group of parties involved in the project to which the carbon

[22] The exit payment is calculated as the contract price multiplied by the number of units otherwise deliverable at that date. Clean Energy Regulator, Code of Common Terms (for auctions 8—13), cl 1.1.1 meaning of 'Buyer's Market Damages' and cl 9.3 Delivery Failure. The Clean Energy Regulator has to date run three 'pilot' exit arrangements where sellers who have delivery obligations within the exit window can apply for a delivery exit arrangement. See for details https://www.cleanenergyregulator.gov.au/ERF/Want-to-participate-in-the-Emissions-Reduction-Fund/Step-4-Delivery-and-payment/managing-a-contract/fixed-delivery-exit-arrangements.

[23] Clean Energy Regulator, 'Auction results: Auction June 2018' (31 October 2018) https://www.cleanenergyregulator.gov.au/ERF/auctions-results/june-2018.

[24] Clean Energy Regulator, 'Quarterly Carbon Market Report – September Quarter 2023', section 1, Australian carbon credit units (8 December 2023) https://www.cleanenergyregulator.gov.au/Infohub/Markets/quarterly-carbon-market-reports/quarterly-carbon-market-report-%E2%80%93-september-quarter-2023.

[25] Ibid.

[26] This issue was raised as part of the broader consultation undertaken in relation to the implementation of the recommendations of the ACCU Review. Department of Climate Change, Energy, the Environment and Water, *ACCU Review Discussion Paper* (2023) 16-17.

[27] Johanna Bowyer, Institute for Energy Economics and Financial Analysis, 'Changes to Emissions Reduction Fund Fixed Delivery Contracts: Benefits many carbon credit companies and emitters, leaves taxpayers worse off' (March 2022) 10-11.

abatement contract relates (relevant parties can include the landowner and the carbon services provider). After a period of consultation, a new benefit sharing framework was established that requires evidence that an appropriate benefit sharing arrangement is in place as a condition to taking part in the exit arrangement.[28] This additional condition applied to the third pilot exit arrangements in 2023.

III REFORMS TO THE SAFEGUARD MECHANISM: GIVING IT SOME 'TEETH'

The reforms to the Safeguard Mechanism are designed to transition the scheme to one that provides for real limits and meaningful reductions in emissions. Importantly, amendments added to secure the support of the Greens in the Senate[29] are now reflected in a new object to the *National Greenhouse and Energy Reporting Act 2007* (Cth) in s 3(2) to the effect that the overall emissions from Safeguard Facilities must reduce in line with Australia's NDC. Specifically, net safeguard emissions must decline to 100mt CO_2-e by 2030 (representing over 200mt of abatement in total by 2030[30]) and net nil by 2050.

An important feature of the reformed Safeguard Mechanism is a new, more robust baseline setting mechanism and a strict baseline decline rate. The original production-adjusted baseline setting framework will be retained but will transition from site-specific historical emissions baselines to industry average emissions intensity values by 2030.[31] New facilities will be subject to best practice emissions-intensity values.[32] Baselines will be reduced at a rate of 4.9% per annum to 2030 unless the facility is able to access one of the lower reduction rates for trade-exposed activities.[33]

Under the reformed Safeguard Mechanism, if reported covered emissions fall below the facility's baseline, the facility operator will be issued with Safeguard Mechanism Credit units (SMCs), which is a new carbon unit that is recognised as tradeable personal property.[34] If emissions exceed the baseline, the operator must surrender either SMCs or ACCUs to reduce the excess emissions to nil.[35] There is no limit to the use of ACCUs, but additional reporting requirements are triggered if 30% or more of excess emissions are met by ACCUs.[36] By way of a cost control mechanism, a facility has the option to purchase ACCUs from the government for the fixed price of $75 (for 2023/24, indexed, which is far in excess of the

[28] Clean Energy Regulator, 'Benefit sharing framework' (12 May 2023) https://www.cleanenergyregulator.gov.au/ERF/Want-to-participate-in-the-Emissions-Reduction-Fund/Step-4-Delivery-and-payment/managing-a-contract/benefit-sharing-framework.

[29] Brett Worthington, 'Climate deal struck after Labor and the Greens reach safeguard mechanism agreement' ABC News (online, 27 March 2023) https://www.abc.net.au/news/2023-03-27/greens-safeguard-mechanism-labor-agreement-bandt-bowen/102148956.

[30] Department of Climate Change, Energy, the Environment and Water, *Safeguard Mechanism Reforms* (2023) 1, https://www.dcceew.gov.au/sites/default/files/documents/safeguard-mechanism-reforms-factsheet-2023.pdf.

[31] Ibid at 2.

[32] Ibid at 3.

[33] *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (Cth) s 32. The minimum baseline reduction rates for trade-exposed facilities are 1% for manufacturing and 2% for non-manufacturing.

[34] *Australian National Registry of Emissions Units Act 2011* (Cth) s 48A.

[35] *National Greenhouse and Energy Reporting Act 2007* (Cth) ss 22XF, 22XK and 22XM.

[36] *National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015* (Cth) s 72C(4) and (5).

current ACCU secondary market price) which will then be immediately surrendered.[37] These amendments have, in effect, reintroduced emissions trading but in the form of a 'rate-based' emissions trading scheme (ETS) (historically referred to as baseline-and-credit ETS) rather than the cap-and-trade ETS model used by the CPM.[38]

Until these recent amendments, Safeguard Facilities could act as the proponent of a qualifying ACCU Scheme project, thereby giving rise to ACCUs that could then be used to meet any resulting Safeguard obligations. An example of this from the 2021-22 Safeguard Facility data is Cleanaway Waste Management Limited, one of six facilities issued with ACCUs in that period. With the reform of the Safeguard Mechanism, the Government has made it clear that Safeguard Facilities will no longer be able to register new ACCU Scheme projects[39] but, rather, such abatement activities will have a direct impact on the reported emissions for the facility.

IV TAXATION TREATMENT OF CLIMATE UNITS UNDER DIVISION 420

The package of amendments giving effect to the new Safeguard Mechanism and creating SMCs included amendments to Div 420 of the ITAA 1997 to provide income tax treatment similar to that for ACCUs.[40] Division 420 was also amended in 2023 to provide a different tax outcome for certain primary producers whose activities give rise to ACCUs.[41] The effect of these various amendments is to create subtly distinct taxation outcomes for three categories of units: ACCUs; ACCUs held by qualifying primary producers; and SMCs.

Given that the Government has decided to rely on market mechanisms to find the lowest cost abatement and sequestration activities, from a policy perspective the tax treatment of these unit classes should be as neutral as possible to limit interference with the carbon market. However, structural features to the schemes under which the units are created arguably justify differences in treatment.

A. *Introduction*

According to the Explanatory Memorandum to the Safeguard Mechanism amending legislation, the amendments to Div 420 to include SMCs was 'so that they receive the same tax treatment as other specified units, like ACCUs'.[42] However, what will be shown below is that by only making the minor amendment to the definition of REUs to include SMCs and not also including SMCs in a number of provisions that otherwise only apply to ACCUs, the tax treatment of SMCs is not the same as the tax treatment of ACCUs in a material way. Both

[37] This mechanism is provided by way of s 11AB of *Carbon Credits (Carbon Farming Initiative) Rule 2015* (Cth).
[38] This terminology is adopted, for example, by the World Bank specifically in relation to Australia in its report *State and Trends of Carbon Pricing 2023* (2023) 25 https://openknowledge.worldbank.org/entities/publication/58f2a409-9bb7-4ee6-899d-be47835c838f.
[39] Department of Climate Change, Energy, the Environment and Water, *Final Design of the Safeguard Mechanism Reforms* (May 2023).
[40] *Safeguard Mechanism (Crediting) Amendment Act 2023* (Cth).
[41] *Treasury Laws Amendment (2023 Measures No 2) Act 2023* (Cth).
[42] Revised Explanatory Memorandum, Safeguard Mechanism (Crediting) Amendment Bill 2023, 33.

categories of units are created by being issued by the Clean Energy Regulator in effect for free—associated costs are only in relation to application fees and required reporting, which are eligible for a specific deduction in relation to ACCUs.[43] However, the value of ACCUs issued to the proponent of an ACCU project is assessable on receipt whereas the value of SMCs issued to a Safeguard Facility is only realised for tax purposes if and when the units are sold. With the recent introduction of a concessionary regime for ACCUs issued to certain primary producers, which also results in deferral, we in fact have three alternative tax treatments for REUs.

B *The taxation of ACCUs generally*

As I and my co-author described in greater detail when Div 420 was initially introduced,[44] the approach adopted in this division is a modification of the trading stock rules found in Div 70 which was coined the 'rolling balance method' in the Explanatory Memorandum.[45] Division 420 applies to 'registered emissions units' (REUs), which was defined to include Kyoto units and ACCUs, as well as the carbon units that were to be traded under the Carbon Pricing Mechanism.[46] The term 'Kyoto units' has the same meaning as under the *Australian National Registry of Emissions Units Act 2011* (Cth) (ANREU Act), thereby picking up the variety of units issued under the Kyoto Protocol.[47] These Kyoto units may be acquired for purposes other than compliance, such as to meet 'carbon neutral' obligations under the Federal Government's Climate Active standard.[48] (This article does not address the tax treatment of voluntary offsetting.) All provisions within Div 420 were amended in 2014 to remove reference to carbon units issued under the Carbon Pricing Mechanism with the repeal of the emissions trading scheme.[49] The rules in Div 420 have otherwise remained largely unchanged until the two sets of amendments in 2023.

The basic features of the rolling balance method provide the following:

- costs incurred to acquire an REU are deductible when the unit is acquired (when you become the holder) (s 420-15);
- the proceeds from the sale of an REU are assessable income (s 420-25);
- if the unit is retained (banked) the value is included in the value of units held as at the end of the year (in effect deferring the deduction for the cost) (this is referred to as the 'carrying value' of a unit in this article); and
- any change in the total value of units held across the year gives rise to income or a deduction (s 420-45).

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[43] *ITAA 1997* s 420-15(4).
[44] Celeste Black and Michael Dirkis, "Farming Carbon: Taxation implications of the Carbon Farming Initiative" (2011) 21 *Revenue Law Journal* 53.
[45] Explanatory Memorandum to Clean Energy (Consequential Amendments) Bill 2011, ch 2.
[46] *ITAA 1997* s 420-10.
[47] *Australian National Registry of Emissions Units Act 2011* (Cth) s 4. 'Kyoto unit' means assigned amount units, certified emission reductions, emissions reduction units, removal units and prescribed units issued in accordance with the Kyoto rules.
[48] Climate Active, *Carbon Neutral Standard for Organisations* (2022) Appendix A.
[49] *Clean Energy Legislation (Carbon Tax Repeal) Act 2014* (Cth), effective 1 July 2014.

Capital gains and losses in relation to REUs are disregarded,[50] REUs are not trading stock,[51] and REUs are exempt from the taxation of financial arrangements rules in Div 230.[52]

From the perspective of a project proponent carrying on a registered ACCU Scheme project, reported emissions reductions or sequestration will give rise to the issuance of ACCUs by the Clean Energy Regulator once the report is processed. The new ACCUs will appear in the proponent's ANREU account. At this point, the unit is considered to be 'held' for the purposes of Div 420.[53] Such units are referred to in this article as 'issued ACCUs', as distinct from purchased ACCUs.

Expenses incurred in the carrying out of the project would generally be deductible under s 8-1 given their connection either to the business connected to the project or, if it is a stand-alone activity, due to the connection between the expenses and the production of assessable income taking the form of the issued ACCUs. Div 420 treats costs incurred to become the holder of an REU as deductible, which thereby provides a specific deduction for the cost of an REU that is acquired on the secondary market.[54] However, for project proponents who apply for ACCUs to be issued to them (rather than acquired on market) this deduction is limited to those expenses incurred in preparing or lodging the application for a certificate of entitlement or an offsets report.[55] Other project costs could still be deductible under the general deduction or other specific deduction rules (eg Div 40 for equipment depreciation).

I *Application to Carbon Abatement Contracts*

Many ACCU Scheme project proponents engage with the auction process so that they have a guaranteed income stream via the sale of the specified volume of project-generated ACCUs under the resulting carbon abatement contract. This guarantee of minimum income could be an important factor to potential investors or financiers of the project. Participation in auctions became substantially more attractive with recent changes described above – the introduction of optional delivery contracts and fixed delivery contract exit arrangements. The amount received by the proponent from sales to the Clean Energy Regulator under the resulting carbon abatement contract is assessable under s 420-25.

As described above, a project proponent may apply for an exit arrangement in relation to a required sale under a fixed delivery contract when ACCUs are trading on the secondary market for more than double the contract price. This profit maximising behaviour presumes that the exit fee is a deductible expense. There is authority that payments to be released from an onerous contract may in some circumstances be a capital expense[56] but in this context there is a strong argument that the specific carbon abatement contract is not of itself a capital asset, it does not form part of the 'profit yielding structure' of the activity.[57] Even more

[50] *ITAA 1997* s 118-15.
[51] *ITAA 1997* s 70-12.
[52] *ITAA 1997* s 230-481.
[53] *ITAA 1997* s 420-12.
[54] *ITAA 1997* s 420-15.
[55] *ITAA 1997* s 420-15(4).
[56] See, eg, *Foley Bros Pty Ltd v FCT* (1965) 13 ATD 474, decision of the High Court before McTiernan J.
[57] The relevance of the distinction between the profit yielding structure of the business enterprise and its day-to-day affairs was established in *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337, and this distinction was relied upon in *Foley Bros,* 13 ATD at 481.

particularly, given that the exit fee is paid only for the release of the particular delivery obligation within the specified window (and not for the cancellation of the contract as a whole), the argument is even more clear that the outgoing is of a revenue nature and will be deductible on the basis of the connection with the broader ACCU scheme activities that are entered into to produce assessable income.

II *Other dealings with ACCUs*

Alternatively, if there is no carbon abatement contract in place, there are ACCUs being generated above the contracted volume, or the project proponent has determined not to go ahead with the sale under an optional delivery contract, those newly issued ACCUs could be sold within the same tax year on the secondary market. Such sales proceeds are similarly included in assessable income.

Where newly issued ACCUs are banked (retained), their value must be taken into account in determining the ACCUs held at year end. Section 420-45 requires a comparison (like that undertaken for trading stock under s 70-35) of the value of all REUs held at beginning and the end of the year. A deduction is available for an overall decline in value or an amount is included in assessable income for any overall increase in value. Also similar to Div 70, the taxpayer can choose to value REUs at year end at FIFO cost, actual cost or market value.[58] This value is then carried into the opening value of REUs in the following year. However, the wording of the relevant section suggests that one method must be used for all REUs, whereas the corresponding provision in Div 70 allows the election to be on per item basis.[59] There are also restrictions on changing valuation methods for REUs from year to year.[60] Given the volatility Australia's ACCU market to date, it is considered unlikely that a taxpayer would elect to use market value for their REUs and, for the balance of this article, the discussion is based on the use of a cost method.

Critically, the 'cost' of an ACCU issued under the ACCU Scheme is taken to be its market value immediately after it is acquired.[61] When this deemed cost is included in the value of the REUs on hand at year end, this will represent an increase in the value of REUs held and has the effect of including that value in assessable income. The same effect would follow if the taxpayer were using the market value method. The receipt of ACCUs by a project proponent is therefore treated in the same way as most government grants to business—as assessable income.[62]

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[58] *ITAA 1997* s 420-55.

[59] *ITAA 1997* s 420-57(2): 'you may choose one of the following methods … for working out the value of *the* registered emissions units…' (emphasis added), compared to s 70-45(1): 'you must elect to value *each item* of trading stock on hand…' (emphasis added).

[60] The *ITAA 1997* s 420-57(5) and (6) restrictions include that the same method must be used for at least four years before a change and the taxpayer cannot change from FIFO cost to actual cost.

[61] *ITAA 1997* s 420-60(3).

[62] A government grant (or bounty or subsidy) to business may be assessable as ordinary income or, if not, will be picked up by ITAA s 15-10. See, eg, *GP International Pipecoaters Pty Ltd v FCT* (1990) 170 CLR 124 and *MIM Holdings v C of T* [1997] FCA 363. See also TR 2006/3 'Income tax: government payments to industry to assist entities (including individuals) to continue, commence or cease business'. The potential to characterise issued ACCUs in such a way was acknowledged in the Explanatory Memorandum to Clean Energy (Consequential Amendments) Bill 2011 at [2.108].

In relation to valuation, the Government has announced that it will establish a carbon market, the Australian Carbon Exchange,[63] but in the interim other sources of information regarding trades on the secondary market are required to determine the value of the ACCUs at a given time. The Clean Energy Regulator relies on data from CORE Markets and Jarden in compiling its Quarterly Carbon Market Reports.[64] ACCUs values can be volatile. For example, the Government announcement of the fixed delivery contract exit arrangements in March 2022 saw a drop in the spot market prices of ACCUs from $47 to $30.[65] In addition, similar to offset markets globally, ACCUs are not viewed as generic, and the project type can impact on the value of the ACCUs. In its most recent Quarterly Carbon Market Report (September 2023), the Clean Energy Regulator noted that ACCUs issued under the human induced regeneration method traded at a $4 premium over the generic ACCU price.[66]

When a purchased ACCU is sold, the operation of Div 420 mirrors that of Div 70, in effect producing a net profit or loss figure by including the proceeds in assessable income, offset by a deduction for the decline in the value of REUs held at the year-end that reflects the carrying value of the REU that was sold.

Voluntary surrender (retiring) of ACCUs by a business to the Clean Energy Regulator to achieve a carbon neutral goal, for example under Climate Active, should similarly generate a deduction for the carrying value. Like other expenses incurred by business in line with corporate social responsibility goals, the connection with the production of assessable income may be less direct but such expenses are still ordinarily incurred in carrying on the business to produce assessable income and therefore deductible.[67]

C *Primary Producer ACCUs*

A new set of concessions for primary producers who undertake ACCU projects was enacted in 2023 separate to the Safeguard Mechanism amendments.[68] The two main concessions are: to allow income from the sale of ACCUs to be treated as primary production income (therefore preserving eligibility for the Farm Management Deposit Scheme[69] or income averaging[70]); and to defer the taxation point on project-issued ACCUs until sale (rather than

[63] The Government announced in December 2023 that the Clean Energy Regulator has contracted with a non-government entity, the Trovio Group, to develop a new unit register to facilitate the Carbon Exchange. Clean Energy Regulator, Media Release: 'Australian Carbon Exchange reaches a major milestone' (19 December 2023) https://www.cleanenergyregulator.gov.au/ERF/Pages/News%20and%20updates/News-item.aspx?ListId=19b4efbb-6f5d-4637-94c4-121c1f96fcfe&ItemId=1298.
[64] 'Quarterly Carbon Market Report – September Quarter 2023' (n 24).
[65] Bowyer (n 27) 6.
[66] 'Quarterly Carbon Market Report – September Quarter 2023' (n 24).
[67] The connection to assessable income or a business that is required under *ITAA 1997* s 8-1 is incorporated into the operation of Div 420 by way of s 420-40(1)(d).
[68] *Treasury Laws Amendment (2023 Measures No 2) Act 2023* (Cth).
[69] *ITAA 1997* Div 393.
[70] *ITAA 1997* Div 392. Section 392-80(2)(b) now includes in 'assessable primary production income' any amount included in income under s 420-25 from ceasing to hold a PPREU. This inclusion, which is also effective for Div 393 purposes, allows the proceeds from the sale of ACCUs to be treated as primary production income rather than non-primary production income. This is important given that eligibility of both Divs 392 and 393 have a cap of non-primary production income.

on issue). These measures are designed to encourage primary producers to undertake carbon abatement activities.[71] They do not apply to ACCUs acquired on the secondary market.

A new sub-category of 'primary producer registered emissions unit' (PPREU) has been created.[72] Such units are ACCUs issued directly or indirectly (via a carbon services provider) to the primary producer in relation to an eligible offsets project that is carried on in the area, or an area connected with the area, on which a primary production business is carried on, where the ACCUs are first held on or after 1 July 2022.[73] The holder must be an individual who directly carried on the primary production business or who was a beneficiary of a trust or partner of a partnership that did the same. Incorporated farms are excluded. Income from the sale of PPREUs as well as payments from a carbon service provider that represent the value of such ACCUs (unless there is merely a lease between the primary producer and the carbon service provider) is considered primary production income.[74]

The deferral of income is achieved by an amendment to the effect that Subdiv 420-D (other than s 420-60) does not apply to a PPREU.[75] Subdiv 420-D contains the rules that create the rolling balance method, requiring the comparing of the value of REUs at year end. By removing the rolling balance method, the Div 420 rules that remain operational simply allow a deduction for expenditure incurred in lodging ACCU-related reports (s 420-15) and expenses in relation to ceasing to hold the ACCU (s 420-42) and include the proceeds on disposal in assessable income (s 420-25). Section 420-60 is the rule that deems the cost of an ACCU issued to you as the market value. It is unclear what effect the retention of s 420-60 is meant to achieve. The Explanatory Memorandum merely states that the rule that cost picks up the market value for all issued ACCUs continues to apply.[76]

D *Safeguard Facilities: ACCUs and SMCs*

As described above, Safeguard Facilities may already hold ACCUs, either generated from projects registered before 2023 under the ACCU scheme or acquired on the secondary market and may continue to have new ACCUs issued to them for ACCU projects already underway. The Clean Energy Regulator Quarterly Market Report for September 2023 shows that 5.4m of the total 33.5m ACCUs held in ANREU accounts are in accounts of Safeguard Facilities.[77] These units can be used to meet a liability arising if reported emissions exceed the facility's baseline.

A Safeguard Facility must report its covered emissions for the compliance period ending 30 June by 31 October.[78] If reported emissions are below the baseline for the year, SMCs will be issued to the operator of the Safeguard Facility by 31 January of the year following the end of a compliance period. Like ACCUs, SMCs have little direct costs associated with their issue

[71] Explanatory Memorandum to Treasury Laws Amendment (2023 Measures No 2) Bill 2023 at [3.7] and [3.10]—[3.11].
[72] *ITAA 1997* s 420-13.
[73] Ibid.
[74] *ITAA 1997* s 392-80(2)(e) extends the notion of primary production income to amounts received from a carbon service provider in relation to ACCUs obtained in relation to the project.
[75] *ITAA 1997* s 420-62
[76] Explanatory Memorandum to Treasury Laws Amendment (2023 Measures No 2) Bill 2023, [3.17].
[77] 'Quarterly Carbon Market Report – September Quarter 2023' (n 24).
[78] Reporting obligations are under the *National Greenhouse and Energy Reporting Act 2007* (Cth).

by the Clean Energy Regulator—they arise by operation of the scheme rules—so these units are referred to as 'free' SMCs in this article (as distinct from purchased SMCs). 'Free' SMCs can then be sold or banked for use in later periods if/when emissions exceed the baseline. Alternatively, if emissions exceed the baseline, ACCUs or SMCs in the amount of the excess must be surrendered by 31 March.

As noted above, the EM suggests that the 2023 amendments to ITAA 1997 were designed to produce the 'same' treatment for SMCs as for other emissions units but what the amendments actually create is a tax treatment most similar to the rule that applied to the free carbon units that were to be issued to coal-fired electricity generators under the now repealed Carbon Pricing Mechanism.[79] The 2023 tax amendment was very simple. A new subsection was added to the meaning of 'REU' to include a SMC unit.[80] However, critically, the rule that operates to deem ACCUs to have a cost equal to the market value on issue (thereby indirectly including that value in assessable income by way of the rolling balance method, as described above) was not also amended to include SMCs. The 'cost' of an SMC for the purposes of determining the rolling balance therefore only includes any actual costs that are considered to be appropriately absorbed into those units, which may well be nil. Unless the market value option for REUs has been elected, SMCs will be carried at nil or minimal cost.

To put this into the context of the operation of the Safeguard Mechanism, if a facility takes steps to reduce emissions ahead of its declining baseline, it will be rewarded with the issue of 'free' SMCs. These SMCs may be retained as a buffer for later years when emissions might exceed the reduced baseline. The government could have followed the treatment of ACCUs and taxed the value of 'free' SMCs upfront on issue and then allowed a deduction for that value when the SMCs were surrendered. This, however, creates a timing disadvantage. The alternative that was adopted in the legislation instead minimises tax implications—without the cost deeming rule to recognise the value of 'free' SMCs on issue, there is no expense when the 'free' SMCs are surrendered. Only if and when SMCs are sold on the secondary market would the value be assessed.

V IMPACT OF ALTERNATIVE COST RULES

One of the main original stated purposes of providing bespoke taxation rules for REUs in Div 420 was to achieve neutrality amongst holders.[81] This is clearly achieved in relation to purchased REUs, where the purpose of holding (trading asset, compliance hedge, or voluntary offsetting) does not trigger different rules. Discrete provisions also serve the goals of simplicity and certainty.[82] However, the following table illustrates how the recent changes

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[79] The approach is also similar to that provided for free allocation to emissions-intensive, trade-exposed facilities except that the 'no disadvantage rule' (former s 420-58) has not been revived. See Celeste Black, 'Considering the taxation implications of Australia's carbon pricing mechanism' (2012) 42:2 *Australian Tax Review* 136, 149-151.

[80] New *ITAA 1997* s 420-10(e). In addition, s 420-52(a) was amended to correspondingly include a new (iv) of SMCs. *Safeguard Mechanism (Crediting) Amendment Act 2023* (Cth) sch 1, pt 2.

[81] Australian Government, *Carbon pollution reduction scheme: Australia's low pollution future: White paper* (2008) 14-4 (*CPRS White Paper*).

[82] Ibid.

to Div 420 in response to changes in government climate policies have produced variations in tax outcomes across REU categories, in some cases rather significant ones, which lead to complexity. A 'tax neutral design' advocated for by the government during the rule development stage 'minimises distortions to decisions about acquiring, surrendering or selling permits.'[83] Therefore variability in tax treatment may also undermine this efficiency goal.

Table 1: Tax treatment of new REU holdings

Unit type and context	*Cost rule for rolling balance*	*Practical impact*
ACCUs issued to project proponent incl Safeguard Facility	Cost = market value on issue	Value of ACCUs assessable in year of issue
ACCUs issued to eligible primary producer	Cost not relevant as rolling balance not applicable	Value of ACCUs only assessable upon sale
SMCs issued to Safeguard Facility	Cost = actual cost (likely nil)	Value of SMCs only assessable if and when sold
ACCUs and SMCs acquired on secondary market	Cost = purchase price	Profit/loss recognised on sale Mirrors Div 70 treatment

SMCs issued to Safeguard Facilities will be carried at little or nil cost and coupled with the realisation basis under Division 420, this creates an enhanced 'lock-in' effect. The treatment of PPREUs also creates lock-in. The lock-in effect has been described in relation to the capital gains tax and is recognised to distort market decisions regarding whether to retain or realise investments, impeding the efficient functioning of markets.[84] The lock-in effect incentivises investors to retain assets that have accrued gains and to sell assets that are accruing losses. This is further pronounced if the cost of the asset for tax purposes is nil. These tax effects may encourage Safeguard Facilities to hold onto issued SMCs, and the resulting secondary market for SMCs could be very shallow in practice. Similarly, the new treatment of PPREUs may encourage new ACCU Scheme projects but the resulting ACCUs may be held by the original project proponents longer due to the income deferral.

The tax rules may also influence the choice between ACCUs, and SMCs used to meet a compliance obligation under the reformed Safeguard Mechanism. The surrendered REU is no longer included in the rolling balance at year end, in effect of producing a deduction for the carrying cost. This is an appropriate outcome as this is a regulatory compliance cost that would otherwise have been treated as a deductible business expense under s 8-1. 'Free'

[83] Ibid 14-2.
[84] For a relatively recent analysis of the effect of the realisation basis of the capital gains tax on markets, including the lock-in effect, see Treasury, *Australia's Future Tax System, Final Report: Part 2 – Volume 1 (the Henry Review)* (2010) 63-64. For an early analysis of the lock-in effect of capital gains tax in the United States see Charles C Holt and John P Shelton, 'The lock-in effect of the capital gains tax' (1962) 15:4 *National Tax Journal* 337.

ACCUs issued to the Safeguard Facility have a deemed cost of market value on issue, which matches the cost valuation alternative for purchased ACCUs and purchased SMCs. If a 'free' SMC is issued to a Safeguard Facility, banked and later surrendered to meet an emissions obligation, there will be no income tax consequences: no income is derived, nor expense incurred, the transactions being invisible to the tax system. Any units which are purchased and surrendered within one year will produce the deduction for the cost of acquisition. Expectations are that the price of carbon units in Australia will increase over time from the relatively low current trading value, such that greater tax deductions would be generated through the acquisition of new units to meet compliance obligations, with 'free' SMCs producing the lowest tax expense.

VI CONCLUSION

The government's stated objectives in designing the original Div 420 were to ensure that the tax treatment of units did not compromise the economic effectiveness of the emissions reduction scheme as well as to incorporate the traditional tax axioms of simplicity, efficiency and equity.[85] Amendments to Div 420 in 2023 to add rules for SMCs and PPREUs have created additional complexity that may negatively impact the efficiency of Australia's carbon markets. Given the different tax treatments of scheme issued ACCUs and 'free' SMCs, as well as different carrying costs of SMCs depending on the circumstances in which they were acquired, Safeguard Facilities will need to weigh up the tax consequences of utilising the specific emissions units already on hand (or buying new units) to meet a Safeguard Mechanism liability and will not be neutral as to the different types and parcels of units. Given the nil or minimal cost attached to 'free' SMCs, a Safeguard Facility may prefer to bank these units to meet future liabilities rather than crystalise a taxable gain upon sale. This may limit the volume of SMCs on the secondary market and shift demand to ACCUs. On the other hand, the tax deferral created for primary producer ACCUs by the recent amendments is explicitly designed to encourage primary producers to take part in ACCU Scheme projects, thereby ultimately increasing the number of ACCUs on issue. However, the lock-in effect the rules create may inhibit the volume of these units being made available on the secondary market.

[85] *CPRS White Paper* (n 81) 14-2.

CROSS-CONTINENTAL PERSPECTIVES: ANALYSING TAX NON-COMPLIANCE REGULATIONS IN CANBERRA, JOHANNESBURG AND WASHINGTON

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Abstract

This cross-sectional study analyses tax compliance frameworks across South Africa, Australia, and the United States, offering a comparative perspective. Despite amendments to the South African Tax Administration Act, subjective taxpayer behaviour remains a major factor in non-compliance. The primary goal is to refine South Africa's tax penalty system by evaluating its effectiveness against those in Australia and the US. The article delves into the administration of tax non-compliance and understatement penalties, highlighting key similarities and differences. It identifies challenges from past litigations and provides policymakers with actionable insights. This nuanced comparison illuminates global tax penalty structures and informs future regulatory improvements.

Keywords: Administrative practices, Australia, non-compliance, penalty structures, South Africa, Tax administration, Tax evasion, Tax penalty regimes, United States

I INTRODUCTION

The perception of taxation as punitive and unnecessary has long been a point of contention between taxpayers and regulatory authorities. Since the inception of formal tax systems, there has always been a segment of the population resistant to compulsory tax payments, often resorting to various strategies to evade their obligations. This enduring pattern of tax non-compliance, where taxpayers fail to meet the requirements outlined by tax legislation, reflects deeper tensions rooted in historical precedent and conflicting views on the fairness of tax burdens and the role of government in society.

Tax compliance[1] is a cornerstone of modern economies, as few alternatives exist to fund the extensive government expenditures necessary for national functioning. Non-compliance with

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[1] James, Simon, and Clinton Alley. "Tax compliance, self-assessment and tax administration." (2002). The researchers contend that defining tax compliance, in its simplest terms, often revolves around the extent to which taxpayers adhere to tax laws. However, akin to many conceptual frameworks, the understanding of compliance can be viewed along a continuum of definitions. This spectrum spans from a more narrowly focused law enforcement approach, encompassing broader economic

tax obligations presents a significant challenge for governments, as it directly undermines public revenue and compromises the ability to meet essential public needs. Government expenditures span crucial sectors[2], all of which require substantial financial resources. While governments may generate some revenue through alternative means, these streams are often insufficient to cover the full scope of expenditures. Consequently, governments may resort to borrowing, but such loans must be repaid with interest, which further highlights the critical importance of taxation as the primary method of funding government operations. Taxation, therefore, serves as a necessary instrument for economic sustainability rather than merely a regulatory burden[3].

Effective tax collection depends on widespread adherence to tax obligations. Non-compliance, whether deliberate or inadvertent, is frequently seen by tax authorities as resistance to government mandates, prompting enforcement measures such as penalties. This resistance can take the form of legal tax avoidance or illegal tax evasion[4]. Tax avoidance involves the strategic structuring of financial affairs to minimize tax liability within the bounds of the law, often taking advantage of legal loopholes or anti-avoidance measures[5]. For such strategies to be lawful, tax authorities must determine that the primary intent is not to evade taxes. In contrast, tax evasion is the illegal manipulation of financial records or tax filings to reduce tax liability, such as by falsifying income or inflating deductions. This distinction between avoidance and evasion is critical, as the latter constitutes a criminal offense, while the former remains a contested but technically legal practice.

Despite efforts to enhance tax compliance, tax evasion remains a significant concern, distinct from tax avoidance due to its intentional and illegal nature. It occurs when individuals deliberately fail to meet their tax obligations, a practice that has persisted throughout history and is expected to continue. While some taxpayers view taxes as burdensome, fulfilling these obligations is a commitment to fiscal citizenship and adherence to the nation's tax laws. Tax evasion is a global issue, often involving high-profile individuals, as reported by the media[6]. Tax authorities face ongoing challenges in combating this behaviour, balancing enforcement with encouraging voluntary compliance. To deter evasion, they impose penalties, recognizing it as a serious offense.

The task of ensuring tax compliance is formidable, particularly with the growing reliance on self-assessment and electronic commerce. Self-assessment[7] shifts the responsibility for

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interpretations, to more encompassing versions that involve taxpayer decisions aligning with the broader societal objectives articulated in tax policy. Beginning with the narrower end of the continuum, one proposed metric for gauging the degree of non-compliance is the 'tax gap.' This metric signifies the variance between the actual revenue collected and the hypothetical amount that would be obtained with 100 percent compliance. This approach provides a quantitative measure to assess the effectiveness of compliance efforts and the extent to which tax objectives are being realized.

[2] Such as healthcare, education, public safety, political stability, and law and policy development.

[3] James, Simon, and Clinton Alley. "Tax compliance, self-assessment and tax administration." (2002).

[4] Alm, J. (2018), *What motivates tax compliance?* Journal of Economic Survey, pp. 1-36

[5] Sections 80A – 80L of the Income Tax Act 58 of 1962

[6] Since time immemorial, taxpayers have sought means to mitigate or evade their tax liabilities, a trend anticipated to persist. According to Phindi Mjonondwane, the spokesperson for NPA South Gauteng, former Kaizer Chiefs defender Jimmy Tau found himself in legal trouble and paid a fine of R300 as an admission of guilt. Additionally, football star Teko Modise faced fraud charges for alleged failure to submit tax returns from 2013 to 2017. Actress Katlego Danke appeared in the Johannesburg Magistrate's Court on 21 August 2018 on charges of tax-related fraud. Moreover, Kaizer Chiefs goalkeeper Itumeleng Khune was under investigation by the Hawks for allegedly not submitting tax returns for the years 2016 and 2017. (Malatji, 2018).

[7] James, Simon, and Clinton Alley. "Tax compliance, self-assessment and tax administration." (2009). In their article both researchers argue that the prominence of tax compliance within tax policy is poised to grow, particularly as persistent challenges persist, and new complexities emerge from factors like self-assessment, the globalization of economies, and the advent of electronic commerce. These developments necessitate careful consideration of their policy implications on the

accurately calculating and reporting tax liabilities from tax authorities to taxpayers, requiring them to have a thorough understanding of their obligations. This complexity amplifies the challenges faced by tax authorities in promoting compliance.
The significance of the research presented in this article lies in its potential to offer valuable insights to policymakers and relevant authorities, particularly in developing countries, regarding necessary reforms to their penalty regimes. These refinements would align with the legal doctrine of *nulla poena sine lege*, which asserts that no punishment can be imposed without a pre-existing law explicitly prohibiting the conduct in question[8]. This principle has profound implications for the administration of penalties, particularly in two key dimensions[9].

A *Research problem*

A comparative analysis of penalty regimes enables policymakers to identify areas for improvement within their own frameworks. By leveraging international best practices and experiences, they can make informed decisions to enhance their country's penalty system. This article presents a comparative analysis of the tax compliance regulatory frameworks in South Africa, the United States, and Australia. The title of the article is inspired by the capital cities: Johannesburg, Washington, and Canberra.

The United States and Australia, with their extensive experience in tax administrative laws, offer valuable insights for this analysis. By examining their practices, the article aims to extract lessons that can strengthen and align South Africa's penalty regime with international standards.

Although the primary focus is on improving the tax penalty regime in a developing African nation, the research has broader implications for international tax revenue authorities. The choice of South Africa, the United States, and Australia for this comparative analysis, as depicted in Figure 1, is based on strategic considerations.

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administration of the tax system. Notably, the introduction of self-assessment introduces a specific risk—the potential temptation to resort to a more stringent enforcement regime. This highlights the importance of balancing effective enforcement with fair and equitable practices in order to maintain the integrity and effectiveness of the tax system.

[8] GrÄƒdinaru, Daniel. "The Principle of Legality." Proceedings of the 11th International RAIS Conference, November 19-20, 2018. No. 044DG. Research Association for Interdisciplinary Studies, 2018.

[9] First, it mandates that penalties must be clearly and precisely defined. The consequences for specific infractions must be articulated in a manner that is both comprehensible and unambiguous, ensuring that individuals have a clear understanding of the potential legal repercussions of their actions. This clarity safeguards individuals' rights to fair treatment and due process under the law. Second, the imposition of penalties must adhere to transparent and well-defined legal procedures. This requirement ensures that penalties are imposed consistently, predictably, and in accordance with established legal rules. By upholding these procedural safeguards, the principle of nulla poena sine lege prevents arbitrary or unjust punishment, promotes the rule of law, and ensures a fair legal system.

Figure 1: Geographic location of South Africa, United States and Australia[10]

South Africa's membership in organizations such as the African Union, the Southern African Development Community (SADC)[11], and the BRICS Group highlights its commitment to regional integration, economic development, and cooperation[12]. Additionally, its participation in the United Nations (UN) since the end of apartheid in 1994 reflects its dedication to global collaboration, peacekeeping, and adherence to international norms[13].

In contrast, the United States stands as a global economic powerhouse with a complex and established tax regime. Its extensive legal framework and enforcement mechanisms provide a nuance for comparison, showcasing both the strengths and challenges of a mature tax system[14]. Australia, with its distinctive legal tradition that blends common law principles and progressive regulatory practices, contributes a dynamic perspective on tax compliance[15]. The overarching objective of this article is to conduct a comprehensive comparative analysis[16] of the criminal and administrative penalty regimes related to tax non-compliance in South Africa, the United States, and Australia. This article strategically selects these nations

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[10] Ponyana and Ndlovu, 2024.

[11] Serving as a key player in SADC, South Africa actively promotes trade, infrastructure development, and socio-economic ties among the 16 member states.

[12] Affiliations with BRICS, the UN, and SADC collectively points to South Africa's commitment to economic collaboration, adherence to international governance protocols, and a focus on regional growth strategies.

[13] Holding non-permanent seats on the UN Security Council multiple times further solidifies South Africa's image as a responsible and cooperative global actor.

[14] The United States Code, specifically Section 6651 of Title 26, Subtitle F, Chapters 61 and 68, Subchapter A, Part I, contains tax administrative penalty clauses akin to those in South Africa. The provisions of this legislation are subject to examination and comparison with those outlined in Chapters 15 and 16 of the South African Tax Administration Act to ascertain potential areas necessitating improvement.

[15] The Australian Tax Administration Act 1953 (hereafter Australian Tax Administration Act) contains penalty provisions similar to those found in South Africa, particularly in Part III, "Prosecution and Offences," Division 2, spanning from Sections 8B to 8W.

[16] This article critically evaluates and contrasts these provisions with Chapters 15 and 16 of the South African Tax Administration Act, aiming to discern whether any improvements are warranted to align with international best practice principles. Additionally, the severity of penalties for non-compliance, particularly regarding non-payment of taxes or understatement of taxable income, is scrutinized to determine variances between South Africa and Australia.

to encompass a diverse range of regulatory approaches, enabling a nuanced examination of how historical, legal, and geographical factors influence tax compliance frameworks. Notably, when developing the South African Tax Administration Act, it was essential for South African tax authorities to adhere to international best practices in tax administration—principles such as fairness, equity, certainty, simplicity, efficiency, and effectiveness. As part of this effort, the South African Revenue Service (SARS) conducted a comparative analysis with tax administrations in Australia and the United States[17].By investigating the factors contributing to non-compliance and evaluating measures to promote compliance, this research aims to provide valuable insights for developing an efficient and equitable tax system that enhances compliance and improves revenue collection[18].

B *Research method*

This article adopts a qualitative research approach, firmly situated within the interpretivist paradigm. Within this paradigm, emphasis is placed on comprehending the subjective experiences and meanings that individuals attribute to social phenomena. The interpretivist paradigm subscribes to the epistemological belief that reality is not an objective, fixed, and quantifiable entity, but rather a dynamic and subjective construct shaped by individual perceptions, values, and cultural contexts. The primary aim of the article is to explore the social reality by delving into the subjective experiences of individuals within Australia and the United States concerning tax administrative processes, particularly penalties, and the significance they attach to them.

Moreover, this research approach acknowledges the ontological belief that social reality is socially constructed. In other words, the article recognizes that social reality is established and perpetuated through social processes and interactions. Consequently, the research endeavours to examine and analyse the social constructions of reality by scrutinizing secondary texts, rather than quantifying or measuring social phenomena. Through this methodological lens, the article seeks to uncover the intricate and dynamic ways in which social reality is shaped, how individuals navigate it, and how their experiences and perspectives are influenced by social and cultural factors.

To gather secondary data, the article employs a comparative legal approach. This methodological choice is deliberate and purposeful, designed to identify relevant policy documents, journal articles, book chapters, court cases, legislations, and online publications related to the research question. The comparative legal approach is favoured for its methodical, replicable, transparent, and comprehensive nature. This approach ensures that the research process remains highly structured and rigorous, facilitating a thorough analysis of the literature.

C *Outline of this article*

[17] Tax Administration Bill, '…The drafting of the TAB was informed by international best practice a comparative evaluation the tax administration laws of other countries with practical experience with tax administrative laws over long periods, such as Australia….and the United States'

[18] The anticipated outcomes of this research carry significant implications for both the government and taxpayers. A more efficacious penalty regime will not only serve as a deterrent against non-compliance but also ensure fairness and legitimacy in tax administration. It will foster a sense of equity among compliant taxpayers and contribute to the overall stability and efficiency of the tax system.

This article examines tax non-compliance, starting with the underlying factors contributing to taxpayers' failure to meet their obligations and conditions that increase default likelihood. It then explores initiatives by SARS aimed at promoting voluntary compliance through various policies and programs. Following this, it investigates corrective measures implemented by tax authorities in Australia and the United States, including educational initiatives and enforcement strategies to enhance compliance. Finally, the article compares South Africa's penalty regime, as detailed in Chapters 15 and 16 of the Tax Administration Act, with the penalty frameworks of the U.S. and Australia, focusing on South Africa's percentage-based penalty under Section 210(2) and fixed-amount penalty under Section 211(1)[19] in relation to similar provisions in the U.S. Internal Revenue Code (IRC 6651) and Australia's Tax Administration Act[20], including its general anti-avoidance rules (GAAR)[21].

II NON-COMPLIANCE WITH TAX LAWS AND FAILURE TO PAY TAXES

Understanding taxpayer behaviour and the factors influencing their compliance attitudes are pivotal in crafting effective compliance strategies[22]. This section undertakes an in-depth examination of the myriad factors that underlie taxpayers' non-compliance and defaulting on tax payments.

A *Reasons for non-compliance with tax laws*

Recent years have seen a surge in research on tax compliance, with scholars like Becker[23], Alm *et al*.[24], Doran[25], Wenzel, and Thielman[26] contributing extensive reviews and empirical studies. James and Alley[27] argue that taxation works best when compliance is voluntary, reflecting taxpayers' willingness to follow both the spirit and specifics of tax laws without enforcement. Voluntary compliance benefits governments, yet non-compliance persists. Scholars question whether this stems from taxpayers feeling they do not see sufficient returns on their contributions, confusion over ambiguous tax laws, or concerns about unequal enforcement.

[19] U.S. Code 301.6651-1, Title 26, Subtitle F, Chapter 61, Subchapter A, Part I

[20] Sections 8B to 8W of the Tax Administration Act 1953

[21] Part IVA of the Income Tax Assessment Act 1936 (Cth)

[22] Kirchler, Erich. The economic psychology of tax behaviour. Cambridge university press, 2007.

[23] Becker, Gary S. "Crime and punishment: An economic approach." Journal of political economy 76.2 (1968): 169-217.

[24] Alm, James, Betty R. Jackson, and Michael McKee. "Estimating the determinants of taxpayer compliance with experimental data." National tax journal 45.1 (1992): 107-114.

[25] Doran, Michael. "Tax penalties and tax compliance." Harv. J. on Legis. 46 (2009): 111. Doran highlights the crucial role tax penalties play in encouraging compliance, asserting that these penalties clearly define the behaviour expected of taxpayers , distinguishing those who fulfill their obligations from those who do not .

[26] Wenzel, Michael, and Ines Thielmann. "Why we punish in the name of justice: Just desert versus value restoration and the role of social identity." Social justice research 19 (2006): 450-470.

[27] James, Simon, and Clinton Alley. "Tax compliance, self-assessment and tax administration." (2009). The researchers posit that the fundamental objective of taxation is to serve the welfare of citizens rather than to act as a punitive measure. In this light, adopting a policy that aligns with the adage "the unreasonable severity of the laws obstructs their execution" seems fitting. While the existence of sanctions is undoubtedly imperative to support effective tax administration, critical questions arise concerning the necessary extent of their application and the vigour with which they should be enforced. Importantly, there exist more constructive approaches to foster tax compliance that are in harmony with the overarching purpose of public spending as a net public benefit. Recognizing the positive role taxation plays in societal well-being can inform a more balanced and effective approach to compliance strategies.

Historically, resistance to taxation has been fierce, as noted by Burg[28], who highlights that taxation has often been viewed as excessive and met with heated reactions. This resistance dates back to ancient civilizations and emphasizes the complex relationship between taxpayers and tax obligations[29]. Taxation itself is mandatory, with legal frameworks requiring contributions to the national revenue fund[30]. Torgler[31], however, notes that some view paying taxes as a moral dilemma, with the Duke of Westminster principle[32] reinforcing that taxpayers are only obliged to pay what the law demands, with no moral obligation to contribute beyond that.

The Duke of Westminster principle helps clarify the distinction between tax evasion, tax avoidance, and tax planning. Tax evasion involves illegal activities, such as falsifying information or concealing income to unlawfully reduce tax liability and is subject to legal penalties. Tax avoidance, while legal, exploits loopholes or inconsistencies in tax laws to reduce tax liabilities in ways not intended by lawmakers, often raising ethical concerns. In contrast, tax planning is a lawful and responsible approach where individuals or businesses organize their finances to minimize tax liability while complying with both the letter and intent of the law. A detailed discussion on tax planning falls outside of the scope of this paper.

In his seminal work, *Why People Obey the Law*, Tom Tyler[33] argues that compliance is rarely absolute[34]. Tyler's research suggests that lawmakers and legal authorities would achieve greater success by fostering respect for the legal system, rather than relying solely on the threat of sanctions[35]. Tyler further emphasizes that the effectiveness of legal authorities is contingent upon their ability to influence public behaviour[36]. Legal rules and judicial

[28] Burg, David F. A world history of tax rebellions: An encyclopaedia of tax rebels, revolts, and riots from antiquity to the present. Routledge, 2004.

[29] Van de Braak, Hans. "Taxation and tax resistance." Journal of Economic Psychology 3.2 (1983): 95-111 defines tax resistance as the deliberate efforts by citizens to avoid or resist tax payments. This phenomenon persists across cultures and historical contexts, illustrating its persistent and multifaceted nature.

[30] Although the exact origins of taxation remain uncertain, historical evidence suggests taxes were imposed in ancient times, such as the collection of tithes from citizens' harvests in Mesopotamian history. Stevens, Marty E. "Temples, tithes, and taxes: the temple and the economic life of ancient Israel". Baker Books, (2006) explains "taxes" as "regularized payments owed to the governing political authority, often charged as a percentage of income or as a special activity fee: in other words, taxes were the secular version of tithes." This suggests that in antiquity, taxes were owed to the Mesopotamian state (political), while tithes were presented to the temple (religious). During the Mesopotamian era, taxes took the form of tithes, consisting of one percent of each landowner's produce (crops and cattle). In ancient Egypt, taxes were collected in the form of mandatory labour, whereby taxpayers were taxed on their land, considered wealth by the government of the time .

[31] As noted by Torgler, Benno. "What do we know about tax fraud: an overview of recent developments." Social Research: An International Quarterly 75.4 (2008): 1239-1270, there is a notion of a "moral duty not to pay taxes," highlighting the tension between legal obligations and moral considerations.

[32] *Inland Revenue Commissioners v. Westminster (Duke), [1936] AC 1 (HL).* This principle finds support in the famous judgment of Lord Tomlin, who stated: "Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be" . This idea, commonly referred to as the "Duke of Westminster principle," emphasises that a taxpayer is required to pay only the amount legally owed, without any moral or additional obligation to contribute more.

[33] Tyler, Tom R. Why People Obey the Law. Princeton University Press, (2006). JSTOR, https://doi.org/10.2307/j.ctv1j66769.

[34] He notes that while many individuals engage in illegal activities—such as evading taxes, using illegal drugs, or driving under the influence—people are more likely to obey the law when they perceive it as legitimate, rather than out of fear of punishment.

[35] According to Tyler, people are motivated to comply with the law when they believe that legal authorities are acting justly and their decisions are worthy of respect. This belief in legitimate authority is a crucial determinant of compliance.

[36] Legal authorities, while tasked with restricting the activities of those subject to their power, must ultimately rely on the voluntary cooperation of the public to be effective. This highlights the need for further exploration of the relationship between legal authorities and the citizens they govern, particularly the role of voluntary compliance in ensuring the legitimacy and authority of legal systems.

decisions hold little practical value if they do not affect the actions of those to whom they are directed[37].
Alm et al.[38] further explored taxpayer compliance, focusing on how individuals respond to tax rates, penalties, and the perceived risk of detection when choosing non-compliance[39]. Their findings align with the deterrence model, based on the economics-of-crime theory, which posits that taxpayers weigh the risks of detection against the potential benefits of evading taxes. Notably, their study found that higher tax liabilities are linked to increased rates of non-compliance.

I *Economic theory of criminal behaviour (economics-of-crime deterrence model)*

According to Becker's model[40], taxpayers adhere to tax laws primarily due to the adverse economic consequences associated with detection and subsequent punishment for non-compliance[41]. Expanding upon this model, Alm and Torgler introduced refinements that consider a fixed income (I), the declared income subject to taxation (R), the tax rate (t), and the probability (p) of detection for underreported income. If detected, taxpayers face penalties (f) per unit of unreported income. The adjusted model by Alm and Torgler illustrates the calculation of income after detection I_c and for undetected cases I_{nc} ,emphasizing the role of deterrence in shaping taxpayer compliance behaviour.

$I_c = I - tR - f[t(I - R)]$ (Equation adapted from Alm and Torgler[42])

For individuals who evade detection for underreported income, their income (I_{nc}) is represented by the following equation:

$I_{nc} = I - tR$ (Equation adapted from Alm and Torgler[43])

These theoretical constructs amplify the dynamic interplay between enforcement strategies, penalties, and taxpayer decisions, providing a framework to analyse and understand the complexities of tax compliance in modern economies.

The fundamental aim of an effective tax compliance program is to ensure that taxpayers perceive the consequences of underreporting income I_{nc} i as either financially unfeasible or

[37] A judge's ruling, for instance, is ineffectual if the parties involved feel they can disregard it. Similarly, a law that prohibits certain behaviours is ineffective if it fails to change the frequency of those behaviours. Consequently, the capacity of legal authorities to secure voluntary compliance is critical to their authority. Understanding why people follow the law, therefore, becomes a central issue in both legal studies and the social sciences.
[38] Alm, James, Betty R. Jackson, and Michael McKee. "Estimating the determinants of taxpayer compliance with experimental data." National tax journal 45.1 (1992): 107-114. Alm *et. al* suggested that the higher tax rates lead to significantly lower compliance, which is consistent with the notion that the payoff to successful evasion is greater when the tax rate is larger...
[39] Their study posits that rational taxpayers engage in a cost-benefit analysis, weighing their tax liabilities against the potential benefits of non-compliance, particularly when tax rates are high. Accordingly, higher tax rates typically correlate with increased levels of non-compliance. Additionally, their research reveals that rational taxpayers also consider the potential fine imposed upon detection, balancing it against the probability of being caught.
[40] Under Becker's framework, tax compliance is viewed through an "enforcement paradigm," focusing on deterring non-compliance through frequent audits and severe penalties for taxpayers found underreporting their income
[41] This perspective contrasts with simplistic character-based views of crime, which categorize individuals into "good guys" and "bad guys." Instead, the economic model emphasizes that criminal behaviour results from rational choices individuals make based on the perceived benefits and risks. While personal preferences (economic terminology for character traits) may play a role, engagement in criminal activities ultimately hinges on the available choices and the anticipated consequences.to lose are less inclined to view involvement in criminal activities as appealing.
[42] Alm, James, and Benno Torgler. "Do ethics matter? Tax compliance and morality." Journal of Business Ethics 101 (2011): 635-651.
[43] Alm, James, and Benno Torgler. "Do ethics matter? Tax compliance and morality." Journal of Business Ethics 101 (2011): 635-651.

undesirable. In a fully compliant tax system, taxpayers declare their income accurately $I_c = I - tR$, thereby paying taxes on their entire taxable income (R) at the prescribed rate (t), without underreporting.

The deterrence model offers a modern approach to punishment within legal systems, focusing on its dual purpose of prevention and retribution. Deterrence aims to protect society by discouraging potential offenders through the threat of penalties, while retribution, an older justification for punishment, argues that offenders deserve punishment for their actions, prioritizing justice over rehabilitation. This retributive concept was notably applied in *R v Swanepoel*[44], where punishment was seen as a necessary response to past wrongdoing that required expiation. In contrast, reformative, preventative, and deterrent theories focus on the future, emphasizing the societal benefits of penal measures designed to correct or prevent future offenses.

II *Economic theory of Non-Threatening Regulatory (moral persuasion model)*

Wenzel[45] challenges the traditional deterrence model from the economics-of-crime framework by viewing taxpayers as moral agents who recognize the ethical importance of contributing fairly to public revenue. He argues that personal integrity and social norms play a significant role in tax compliance[46].

In contrast, Moore's[47] fraud triangle (as depicted in Figure 2) highlights three key elements of fraud: opportunity, rationalization, and pressure. Opportunity refers to the circumstances enabling undetected fraud, rationalization involves moral justification, and pressure arises from financial or societal expectations. This model explains how psychological, social, and situational factors contribute to fraudulent behaviour.

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[44] R v Swanepoel 1945 AD 444

[45] Wenzel, Michael. "Misperceptions of social norms about tax compliance." Australian Journal of Psychology. Vol. 53. 1 Grattan Street, Carlton, Victoria 3053, Australia: Australian Psychological Soc, 2001. "In the survey on the cash economy (Artcraft Research, 1998) commissioned by the Australian Tax Office (Tax Office), people almost unanimously agreed that 'tax cheats unfairly shift the burden onto honest taxpayers' (97% agreed); and they disagreed with the statement that 'if you are not happy with how the government spends your taxes, it's OK to hold some of it back by not declaring everything you earn' (95% disagreed)."

[46] Wenzel, Michael. "The social side of sanctions: Personal and social norms as moderators of deterrence." Law and human behaviour 28 (2004): 547-567. Wenzel suggests that the tax compliance comes from highly honest individuals in a high integrity community that gives people an identity they value. Yet in addition the state must keep faith with high integrity citizens by deterring those with low integrity who do not pay their share. Unlike the deterrence model, which focuses on punitive measures, Wenzel suggests that strong community norms and personal morality lead individuals to voluntarily comply with tax regulations, even without strict enforcement.

[47] Moore, Jennica "Occupational fraud models: a comparative analysis and proposed expanded model." International Journal of Accounting Research 8 (2020): 203.

Figure 2: The Fraud Triangle[48]

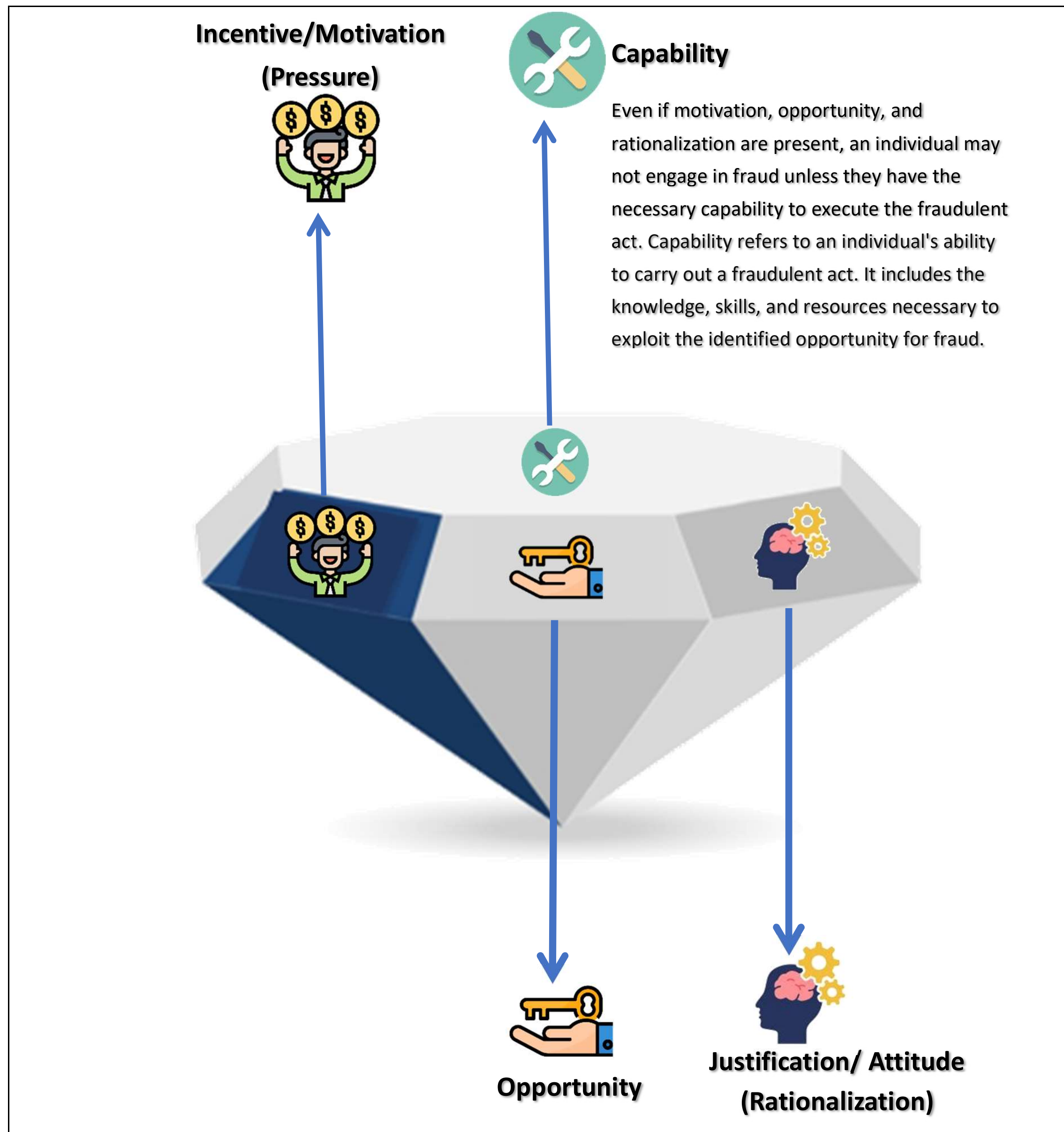
Moore[49] critiques the fraud triangle model for its limited explanation of why individuals commit fraud, leading to the development of the fraud diamond model. This expanded framework (as depicted in Figure 3) retains the elements of "Opportunity" and "Rationalization" but redefines "Pressure" as "Incentive," focusing on the motivation behind fraud. It also introduces "Capability," assessing the perpetrator's ability to execute the fraud. By adding this new dimension, the fraud diamond offers a more comprehensive

[48] Poyana and Ndlovu 2024.

[49] Moore, Jennica "Occupational fraud models: a comparative analysis and proposed expanded model." International Journal of Accounting Research 8 (2020): 203.

understanding of fraud, incorporating both situational factors and personal abilities into the analysis.

Figure 3: The Fraud Diamond[50]



B *Tax fraud versus tax non-compliance: Is there a difference?*

The distinction between tax fraud and tax non-compliance is crucial, as it has significant legal and fiscal implications. Non-compliance refers to failing to meet tax obligations as defined by

[50] Diagram of Fraud Diamond created by Luvuyo Sidwell Poyana and Jane Ndlovu (2023).

laws and public notices, while tax fraud involves intentional deception to evade taxes[51]. Fraud undermines tax collection, destabilizes fiscal systems, and often leads to higher taxes for compliant taxpayers[52]. Additionally, it distorts resource allocation by allowing some individuals to avoid their tax responsibilities.

Although tax non-compliance and fraud are often conflated, they are distinct[53]. Firozabadi et al.[54] offer a comprehensive definition of fraud, highlighting intentional false representations that result in financial loss, which clarifies the distinction between fraud and non-compliance.

Despite legislative provisions, ambiguity remains regarding why certain acts do not consistently qualify as fraud[55]. This inconsistency complicates the legal treatment of fraudulent activities, underlining the need for clearer distinctions between deliberate fraud and unintentional breaches. Rather than providing a precise legal definition of fraud, this article focuses on evaluating regulatory strategies to address non-compliance. For this discussion, tax fraud is understood as deliberate acts such as providing false information, reckless mismanagement of tax affairs, or intentional disregard of tax laws. Such behaviours often aim to exploit tax incentives.

The article posits that strengthening tax morale, where taxpayers develop a stronger sense of duty toward compliance, raises the moral cost of engaging in fraud. As a result, this enhanced moral obligation reduces the temptation to commit tax fraud. The persistence of tax fraud, however, highlights the need for governments to allocate resources effectively to combat non-compliance. These resources are critical for implementing strong measures to deter fraud and promote a culture of compliance with tax laws.

III CORRECTIVE ACTIONS IMPLEMENTED BY SOUTH AFRICAN TAX AUTHORITIES TO FOSTER TAXPAYER COMPLIANCE

This section examines South Africa's strategies to promote tax compliance and payment[56]. Furthermore, this section evaluates the impartiality, equitability, and efficacy of the current South African tax administration penalty system in comparison to the previous regime enshrined in Sections 75 and 76 of the Income Tax Act. This analysis will incorporate a review

[51] Section 210 (2) of the Tax Administration Act 28 of 2011
[52] Torgler, Benno. "What do we know about tax fraud: an overview of recent developments." Social Research: An International Quarterly 75.4 (2008): 1239-1270.
[53] Notably, South African legislative frameworks, including the Income Tax Act No. 58 of 1962 and the Tax Administration Act No. 28 of 2011, lack specific definitions for "tax fraud" or "fraud." While the Income Tax Act defines "tax" broadly as any levy excluding penalties and interest, the absence of a clear legal definition for "tax fraud" poses conceptual and interpretative challenges. Without clear statutory definitions, legal interpretation typically relies on dictionary meanings and case law.
[54] See Firozabadi, Babak Sadighi, Yao-Hua Tan, and Ronald M. Lee. "Formal definitions of fraud." Norms, logics and information systems-new studies in Deontic logic and computer science (1998): 275-288.
[55] For instance, section 234 of the South African Tax Administration Act lists offenses involving false documents, untruthful replies, or false oaths, also punishable by fines or imprisonment up to two years. Distinctions arise when the Commissioner of SARS determines that an offense was unintentional, such as in cases where a taxpayer's inability to file a return stemmed from being abroad without internet access. This disparity prompts critical inquiries into the definitional boundaries of fraud within South African legal contexts.
[56] It specifically scrutinizes the corrective measures implemented by the SARS as outlined in Chapters 15 and 16 of the Tax Administration Act.

of Chapters 15 and 16 of the Tax Administration Act and relevant case law to provide a comprehensive understanding of the contemporary enforcement mechanisms[57]
During the 2021/2022 fiscal year, SARS collected ZAR 215.45 billion from non-compliant taxpayers[58], amounting to 13.78% of total tax revenue—an increase from ZAR 171.97 billion (10%) in 2020/2021[59]. These infractions resulted in over ZAR 14.2 million in administrative penalties, highlighting the agency's efforts to address both intentional and unintentional non-compliance[60].

This system of penalties, however, is not a recent development. South Africa's approach to taxation has evolved significantly over the centuries. Taxation can be traced back to the 1670s, with one of the earliest recorded tax agreements being a tribute of thirty cattle, as outlined in a peace treaty between colonial Governor Joan Bax and Khoikhoi leader Gonnema[61]. Over time, this basic system expanded to include a variety of taxes such as Income Tax, introduced in the early 1900s, followed by Estate Duty, Capital Gains Tax, and others that now form part of modern tax legislation.

In the past, Section 75 of the Income Tax Act outlined a range of penalties for offenses, though these were often vague and inconsistently enforced by SARS. The penalties included fines of ZAR 100 (subsequently revised to ZAR 500) and a three-month (subsequently extended to twenty-four months) imprisonment term for failing to submit returns, provide required documents, or obstructing SARS officials, but the lack of clear enforcement mechanisms often left penalties ineffective[62].

Section 75 of the South African Income Tax Act also applied to cases where individuals obstructed SARS officials[63], failed to maintain records for five years[64], or submitted false documents. SARS had the authority to impose fines, initially set at ZAR 10 and later increased to ZAR 50 for each day the offense continued, or imprisonment for up to 24 months[65]. However, the previous penalty regime allowed SARS broad discretion in imposing penalties, often leading to inconsistencies and perceived injustices[66].

[57] Taxpayer W v Commissioner for the South African Revenue Service, (No 24622), (2019)., Taxpayer S v Commissioner for the South African Revenue Service, (No 45997), (2022).
[58] Taxpayers are mandated, as per Sections 25 to 28 of the South African Tax Administration Act, to submit their tax returns along with supporting documentation within stipulated timelines . Failure to adhere to these requirements categorizes the taxpayer as non-compliant under Section 210(2) of the South African Tax Administration Act, thereby exposing them to penalties delineated in Sections 211(1) and 212 of the same legislation. Additionally, taxpayers must maintain accurate records that satisfy SARS for prescribed durations. A failure to meet these record-keeping obligations also results in non-compliance under Section 210(2) of the TAA, with associated penalties outlined in Section 211(1) of the South African Tax Administration Act. Furthermore, taxpayers are obligated to settle their tax liabilities promptly for all relevant tax categories corresponding to their taxable activities. Non-compliance with this obligation, as governed by Section 210(2) of the South African Tax Administration Act, subjects the taxpayer to penalties detailed in Sections 211(1), 222, and 223 of the South African Tax Administration Act.
[59] See SARS Annual Report 2021/2022 tax year, pages 11 and 28
[60] See SARS Annual Report 2021/2022 tax year, pages 11 and 28.
[61] The Shaping of South African Society, 1652 – 18402, by Richard Elphick and Hermann Giliomee, published by Wesleyan University Press, 15 Jan 2014, pages 646.
[62] Sections 75(1)(a)-(f) of the South African Income Tax 58 of 1962, these sections are now repealed.
[63] Section 75 (1) (e) of the Income Tax Act 58 of 1962
[64] Section 75 (1) (f) of the Income Tax Act 58 of 1962
[65] Section 75 (3) (1) of the Income Tax Act 58 of 1962
[66] Section 75 (3) (1) of the Income Tax Act 58 of 1962

This discretion[67] created challenges for taxpayers, who could face both fines and additional tax penalties for failing to submit their tax returns. Under Section 76(1) of the South African Income Tax Act, these additional taxes were not income taxes but penalties, resulting in taxpayers being penalized twice for the same infraction. This led to dissatisfaction, notably in the case of *Appellant v CSARS*[68], where the taxpayer argued that being fined and penalized for the same violation violated Section 35(3)(m) of the South African Constitution[69], which guarantees the right not to be tried or punished twice for the same offense.

Remarkably, the court ruled that a taxpayer subjected to additional tax was not considered an "accused person" under Section 35(3) of the Constitution, meaning the taxpayer was not facing criminal trial or imprisonment. As a result, the imposition of additional tax did not contravene constitutional protections against double jeopardy, since no criminal record or imprisonment was at stake[70].

The case of *S v Odendaal*[71] clarified that administrative penalties should not be equated with criminal penalties[72], as their primary purpose is to enhance the effectiveness of the tax system, not to punish[73]. However, concerns arose over the inconsistent application of non-compliance penalties and arbitrary practices observed in SARS branch offices.

For example, under Section 76 of the South African Income Tax Act, SARS could impose understatement penalties of up to twice the amount of tax owed when taxpayers failed to submit returns or omitted taxable income[74]. The Act also allowed SARS to impose a penalty equal to the difference between the erroneous tax paid and the correct tax amount[75]. While the Act provided guidelines for remission of penalties, SARS frequently imposed additional taxes—sometimes as high as 200%—deviating from these guidelines[76].

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[67] In the case of Tafeni v S (A 282/15) [2015] ZAWCHC 150; 2016 (2) SACR 720 (WCC) (16 October 2015) , the presiding High Court Judge expounded on the notion of discretion, distinguishing between narrow discretion, sometimes denoted as "true discretion," and wide discretion, occasionally termed "discretion in the loose sense". Narrow discretion emerges when the decision maker confronts a broad spectrum of equally permissible choices, from which a decision is made, and such a decision cannot be deemed erroneous upon appeal, as an alternative decision might have been reached had the appeal functioned as the initial decision maker and selected a different choice. In contrast, wide discretion denotes a scenario wherein the decision maker lacks an array of equally permissible choices Definition of the narrow discretion "The essence of a discretion in [the true] sense is that, if the repository of the power follows any one of the available courses, he would be acting within his powers, and his exercise of power could not be set aside merely because a Court would have preferred him to have followed a different course among those available to him." Media workers Association of South Africa and Others v Press Corporation of South Africa Ltd [1992] ZASCA 149; 1992 (4) SA 791. Definition of the narrow discretion "The essence of a discretion in [the true] sense is that, if the repository of the power follows any one of the available courses, he would be acting within his powers, and his exercise of power could not be set aside merely because a Court would have preferred him to have followed a different course among those available to him." Media workers Association of South Africa and Others v Press Corporation of South Africa Ltd [1992] ZASCA 149; 1992 (4) SA 791.

[68] *ITC 11641 ZATC (2006)*

[69] Section 35(3)(m) of the Constitution of South Africa stipulates that every accused individual possesses the right to a fair trial, encompassing the right not to be tried for an offense pertaining to an act or omission for which the accused individual has previously been convicted.

[70] Furthermore, there exists no possibility of the taxpayer receiving a sentence of imprisonment or enduring any deprivation of liberty.

[71] *S v Odendaal (1995 (2) SACR 449 (T)) (1995 (2) SACR 449 (T))*

[72] *ITC 1825 (70 SATC 68):* A fundamental distinction between administrative and criminal penalties lies in their respective contexts of imposition: criminal penalties arise from criminal charges pursuant to section 35(3)(m) of the Constitution of South Africa, while administrative penalties stem from non-compliance with administrative tax regulations .

[73] Section 209 of the Tax Administration Act 28 of 2011

[74] Section 76 (1) (a) of the Income Tax Act 58 of 1962

[75] Section 76 (1) (c) of the Income Tax Act 58 of 1962

[76] *CIR v Da Costa*, 1985 (3) SA 768 (A), 47 SATC 87, 1985 *Taxpayer* 209

Before granting remission, SARS had to confirm the absence of extenuating circumstances and ensure no intent of tax evasion existed[77]. However, the provisions of Section 76 were marked by ambiguity, inconsistency, and a lack of transparency, as SARS held discretionary power in penalty imposition. This discretion led to cases like *Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS*[78], where SARS imposed penalties without providing adequate or any reasoning, highlighting flaws in the enforcement process.

To address deficiencies in the previous penalty framework, a new regime was introduced through Chapters 15 and 16 of the South African Tax Administration Act, effective from 1 October 2012[79]. The updated system aims to enhance compliance by ensuring broad adherence to tax legislation and administering penalties in a fair, consistent, and proportionate manner, based on the severity and duration of non-compliance[80].

The new penalty regime corrects shortcomings in the previous system, which failed to meet key tax principles like fairness and clarity, as emphasized by Adam Smith[81]. It introduces structured penalties, including fixed amount penalties, reportable arrangement penalties, percentage-based penalties, and clear procedural guidelines for SARS and taxpayers[82]. This system also distinguishes between intentional non-compliance[83], which constitutes tax evasion and is a criminal offense, and unintentional non-compliance[84], often caused by ambiguous tax laws.

Despite improvements, concerns remain regarding SARS' discretionary power in granting relief and the potential for double penalties—fixed penalties for late returns and percentage-based penalties for unpaid tax liabilities. These challenges are further explored in the article, examining their impact on the goals of the Tax Administration Act.

The primary aim of these measures is to ensure penalties are imposed efficiently, effectively, and impartially, in proportion to the severity and duration of non-compliance. Under Chapter 15 of the South African Tax Administration Act, fixed amount penalties can be levied when taxpayers fail to meet obligations outlined in SARS' public notices. Penalties vary based on taxable income, starting at ZAR 250 for income up to ZAR 250 000 and reaching ZAR 16 000 for income exceeding ZAR 50 million[85]. Penalties accumulate monthly for up to 35 months, or 47 months if SARS lacks current taxpayer contact details[86].

For specific entities, such as stock exchange-listed companies, businesses with gross income over ZAR 500 million, or entities exempt from income tax but liable under other laws with income above ZAR 30 million, an initial penalty of ZAR 8 000 is imposed, with monthly escalations[87]. As depicted in Table 1, if a taxpayer's income is unknown, SARS can impose a

[77] Section 76 (2 (a) of the Income Tax Act 58 of 1962
[78] *Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS 2005 ZAGPHC 121*. In this case, the taxpayer petitioned the Commissioner of SARS for reasons to support the assessment issued by SARS, and the court ruled in favour of the taxpayer, compelling SARS to provide a structured response that outlined the pertinent statutory provisions, the factual findings underpinning the conclusions, and the reasoning process leading to those conclusions.
[79] Section 209 of the Tax Administration Act 28 of 2011
[80] Section 76 (2 (a) of the Income Tax Act 58 of
[81] Adam Smith. "The Nature and Causes of the Wealth of Nations", (1776) pages 451 and 452, Part II.
[82] These sections emphasized the need for a penalty system that is fair, just, clear, consistent, transparent, and equitable
[83] Section 210 (2) of the Tax Administration Act 28 of 2011
[84] Section 213 of the Tax Administration Act 28 of 2011
[85] Sections 210 (1) and 211 (1) of the Tax Administration Act, 28 of 2011
[86] Section 211 (2) of the Tax Administration Act, 28 of 2011
[87] Section 211 (3)(a) - (d) of the Tax Administration Act, 28 of 2011

default ZAR 250 penalty or estimate taxable income to apply the appropriate penalty. Adjustments are made if actual taxable income differs from estimates[88].
These provisions are key to promoting compliance and fairness in tax enforcement, ensuring that penalties are aligned with income and taxpayer categories, thereby supporting a more equitable tax system in South Africa[89].

Table 1: Fixed amount penalty table[90]

Item	Assessed loss or taxable income for 'preceding' year	Penalty (ZAR)
(i)	Assessed loss	250
(ii)	R0-R250 000	250
(iii)	R250 001-R500 000	500
(iv)	R500 001-R1 000 000	1 000
(v)	R1 000 001-R5 000 000	2 000
(vi)	R5 000 001-R10 000 000	4 000
(vii)	R10 000 001-R50 000 000	8 000
(viii)	Above R50 000 000	16 000

Taxpayers who fail to disclose information about a "reportable arrangement" under Section 37 of the South African Tax Administration Act face significant penalties: ZAR 50 000 per month for participants and ZAR 100 000 per month for promoters, with a maximum duration of 12 months[91]. If the anticipated tax benefit from such an arrangement exceeds ZAR 5 million, the penalties double, and if it exceeds ZAR 10 million, they triple[92].

Another type of penalty is the "percentage-based penalty," which is applied when SARS determines that tax payments were delayed[93]. This penalty equals the amount of unpaid tax, but the specific percentage is left to the discretion of the Commissioner, raising concerns about fairness due to the lack of clear guidelines.

Part D of Chapter 15 outlines the procedural framework for imposing penalties. Penalties must be formalized through a 'penalty assessment,' and SARS is required to issue a notice that includes details of the non-compliance, the penalty amount, payment deadlines, provisions for automatic escalation, and procedures for requesting penalty remission[94].

Penalties must be paid by the deadline stated in the notice. If a penalty assessment coincides with a tax assessment, payment must be made by the specified tax deadline[95]. SARS must also inform taxpayers of any adjustments to penalties as per the relevant sections of the Tax Administration Act[96].

[88] Section 211 (4)(a) – (b) of the Tax Administration Act, 28 of 2011
[89] Section 211 (5) of the Tax Administration Act, 28 of 2011
[90] Section 211 (1) of the Tax Administration Act, 28 of 2011
[91] Section 212 (1)(a) – (b) of the Tax Administration Act, 28 of 2011
[92] Section 212 (2) of the Tax Administration Act, 28 of 2011
[93] Section 213 (2) of the Tax Administration Act, 28 of 2011
[94] Section 214 (1) of the Tax Administration Act, 28 of 2011
[95] Section 214 (2) of the Tax Administration Act, 28 of 2011
[96] Section 214 (3) of the Tax Administration Act, 28 of 2011

Taxpayers may find it inequitable to receive penalties before having a chance to explain their non-compliance. While the presumption of innocence applies to criminal offenses—such as intentionally failing to register or providing false information—not all violations fall under criminal law, including failures to disclose income or pay taxes. SARS has the burden of proof to establish a taxpayer's non-compliance and the legality of imposed penalties. However, taxpayers have the right to appeal under Section 103 of the Tax Administration Act.

The "Procedure to request remittance of penalty" allows individuals who are dissatisfied with a penalty assessment from SARS to seek remission[97]. To initiate this process, taxpayers must fill out the designated form, detailing the circumstances that led to their non-compliance and providing any necessary supporting documentation[98].

Once SARS receives the remittance request, it must suspend any collection actions related to the penalty for 21 business days after informing the taxpayer of its decision. This suspension is waived if SARS suspects asset dissipation or fraud related to the non-compliance or if specific grounds for remittance are present[99].

Additionally, if the non-compliance relates to Sections 216 or 217 of the Tax Administration Act, SARS may extend the 21-day period for submitting the remittance request if there are reasonable grounds for its late submission or exceptional circumstances that hinder the taxpayer's ability to file the request[100].

The "Procedures to Request Remittance of Penalty" assist taxpayers who have received a penalty assessment notice from SARS and wish to seek a reduction or cancellation of the penalty. To initiate this process, taxpayers must complete a prescribed form detailing the circumstances that led to their non-compliance and provide any required supporting documentation. For 21 days after SARS decides on the remittance request, no collection actions related to the penalty can be taken, unless there is a risk of asset dissipation or suspected fraud. SARS can also extend this 21-day period if the non-compliance relates to Sections 216 or 217 of the Tax Administration Act and if there are valid reasons for a late remittance request or exceptional circumstances that hinder timely submission[101].

Furthermore, the "Remittance of penalty for failure to register" allows SARS to waive penalties, either fully or partially, if a taxpayer voluntarily submits all outstanding tax returns. Similarly, under the "Remittance of Penalty for Nominal or First Incidence of Non-Compliance," SARS has the discretion to remit penalties for initial infractions outlined in Sections 210, 212, or 213[102]. If non-compliance lasts less than five business days and valid reasons are given, penalties may be reduced by up to ZAR 2 000[103]; for penalties under Section 212, the limit is ZAR 100 000[104]. For Section 213 violations, penalties may be fully or partially remitted if they are the first instance of non-compliance or involve amounts under ZAR 2 000, provided the issue has been rectified[105].

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[97] Section 215 (1) of the Tax Administration Act, 28 of 2011
[98] Section 215 (2)(a) – (b) of the Tax Administration Act, 28 of 2011
[99] Section 215 (3) of the Tax Administration Act, 28 of 2011
[100] The "Procedures to request remittance of penalty" aim to assist taxpayers who have received a penalty assessment notice and wish to request that SARS remit the penalty.
[101] Section 215 (4)- of the Tax Administration Act, 28 of 2011
[102] Section 216 (a) – (b) of the Tax Administration Act, 28 of 2011
[103] Section 217 (1) of the Tax Administration Act, 28 of 2011
[104] Section 217 (2) of the Tax Administration Act, 28 of 2011
[105] Section 217 (3) of the Tax Administration Act, 28 of 2011

SARS evaluates exceptional circumstances when reviewing remittance requests, which can include natural disasters, civil unrest, severe illness, financial hardship, or delays caused by SARS itself[106]. If deemed appropriate, SARS may remit all or part of the penalty based on these considerations.[107] SARS can issue an adjusted assessment within three years of a penalty assessment[108] if it determines that the penalty was improperly applied under Chapter 15 of the Tax Administration Act.[109]

Chapter 16 of the Tax Administration Act establishes the "understatement penalty," applicable when taxpayers intentionally or unintentionally understate their tax liabilities, contingent upon certain conditions and SARS' approval. This penalty requires taxpayers to pay an additional amount alongside the tax owed for that period, with the penalty determined by the highest applicable percentage outlined in Table 2[110].

To calculate the shortfall, the following components are considered:

1. The difference between the correct taxable amount for the period and the understated amount.
2. The difference between the correct refundable amount for the period and the understated amount.
3. The difference between the correct assessed loss or carried-forward benefits from previous periods and the understated amount, multiplied by the tax rate specified in Section 222(5).[111]

If the understatement involves both taxable and refundable amounts, overlapping figures must be adjusted in the shortfall calculation[112]. The taxpayer is liable for the maximum applicable tax rate, ignoring any assessed losses or benefits from prior periods[113].

[106] Section 218 (1) of the Tax Administration Act, 28 of 2011
[107] Section 218 (2) of the Tax Administration Act, 28 of 2011
[108] Section 219 of the Tax Administration Act, 28 of 2011
[109] Section 220 of the Tax Administration Act, 28 of 2011
[110] Section 222 (1) and (2) of the Tax Administration Act, 28 of 2011
[111] Section 222 (3) of the Tax Administration Act, 28 of 2011
[112] Section 222 (4) of the Tax Administration Act, 28 of 2011
[113] Section 222 (5) of the Tax Administration Act, 28 of 2011

Table 2: Understatement penalty percentage table[114]:

Item	Behaviour	Standard case	If obstructive, or if it is a 'repeat case'	Voluntary disclosure after notification of audit	Voluntary disclosure before notification of audit
(i)	'Substantial understatement'	25%	50%	5%	0%
(ii)	Reasonable care not taken in completing return	50%	75%	25%	0%
(iii)	No reasonable grounds for 'tax position' taken	75%	100%	35%	0%
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

An understatement penalty may be applied when an assessment is based on estimations under Section 95 of the Tax Administration Act or through an agreed assessment per Section 95(3)[115]. SARS has the discretion to remit this penalty for significant understatements if the taxpayer fully discloses the arrangement causing the prejudice to SARS or government revenue by the return's due date[116]. Additionally, the taxpayer must provide an opinion from a registered tax practitioner, assessing the specific facts and circumstances and confirming that the taxpayer's position is likely to prevail if contested in court[117].

If a taxpayer disputes SARS' decision not to remit the penalty, they can pursue objections or appeals as outlined in Chapter 9 of the Tax Administration Act. Table 2 outlines penalties based on taxpayer conduct but does not address cases where insufficient information hinders determining taxpayer behaviour. As a result, SARS can impose penalties even when there is uncertainty about taxpayer conduct, leading to the potential for double penalties. For instance, a failure to maintain necessary documents may incur a penalty under Section 210, in addition to an understatement penalty if the taxpayer's estimate falls short of SARS' determination. This highlights the critical need for taxpayers to keep accurate records and provide all required information to reduce the risk of penalties. Taxpayers can formally contest SARS' penalty decisions under Chapter 9 of the Tax Administration Act if disputes arise.

In conclusion, South Africa's previous penalty regime, established under Section 75 of the Income Tax Act of 1962, imposed fines or imprisonment for up to 24 months on taxpayers who failed to submit returns or obstructed tax officials. However, this approach was inconsistent, lacked transparency, and failed to effectively encourage voluntary compliance. Taxpayers often weighed the risks of non-compliance against the likelihood of being caught, diminishing the deterrent impact of penalties.

[114] Section 223 (1) of the Tax Administration Act, 28 of 2011
[115] Section 223 (2) of the Tax Administration Act, 28 of 2011
[116] Section 223 (3) of the Tax Administration Act, 28 of 2011
[117] Section 224 of the Tax Administration Act, 28 of 2011

To address these shortcomings, the South African Tax Administration Act 28 of 2011 introduced a new penalty framework. Penalties are now calibrated according to the severity of non-compliance, with stricter consequences for deliberate underreporting or providing inaccurate information. For instance, taxpayers who omit income or submit inaccurate returns can face penalties of up to 200% of the tax shortfall. These measures aim to deter tax evasion and promote adherence to tax obligations.

Despite these improvements, some criticisms persist. Section 213 grants SARS discretion in imposing percentage-based penalties, and the possibility of facing dual penalties for the same offense under different provisions may lead to perceptions of inequity among taxpayers and the public. The next section will compare these reforms with measures implemented in Australia and the United States to foster tax compliance.

IV CORRECTIVE ACTIONS IMPLEMENTED BY AUSTRALIAN TAX AUTHORITIES TO FOSTER TAXPAYER COMPLIANCE

This section provides an in-depth examination of the strategies employed by tax authorities in Australia to promote taxpayer compliance and ensure the fulfillment of tax obligations. Specifically, it focuses on the Australian *Tax Administration Act*, Sections 8B to 8W.
The date 1 January 1901 holds significant importance in Australian history, marking the Federation of the Commonwealth of Australia. On this day, the Commonwealth Constitution[118] came into effect, with section 51 conferring upon the Federal Government the power to impose taxes[119]. Before 1901, the revenue of Australia's colonies was predominantly derived from indirect taxes, such as customs and excise duties[120]. These forms of taxation were favoured for their administrative simplicity and the relatively low level of public scrutiny they attracted. However, reliance on regressive taxation prompted concerns about equity and economic sustainability within the colonies. Revenue was also collected through fees for wharfage, port entry and exit, and levies on alcohol. Customs duties, particularly on major exports, provided a reliable source of income for colonial governments.

By the turn of the century, Australia had evolved into a modern economy with growing urban and rural populations, necessitating increased government intervention. The social and demographic transformations of the time prompted changes in taxation policy, shifting from the predominantly indirect taxes to more direct, progressive forms of taxation, such as land

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[118] The Australian Constitution is modelled partly on the United States Constitution and partly on the constitutional and parliamentary traditions of the United Kingdom. It establishes the federal (Commonwealth) government while recognizing the sovereignty of the State governments, which were self-governing colonies of the British Empire prior to federation—namely, New South Wales, Queensland, Victoria, South Australia, Tasmania, and Western Australia. The Australian Capital Territory and the Northern Territory, however, remain subject to federal legislative control, with delegated powers over taxation and administration.

[119] Australia operates as a dual federation, as local government is not formally recognized in the Constitution. However, in practice, governance occurs at three levels: federal, state, and local. The Constitution itself is entrenched, meaning it can only be amended through a referendum that achieves a majority of votes in a majority of States. This stringent requirement is seldom met, making constitutional amendments, including those aimed at reforming Australia's fiscal federal system, exceptionally difficult to achieve.

[120] Sam Reinhardt and Lee Steel1 A brief history of Australia's tax system https://treasury.gov.au/publication/economic-roundup-winter-2006/a-brief-history-of-australias-tax-system#P8_113

and income taxes. The pace and nature of this transition varied among the colonies, reflecting their respective stages of economic development. In general, the evolution of Australia's tax system mirrored broader economic and social changes, adapting to meet the shifting needs of both society and government intervention. A detailed examination of the historical evolution of Australia's taxation system, however, lies beyond the scope of this paper.
In 2021, Australia marked 40 years[121] since the introduction of its GAAR under Part IVA of the *Income Tax Assessment Act 1936*[122]. Australia was among the first countries to adopt a GAAR that segmented the analysis into distinct elements: a scheme, a tax benefit[123], and an objective sole or dominant purpose test. When a tax benefit is determined to be linked to a scheme subject to the GAAR, and the purpose threshold is satisfied, the Commissioner of Taxation has the authority to issue a determination cancelling all or part of the tax benefit. The Commissioner is also empowered to take any necessary actions to give effect to that determination. To implement this determination, the Commissioner must issue an amended assessment. Additionally, the Commissioner may make compensatory adjustments affecting other taxpayers.

Despite the presence of a GAAR in Australia's income tax law for over a century, and in its current form under Part IVA, the precise definition of 'tax avoidance' remains elusive. A persistent challenge is the uncertainty and risk inherent in the interactions between taxpayers and the ATO. One perspective holds that "tax avoidance" is, at its core, an indeterminate term, with its meaning derived solely from the operation of the statutory GAAR[124].

Conversely, another view, advanced by John Prebble[125], suggests that 'tax avoidance" can be identified independently of the GAAR. This interpretation focuses on the purpose or intent behind the statutory regime, identifying "use, misuse, or abuse" of the law to minimize tax liabilities as the defining characteristic of tax avoidance. Prebble has also acknowledged the difficulty in defining tax avoidance comprehensively or in terms of specific legal rules, highlighting the complexity of this ongoing debate.

In Australia, penalties are imposed when a taxpayer's actions cross the line from avoidance to evasion under the Tax Administration Act. This Act serves as a model for South Africa and other jurisdictions aiming to enhance their tax administration frameworks. It allows for the imposition of non-compliance penalties based on a statutory formula or a penalty unit table as depicted in Table 3. Penalties start at one penalty unit, valued at AUD 222, with a maximum of 75 penalty units, equating to AUD 16,650. In certain circumstances, penalties may exceed this maximum.

[121] Since its inception in 1981, the GAAR has been the subject of extensive judicial scrutiny.
[122] The introduction of Part IVA, which replaced section 260 of the Income Tax Assessment Act 1936, aimed to target the most egregious instances of tax avoidance. The replacement was implemented by the Liberal-National (conservative) government, reflecting a broader policy shift toward stricter anti-avoidance measures.
[123] Amendments introduced in 2013 sought to reinforce the GAAR and counteract judicial interpretations of the term "tax benefit"; however, these amendments have not yet been tested in the courts. Additionally, as part of Australia's unilateral efforts aligned with the G20-OECD Base Erosion and Profit Shifting (BEPS) initiative, the GAAR was further amended to address tax avoidance by large multinational enterprises (MNEs). This was achieved through the introduction of the Multinational Anti-Avoidance Law (MAAL) and the Diverted Profits Tax (DPT), both of which were incorporated into Part IVA.
[124] This viewpoint was articulated by David Bloom QC, who asserted that "tax avoidance is that which is struck down by the GAAR and the Targeted Anti-Avoidance Rules (TAARs); axiomatically, it is always unsuccessful and always ineffective."
[125] Rebecca Prebble and John Prebble "*Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study*" (2010) 55 SLU 21 at 24. "The concept of tax avoidance is well-known ... we mean, broadly, the form of tax minimisation that involves the creation or deployment of commercial arrangements that specifically seek to use (or misuse, or abuse) the law to minimise tax that would otherwise be payable."

The penalty amount is calculated by multiplying the penalty unit's value by the number of units, rounded down to the nearest dollar. This system reflects Australia's commitment to maintaining a structured penalty framework that balances deterrence with fairness, promoting effective tax administration and encouraging taxpayer compliance.

The penalty unit serves as a standard measure for assessing penalties across various legislative frameworks, including national and local government statutes and penalty infringement notices. Additionally, the Penalties and Sentences Act 1992 (PS) mandates annual indexation of the monetary value assigned to each penalty unit, which takes effect on 1 July each year.

Table 3: The penalty unit value in terms of the Australian tax authorities is based on when the offence occurred

When transgression occurred	Penalty unit amount (AUD)
1 July 2020 to 31 December 2022	222
1 July 2017 to 30 June 2020	210
31 July 2015 to 30 June 2017	180
28 December 2012 to 30 July 2015	170
Up to 27 December 2012	110

In Australia, penalties are determined through judicial proceedings, where courts assess all relevant evidence to establish an appropriate penalty for the offense committed[126]. The Australian Taxation Office (ATO) is responsible for administering and enforcing tax laws, acting as the primary custodian of the Australian Tax Administration Act.

The ATO's main goal in imposing penalties is to encourage compliance with tax obligations among individuals and entities. Section 8C of the Australian Tax Administration Act specifies circumstances that may constitute an offense, including when a taxpayer:

- Refuses or fails to provide necessary information or documents to the Commissioner or authorized entities.
- Neglects to submit information or instruments for assessment in the prescribed manner.
- Fails to notify the Commissioner of relevant issues.
- Omits to produce required books, papers, records, or other documents.
- Neglects to attend before the Commissioner or comply with educational directives related to superannuation[127].
- Fails to file applications for registration or cancellation under the 'A New Tax System Act 1999'.
- Fails to comply with provisions of other relevant legislation[128].

[126] Section 8E of the Tax Administration Act 1953
[127] Subsection 384-17(1) of Schedule 1
[128] Subsection 45A(2) of the 'Product Grants and Benefits Administration Act 2000', or Subsection 82-10F(4) of the 'Income Tax (Transitional Provisions) Act 1997'

These provisions establish a structured framework for enforcing tax compliance, ensuring taxpayers understand their obligations and face penalties for non-compliance.
Section 8C of the Australian Tax Administration Act imposes strict obligations on taxpayers, with legal consequences governed by the Criminal Code[129]. Specifically, Section 6.2 of the Criminal Code introduces an absolute liability framework, where the prosecution does not need to prove intent, knowledge, recklessness, or negligence. However, this strict rule can be waived if the taxpayer demonstrates they were incapable of complying with the relevant taxation law[130].

This absolute liability system places a heavy burden on taxpayers, requiring them to prove their ability to comply, which may be viewed as overly harsh or confusing. Section 8D of the Act similarly applies strict liability for failing to respond to Commissioner inquiries, as outlined in Section 6.1 of the Criminal Code. Unlike absolute liability, strict liability allows for a "reasonable mistake" defence under Section 9.2 if the taxpayer can prove their incapacity to comply with tax law[131].

Overall, these provisions establish a compliance framework that uses both absolute and strict liability to ensure adherence to tax laws, while providing limited defences for genuine incapacity. Section 8E of the Australian Tax Administration Act outlines penalties for non-compliance with taxation law, specifically for offenses under Section 8C or Subsections 8D(1) and 8D(2). According to Subsection 8E(1), individuals convicted of these offenses may face fines of up to 20 penalty units.

If the court determines that the individual has prior convictions for similar offenses, as stated in Subsection 8E(2), the penalty can increase to a maximum of 40 penalty units. Furthermore, Subsection 8E(3) specifies that if a natural person is convicted and the Commissioner chooses to treat the offense differently from typical taxation violations—especially in cases involving multiple prior convictions—the penalty may rise to a maximum of 50 penalty units, along with the possibility of up to 12 months of imprisonment or both.

The statutory provisions in the Australian Tax Administration Act create a graduated penalty framework to deter non-compliance with tax laws by escalating penalties based on the severity and frequency of offenses. Section 8F allows the Commissioner to treat certain offenses differently from typical tax violations, offering flexibility in legal proceedings.
In addition to penalties, Section 8G enables courts to impose compliance requirements after a conviction for offenses under Section 8C or Subsections 8D(1) or 8D(2). Non-compliance with these requirements constitutes a separate offense, punishable by fines of up to 50 penalty units.

Furthermore, Section 8HA outlines additional penalties for non-compliance if the court finds that the actions were intended to facilitate tax avoidance. If intentional tax avoidance is proven, penalties can reach 300% of the tax liability avoided, or 200% in other cases. Overall, these provisions emphasize the Australian tax administration's commitment to enforcing

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[129] Section 8C of the Tax Administration Act 1953

[130] Section 6.2 (1) of Criminal Code; "If a law that creates an offence provides that the offence is an offence of absolute liability: (a) there are no fault elements for any of the physical elements of the offence; and (b) the defence of mistake of fact under Section 9.2 is unavailable." Section 6.2 (2) of the Criminal Code; "If a law that creates an offence provides that absolute liability applies to a particular physical element of the offence: (a) there are no fault elements for that physical elements; and (b) the defence of mistake of fact under Section 9.2 is unavailable in relation to that physical element.".

[131] Ibid. supra n. 145

compliance and discouraging tax avoidance through both punitive measures and added compliance obligations.

Committing false or misleading statements[132] or improperly maintaining records[133] constitutes serious non-compliance under Australian tax law, punishable by penalties in penalty units or imprisonment[134]. Recklessly making false statements[135] or negligently mishandling records also falls under non-compliance[136], attracting penalties in penalty units or imprisonment[137]. The Commissioner retains discretion to categorize offenses outlined in preceding sections differently than as prescribed taxation offenses[138].

Serious non-compliance includes intentionally misleading record-keeping or falsifying identities to deceive[139], which carry severe penalties in penalty units or imprisonment[140]. These provisions reflect the stringent measures aimed at maintaining integrity within Australia's tax system, ensuring compliance with legal requirements, and deterring fraudulent activities - see Table 4.

Table 4: The summary of the other penalties imposed to non-compliance in Australia

Tax Obligation	**Penalty for non-compliance**
Records must be kept or retained as required	20 penalty units
Declaration must be retained and/or produced as required	20 penalty units
Authorized tax officer must be granted access and reasonable facilities	20 penalty units
Application for or cancellation of goods and services tax registration when required	20 penalty units
Issuing a required tax invoice or adjustment note	20 penalty units
Both principal and agent cannot issue tax invoice or adjustment note for the same taxable supply or adjustment event	20 penalty units
Required to register as a pay as you go (PAYG) withholder	5 penalty units
Required to Submit an electronic activity statement	5 penalty units
Required to pay an amount electronically	5 penalty units

Table 5 highlights that under the Australian Tax Administration Act, understatement penalties are determined by the taxpayer's behaviour that led to the understatement. Australian authorities impose a base rate penalty, expressed as a percentage of the understatement

[132] Section 8K of the Tax Administration Act 1953
[133] Section 8L of the Tax Administration Act 1953
[134] Section 8M of the Tax Administration Act 1953
[135] Section 8N of the Tax Administration Act 1953
[136] Section 8Q of the Tax Administration Act 1953
[137] Section 8R of the Tax Administration Act 1953
[138] Section 8S of the Tax Administration Act 1953
[139] Section 8U of the Tax Administration Act 1953
[140] Section 8V of the Tax Administration Act 1953

amount, which ranges from 25% to a maximum of 75%, depending on the severity and intent behind the non-compliance.

Table 5: Base rate penalty and behaviour leading to an understatement in Australia

Behaviour	**Base rate percentage**
Refuse or neglect to take reasonable care.[141]	25% of an understatement
Recklessness[142]	50% of an understatement
Intentional disregard[143]	75% of an understatement

Australia's penalty framework under the Tax Administration Act covers various non-compliance scenarios but has been criticized for its lack of fairness and transparency. One concern is the Commissioner's authority to reclassify offenses as prescribed taxation offenses, potentially weakening the regime's clarity. This issue was highlighted in *Commissioner of Taxation v White*[144], where the court upheld a 50% penalty for recklessness, despite the taxpayer's appeal. Additionally, Australia's regime includes administrative penalties, such as those for failure to withhold Pay As You Go (PAYG) taxes, which apply to companies and their directors.

V CORRECTIVE ACTIONS IMPLEMENTED BY THE UNITED STATES TAX AUTHORITIES TO FOSTER TAXPAYER COMPLIANCE

This section provides an in-depth examination of the strategies employed by tax authorities in the United States to promote taxpayer compliance and ensure the fulfillment of tax obligations. Specifically, it focuses on the U.S. Code 6651, Title 26, Subtitle F, Chapters 61 and 68, Subchapter A, Part I, along with pertinent case law. Through a detailed review and analysis of these legislative provisions, this section aims to offer a comprehensive understanding of the diverse corrective actions available to tax authorities and their practical application in encouraging adherence to tax laws.

Early American history was deeply intertwined with taxation, although it lacked a significant revenue source like the modern income tax[145]. In the 17th century, original colonists and traders often enjoyed exemption from tax collection by their parent countries for extended periods, sometimes up to two decades. While the American colonies did impose property taxes, excise taxes, poll taxes, and early forms of income taxes, these levies were much lighter compared to those in Great Britain. Meanwhile, the British government, burdened by debt from various global conflicts, sought additional revenue from the American colonies, sparking the tax struggles that eventually led to the American Revolution.

The British government's imposition of several key taxation measures further strained relations with the American colonies. These included the Sugar Act of 1764, which taxed

[141] Section 8K of the Tax Administration Act 1953
[142] Sections 8N and 8Q of the Tax Administration Act 1953
[143] Sections 8C and 8K of the Tax Administration Act 1953
[144] Commissioner of Taxation v White (No 2), [2010] FCA 730, 2010 ATC 20-195.
[145] Tax Foundation. History of Taxes Available https://taxfoundation.org/taxedu/educational-resources/primer history-of-taxes/

molasses, sugar, and wine, the Stamp Act of 1765, which taxed essential printed materials like legal documents and newspapers, and the Townshend Acts of 1767, which taxed 72 items, including tea—a tax that famously triggered the Boston Tea Party. The concept of "taxation without representation" emerged as a central grievance, shaping the formation of the American legislative system. This sentiment found expression in Article I, Section 2 of the U.S. Constitution, granting elected representatives in Congress the sole authority to levy taxes on all citizens. Despite lower tax rates compared to England, the colonies lacked a formal representative body, influencing the development of state and local tax systems.

In the United States, corrective actions against non-compliance are detailed in Chapter 68 of the Internal Revenue Code, specifically Sections 6651 to 6658, Subchapter A. The Internal Revenue Service (IRS) was established to execute the duties of the Secretary of the Treasury as per Section 7801 of the Internal Revenue Code, with authority to administer and enforce internal revenue laws, delegating enforcement as necessary.

Key non-compliance actions and corresponding penalties outlined in Subchapter A of Chapter 68 of the Internal Revenue Code include:

- Failure to file tax returns[146]
- Failure to file certain information returns[147]
- Failure to pay tax[148]
- Failure of individuals to pay estimated income tax[149]
- Failure of entities to pay estimated income tax[150]
- Failure to make tax deposits[151]
- Submission of bad checks[152]
- Additional tax in cases of jeopardy[153]

These provisions delineate the IRS's approach to enforcing compliance and administering penalties for various forms of tax non-compliance.

Taxpayers may face additional financial burdens beyond their tax liabilities due to non-compliance. For instance, under Subchapter A of Chapter 61 of the Internal Revenue Code, failing to file tax returns on time incurs a penalty of 5% of the required tax amount per month, capping at 25% of the total tax owed[154]. This penalty is calculated on the net amount due, factoring in any prior payments or applicable tax credits[155], and excludes failures related to estimated tax declarations under Sections 6015 or 6016[156]. Additionally, the Secretary of the Treasury can impose a USD 1 penalty for each statement not filed, with a maximum of USD 1 000 per year[157]. For underpayments due to negligence, a 5% penalty applies; however, if the

[146] Section 6651 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[147] Section 6652 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[148] Section 6653 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[149] Section 6654 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[150] Section 6655 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[151] Section 6656 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[152] Section 6657 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[153] Section 6658 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[154] Section 6651 (a) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[155] Section 6651 (b) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[156] Section 6651 (c) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.
[157] Section 6652 (a) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F. As mandated by Section 6041 (information at source), Section 6042 (payments of corporate dividends), Section 6044 (patronage dividends), Section

underpayment results from intentional tax evasion[158], the penalty escalates to 50%, with no additional failure-to-pay penalty incurred[159]. Interest on any underpayment accrues at a rate of 6% per annum for both individuals[160] and corporations[161] that fail to pay estimated income tax.

Under Title 26, individuals required to deposit tax payments into designated government accounts must comply by the specified deadline. Failure to do so, unless justified by reasonable cause and not wilful neglect, results in a penalty of 1% of the underpayment for delays of up to one month, increasing by an additional 1% for each subsequent month, capping at a total of 6%. If a cheque or money order is dishonoured, an additional penalty of 1% of the payment amount is imposed, with a minimum penalty of USD 5 if the cheque is under USD 500, unless the issuer had reasonable grounds to believe it would be honoured[162]. Additionally, a 25% penalty is applied to taxpayers violating Section 6851 of the Internal Revenue Code regarding premature termination of a taxable year. Both Australia and the U.S. have distinct penalty structures targeting specific taxpayer behaviours, such as negligence and intentional disregard, clearly defined in their respective tax administration acts.

In the case of *CIC Services, LLC v IRS*[163], where the IRS issued a notice requiring certain information from taxpayers and advisors, the courts upheld the validity of the IRS notice, aligning with the tax penalty provisions established by the IRS. This decision highlights the persistent challenge taxpayers face in comprehending their tax obligations, necessitating proactive education efforts by tax authorities. Taxpayers often seek to minimize their tax liabilities and may exploit regulatory loopholes to evade compliance.

In summary, both Australia's and the United States' penalty frameworks are nuanced and tailored to specific types of offenses, addressing overlaps where multiple provisions may apply. The subsequent section examines a comparative analysis of South Africa's penalty regime, delineated in Chapters 15 and 16 of the South African Tax Administration Act, against the administrative penalty systems of the United States and Australia.

VI A COMPARISON OF THE ENFORCEMENT OF SOUTH AFRICA'S PENALTY REGIME TO THE ADMINISTRATIVE PENALTY REGIMES OF AUSTRALIA AND UNITED STATES

6045 (returns of brokers), or Section 6051(d) (information returns regarding income tax withheld). This penalty can be waived if reasonable cause is demonstrated, and the failure is not attributable to wilful or negligent conduct on the part of the taxpayer

[158] Section 6653 (a) and (b) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[159] Section 6653 (d) and (b) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[160] Section 6654 (a) to (e) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[161] Section 6654 (a) to (e) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[162] Section 6657 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[163] CIC Services, LLC v Internal Revenue Service, (No 19/930), (2020).

This section critically examines South Africa's penalty regime in comparison to those of Australia and the United States concerning non-compliance and failure to pay taxes[164]. The objective is to assess the alignment of South Africa's penalties with international standards and to identify potential areas for enhancement.

A *Comparison of the enforcement of South Africa's penalty regime to the administrative penalty regime of Australia*

South Africa's penalty regime shares key similarities with Australia's, as both systems employ graduated fixed penalties that escalate based on the severity of the offense. In Australia, penalties are structured around a penalty unit system, where one unit equals AUD 222, with penalties reaching up to 75 units (AUD 16 650). In contrast, South Africa uses a fixed penalty schedule, starting at ZAR 250 for taxable incomes between ZAR 0 and ZAR 250 000. This structured approach enhances transparency, allowing taxpayers to understand how penalties are calculated based on the offense.

A notable difference between the two regimes lies in their structural mechanisms. Australia's penalty unit system undergoes regular adjustments to reflect economic changes, while South Africa's fixed penalties have remained unchanged since 2012. Additionally, Australia's framework includes specific penalties, like those for businesses failing to withhold "pay as you go" taxes, which are absent in South Africa's system.

There are also significant legal similarities, as Sections 8C, 8D, 8K, and 8L of the Australian Tax Administration Act align with sections 22 to 29 in South Africa's Tax Administration Act, providing exemptions when offenses were not deliberate. Both regimes place the burden of proof on the taxpayer to demonstrate non-deliberate non-compliance.

However, key distinctions exist. In Australia, penalties can be imposed for false or misleading statements, regardless of direct tax loss to the government, a provision not found in South Africa. Moreover, South Africa imposes a maximum understatement penalty of 200%, whereas Australia's cap is 75%.

B *Comparison of the enforcement of South Africa's penalty regime to the administrative penalty regime of the United States of America*

The penalty regimes for non-compliance in South Africa and the United States exhibit key similarities and differences. Both countries impose penalties on taxpayers for failing to file tax returns[165], pay taxes[166], submit required documentation[167], and fulfil estimated income tax

[164] Specifically, Chapter 15 and Chapter 16 of the Tax Administration Act 28 of 2011 in South Africa are compared with Sections 8B to 8HA of the Australian Tax Administration Act and Chapters 61 and 68 of Subchapter A of the U.S. Code 6651, focusing on analogous provisions related to offenses and penalties.
[165] Section 6651 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F. Section 25 of the Tax Administration Act 28 of 2011
[166] Section 6653 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F. Section 151 of the Tax Administration Act 28 of 2011
[167] Section 6652 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F. Sections 25 and 28 of the Tax Administration Act 28 of 2011

payment obligations. However, the structure and severity of penalties differ significantly between the two jurisdictions[168].

In South Africa, penalties are determined using a fixed amount penalty table. For instance, the penalty for failing to file returns or pay taxes ranges from ZAR 250 for individuals with taxable incomes or assessed losses between ZAR 0 and ZAR 250 000, to a maximum of ZAR 16 000 for taxable incomes exceeding ZAR 50 million. In contrast, the penalty framework in the United States applies varying percentages based on the nature of non-compliance. For example, failing to file a tax return incurs an initial penalty of 5%, increasing by an additional 5% for each subsequent month of non-compliance, capped at a maximum of 25% of the tax liability.

The methods of calculating penalties also differ. The U.S. system levies penalties as a percentage of the tax owed, incrementally increasing for persistent non-compliance, particularly targeting more substantial offenses with higher rates[169]. South Africa, on the other hand, employs fixed amounts based on assessed losses or taxable income. Furthermore, the U.S. penalty regime encompasses specific penalties not found in South Africa, such as those for failure to make tax deposits or submitting inadequate checks. While South Africa may address these issues under Section 223 of the Tax Administration Act, the structure and application differ.

In terms of understatement penalties, South Africa allows for penalties of up to 200% of the understatement amount, whereas in the United States, penalties can reach 50% when tax evasion is evident. Additionally, the U.S. framework addresses instances where an offense falls under multiple penalty provisions, ensuring that the higher penalty is applied[170]. In contrast, the South African regime lacks explicit provisions to prevent taxpayers from facing penalties for the same offense under different sections of the Tax Administration Act. For instance, a taxpayer could potentially incur penalties for both failure to pay taxes[171] and for understatement[172].

Overall, while both jurisdictions have established frameworks for imposing penalties on non-compliance, the differences in structure, calculation, and enforcement mechanisms reflect distinct approaches to promoting tax compliance. Tables 6 and 7 provide a comparative overview of the penalties imposed in these jurisdictions, but it is crucial to acknowledge potential variations in how these penalties are administered across different countries.

[168] Section 6654 of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F. Section 95 of the Tax Administration Act 28 of 2011

[169] Section 6657 of the Internal Revenue Code, Chapter 68, subchapter A, Title 26, Subtitle F.

[170] Sections 6653 (b) and (d) of the Internal Revenue Code, Chapter 68, Subchapter A, Title 26, Subtitle F.

[171] Section 211 of the Tax Administration Act.

[172] Section 223 of the Tax Administration Act.

Table 6: Non-Compliance comparison

Taxpayer Behaviour	**South Africa** [1]	**Australia**		**United States**	
Currency	**ZAR**	**AUD**	**AUD Converted to ZAR**	**USD**	**USD Converted to ZAR**
Intentional non-compliance	250 – 16 000	222 – 16 650	2 850 – 213 786	1 – 1 000	18 – 18 000
Gross negligence	250 – 16 000	222 – 16 650	2 850 – 213 786	1 – 1 000	18 – 18 000
No reasonable care taken	250 – 16 000	222 – 16 650	2 850 – 213 786	1 – 1 000	18 – 18 000
Relevant legislation	Section 211 of Tax Administration Act	Sections 8C to 8W of Australian Tax Administration Act and ATO (a)		Sections 6651, 6652, 6653, 6654, 6655, 6656, 6657, 6658 of the IRS code	
Note 1: Failure to disclose "reportable arrangement" either ZAR 50 000 or ZAR 100 000 for every month up to 12 months					

Table 6 highlights that all three countries evaluate taxpayer behaviours leading to non-compliance and impose penalties based on the severity of the offenses. This comparison shows that each jurisdiction considers mitigating factors that may indicate whether non-compliance was intentional or an instance of tax evasion.

Australia enforces the strictest penalty, reaching AUD 16 650 (approximately ZAR 213 786), which is influenced by annual adjustments in the penalty unit value. This reflects Australia's stringent approach to addressing non-compliance. In contrast, the United States imposes the lowest penalty among the three jurisdictions, at USD 1 000 (approximately ZAR 18 000). However, the U.S. regime stands out due to its precise and detailed penalties tailored to specific offenses, while South Africa utilizes a fixed penalty schedule.

Table 7: Understatement comparison

Taxpayer behaviour	**South Africa**	**Australia**	**United States**
Intentional non-compliance	75% - 200%	75%	50%
Gross negligence	50% - 125%	50%	5% - 25%
No reasonable care taken	25% - 100%	25%	1% - 25%
Relevant legislation	Section 223 of Tax Administration Act	Sections 8C, 8K and 8N of Australian Tax Administration Act and ATO	Sections 6651 – 6658 of the IRS code

Table 7 shows that South Africa enforces the highest penalties for understatement, reaching up to 200%, compared to Australia's 75% and the United States' 50%. This stark difference highlights the higher prevalence of non-compliance in South Africa. All three countries assess penalties based on similar factors, including substantial understatement of income, the potential loss of government revenue if undetected, the level of care taken in filing returns, lack of reasonable grounds for the tax position, gross negligence, and intent to evade taxes.

The next section will evaluate how South Africa's penalty regime aligns with global best practices, noting its strengths and areas for improvement.

VII CONCLUSION AND RECOMMENDATIONS

South Africa, Australia, and the United States implement similar penalty frameworks aimed at promoting voluntary compliance and deterring tax evasion. South Africa, facing significant compliance challenges, imposes the second-highest penalties for non-compliance and the highest penalty rate for underpayment at 200%. Lombard (2008) supports retaining this high rate due to South Africa's status as a developing country, where tax evasion remains prevalent. In contrast, the South African Institute of Tax Practitioners (SAIT) advocates for a reduction in the penalty rate.

Despite efforts to foster voluntary compliance, all three countries face ongoing challenges in interpreting and applying tax legislation. In response, SARS has outlined nine strategic objectives, focusing on taxpayer education and awareness to address these challenges and align with international best practices.

This article critically examined South Africa's penalty regime, as detailed in Chapters 15 and 16 of the Tax Administration Act, comparing it to the systems of Australia and the United States. The study traces the deep-rooted origins of tax non-compliance and reveals that

contemporary issues persist, often stemming from taxpayers' perceptions of insufficient value in government services funded by taxes.

South Africa has taken steps to address non-compliance, with SARS implementing strategies to promote fairness, monitor taxpayer behaviour, and impose equitable penalties. These measures are part of a broader effort to foster voluntary compliance and enhance the administration of tax laws. The article concludes with recommendations for improving South Africa's penalty regime in line with international best practices.

The new South African penalty regime shows improvement in clarity and fairness but also reveals some shortcomings, particularly in the lack of specific guidelines for percentage-based penalties under the "Imposition of percentage-based penalty" clause[173]. This discretion given to SARS may lead to inconsistencies in penalty application. Despite this, the revised framework offers clearer procedures for imposing penalties and allows taxpayers to lodge objections and apply for penalty remissions with well-defined requirements.

The article also examined enforcement strategies in Australia and the United States, noting that these countries have more nuanced approaches, with penalties tailored to specific types of offenses. Their legislation addresses instances where offenses overlap with other penalty provisions, providing clarity in enforcement. While South Africa's penalty regime aligns with those of Australia and the United States in many respects, key differences remain. Australia imposes penalties for business failures to withhold Pay-as-you-go (PAYG) and non-deposit of taxes, while the United States penalizes bad checks. South Africa, however, has the highest penalty for understatement, up to 200%, whereas Australia holds the highest non-compliance penalty at AUD 16 650 (about ZAR 215 000).

In comparing the penalty regimes of South Africa, Australia, and the United States, South Africa's framework is relatively clear but lacks the detailed specificity found in the U.S. regime, which simplifies enforcement. Australia and the United States offer more precise guidance on penalties tailored to specific offenses, contributing to lower overall penalties in the U.S. Several recommendations for improving South Africa’s penalty regime were proposed based on this comparative analysis.

To improve South Africa's penalty regime under the Tax Administration Act, several key changes are recommended. Firstly, Section 213 should specify exact percentage-based penalties, eliminating ambiguity and ensuring consistency in how SARS imposes penalties. Secondly, similar to the United States IRS model, each provision should outline penalties for specific offenses. For example, Section 22 could specify penalties for failing to register while accounting for mitigating circumstances.

Additionally, the Act should clarify precedence when multiple penalties may apply to avoid overlapping penalties, an area where the U.S. system offers clearer guidance. A shift towards a behavioural change approach, where penalties are seen as tools to encourage compliance rather than simply as punishment, is also recommended[174]. Introducing more stringent penalties for repeat offenders, as in the IRS model, would help address recurring non-compliance. Furthermore, while penalties for failing to submit tax returns are necessary, the Act should avoid excessive duplication of penalties, striking a balance between revenue collection and fairness in line with South Africa’s constitutional rights.

[173] Section 213 of the Tax Administration Act 28 of 2011.
[174] James, Simon, and Clinton Alley. "Tax compliance, self-assessment and tax administration." (2002).

In conclusion, aligning South Africa's penalty regime with international best practices, particularly the specificity and clarity of the U.S. system, would enhance its fairness and effectiveness. Clearly defining penalties for each offense and addressing overlaps between provisions would streamline implementation for SARS and foster greater taxpayer compliance.

MACHIAVELLIANISM AND TAX AVOIDANCE

JOHN TRETOLA*

Abstract

Machiavellianism refers to a psychological trait characterized by cunning, manipulativeness, and a willingness to exploit others for personal gain. Tax avoidance involves manipulating the tax system to achieve, usually by artificial non-commercial arrangements, a tax related outcome that is not intended by Parliament. The connection between Machiavellianism and tax avoidance lies in the strategic and manipulative nature of both concepts. However, whilst it is true that not all individuals who engage in tax avoidance are necessarily Machiavellian, it is very likely that nearly all Machiavellians will engage in tax avoidance due to their manipulative self-serving natures. This paper seeks to compare the outcome of five known recent studies that explored the link between Machiavellianism and tax avoidance. These five studies have taken place in different countries but lead to the same ultimate conclusion that Machiavellianism behaviour leads to tax avoidance behaviour. Although, none of the five studies took place in Australia, due to the studies exploring the interaction of personality traits of taxpayers with their level of tax compliance or their propensity to engage in tax avoidance practices, it is considered that the results of these studies are equally applicable to Australian taxpayers who have Machiavellian traits.

The first of these studies took place in 2007 in Hong Kong with the results published in a paper released in 2008. This study of Hong Kong tax professionals engaged in advising corporate tax clients did find a very strong link between Machiavellian behaviour and unethical corporate behaviour and also the adoption of more aggressive tax avoidance practices. The second of these studies took place in Brazil in 2015 of 131 management students and workers and it reviewed the ethical and tax compliance behaviour of managers located in Brazil and it also found a strong link between Machiavellian behaviour and unethical behaviour and propensity to engage in tax avoidance practices.

A third study was undertaken in 2017 in the United States involving a study of 212 taxpayers and this found that Machiavellianism was associated with a lack of concern for conventional moral standards and led to a predisposition for unethical behaviour and consequently inevitably leads to higher intentions to engage in tax avoidance practices. The fourth study took place in Iran in 2019 and revealed that Machiavellian traits (characterized by having low empathy for others, and a willingness to ignore moral norms) had a significant direct effect on increasing tax avoidance behaviour.The fifth study took place in Indonesia in 2022 and also concluded that taxpayers who possess Machiavellian traits have a much greater propensity, than taxpayers who do not possess those traits, to engage in tax evasion and avoidance practices.

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In comparing these five recent studies, this paper seeks to summarise the lessons learned from those research studies to help better understand the behaviours which underpin tax avoidance. These studies show, in their outcomes, a clear link between individuals who score high in Machiavellian traits and their propensity to engage in tax avoidance practices. The lessons learned also show a consistent pattern that Machiavellians are more likely to engage in opportunistic decision making and so are more prone to tax avoidance as they have less empathy for others and are more likely to ignore moral norms for their own benefit.

I INTRODUCTION

This paper seeks to provide a comparative analysis of recent studies undertaken in Hong Kong, Brazil, the United States, Iran and Indonesia that have sought to link Machiavellianism with tax avoidance and to draw out from this comparison any consistent findings to cement any link between Machiavellianism and tax avoidance.[1] Reviewing these recent studies reveals commonalities in findings indicating that there are common factors that may increase the likelihood for a taxpayer to engage in tax avoidance. Machiavellianism is a personality trait and condition that has been well-researched and identified, and these five studies have all sought to determine categorically if there was a clear link between this condition and a greater propensity to engage in tax avoidance.

A *Machiavellianism*

The term 'Machiavellian' is named after the Italian Renaissance diplomat and philosopher Niccolò Machiavelli, a political adviser to the Medici family in the fifteenth century, best known for his book 'The Prince'. In the book 'The Prince', Machiavelli discussed political strategies and the nature of power.[2] Machiavelli saw people as objects to be manipulated in the pursuit of personal goals, even by deliberate fraud; and advised rulers to do so.[3]

Machiavellianism is defined as a personality trait characterized by "a calculating attitude towards human relationships and a belief that the end justifies the means, but it is inhuman."[4] It is characterized by cunning, manipulativeness, and a willingness to manipulate and exploit others for personal gain. Machiavellianism is considered one of the traits in the "Dark

[1] (Hong Kong) William E. Shafer & Richard S. Simmons, 'Social responsibility, Machiavellianism and tax avoidance- a study of Hong Kong professionals', *Accounting, Auditing & Accountability* Journal, Vol. 21. No. 5, 2008 695-720; (Brazil) M.F. D'Souza & G.A. Lima, (2015), the dark side of power: The dark triad in opportunistic decision-making, *Advances in Scientific and Applied Accounting* 8(2), 135-156; (United States) W. E. Shafer & Z. Wang, (2018), Machiavellianism, social norms and taxpayer compliance, *Business Ethics: A European Review*, 27; (Iran) H.E.K. Olia, B. Banimahd and S. Kheradyar, (2019) *Iranian Journal of Finance*, Vol. 3, No. 1 at 55; (Indonesia) Zesmitha Kisman, Junaidi, 'The effect of love of money, Machiavellianism, and tax rates on tax evasion', *Journal Ilmiah Akuntansi dan Keunangan,* Vol. 11, No. 2, 2022, 102-110.

[2] Niccolo Machiavelli, "The prince (1513)." *Hertfordshire: Wordsworth Editions* (1993).

[3] G. R. VandenBos, (org.) (2010). Dicionario de psicologia da American Psychological Association. Trad. Daniel Bueno, et. Al. Porto Alegre: Artmed, at 1040.

[4] Ibid (VandenBos) n3.

Triad," alongside narcissism and psychopathy. [5] Paulhus and Williams in 2002 developed a study on the subclinical personality traits considered socially aversive such as narcissism, Machiavellianism and psychopathy, which collectively are called the Dark Triad.[6]

According to Cervone and Pervin, personalities "are psychological qualities that contribute to one's enduring and distinct feeling, thinking and behaving patterns."[7] A person's conduct can be summarized, explained and predicted by personality traits defined as relatively stable, consistently and permanent internal characteristics which are deducted from a pattern of behavior, attitudes, feelings and habits.[8]

Individuals high in Machiavellianism are typically strategic in their interactions, prioritizing their own interests over those of others and being willing to use deceit and manipulation to achieve their goals. This is especially so in the management environment where individuals with Machiavellian traits, where they assume positions of management and leadership, seek to manage by the manipulation and control of others.[9] These individuals, as leaders, are less willing to adhere to procedures or to seek high standards of ethics and morality and instead focus on their own personal power.[10] Individuals with high Machiavellian characteristics also do not have the ability to understand the emotions of others.[11] Machiavellianism is therefore a personality trait characterized by exploitative, self-serving behaviours.[12]

A Machiavellian individual will influence another to deceive them to achieve their own selfish goals and will have no qualms about using unethical methods to do so.[13] Machiavellian individuals can be characterized as having manipulative, cold and calculating personalities and who lack even basic levels of concern for conventional standards of morality or ethics.[14]

McHoskey, Worzel and Szyarto described individuals who score high in Machiavellian traits as possessing a superficial charm; a propensity for pathological lying, manipulation and deceit and who have low levels of empathy and guilt or remorse and who tend to deny responsibility for their actions.[15]

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[5] P. J. Watson, M. D. Biderman, & S. M. Sawrie (1994) Empathy, sex role orientation and narcissism. *Sex Roles, 30,* 701-723.
[6] D. L. Paulhus & K. Williams, (2002): The dark triad of personality, narcissism, Machiavellianism and psychopathy. *Journal of Research in Personality*, 36, 556-563.
[7] D. Cervone & L.A. Pervin (2008). Personality: Theory and research (1oth edition). New York: John Wiley and Sons.
[8] Ibid (VandenBos) n3.
[9] B. Fehr, D. Samsom & D.L Paulhus (1992), The Construct of Machiavellianism: twenty years later, in C.D. Spielberger & J.N. Butcher (Eds.), *Advances in personality assessment*, 9, 77-116. Hillsdale, NJ: Erlbaum.
[10] T.A. Judge, R.F. Piccolo & T. Kosalka (2009), The bright and dark side of leader traits: a review and theoretical extension of the leader trait paradigm, *The Leadership Quarterly* 20(6), 855-875.
[11] C. Wastell & A. Booth, (2003), Machiavellianism: An alexithymia perspective, *Journal of Social and Clinical Psychology*, 22, 730-44.
[12] T. Bereczkei, B. Birkas and Z. Kerekes (2010), The presence of others, prosocial traits Machiavellianism: A personality x situation approach. *Social Psychology, 41*(4), 238-245; R. Christie, & F. Geis (1970) *Studies in Machiavellianism.* New York: Academic Press; D. S. Wilson, D. Near & R. R. Miller (1996) Machiavellianism: A synthesis of the evolutionary and psychological literatures. *Psychological Bulletin.*
[13] H.E.K. Olia, B. Banimahd and S. Kheradyar, (2019) *Iranian Journal of Finance*, Vol. 3, No. 1 at 55.
[14] W. E. Shafer & Z. Wang, (2018), Machiavellianism, social norms and taxpayer compliance, *Business Ethics: A European Review*, 27, 42 at 43.
[15] J.W. McHoskey, W. Worzel & C. Szyarto, (1998), Machiavellianism and psychopathy, *Journal of Personality and Social Psychology*, 74(1), 192-210.

Research suggests that Machiavellians attempt to gain personal benefits in 'everyday dealings' and are generally less persuaded by others.[16] Therefore, possessing a low concern for others is a logical outcome of Machiavellianism behaviour.[17] Studies have also shown that Machiavellian individuals tend to be less distracted by moral concerns such as fairness and justice and more single-mindedly pursue 'winning'.[18] Those who engage in tax avoidance are similarly less distracted by moral concerns than personal gain.

II TAX AVOIDANCE, TAX PLANNING AND TAXPAYER BEHAVIOUR

Tax avoidance has existed as long as there has been taxation and is essentially the use of legal loop-holes to artificially reduce the liability to pay tax, without any true economic cost involved.[19] Tax avoidance is a term ascribed to any activity that has the effect of reducing tax payable, whether lawful or otherwise. Tax avoidance is a term that has a strict legal definition in Australia as set out in Part IVA of the *Income Tax Assessment Act* 1936 (ITAA36).

Section 177D (b) of ITAA36 sets out eight matters that are relevant in determining the purpose of the taxpayer in entering into any scheme that has the main or dominant purpose of tax avoidance. This strict legal meaning requires a consideration of all eight of those factors before determining, objectively, what the purpose of the taxpayer was in entering into scheme that produces a tax benefit and if the main or dominant purpose is determined to be tax avoidance then tax avoidance is found.[20] Tax avoidance is also a colloquial term covering both tax avoidance in its strict legal sense and also lawful tax minimisation that is viewed by society as exploitative, immoral or wrong. For the purposes of this paper, the term tax avoidance is given the wider colloquial meaning. Even with taking this colloquial meaning, tax avoidance can mean different things to different people.[21]

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[16] R. Christie, & F. Geis (1970) *Studies in Machiavellianism.* New York: Academic Press.

[17] F. Ali, I. S. Amorim & T. Chamorro-Premuzic (2009), Empathy deficits and trait emotional intelligence in psychopathy and Machiavellianism. *Personality and Individual Differences, 47,* 758-762 and V. S. Athota, P. J. O'Connor & C. J. Jackson (2010), The role of emotional intelligence in moral judgment. In R. Hicks (Ed). *Personality and individual differences: Current directions.* Australia: Australian Academic Press.

[18] F. Geis, S. Weinheimer & D. Berger (1970), 'Playing legislature: Cool heads and hot issues', in R. Christie and F.L Geis (Eds), *Studies in Machiavellianism*, Academic Press, New York, NY., 190-209.

[19] C. Evans, 'Containing Tax Avoidance: Anti-Avoidance Strategies', UNSW, *Faculty of Law Research Series,* Working Paper No. 40, June 2008, 2. This paper was also presented at the Musgrave Memorial Colloquium held in Sydney on 2-4 June 2008. Electronic paper accessed at http://ssrn.com/abstract=1397468 on 12th May 2016. The commentator Krishna also notes that in ancient Mesopotamia some 6,000 years ago, some citizens would swim across a river rather than pay a toll on the use of a ferry: Krishna, V., *Tax Avoidance: The General Anti-Avoidance Rule* (Carswell, Toronto, 1990) 8. As for some further examples from history- in 13th Century England, property taxes were able to be avoided by moving assets outside of the sheriff's jurisdiction and in 17th Century England window taxes could be avoided by covering up windows at the time of the tax collectors visit.

[20] The term 'scheme' is defined in section 177A and the term 'tax benefit' is defined in section 177C of the *Income Tax Assessment Act* 1936. In each case, the terms are defined very broadly.

[21] Christophe Waerzeggers and Craig Hillier, 'Introducing a general anti-avoidance rule (GAAR)', 2016 Vol. 1 *International Monetary Fund, IMF Legal Department* Tax Law IMF Technical Note, 1.

In the English case of *IRC v Willoughby*[22], Lord Nolan stated that tax avoidance involves 'a course of action designed to conflict with or defeat the evident intention of Parliament.' Lord Templeman, also noted that 'tax avoidance reduces the incidence of tax borne by an individual taxpayer contrary to the intentions of Parliament'.[23]

Lord Goff in *Ensign Tankers Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* defined tax avoidance as:

> Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain… or whatever it may be, which otherwise would never have existed.[24]

The 1999 Review of Business Taxation in Australia[25] defined 'tax avoidance' as follows:

> Tax avoidance may be characterised as a misuse or abuse of the law rather than a disregard for it. It is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by the Parliament but also includes manipulation of the law and a focus on form and legal effect rather than substance. The way things are done in order to take advantage of structural loopholes, or to dress up or characterise something to satisfy form but not substance can also stamp an arrangement as avoidance. Tax avoidance represents a serious threat to the integrity of the tax system and to the revenue. It is also a form of subsidy from those paying their fair share of tax according to the intention of the law to those shirking their similar obligations.

Judith Freedman has also concluded that tax avoidance involves behavior that whilst, seemingly compliant, is carried out, contrary to the intention of Parliament.[26] Tax avoidance can therefore be said as referring to the legal minimization of tax liabilities through methods such as exploiting tax loopholes, deductions, and offshore accounts. Tax avoidance activities attack the integrity and equity of the tax system, and they reduce government revenue and are a global problem.[27]

Whilst defining exactly what tax avoidance is, is not an easy task, however, it is certainly possible to explain the characteristics of tax avoidance arrangements when they appear. Tax avoidance arrangements exhibit qualities such as 'artificiality', 'undue complexity' and a 'lack of business reality'. Tax avoidance is therefore likely to involve arrangements that appear genuine but in point of fact have little or no real underlying business activity or purpose and also involve a substantial removal of any real risk to the taxpayer. Tooma has described tax avoidance as the legal exploitation of the letter of the law to one's own advantage without regard to the purpose of the law.[28]

[22] 1997 S.T.C. 995, 1004c
[23] Lord Templeman in '*Tax Avoidance and the Law*', (Adrian Shipwright (ed), Key Haven, London, 1997) at 1.
[24] *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] 1 AC 655, 681.
[25] The Review of Business Taxation, 'A Tax System Redesigned', (Ralph Report) July 1999 at 243 accessed on 1 February 2016 at http://www.rbt.treasury.gov.au/publications/paper4/index.htm
[26] Judith Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle' [2004] *British Tax Review* 332.
[27] Chris Atkinson, 'General anti-avoidance rules: exploring the balance between the taxpayer's need for certainty and the government's need to prevent tax avoidance', *Journal of Australian Taxation* (2012) Volume 14, Issue 1, 1.
[28] Rachel Tooma, *Legislating Against Tax Avoidance*, IBFD, Amsterdam, 2008, 12.

Atkinson has described tax avoidance as an uncertain 'slippery concept' that is hard to define but is a term concerned with lawful conduct that produces unacceptable outcomes.[29] The ATO (2005) has referred to tax avoidance as 'aggressive tax planning'.[30]

A *Distinction between tax avoidance and tax planning*

Tax avoidance needs to be contrasted to tax planning. Tax planning has been described by Delany to be "the arrangement of one's financial and business affairs so as to comply with taxation laws at the lowest possible tax cost".[31] Tax planning is not tax avoidance and is behavior which is sanctioned by the government. Tax avoidance, on the other hand, seeks to reduce the overall tax liability but does so by giving the illusion that the transaction complies with the letter of the law but that the tax advantage is not one intended by the law.[32]

B *Drivers of tax avoidance and unethical behaviour- a multi-disciplinary approach*

There has already been some multi-disciplinary research into tax compliance with ccontributions having come from the disciplines of accounting, law, economics, sociology and psychology. Several comprehensive literature reviews have also been conducted including, for example, Jackson and Milliron,[33] Andreoni et al,[34] and Richardson and Sawyer.[35] The reviews indicate that there are mainly two schools of thought, or drivers, for greater or lesser tax compliance by taxpayers. These being the 'economic' school and 'psychology' school.

Models developed by proponents of the psychology school fall into a number of sub categories. The studies in these sub categories are many and varied in terms of methodologies employed and compliance factors examined. Witte and Woodbury used mathematical modelling in their 1985 study.[36] Smith and Kinsey used prospect theory to a model of the social-psychological factors that are considered and weighed up by persons before forming an intention concerning a particular action.[37]

Importantly the psychology model can take the form of either a social psychology model (purely behavioural) or fiscal psychology model, which is a combination of both social

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[29] Atkinson, (n27) 2-3.
[30] ATO, *Aggressive Tax Planning End-To-End Process*, (ATO Practice Statement, Law Administration PS LA 2005/25, December 2005).
[31] Tom Delany, 'Tax Planning v Tax Avoidance: Simply an Objective Test?' paper presented at the 19th annual Australasian Tax Teachers' Association (ATTA) conference in Brisbane in January 2007, 1.
[32] Ibid (Delany n.31).
[33] B.R. Jackson and V.C. Milliron,'Tax Compliance Research: Findings, Problems, and Prospects' (1986) 5 *Journal of Accounting Literature* 125, 142.
[34] J. Adreoni, B. Erard, and J. Feinstein, 'Tax Compliance'(1998) 36(2) *Journal of Economic Literature* 818.
[35] M. Richardson and A.J. Sawyer, 'a Taxonomy of the Tax Compliance Literature: Further Findings Problems and Prospects' (2001) 16 *Australian Tax Forum* 137, 149.
[36] Ann D. Witte and Diane F. Woodbury, (1985) 'The Effect of Tax Laws and Tax Administration on Tax Compliance: The Case of the U.S. Individual Income Tax,' 38 *National Tax Journal* 1
[37] Kent W. Smith & Karyl A. Kinsey, (1987) 'Understanding Taxpaying Behavior: A Conceptual Framework with Implications for Research', *Law & Society Review,* Vol. 21, No. 4 (1987), pp. 639-663.

psychology and economic models. Social psychology models inductively examine the attitudes and beliefs of taxpayers in order to understand and predict human behaviour.

Fiscal psychology models draw on both the economic deterrence and the social psychology models and generally view tax enforcement as a behavioural problem and one that can be resolved by co-operation between taxpayers and tax collectors.[38] A study by Ajzen and Fishbein,[39] used the model of reasoned action combining both economic deterrence and social psychological models and so combining aspects of both material consequences and normative expectations, found that taxpayer behaviour is directly determined by their intentions, which are a function of their attitude towards behaviour and perception of social norms. This research indicated that a person's compliance behaviour is influenced by their peers and community standards, which thereby impact upon their thinking and actions.

An Australian study by Devos into tax compliance behaviours over the tax years 2002 to 2006, found that there was no change in taxpayer behaviour even when the taxpayers were made aware of potential penalties before they undertook non-complying behaviour. This study found that penalties were not something taxpayers contemplated or considered in their compliance decisions, but rather the focus of these taxpayers was on how to reduce the actual payment of tax. This study did, however, find that the tax morals or morale of non-compliant taxpayers were also influential upon their behaviour.[40]

However, other studies have shown a direct link between compliance behaviour and the possibility of being detected. For instance a study by Klepper and Nagin in 1989 found that taxpayer behaviour involves a balancing of the action undertaken whereby if severe penalties are a possibility, then this will still not be a deterrence if there is a limited chance of detection. Conversely, if there are only minor penalties, these may provide a strong deterrent if there is a high likelihood of detection.[41]

Overseas studies that have investigated tax morale have found that higher legitimacy for political institutions has led to higher tax morale.[42] In a study of 30 developed and developing countries, (although primarily non-African), it was determined that tax morale and compliance is highest in the countries characterised by a high control of corruption and a low size of bureaucracy.[43]

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[38] M McKerchar and C. Evans, 'Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy makers and Revenue Authorities' (Paper presented at the 21st Australasian Tax Teachers Annual Conference, University of Canterbury, 20-22 January 2009) 27.

[39] I. Ajzen and M. Fishbein, Understanding Attitudes and Predicting Social Behaviour (1980).

[40] K. Devos, 'An Investigation into Australian Personal Tax Evaders- Their Attitudes towards Compliance and the Penalties for Non-Compliance', *Revenue Law Journal* (2009) Vol. 19, Issue 1, Article 2, 38-39. The literature referred to in this study was: K.W. Smith, 'Integrating three Perspectives on Non-Compliance A Sequential Decision Model' (1990) 17(3) Criminal Justice and Behaviour 350; H. Elffers, H.S.J Robben and D.J. Hessing, 'On Measuring Tax Evasion' (1992) 13(4) *Journal of Economic Psychology* 545 and B. Torgler and K. Murphy, 'Tax Morale in Australia: What shapes it and has it changed over time?' (2004) 7(2) *Journal of Australian Taxation* 298.

[41] Steven Klepper, Daniel Nagin "Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution" *Law & Society Review*, Vol. 23, No. 2 (1989), pp. 209-240 https://www.jstor.org/stable/3053715?seq=2

[42] B.Torgler and F. Schneider, 'What shapes attitudes Toward Paying Taxes? – Evidence From Multicultural European Countries' 2007 88(2) *Social Science Quarterly* 443.

[43] R. Picur and A. Riahi-Belkaoui, 'The Impact of Bureaucracy Corruption and Tax Compliance' (2006) 5(2) *Review of Accounting and Finance* 174.

Kornhauser identified the importance of tax morale to tax compliance as he made it a recommendation in his advice to the IRS that they endorse a tax morale approach to compliance that recognised the varying attitudes and behaviours of taxpayers.[44]

C *Tax Compliance behaviours*

Alm, Martinez-Vasquez and Torgler (2010)[45] have noted that the traditional economics of crime approach to non-compliance is no longer adequate to explain tax compliance.[46] Under this economics of crime approach, a rational individual is viewed as maximizing the expected utility of the tax evasion gamble, weighing the benefits of successful cheating against the risky prospect of detection and punishment, and individuals pay taxes because they are afraid of getting caught and penalized if they do not report all income.

However, Alm, Martinez-Vasquez and Torgler state that rather, "the basic model of individual choice must be expanded by introducing some aspects of behaviour or motivation considered explicitly by other social sciences."[47] These aspects fall within the rubric of behavioural economics, using methods and evidence from other social sciences (especially psychology) to inform the analysis of individual and group decision-making."[48] Torgler has also separately provided empirical evidence showing that tax morale, defined as one's intrinsic motivation to pay taxes, has a significant impact on tax evasion[49].

III ETHICAL THEORIES THAT UNDERPIN TAXPAYER BEHAVIOUR

Given that Machiavellians show little regard for social norms as the studies mentioned earlier have shown[50], it is relevant to consider the different ethical theories which can be used to understand how individuals make decisions when faced with an ethical dilemma. These ethical theories are all underpinned by an individual's moral foundations.[51]

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[44] M.E. Kornhauser, 'a Tax Morale Approach to Compliance: Recommendations for the IRS' (2007) 8(6) *Florida Tax Review* 599.
[45] J. Alm, J. Martinez-Vazquez, & B. Torgler, (Eds.). (2010). *Developing alternative frameworks for explaining tax compliance*. ProQuest Ebook Central at page 3.
[46] As first developed by Becker in 1968 in, G.S. Becker, (1968) "Crime and punishment – an economic approach", *Journal of Political Economy*, 76 (2): 169–217.
[47] Ibid (Alm, Martinez-Vasquez & Torgler) n45.
[48] Ibid (Alm, Martinez-Vasquez and Torgler), n45.
[49] **B.** Torgler, (2007) Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis, Cheltenham, UK: Edward Elgar. Tax evasion is the more extreme (and criminal) element of tax avoidance as evasion involves deliberate actions to conceal and avoid the payment of taxes, whereas tax avoidance uses artificial methods, within the law, to minimise tax liability.
[50] Paulhus & Williams (n6) and Cervone & Pervin (n7) and others.
[51] H. Etemadi, S. Sepasi and M. Boshagh, (2016), The ethics of business, social responsibility and corporate performance, *Quarterly Journal of Ethics in Science and Technology*, Vol. 3, 107-115.

Many studies have confirmed the relationship between morality and emotion in shaping moral judgments in tax compliance. This research has found clear evidence that a person's moral values significantly influence their tax behaviour.[52]

Egoism is one such ethical theory as it is a teleological ethical theory that is concerned with the consequences of behaviour and producing the greatest good, from an individual perspective. Egoism theory states that a person ought to act in a way that produces the greatest good for himself or herself. That is, a person should act in their own self-interest. Since egoism is only concerned with maximising good for the individual, the individual is free to determine how to maximise good at any time. The egoistic ethical approach is the approach that is likely to be adopted by those individuals that rate high in Machiavellianism. Such individuals are more likely to choose this approach to resolving ethical choices regardless of how they would rate against any emotional intelligence rating.

Another ethical theory is that of cconsequentialism or also known as uutilitarianism. This ethical theory is concerned with the consequences of a choice and evaluates behaviour according to the consequences of that behaviour. This ethical theory would choose an outcome, when faced with a choice of outcomes, that results in the greater good for the greatest number. In economic terms, such a choice would involve a cost/benefit analysis resulting in a selection of a choice that results in the greater differential of positive benefits as against negative costs. Utilitarianism is also a teleological ethical theory as it is also concerned with the consequences of behaviour. Jeremy Bentham and John Stuart Mill were proponents of this ethical approach, and they identified that everyone's happiness is of equal worth and so counts the same in weighing up the benefits versus the costs of the action.

As Machiavellians do not value the happiness of others but rather our only self-seeking in their outcomes, the ethical approaches of consequentialism and utilitarianism are not ethical approaches that those individuals who rate high in Machiavellianism would choose.

Another theory of ethics is the virtue based ethical approach. This ethical theory is 'concerned with acting in a virtuous way' and so acting honestly and without being guided by self-interest. This ethical theory is a deontological ethical theory as it is an approach that places priority on the motives behind conduct rather than be concerned with the outcome of the conduct. Immanuel Kant and Socrates were two famous proponents of this virtue based ethical theory. Socrates was famously charged with corrupting the youth of Athens and introducing strange gods and was sentenced to die by drinking poison hemlock and chose to do so as a final lesson to his students rather than to seek his personal liberty at the expense of honouring the laws of Athens.[53] Due to the emphasis placed on the motivations behind the choices being made, this virtue based ethical theory would not be chosen by Machiavellians. Machiavellians display a willingness to ignore moral norms to achieve their own benefits and this is completely at odds with aiming to act in a virtuous way.[54]

[52] J. Olsen, M. Kasper, J. Enachescu, J. Benk, T. Budak & E. Kirchler (2018), Emotions and tax compliance among small business owners: An experimental survey, *International Review of Law and Economics*, 56, 42-52.
[53] Xenophon. *Apology of Socrates to the Jury*, Dakyns translation at Wikisource accessed on 9 February 2024 https://en.wikipedia.org/wiki/Apology_(Xenophon).
[54] William E. Shafer & Richard S. Simmons, 'Social responsibility, Machiavellianism and tax avoidance- a study of Hong Kong professionals', *Accounting, Auditing & Accountability* Journal, Vol. 21. No. 5, 2008 695-720.

A *The connection between Machiavellianism and tax avoidance*

The connection between Machiavellianism and tax avoidance lies in the strategic and manipulative nature of both concepts. Individuals high in Machiavellianism may be more inclined to engage in aggressive tax planning strategies, viewing tax avoidance as a means to increase their wealth and power without regard for the broader societal implications.

B *Links between Machiavellianism and tax avoidance behaviours-earlier studies*

Apart from the five research studies reviewed in this paper, there has not been many other studies examining the link between Machiavellianism and tax avoidance. A1984 study on Machiavellianism and Economic Opportunism by Frizsche and Becker that explored the relationship between Machiavellianism and economic opportunism, such as tax evasion. The researchers found a positive correlation between Machiavellianism and economic opportunism, suggesting that individuals high in Machiavellianism may be more likely to engage in economically opportunistic behaviors, including those related to taxes.[55]

A 2008 study by Kirchler entitled 'Personality and Compliance: A Comparative Study of Tax Auditors and Taxpayers' examined the personality traits, including Machiavellianism of tax auditors and taxpayers and, whilst the focus was not specifically on tax avoidance, found that Austrian tax auditors scored lower in Machiavellianism compared to taxpayers, suggesting that personality traits may play an influence in attitudes toward taxation and compliance.[56]

IV STUDIES ON MACHIAVELLIANISM AND TAX AVOIDANCE BEHAVIOURS

A review will now be made of these recent studies considering the effects of Machiavellianism and tax avoidance. These studies do positively show that there is a clear and direct link between individuals possessing Machiavellian qualities or traits and tax avoidance.

A *2007 Hong Kong study*

The 2007 Hong Kong study of Hong Kong accountants and tax advisers by Shafer and Simmons used a survey of a sample of 1,000 tax professionals in Hong Kong, including professionals in both public accounting and private industry[57]. The survey involved two short scenarios which both consciously misrepresented facts provided to the revenue authorities exploring the use of tax havens and the use of excessive management fees. At the end of each scenario, the respondents were asked to indicate, on a seven-point scale, the extent to

[55] David J. Fritzsche and Helmut Becker. "Linking management behavior to ethical philosophy—An empirical investigation." *Academy of Management Journal* 27.1 (1984): 166-175.
[56] Gangl, K., Hartl, B., Hofmann, E. and Kirchler, E., 2019. The relationship between Austrian tax auditors and self-employed taxpayers: Evidence from a qualitative study. *Frontiers in psychology*, *10*, at 447237.
[57] However, only a total of 186 responses were received with 11 of those responses being unusable.

which the respondent felt that the professional's action was first ethical, and second, socially responsible.

The study found that tax avoidance is repeatedly seen in accountants with Machiavellian personality traits.[58] The study also found that Machiavellianism affects tax advisers' expressed viewpoints towards aggressive tax minimisation.[59] Tax advisers, who rated high in Machiavellianism, were more likely to support the traditional view that the purpose of directors of a company is overwhelmingly, and almost exclusively, to maximise profits of the company and that directors have little responsibility beyond this goal.

The study also found that tax advisers who rated high in Machiavellianism directly affected the ethical and social responsibility judgments of their clients. Further, the study found that the public accounting profession in Hong Kong had become overly commercialised and that there was little thought for acting in the public interest.

The survey concluded that public accountants in Hong Kong, and likely elsewhere, often promote the interest of their clients over and above the public interest.[60] This raises ethical considerations and possible breaches of ethical guidelines. Whilst there is a duty to serve the client and promote their interests, but this service must be balanced with a due consideration and application of ethical behaviour and not being complicit to any tax avoidance arrangement as this would clearly breach the duty to act professionally and to serve the profession and to also act in the public interest that accountants are required by their professional bodies to do.

The study found that taxpayers with stronger Machiavellian orientations more closely related to the narrow stockholder view of corporate theory, seeing corporate responsibility as more tied to the narrow goal of profit maximisation. Finally, the study also found that the respondents that scored higher on Machiavellian ratings were also more likely to engage in international non-compliance,[61] and less likely to feel that corporate ethics and social responsibility were important. They were therefore more likely to view aggressive tax avoidance schemes favourably.[62]

B *The 2015 study of management students in Brazil*

D'Souza & Lima undertook a study in 2015 of 131 MBA students in Brazil who were all either working or had worked in managerial roles. By way of a questionnaire, participants were asked a series of questions based on hypothetical situations in order to verify attitudes and behaviours in a business context.[63] This study connected responses against the Dark Triad personality traits of narcissism, psychopathy and Machiavellianism.[64] Narcissism was characterised as having an excessive self-love, self-entitlement and absorption and hostility

[58] Ibid. (Shafer & Simmons), n54.
[59] Ibid (Shafer & Simmons) n.54.
[60] Ibid at pages 695-6 citing evidence from a study by A. Levitt Jr. and P. Dwyer (2002), *Take on the Street: What Wall Street and Corporate America Don't Want You To Know,* Pantheon Books, New York, NY.
[61] Ibid (Shafer & Simmons), n.54 at 697.
[62] Ibid (Shafer & Simmons), n.54 at 711.
[63] M.F. D'Souza & G.A. Lima, (2015), the dark side of power: The dark triad in opportunistic decision-making, *Advances in Scientific and Applied Accounting* 8(2), 135-156 at 145-150.
[64] Ibid (Paulhus & Williams) n6.

whereas psychopathy was characterised by the ability to influence and dominate others, demonstration of low anxiety; propensity for risk taking behaviour , reckless, selfish and aggressive behaviour involving blaming others if something goes wrong.

The study revealed that managers that scored high in Machiavellianism, and so possessed aversive personality traits such as lack of guilt, impulsiveness, insensitivity and need for power, can manipulate accounting information to promote the company and themselves. The empirical evidence also revealed that respondents with high traits of the Dark Triad, including Machiavellianism, are much more likely to engage in opportunistic decision-making and are therefore more willing to issue fraudulent financial reports and engage in other unethical behaviours, such as tax avoidance.[65]

The study validated the expectations that individuals that rated high in Machiavellian traits are also likely to be rated high in narcissism and psychopathy and has highlighted the potential of the presence of the Dark Triad in business affairs in all countries.

C *The 2017 United States study*

Shafer and Wang in a 2017 study of 212 taxpayers in the United States were the first to specifically examine the effect of Machiavellianism and social norms on taxpayer intentions to over-claim deductions.

The study involved an online survey of experienced taxpayers using Qualtrics software. Out of 2,595 survey invitations, 214 usable survey responses were obtained. The survey tested three key hypotheses with the first being that higher levels of Machiavellianism would be associated with a higher intention to engage in tax evasion. The second hypothesis tested whether higher levels Machiavellianism was associated with lower perceived levels of social norms with the third hypothesis testing whether having lower levels of social norms would be associated with a higher likelihood to engage in tax evasion. Tax evasion in this context was defined as tax fraud and so is a more extreme version of tax avoidance as it does involve fraud and a criminal intent whereas tax avoidance does not involve any criminal intent.

This US study confirmed that Machiavellianism is a dark personality trait that directly does affect tax evasion/avoidance.[66] The study revealed that individuals who rated high on Machiavellianism tended to exhibit a fundamental distrust of others' intentions and motives and so having higher levels of Machiavellianism correlates directly with having lower levels of ethical responsibility.

The study also found that as Machiavellianism is associated with a lack of concern for conventional moral standards it leads to a predisposition for unethical behaviour and therefore leads to higher intentions to commit tax fraud and tax avoidance.[67] The study therefore concluded that Machiavellianism is directly associated with tax evasion and fraud intentions.[68]

[65] Ibid (D'Souza & Lima), n63 at 150-151.
[66] Ibid. (Shafer & Wang), n14.
[67] Ibid. (Shafer & Wang), n.14 at 44-48.
[68] Ibid. (Shafer & Wang), n.14 at 48.

D *The 2019 Iranian study*

An Iranian study, with its results released in 2019, sought to test for a link between Machiavellianism and tax avoidance behavior and was based on a survey of 500 accountants and financial managers of listed and unlisted companies in Iran in 2019 also concluded that Machiavellianism and moral foundations have a significant impact on tax avoidance.[69]

The authors of this study recognized that possessing negative emotions and traits may lead to the violation of social norms and so more likely lead to tax evasion and avoidance.[70] Negative emotions and traits were recognized as Machiavellian in nature as they involved manipulating the emotions of others for one's own benefit.[71] The study also recognized that accountants tended to have lower levels of emotional intelligence than professionals in other fields of business and economics.[72] The study confirmed the results of prior psychological studies that confirmed the relationship between morality and emotions in shaping moral judgments in tax compliance.[73]

The 2019 Iranian study concluded that possessing Machiavellian traits (low empathy for others, willingness to ignore moral norms) had a significant direct effect on increasing tax avoidance behaviour.[74] The study also acknowledged that future research into tax compliance intentions should control for personal characteristics such as Machiavellianism.

E *The 2022 Indonesian study*

The 2022 Indonesian study on 334 taxpayers located in Pelapo City (a region of Indonesia) sought to determine the effect of having a strong love of money (being greedy) and Machiavellianism and the level of tax rates and what effect these had on tax evasion and avoidance. The taxpayers were sent a questionnaire for which the results were then subject to structural equation modelling. The study used, as a definition for Machiavellian behaviour the general idea that the "ends justify the means" as outlined by Indonesian authors.[75]

The results of the study revealed that taxpayers with Machiavellian traits, for example the willingness to ignore moral norms for their own benefit, had a much greater propensity, than other taxpayers, to engage in tax evasion and avoidance practices.[76]

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[69] Ibid. (Olia, Banimahd and Kheradyar), n13.at 54-55.
[70] Ibid. (Olia, Banimahd & Kheradyar), n.13 at 54-55.
[71] Ibid. (Olia, Banimahd & Kheradyar), n.13 at 54-55.
[72] S. Baksh Refahi; S. Yar Kherad; M. Saraei Oshack, (2018), 'personal emotion and profit management behavior: a test of positive attitude psychology theory', *Accounting Quarterly*, 241-254.
[73] Ibid. (Olia, Banimahd & Kheradyar), n.13 at 57-68) quoting as a reference on this, J. Olsen, M. Kasper, J. Enachescu, S. Benk, T. Budak, & E. Kirchler (2018) Emotions and tax compliance among small business owners: an experimental survey, *International Review of Law & Economics*, 56, 42-52.
[74] Ibid. (Olia, Banimahd & Kheradyar), n.13 at 57-68); Zesmitha Kisman, Junaidi, 'The effect of love of money, Machiavellianism, and tax rates on tax evasion', *Journal Ilmiah Akuntansi dan Keunangan,* Vol. 11, No. 2, 2022, 102-110 at 108.
[75] Jamalallail, U.F., Goreti, M. & Indarti, K. (2022), *Determinan Penggelapan Pajak (Tax Evasion) Dengan*, 14(1), 93-106.
[76] Kisman & Junaidi (n74).

However, the study also found that the love of money of itself does not have any structural relationship with tax evasion or avoidance. The Indonesian study concluded that the greater the Machiavellian character of the taxpayer, the higher the likelihood of tax evasion or avoidance. The study concluded that taxpayers with Machiavellian traits are more likely to engage in tax avoidance behaviours because of their tendency to ignore morals for their own benefit.[77]

F *The commonalties of these studies*

The five studies reviewed in this paper, despite the fact that they were undertaken over different years and in different countries, have all reported a clear link between individuals who score high in Machiavellian traits and their propensity to engage in tax avoidance practices.[78] This should not come as any real surprise as the social norms of taxpayer compliance do not apply to Machiavellians.[79] Machiavellians have no empathy to others and so show a lack of concern for the welfare of others and so do not follow utilitarian ethical approaches. Machiavellians also ignore moral norms for their own benefit which is the direct opposite of acting in a virtuous way and so do not follow virtue-based ethical approaches. Machiavellians follow egoistic ethical approaches putting their own welfare front of centre of their actions.

The 2008 Hong Kong study found that individuals scoring high on a Machiavellian score were less likely to feel that corporate ethics and social responsibility were important and that instead they were more likely to view aggressive tax avoidance schemes favourably.

The 2015 Brazilian study recognised that Machiavellians are more likely to engage in opportunistic decision making and so are more prone to tax avoidance. The 2017 US study confirmed the results of the 2008 Hong Kong study by confirming that Machiavellianism is associated with a lack of concern for conventional moral standards and for a great propensity to engage in tax avoidance practices.

The2017 United States study revealed that higher levels of Machiavellianism leads to a predisposition for unethical behaviour and therefore leads to higher intentions to commit tax fraud and tax avoidance. The study also found that individuals who rated high on Machiavellianism tended to exhibit a fundamental distrust of others' intentions and motives and so higher levels of Machiavellianism correlates directly with lower levels of ethical responsibility and so these individuals exhibited a higher propensity to claim higher deductions over and above other taxpayers.

Both the 2019 Iranian study and the 2022 Indonesian study both concluded that possessing Machiavellian traits (having low empathy for others and a willingness to ignore moral norms) had a significant direct effect on increasing tax avoidance behaviour.

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[77] Ibid. (Kisman & Junaidi) n.74 at 108.
[78] Ibid (Shafer & Simmons), n.54 at 699; (Shafer & Wang), n.14; (Olia, Banimahd & Kheradyar), n.13; (Kisman & Junaidi), n.74 and (D'Souza & Lima), n.63.
[79] Ibid (Shafer & Wang), n.14; (Olia, Banimahd & Kheradyar), n.13 and (Kisman & Junaidi), n.74.

V CONCLUSIONS AND IMPLICATIONS FOR TAX AUTHORITIES

The recent studies in Machiavellian behaviours establish an undeniable link between possessing Machiavellian personality traits and a greater propensity to engage in tax avoidance behaviours. The findings in these studies are also of relevance in the Australian context as possessing Machiavellian behaviours is a personality trait and pattern of behaviour and is not country specific. That these studies reveal a clear link between these personality characteristics and tax avoidance behaviours is undeniable.

The studies also provide a salient lesson that in designing research into the links between social norms and taxpayer compliance, personality traits like Machiavellianism should be recognised and a control must be made for Machiavellian traits. Furthermore, any tests for effectiveness of any government interventions designed to shift social norms in respect to taxpayer compliance should also control for Machiavellianism to ensure more meaningful results.[80]

The taxpayer related studies and the psychological studies in the past give little reason to expect the level of taxpayer compliance by Machiavellians to change anytime soon. Machiavellians are not motivated by ethical considerations and societal norms. Government revenue authority tax audit and compliance design must therefore be tailored to expect to encounter Machiavellians but the best way to meet the challenges of taxpayer compliance with Machiavellian individuals is to have an effective and well-resourced compliance program.

The Australian Tax Office has developed a compliance model that has identified that the allocation of more audit resources need to be directed to that part of the community that are non-compliant.[81] The recent studies have confirmed that there is a clear and direct link between Machiavellianism and a greater propensity to engage in tax avoidance and evasion practises and so the non-compliant part of the Australian tax community would include Machiavellians. Knowing this clear link now exists between Machiavellians and tax avoidance should assist revenue authorities develop ways of identifying Machiavellians and so more efficiently target audit activity and develop more effective intervention strategies.

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THE MEANING OF FAIRNESS IN VOLUNTARY DISCLOSURE PROGRAMS

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Abstract

This study investigates the role of fairness in voluntary disclosure programs (VDP) and its impact on taxpayer compliance behavior. It emphasizes the need for aligned taxation regulations to enhance state revenue and tax equity. Using qualitative methods, interviews were conducted with regulators, academics, practitioners, and tax administrators from the Bali Tax Regional Office. Findings indicate that VDP reflects fairness through higher tax rates and penalties, but fairness also requires consideration of legal certainty and economic factors to build public trust. The research provides insights for tax authorities to improve compliance by addressing fairness in future VDP procedures.

Keywords: Voluntary Disclosure Program (VDP), Tax Justice, taxpayer compliance, fairness, harmonizing taxation regulations

I INTRODUCTION

The existence of tax is contrived as the primary and greatest source of state revenue in the State Budget. Over 80% of state revenue is financed from tax revenue [6]. This drives the government to perform varied attempts in securing revenue from tax, especially these days. Covid-19 pandemic caused this country to decrease especially in economic aspect. On the

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[6] I Nyoman Putra Yasa, Sunitha Devi and I Putu Hendra Martadinata, 'Relevansi Slippery Slope Theory Ditinjau Dari Perspektif Gender Wajib Pajak' (2020) 16(1) *InFestasi* 13; I Nyoman Putra Yasa, I Putu Hendra Martadinata and I Gede Putu Banu Astawa, 'Peran Theory of Planned Behavior Dan Nilai Kearifan Lokal Terhadap Kepatuhan Wajib Pajak: Sebuah Kajian Eksperimen' (2020) 3(2) *EKUITAS (Jurnal Ekonomi dan Keuangan)* 149; I Nyoman Putra Yasa and I Putu Hendra Martadinata, 'Taxpayer Compliance from the Perspective of Slippery Slope Theory: An Experimental Study' (2019) 20(2) *Jurnal Akuntansi dan Keuangan* 53.

other hand, this country needed fund to recover economic condition and mainly society's health. [7]

One of the efforts conducted by the government in order to secure as well as increase income capability from tax is by performing a reformation in taxation. The reformation tested was by producing new policies through Law Number 7 Year 2021 regarding Taxation Regulation Harmonization (TRH). Over their press release stated on www. kemenkeu. go. id, Sri Mulyani reported that taxation regulation principles in this TRH law were that taxpayers had to distribute fairness, convenience, usefulness, legal certainty, and resulting in national interest, hence there are 3 (three) reformation steps tested in this law, which are 1) taxation administration strengthening, 2) tax based expansion that results in fairness and equality through policies revision of income tax (PPh), VAT (PPN), excise, and carbon tax imposition, and 3) Voluntary Disclosure Program.

Sourcing the three steps in taxation reformation post TRH Law issuance, what is definitely interesting would be regarding VDP policy. VDP is a program that shares an alternative for taxpayers who have not completely informed past wealth to explore the policy by submitting appropriate income tax upon submitted wealth disclosure. [8] Previously in 2016, the government administered a Tax Amnesty program that described a policy in providing amnesty for taxpayers who had not or did not perform their taxation obligation properly and correctly [9]. Still according to Hasanah[10] numerous residents called VDP as tax amnesty version II. This was due to meaning that the government performed a similar action.

The existence of this VDP drew pros and cons amongst society. Said [11] stated that this program was an injustice for compliant taxpayers. Moreover, still according to Said[12], this program was an unconstitutional act and an action that promoted money laundering. This program would also impact taxpayers' compliance. In the future, this program will decrease taxpayers' compliance especially as the tax amnesty comes to an end. On the other hand, VDP can be a part of government activity in increasing tax revenue because it gives an opportunity for taxpayers to be a part in taxation administration in Indonesia.

This research is undertaken to research how far fairness means in Voluntary Disclosure Program (VDP). In her research Hasanah [13] stated that not all layers of society accepted the policy mainly from the justice side, thus she suggested delving into the justice potential of VDP. Another research conducted by Haryadi[14] stated that there was a grey area in VDP

[7] Nur Alfiyah and Sri Wahjuni Latifah, 'Pengaruh Pelaksanaan Kebijakan Sunset Policy, Tax Amnesty, Dan Sanksi Pajak Terhadap Kepatuhan Wajib Pajak Orang Pribadi' (2017) 7(2) *Jurnal Reviu Akuntansi dan Keuangan* 1081.
[8] Adinda Suci Cahya Ningtyas and Aisyaturrahmi Aisyaturrahmi, 'Urgensi Program Pengungkapan Sukarela (Tax Amnesty Jilid II) Berdasarkan Sudut Pandang Wajib Pajak' (2022) 10(1) *Jurnal Akuntansi dan Keuangan* 51.
[9] Uswatun Hasanah et al, 'Analisis Perbandingan Tax Amnesty Jilid I Dan Jilid II (Program Pengungkapan Sukarela) Serta Peluang Keberhasilannya' (2021) 5(2) *Owner* 706.
[10] Hasanah et al. (2021)
[11] Said (2017)
[12] Said (2017)
[13] Hasanah et al. (2021)
[14] Haryadi (2022)

implementation especially in legal certainty. This research later on accommodated an advice from the research undertaken by Hasanah [15] and Haryadi [16].

The government has implemented various effective methods to increase taxpayer compliance, namely by creating a tax amnesty policy (2016) and a voluntary disclosure program (PPS) in 2022. This policy has been implemented since January 1, 2022 - June 30, 2022 (Hanvansen et all, 20220. The amount of tax revenue is determined by the taxpayers themselves. In this case, the most determining factor is taxpayer compliance. They are required to be aware and responsible for their tax obligations. The reason compliance is considered very important is because this compliance can increase revenue and make taxpayers understand the meaning of paying taxes. Although there are still many tax frauds in Indonesia.

This study aims to obtain empirical evidence on the importance of how the meaning of the fairness of voluntary programs affects taxpayer compliance. So theoretically, the results of this study are expected to add to the theory that can be a reference for practical levels that are implicational in efforts to improve taxpayer compliance in terms of a sense of justice for taxpayers. The results of this study can also be a consideration for tax authorities for future procedures, especially in terms of justice, so that public trust increases which will then affect the level of compliance.

II EXPLANATION OF TERMS

A *Tax Justice*

For taxpayers, fairness is such a meaningful thing which later on can turn them into behaving obediently. That fairness can only be called fairness if that fairness is truly experienced by them. Sourcing to attribution theory, one will behave supposing that he is affected by an aspect that comes from within or outside himself. Therefore, once related with tax justice sourcing to attribution theory, in this theory one's behavior is externally caused by an aspect outside his expertise[17]. Tax justice is assumed to be an influence from taxpayers' point of view regarding tax embezzlement if one does not look closely into his tax rights and obligations. [18] In universal, Wardana[19] reported that on the occasion that tax is a harmony between benefits gained and cost expensed. In taxation realm, tax justice is assumed to be as long as tax payment tested by taxpayers gains worthy benefits of government service towards society. Weinzierl [20]divided justice in taxation into 2 (two) groups, which are 1) vertical equity group, which is a different treatment based on taxpayers' personality, for instance

[15] Hasanah et al. (2021)
[16] Haryadi (2022)
[17] Diswandi Ma'ruf, Prayitno Basuki, 'The Relationship Between The Implementation Of The Voluntary Disclosure Program With The Principle Of Justice In Taxation' (2023) 7(3) *American Journal of Humanities and Social Sciences Research* 208.
[18] Akbar Yoga Karunia Ikhsan Sudiro, Icuk Rangga Bawono and Rasyid Mei Mustofa, 'Effect Of Tax Justice, Tax System, Technology And Information, And Discrimination Of Personal Perspection Of Personal Tax Mandatory About Tax Ethics' (2020) 8(1) *JAK (Jurnal Akuntansi) Kajian Ilmiah Akuntansi* 76.
[19] Wardana (2021)
[20] Weinzierl (2014)

tariff comparison between individual business and business entity. 2) Horizontal equity group, which is justice served granted that taxpayers share similar characteristics.

The concept of tax justice is defined as the principle of taxation which treats all taxpayers equally. That is, the State may not discriminate or arbitrarily in collecting taxes. Tax collection is carried out under the same conditions and must be treated equally. Following the legal objective of achieving justice, tax collection must be fair in statutory regulations and implementation. The aim is to provide legal guarantees to the State and its citizens. According to Mangoting, as quoted by Ariema (2008), justice is the keyword in the government's efforts to collect funds from the community (transfer of resources). Taxes must be imposed relatively and evenly by the principle of equality (fairness). Taxes are imposed on individuals in proportion to their ability to pay these taxes, and according to the benefits they receive from the State. There are two well-known principles of justice in tax collection: The benefit of Principle Approach and the Ability to Pay a Principle Approach. A tax collection system is fair according to the benefit principle approach if the amount of tax each taxpayer pays is proportional to the benefits he receives from government activities. Information regarding the value of the benefits enjoyed by taxpayers for the facilities provided by the government, which are financed from tax revenues, is an absolute requirement to be able to apply tax imposition through this approach (Maaruf et al, 2023)

B *Voluntary Disclosure Program (VDP)*

In pursuance of increasing taxpayers' compliance and state revenue from taxation zone, the government produced a number of policies such as validating Law number 7 Year 2021 on taxation regulations harmonization. One of the policies stated that law is Voluntary Disclosure Program (VDP). VDP is a voluntary activity where it shares means to rectify their taxation obligations (OECD, 2015).

C *Philosophical Meaning of Justice upon Voluntary Disclosure Program.*

The effectuation of the self-assessment tax collecting system provides an opportunity for society, in this case taxpayers to actively calculate, pay, and report all taxation aspects themselves. Aside from its practicality, this system is expected to be able to reduce the government's work in tax collecting [21]. On the other hand, self-assessment system implementation could cause fraud in taxation aspects committed by society [22]. One of the triggering factors is injustice in taxation system [23]. Therefore, the government constantly strives to increase justice in taxation system; one of the efforts is performing Voluntary Disclosure Program (VDP).

In its implementation according to Law number 7 Year 2021 on Taxation Regulations Harmonization, there are 2 (two) activity designs in VDP. The first design is the sought subjects are individual taxpayers and entities that have been included in amnesty in 2016. These taxpayers are given the opportunity to submit or deliver wealth that has not been fully or partially disclosed in the statement letter, as long as Directorate General of Tax (DGT) has

[21] Enggar Pratiwi and Ronny Prabowo, 'Keadilan Dan Diskriminasi Pajak Terhadap Penggelapan Pajak: Persepsi Wajib Pajak Orang Pribadi' (2019) 2(1) *AFRE (Accounting and Financial Review)*.
[22] Ibid.
[23] I Nyoman Darmayasa, 'Preskriptif Ketentuan Umum Perpajakan Dalam Perspektif Akuntansi Pancasila' (2019) 10(1) *Jurnal Akuntansi Multiparadigma*.

not obtained it. Wealth explained is nett wealth sourcing from total wealth owned reduced by total debt. Not only that, in the first design wealth that is allowed to be exposed is wealth owned and earned by taxpayers starting from January 1, 1985 to December 31, 2015. Nett wealth explained past that time is assumed to be added to final taxable income. The following is the first design tariff according to Law no. 7 Year 2021 on VDP. Present the methodology used in the study, as well as the research techniques used.

Table 1. Tariff according to Law No.7 - Year 2021 on VDP

Tariff	Provision
6% sourced from net wealth owned and located in Indonesia	Capital investment executed in Indonesia is businesses in natural resources or renewable energy zone, and or state securities / *SBN*.
8% sourced from net wealth owned and located in Indonesia	Capital investment executed in Indonesia is businesses that are not in natural resources or renewable energy zone, and or state securities / *SBN*.
6% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is diverted to Indonesia where it is utilized as capital investment in Indonesia on businesses in natural resources or renewable energy zone, and or state securities / *SBN*.
8% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is diverted to Indonesia where it is utilized as capital investment in Indonesia on businesses not in natural resources or renewable energy zone, and or state securities / *SBN*.
11% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is not invested in Indonesia.

Source: Law No. 7 Year 2021 on Harmonizing Taxation

In the second design, targeted items are Individual Taxpayers. It differs from the first design; in the second design it focuses more on taxpayers that were not included in the Tax Amnesty program with a disclosure provision of: a) reporting nett wealth value earned from January 1, 2016 - December 31, 2020, b) reporting currently earned wealth on December 31, 2020, and c) wealth that has not been reported in Annual Tax Return individual income tax in tax year of 2020. Along with the first design, that wealth is assumed to be an extra income earned by individual taxpayers in 2020 that is subject to final income tax. The following are the second design tariff according to Law number 7 Year 2021 on VDP.

Table 2. Tariff according to Law No. 7 - Year 2021 on VDP.

No	Tariff	Provision
11.	12% sourced from net wealth owned and located in Indonesia	Capital investment executed in Indonesia is businesses in natural resources or renewable energy zone, and or state securities / *SBN*.
22.	14% sourced from net wealth owned and located in Indonesia	Capital investment executed in Indonesia is businesses that are not in natural resources or renewable energy zone, and or state securities / *SBN*.
33.	12% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is diverted to Indonesia where it is utilized as capital investment in Indonesia on businesses in natural resources or renewable energy zone, and or state securities / *SBN*.
44.	14% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is diverted to Indonesia where it is utilized as capital investment in Indonesia on businesses not in natural resources or renewable energy zone, and or state securities / *SBN*.
5.	18% sourced from net wealth owned and located outside Indonesia	Wealth abroad that is not invested in Indonesia.

Source: Law No. 7 Year 2021 on Harmonizing Taxation

D *Taxpayers' Compliance*

According to Pasaribu and Tjen [24], compliance is a fulfillment of regulations in taxation that has to be fulfilled voluntarily by taxpayers without any prior inspection, investigation, warning, threatening, and criminal or administrative sanction application. Hence taxpayers' compliance is all kinds of taxation regulations and taxation rights and obligations implementation in adherence to available taxation law that has to be obeyed and fulfilled by taxpayers. There are two types of taxpayers' compliance in taxation, [25] which are: 1) Formal Compliance, in which taxpayers formally carry out their responsibilities based on the decree in available taxation regulations. For example, submitting Annual Tax Return on time and not overdue, while 2) Material Compliance, in which taxpayers fulfill their obligations substantially or realize all taxation material stipulations that are appropriate with the content and soul of material compliance tax law as well as formal compliance.

Referring to Minister of Finance Regulation No. 74/PMK.03/2012 regarding taxpayers determination with certain criterias, it is regulated concerning taxpayers' obedience category . which are: 1) Time conformity in submitting Annual Tax Return (ATR), 2) Does not have any unpaid tax debt that has obtained installment permission or tax payment delay, 3) Financial statement is audited by Public Accountant or government financial supervision

[24] Pasaribu & Tjen (2016)
[25] Herwinarni & Anggraeni (2016)

board with Unqualified (Audit Opinion) opinion within 3 (three) years, 4) Has never been punished over criminal action in taxation referring to court sentence that has binding legal force within the past 5 (five) years.

III RESEARCH METHOD

This research applies a qualitative descriptive approach. Qualitative descriptive research is conducted by describing identified problems or issues, or in other words it is an effort to disclose existing facts [26]. In this research the phenomenon that would like to be disclosed is interpreting justice concept upon Voluntary Disclosure Program activity or which is often called as tax amnesty volume II, while the data used in this research is primary data, which is obtained directly from the source person or informant. There are 5 respondents consisting of 2 taxpayers and 3 people as consultant practitioners, academics (tax lecturers), authorities (tax office employees), 1 OP taxpayer, 1 Corporate Person. While the criteria for research respondents are, Practitioners from tax consultants: considered to have an understanding of taxation and assist taxpayers in fulfilling their compliance. Tax academics: have an understanding of taxation and are neutral/impartial between taxpayers and tax authorities. Authorities (from the tax office): have an understanding of taxation, in addition to having the authority to issue tax regulations. Data collection method is conducted by structured and unstructured interview methods. The source person of this research are regulators from Tax Office, academics from Bali University Tax Center Association (*ATPETSI*) and practitioners from tax consultant associations. These respondents are selected due to their proper comprehension regarding the VDP. Based on the interviews conclusions are drawn.

IV RESULTS AND DISCUSSION

The analysis and discussion of the results should characterize the context of the research, either through the description of the environment, conjuncture or economic sector. Present the development of the research. Structuring subsections in the sense of 'responding' to the objectives to which the work proposes. It can be structured in subsections in order to respond to the objectives to which the work proposes.

A *Voluntary Disclosure Program and taxpayers' compliance.*

Covid-19 virus phenomenon that hit the world including Indonesia has impacted greatly in numerous sectors. The restriction of society's activity through Large Scale Social Restriction (LSSR) / *Pembatasan Sosial Masyarakat berskala Besar (PSBB)* and Community Activity Restriction Enforcement (CARE) / *Pemberlakukan Pembatasan Kegiatan Masyarakat (PPKM)* in various levels impacted greatly towards the world of industries in Indonesia. Numerous companies made their employees redundant or even laid off their workers as a

[26] Sugiyono, *Metode Penelitian Kuantitatif, Kualitatif Dan R&D* (Alfabeta, 2011).

result of no production [27]. According to Hanvansen and Wenny [28], this Covid-19 phenomenon also impacted the national economy. The prolonged pandemic delivered the national economy to recession. It is viewed from the number of unemployment in 2020 at 7.07%, increasing as much as 1.84% from 2019. This economic decrease affected national tax revenue. Tax revenue realization was only 84.7% of the state budget target or decreasing by 19.6% compared to 2020, while tax was the highest revenue source.

This phenomenon then impacted the government when they later issued various regulations to aid national economy recovery in order to increase state revenue from tax sector. One of the regulations issued was by issuing Law Number 7 Year 2021 on Taxation Regulations Harmonization (TRH) / *Harmonisasi Peraturan Perpajakan (HPP)* [29]. This law issue was expected to provide justice, a healthier, more effective and accountable climate. Furthermore, one of the bases in issuing this regulation was to increase state revenue from tax sector. One of the programs in TRH law that was executed to increase revenue from tax sector was through Voluntary Disclosure Program (VDP) activity [30]. Related with state revenue in VDP program, a tax academic from *ATPETSI* Bali Bapak Nyoman stated his opinion as follows:

> "…Textually VDP - voluntary disclosure program is a voluntary disclosure program, becoming a priority solution towards conditions that background and urge fund needs for economic recovery."

The opinion from Bapak Nyoman was also supported by tax authority that was represented by Singaraja Primary Tax Office Bapak Wisman, who opinionated as follows:

> "…VDP is one of various programs created by the government in order to increase state revenue from the tax sector."

Based on both opinions stated by practitioner from *ATPETSI* and authority party from Singaraja TO, they supported the previous research opinion that stated one of the purposes of VDP was to increase revenue from taxation sector. Based on the data quoted from www.newsddtc.co.id, the amount of funds received from VDP was Rp. 114,55 trilions. This amount sustained state revenue from tax sector that was growing until the end of June 2022 as much as 55.7% with an achievement as much as 58.5% of the 2022 state budget target (Utomo, 2022).

Aside from the revenue aspect, VDP was also considered capable of increasing taxpayers' compliance behavior. [31] Related with compliance, practitioner party from one of tax consultant associations Ibu Sagung stated as follows:

> "…In my opinion by implementing VDP, the state is still giving an opportunity for taxpayers for 'atonement' on their insubordination in reporting their ATR."

[27] Ningtyas and Aisyaturrahmi (n 8).
[28] Hannes Hanvansen and Cherrya Dhia Wenny, 'Pengaruh Kesadaran Wajib Pajak Terhadap Kepatuhan Wajib Pajak Kendaraan Bermotor Di Palembang Dengan Sanksi Pajak Sebagai Intervening' (2022) 1(1) *Jurnal Ekonomi Dan Bisnis* 175 <https://jurnal.mdp.ac.id/index.php/msc/article/view/1708%0Ahttps://jurnal.mdp.ac.id/index.php/msc/article/download/1708/597>.
[29] Ferry Irawan and Punjung Raras, 'Program Pengungkapan Sukarela Dalam Rangka Meningkatkan Kepatuhan Pajak Di Masa Pandemi Covid-19' (2021) 1(2) *Pengmasku* 86.
[30] Hasanah et al (n 9).
[31] Ibid.

Based on this practitioner's statement it shows that VDP activity provides an opportunity for disobedient taxpayers to be obedient by submitting untruth in ATR or unreported in the previous year's ATR in VDP. It is also supported by tax authority from TO and academician from *ATPETSI* with opinions as follows:

> "…With an effort from the government towards taxpayers with wealth disclosure without any sanction and a much cheaper redeem tariff from regular income tax, it becomes an opportunity for taxpayers to fulfill their taxation obligation compliance that remained unacceptable until Year 2020."

> "…Once traced in more detail on academic transcript, VDP was initiated from the fact that taxpayers' compliance was not optimal post tax amnesty, there was even a difference in cash and cash equivalents between AEoI data and ATR in 2018."

Based on those three research source person's opinions, it reconfirmed that one of the goals of the voluntary disclosure program mandated based on Law number 7 Year 2021 regarding TRH was to be a state revenue source and able to increase taxpayers' compliance.

VDP is a policy created by the government in order to give a sense of fairness towards society, in this case taxpayers that did not submit ATR in real condition. In addition, this program is an 'atonement' program that can be utilized by non-compliant taxpayers (Haryadi, 2022). This opinion is backed up by the authority party from Singaraja TO Bapak Wisman as follows:

> "…In my opinion, the regulation from VDP undoubtedly takes the taxpayers' side; taxpayers are still given an opportunity to choose with a consequence upon their option."

Based on the authority party's point of view, VDP has a justice aspect where society who have not or did not disclose their wealth could decide a scheme to be followed, whether they would utilize tax imposition based on their income calculation or a final tax aspect upon wealth owned that have not been recorded in ATR (Regulation from Minister of Finance number 196/ PMK.03/2021 regarding Voluntary Disclosure Program Procedures).

A slightly different view was mentioned by the academician party from *ATPETSI* and practitioners. Their opinions are as follows:

> "…The benefit and justice in VDP is more on juridical aspect level. The concept of VDP emphasizes more on legal certainty aspect for taxpayers who participate in VDP, considering the legal certainty indicator is indeed an important part to increase investment during economic recovery condition past the 2-year pandemic. Justice does not become a priority when legal certainty surpasses it, but it does not mean that justice is negated. It is endeavored in a way that it is fair for most taxpayers."

> "…If we compare it with TA in the previous 2016, this VDP policy is still lacking in benefits because its implementation is on quite a high tariff and the regulated tax imposition base causes taxpayers to be not all-out in disclosing their wealth. Moreover, with the current economic condition (Covid-19 pandemic impact) there is a struggle for taxpayers in paying tax ransom. Justice has already been adjusted to a followed scheme thus the tariff conforms to it."

Sourcing to both comments mentioned above by an academic from *ATPETSI* and a practitioner, it could be concluded that VDP indeed provides justice, yet it has to constantly be reviewed regarding its juridical and economic aspects. In juridical aspect, this program

cannot certainly oppose 2016 tax amnesty (TA) activity stipulations, which is stated in Article 18 paragraph 2 of Law no. 11 Year 2016 on Tax Amnesty that unless it is a TA participant, DGT was only given time to obtain unreported assets within 3 years since the stipulation was in effect from July 1, 2016, which was June 30, 2019. VDP regulation started to be in force in 2022; it meant that since VDP enforcement DGT was automatically not entitled to give any sanctions towards taxpayers who did not participate in TA should there be any wealth discovery. If this stipulation is not executed, there will be apathy from society regarding legal certainty [32]. On the contrary, sourcing the economic aspect, society's condition that has not fully recovered from Covid-19 pandemic is a great challenge for the announced fairness.

B *Tax Justice Concept in the future.*

When speaking in general terms of justice, especially in taxation, justice cannot be separated from society's rights and the need to fulfill obligations. [33] Even the fifth precept of Pancasila as the foundation of this country has mentioned it: social justice for all Indonesian people. [34] Based on regulation context, law as the guard in determining taxation implementation has to be in accordance with the legal purpose, which is fair; in this case it is accustomed to society's ability to pay and the government's ability to undertake it generally and evenly [35]. Regarding VDP, this activity cannot be separated from pros and cons in its implementation [36]. Pro society would assume that VDP would increase state revenue with the result that it would affect the increase of the national economy and provide justice for society who have not fulfilled their taxation obligations. On the other hand, for the cons party VDP provides injustice for impoverished society because the solvent society does not pay taxes that have previously been hidden. Furthermore, they assume VDP is a form of the government's despair in collecting taxes, hence society is obliged to pay. Therefore, the concept of fairness in the future will be reflected from how the government in this case tax authority takes actions and is consistent with the applied regulations. Legal certainty is one of the factors in increasing taxpayers' compliance. [37] This opinion is supported by an academic from *ATPETSI* and local authority as follows:

> "...Each policy formulation has to fulfill philosophical, sociological, and juridical aspects. Philosophical aspect: must abide Pancasila values (simply put, it cannot be against it). Its purposes are for the greatest in bringing out justice (the fifth precept) for all taxpayers. Sociological aspect: respond to society's needs and honor value norms in society. Juridical aspect: assure legal certainty and fairness towards society. Fair for each taxpayer or strive for the larger part of taxpayers and provide legal certainty for taxpayers."

Furthermore, "…In my opinion, what has to be noticed in every disposition is simplicity, benefit, justice, and transparency."

[32] Haryadi (n 14).
[33] Pratiwi and Prabowo (n 21).
[34] Darmayasa (n 23).
[35] Pratiwi and Prabowo (n 21).
[36] Hasanah et al (n 9).
[37] Haryadi (n 14).

V CONCLUSION

The research result demonstrated VDP activity that was based on TRH law theoretically was expected to increase tax revenue and taxpayers' compliance behavior. The result was supported by practitioners from ATPETSI and the authority party from Singaraja TO, who backed up the previous research statement where one of the purposes of VDP was to increase revenue from tax. Aside from revenue, VDP was also considered capable of increasing taxpayers' compliance. However, Pratiwi and Prabowo [38] stated that self assessment system implementation could cause fraud in taxation aspects committed by society. One of the triggering factors in tax fraud was unfairness in the taxation system. [39] VDP is a policy created by the government in order to provide a sense of fairness towards society, in this case taxpayers who did not submit ATR based on real conditions. This opinion was supported by an authority party from Singaraja TO Bapak Wisman. A similar opinion was mentioned by an academician from ATPETSI and a practitioner, where they stated that VDP did indeed provide justice. Yet, this justice cannot be separated from juridical and economic aspects.

On the whole, this research result supports the government's policy stated in Law number 7 Year 2021 regarding Harmonizing Taxation Regulation especially those that are related with VDP activity, in which VDP is aimed to increase state revenue, provide justice in terms of taxation and also expected to increase taxpayers' compliance. Theoretically, this research provides explanation related with justice in VDP aspect particularly, and general taxation in general, including an increase in taxpayers' compliance. In practice, this research is expected to provide inputs towards the authority party, in this case tax party, in which seen from this research that there remained overlapping regulations between tax amnesty that was conducted in 2016 with VDP, so it is important for implementation of legal certainty.

The limitation of this research merely interprets justice based on experts' point of view, which are from the tax authority party, academics, and practitioners in taxation party. However, this research did not include taxpayers. It is based on the possibility of difference in interest, where one of the VDP's main purposes was to increase state revenue, while for society tax is a burden. Therefore, the next researcher could do further research by adding arguments from taxpayers without acknowledging the tax meaning aspect from their point of view. Besides that, an alteration in research method from qualitative into quantitative is highly possible in the future, one of them by testing the connection between legal certainty as one of its variables.

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[38] Pratiwi & Prabowo (2019)
[39] Darmayasa (n 23).

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NOT-FOR-PROFIT ORGANISATIONS AND THE TAX STATUS OF PROFESSIONAL SPORT: REVISITING THE EXEMPTION STATUS OF THE AUSTRALIAN FOOTBALL LEAGUE AND ITS CLUBS

Matt Nichol[*]

Abstract

Sport holds a unique place in Australian society. Underlying this position is the tax exemption given to sport under s 50-45 of the Income Tax Assessment Act 1997 (Cth). This exemption does not differentiate between community and professional sport. The Australian Football League ('AFL') and its 18 clubs all enjoy not-for-profit status under the s 50-45 sports exemption and do not pay income tax. This article will argue that the AFL and its clubs should not be tax exempt. The tax exemption was designed for community sporting clubs and leagues with low levels of income and not wealthy professional sports entities. In 2023 the AFL earned $1 billion in revenue and the clubs between $50 million and $105 million in revenue. Another justification for a change in tax status is the AFL's and some club's close relationship with the gambling industry and the receipt of significant income. It will also be argued that the government tax subsidy should not be used by the AFL to pay its executives over $11 million in salary. This article suggests reforms such as amending the s 50-45 exemption to only cover community clubs and leagues, taxing the commercial income of sports that relate to ordinary business income and treating sports as charities and requiring them to benefit the public.

I INTRODUCTION

Some businesses that are not-for-profit entities receive taxation exemptions from income tax, fringe benefits tax and goods and services tax.[1] The not-for-profit sector in Australia consists of approximately 600,000 organisations.[2] The Australian Taxation Office ('ATO') is aware of over 200,000 entities that receive one or more tax concessions. But only 60,000 are registered charities that operate under a legislative scheme and report to the Australian Charities and Not-for-profits Commission. Little is known about approximately 140,000 to 145,000 entities who receive significant tax concessions.[3] Of the entities that are not-for-profits with the ATO, 26 per cent are non-charitable sporting clubs or associations.[4] Subsequently, Australia has been described as a 'tax haven' for charities.[5]

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[1] See Not-for-Profit Sector Tax Concession Working Group, Fairer, simpler and more effective tax concessions for the not-for-profit sector, Final Report, May 2013, 3, 7, 10, Kerrie Sadiq and Catherine Richardson, Tax Concessions for Charities: Competitive Neutrality, the Tax Base and Public Goods Choice' (2010) 25(4) *Australian Tax Forum* 597, 599.
[2] Not-for-Profit Sector Tax Concession Working Group (n 1) 1.
[3] Ann O'Connell, 'Is the tax regime for charities and not-for-profit entities 'fit for purpose'?' (2023) 38(2) *Australian Tax Forum* 267, 270.
[4] Ibid 278.
[5] Sadiq and Richardson (n 1) 600.

Not-for-profits can be differentiated from other organisations on the basis they are voluntary (non-government), altruistic (non-business and no profit motive) and benefit the public (not private).[6] However exemption from taxation is controversial and fuelled by the media's view that the tax exemption for not-for-profits is a concession that puts a taxpayer subsidised hole in government revenue.[7] The value of the charity income tax exemption is unknown but in 2009 it was estimated at a minimum of $4 billion.[8] Tax concessions are justified on the basis that government is subsidising the activities of these organisations as they save government expenditure, provide a public benefit or both.[9] This reflects the fact that personal gain is central to income tax but not the primary purpose of not-for-profits.[10] The absence of clear tax jurisprudence and concerns over revenue holes make not-for-profit organisations a subject that is worthy of academic review.[11]

Professional sport is an industry that receives an income tax exemption as a not-for-profit under the sports exemption contained in s 50-45 of the *Income Tax Assessment Act 1997* (Cth). This exemption does not differentiate between community and professional sports. The Australian Football League ('AFL'), the National Rugby League, Cricket Australia and the Victorian Racing Club all enjoy the s 50-45 exemption and also receive a rebate on fringe benefits given to employees and franking rebates or state tax concessions.[12] This article will focus on the not-for-profit status of the AFL and its clubs. In 2023 the AFL had operating revenues of $1.06 billion, an underlying operating profit of $27.7 million[13] and total assets of $725 million.[14] The revenue of the 18 AFL clubs ranged from $50.39 million at Port Adelaide Football Club to $105.70 million at Richmond Football Club.[15] In addition the AFL receives significant income from the gambling industry. The AFL's preferred betting agency is Sports Bet, and the league receives sponsorship and a percentage of revenues from betting agencies. Some non-Victorian clubs have gambling sponsorship. Until recently all clubs operated poker machine venues, and four Victorian clubs still have poker machines. The subsidising of organisations such as the AFL and its clubs needs to be assessed in terms of efficiency and whether the subsidy goes to entities that provide public benefit, if it is equitable in that businesses are treated in a similar way and whether the concessions go to organisations that need it.[16]

This article will argue in Part III that the AFL and its clubs should not be exempt from taxation laws. The AFL annually generates $1 billion in revenue and clubs have revenues of between $50 million and $105 million. The sports exemption was not intended for professional sports with such large revenue bases but rather community sports clubs and leagues that have small revenues made up of membership fees, sponsorships and perhaps small government grants. The size of the business conducted by the AFL and its clubs mean

[6] Myles McGregor-Lowndes, Matthew Turnour and Elizabeth Turnour, 'Not for profit income tax exemption: Is there a hole in the bucket, dear Henry?' (2011) 26(4) *Australian Tax Forum* 601, 630.
[7] Ibid 602.
[8] Productivity Commission, Contribution of the not-for-profit sector: Research Report (2010) 76, 78.

[9] O'Connell (n 3) 268.
[10] McGregor-Lowndes et al (n 6) 609.
[11] Ibid 605.
[12] O'Connell (n 3) 277.
[13] Australian Football League, AFL Annual Report 2023, 148.
[14] Ibid 153.
[15] This data was collected from club financial reports for 2023 and is included in Part B.
[16] O'Connell (n 3) 268.

the government subsidy is no longer needed, though O'Connell acknowledges some charities apply profits to charitable objects.[17] Also, the public benefit aspect of the AFL and its clubs as not-for-profit entities is not being met historically and currently due to the relationship with the betting industry and the general promotion of gambling on AFL games. Another reason the taxation exemption should not apply to the AFL is it pays its chief executive officer millions of dollars and has a high executive payroll that exceeds $11 million.[18] This article addresses a gap in the literature by contributing to the taxation status of professional sports entities, specifically the AFL.

This article is divided into three parts. Part II sets out a theoretical basis for the article by examining the treatment of not-for-profit entities under Australian income tax law. This part includes analysis of the sports exemption and relevant ATO rulings. Next, Part III explores the not-for-profit status of the AFL and its 18 clubs and looks at arguments for and against the AFL and its clubs retaining taxation exempt status. The article concludes by setting out potential reforms to the taxation status of the AFL and clubs.

II NOT-FOR-PROFITS AND INCOME TAX LAW

Part II will begin by setting out the regulation of not-for-profits under income tax law. It will distinguish between registered charities and other not-for-profit entities. Part II will examine the sports exemption in the *Income Tax Assessment Act* and the relevant taxation rulings of the ATO. Key cases on the sports exemption will be analysed. This part will also set out the principle of mutuality in the tax treatment of organisations with income derived from members. Part II will provide the legal basis for the income tax regulation of sporting clubs and leagues that will enable an examination of the AFL and its clubs in Part III.

A *Who is exempt from the Income Tax Assessment Act?*

The *Income Tax Assessment Act* provides exemptions from income tax for the ordinary and statutory income of specified entities.[19] The exemption applies to charities, education and science.[20] These entities cover charities that are registered with the Australian Charities and Not-for-profits Commission,[21] scientific institutions,[22] public educational institutions,[23] funds established to enable scientific research to be conducted by a public university, public hospital or society[24] and association or club established for the encouragement of science.[25] Exempt charities must be endorsed by the Commissioner for Charities and Not-for-profits.[26] Community service is also exempt where an entity is a society, association or club that is

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[17] Ibid 274.
[18] 'AFL's Travis Auld takes CEO job at Aussie F1 GP', *Sports Business Journal*, 7 December 2023 <https://www.sportsbusinessjournal.com/Daily/Global/2023/07/12/travis-auld-australian-grand-prix.aspx>.
[19] *Income Tax Assessment Act 1997* (Cth), s 50-1.
[20] Ibid s 50-5.
[21] Ibid s 50-5, Item 1.1.
[22] Ibid s 50-5, Item 1.3.
[23] Ibid s 50-5, Item 1.4.
[24] Ibid s 50-5, Item 1.6.
[25] Ibid s 50-5, Item 1.7.
[26] Ibid ss 50-100, 50-105.

established for the purpose of community service, except for political or lobbying purposes.[27] Trade unions, employee associations and employer associations registered under the *Fair Work (Registered Organisations) Act 2009* (Cth) are also exempt.[28] Another category of exemption is for local councils and public authorities.[29] The exemption applies to the health sector and public hospitals, hospitals carried on by a society or association and private health insurers.[30] Societies or associations established for promoting the development of aviation, tourism and various agricultural resources are exempt from income tax.[31] Another exemption is for sports, culture and recreation, where exempt entities include a society, association or club that is established to encourage animal racing, a game or sport, art, literature or music.[32] This article focuses on the income tax exemption for sports, which as will be seen are not-for-profit entities.

B *Origins of the exemption for not-for-profits*

The exemption in Division 50 of the *Income Tax Assessment Act* for charities and other not-for-profit entities is over 100 years old. Australian charities have been exempt from paying income tax since the introduction of taxes by the colonies in 1884.[33] Earlier forms of the exemption were imported from British legislation.[34] The origins of the charity exemption lie in the *Income Tax Assessment Act 1915* (Cth) where religious, scientific, charitable and public education institutions were exempt from paying income tax.[35] Also excluded from income tax under the 1915 Act were friendly societies and trade unions.[36] The tax system for not-for-profits has been amended sporadically, sometimes at the whim of a politician and not as a result of considered tax policy.[37] O'Connell argues that there has been a piecemeal approach to amending legislation for not-for-profits and that there is an inertia to change the system and remove provisions that no longer serve their intended purpose and that is not fit for purpose but rather is a 'dog's breakfast'.[38]

C *The Income Tax Assessment Act and the sports exemption*

Clubs or associations established to encourage a game or sport are exempt from income tax under the sports exemption in section 50-45 of the *Income Tax Assessment Act*. The exemption was first implemented in 1952 when the *Income Tax and Social Services Assessment (No 3) Act 1952* (Cth) introduced a new s 23(g) of the *Income Tax Assessment Act 1936* (Cth) that exempted from income tax societies or clubs established for the encouragement or promotion of an athletic game or sport.[39] For the exemption to apply to the

[27] Ibid s 50-10, Item 2.1.
[28] Ibid s 50-15, Item 3.1 and 3.2.
[29] Ibid s 50-25, Item 5.1 and 5.2.
[30] Ibid s 50-30, Item 6.1, 6.2 and 6.3.
[31] Ibid s 50-40, Item 8.1 and 8.2.
[32] Ibid s 50-45, Item 9.1.
[33] Sadiq and Richardson (n 1) 607.
[34] O'Connell (n 3) 268.
[35] *Income Tax Assessment Act 1915* (Cth), s 11(d).
[36] Ibid s 11(b)(c).
[37] O'Connell (n 3) 268.
[38] Ibid 269.
[39] *St Mary's Rugby League Club Ltd v The Commissioner of Taxation* (1997) BC9702883, Unreported Judgments of the Federal Court of Australia, 1 (Hill J).

AFL and its clubs, they must not carry on business for the purpose of profit or gain for members and they must incur expenses and pursue its objectives principally in Australia.[40] In addition exempt entities must comply with its governing rules and apply its income and assets solely for the purpose for which it was established.[41] These requirements apply to other not-for-profits. A further related requirement identified by the ATO in its public information for sporting organisations is that the sporting club or association be a not-for-profit entity.[42]

The ATO has issued several taxation rulings on the s 50-45 exemption. The 1997 and 2022 taxation rulings are relevant to this article. TR 97/22 provided guidance on sporting clubs seeking exemption under s 50-45 of the *Income Tax Assessment Act*. The ruling stated that three tests had to be satisfied: the club did not operate for the purposes of profit or gain to individual members,[43] it encouraged a game or sport and the encouragement is the club's main purpose.[44] If a club did not meet all three requirements it may still be eligible for a tax exemption for assessable income that is subject to the mutuality principle (to be discussed below).[45] In terms of profit and members, a club's constitution or governing documents were required to contain a prohibition against a distribution of profits and assets among members while it is operating and upon winding-up.[46] Encouragement was given its dictionary meaning of stimulation by assistance which had to be the main or dominant purpose of the club. Examples of direct encouragement included forming, preparing and entering teams and competitors in the game or sport, coordinating activities, organising and conducting tournaments, improving the abilities of participants, improving the standard of trainers and coaches and encouraging increased and wider participation and improved performance. Indirect encouragement was through marketing or facilitating research and development.[47]

The ordinary meaning was given to what is a game or sport.[48] But it should be noted that in 1990 exempt 'sport' was expanded beyond athletic sports and athletic games that involved humans as the sole participants to encompass not-for-profit bodies that promote or encourage any game or sport.[49] A club's main purpose was the encouragement of the relevant game or sport and could be determined after objectively weighing all of the club's features,[50] including that the club in the relevant year conducted activities that were directly related to the game or sport, the sporting activities encouraged by the club were extensive, the club used a significant proportion of its surplus funds to encourage the game or sport and the club's governing documents emphasised that the main purpose of the club was to encourage a game or sport.[51]

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[40] *Income Tax Assessment Act 1997* (Cth), s 50-70(1).
[41] Ibid s 50-70(2).
[42] Australian Taxation Office, Sporting organisations, 24 July 2024 <https://www.ato.gov.au/businesses-and-organisations/not-for-profit-organisations/your-organisation/does-your-not-for-profit-need-to-pay-income-tax/types-of-income-tax-exempt-organisations/sporting-organisations>.
[43] Australian Taxation Office, TR 97/22, Taxation Ruling Income tax: exempt sporting clubs, [7], [9].
[44] Ibid [7].
[45] Ibid [8].
[46] Ibid [10].
[47] Ibid [11].
[48] Ibid [12].
[49] Explanatory Statement to Draft Bill, Taxation Laws Amendment Bill (No. 2) 1990, clause 6, 10.
[50] Australian Taxation Office, TR 97/22, Taxation Ruling Income tax: exempt sporting clubs, [14].
[51] Ibid [15].

In 2022 the ATO replaced TR 97/22 with TR 2022/2.[52] The two rulings are very similar. The revised ruling states a society, association or club may be an incorporated or unincorporated association.[53] Like the previous ruling, an entity must be not-for-profit and not carried on for the purposes of profit or gain for individual members.[54] This requirement can be included in governing documents through a not-for-profit clause or a dissolution clause.[55] Again game and sport are not defined and have their ordinary meaning[56] but include non-athletic activities such as chess or bridge, activities where people use machines (eg. motor racing) and non-competitive activities such as mountaineering.[57] Convention, expectations and rules are a common feature of a game or sport and contributes to the element of organisation. While written rules are not essential, according to TR 2022/2 they turn what is a leisure activity into a game or sport.[58]

D *The sports exemption cases*

The ATO's ruling TR 2022/2 is based on a number of sports cases determined by the Federal Court of Australia and the Administrative Appeals Tribunal. One of the leading cases is the 1990 Federal Court case *Cronulla-Sutherland Leagues Club v Commissioner of Taxation*.[59] The taxation exemption issue addressed by the Full Federal Court on appeal was whether the Cronulla-Sutherland Leagues Club was established to encourage or promote rugby league football.[60] The appellant was known as a 'leagues club' that provided financial support to a 'football club', the Cronulla-Sutherland District Rugby League Football Club. The football club survived on the basis of the funding and the provision of an office and ground by the leagues club.[61] To determine the purpose of the club the Court ruled the purpose is not to be viewed as the periodic, recurrent or static purpose but the purposes of the club in the relevant income year.[62] The Federal Court ruled that the main purpose and not independent or secondary purposes that are ancillary or incidental to the main purpose must be identified to determine if the main purpose is the promotion of sport.[63] Justice Lockhart ruled that true character and nature of the taxed entity must be assessed according to its objects, purposes and activities. Further, the main or predominant object or purpose of the sports club must be the encouragement or promotion of athletic game or sport.[64] His Honour ruled that it is insufficient to look at the purpose of the tax payer at formation but rather the constitution, activities, its history and control are relevant factors that are not static.[65] Justice Lockhart found that the main purpose of the appellant was the provision of a social and sporting club with facilities for its 13,000 members and not the encouragement or promotion of rugby football.[66] Justice Foster concurred with Lockhart J and held the main purpose of the

[52] Australian Taxation Office, TR 2022/2 Taxation Ruling Income tax: the games and sports exemption, [6].
[53] Ibid [8].
[54] Ibid [11].
[55] Ibid [14].
[56] Ibid 17.
[57] Ibid [18].
[58] Ibid [19].
[59] (1990) BC9003405, Unreported Judgments of Federal Court of Australia.
[60] Ibid 4 (Lockhart J).
[61] Ibid 2 (Lockhart J).
[62] Ibid 5 (Lockhart J) and 21 (Beaumont J).
[63] Ibid 8 (Lockhart J).
[64] Ibid 8-9 (Lockhart J) and 21 (Beaumont J).
[65] Ibid 8-9 (Lockhart J).
[66] Ibid 9 (Lockhart J).

taxpayer was to provide the facilities of a licensed club for its members and others.[67] Justice Beaumont dissented. His Honour held that a club that has a diverse range of activities for its members that has nothing to do with the encouragement or promotion of a sport or game can still have as its main purpose the encouragement or promotion of the sport. Justice Beaumont said that the provision of money or the value of money to the sporting body can be the encouragement and promotion of a sport and that the greater the size of the club and the more profitable it is aids in the capacity to provide financial assistance. Further, Beaumont J held that the successful growth of a club does not mean its purpose has changed.[68] Soon after the decision in *Cronulla-Sutherland Leagues Club* the Federal Court stated that it provided the authoritative test for determining whether an organisation encourages or promotes a sport or game under what is now s 50-45.[69] A number of cases applied *Cronulla-Sutherland Leagues Club*.

In 1992 the Administrative Appeals Tribunal decided *Re Tweed Heads Bowls Club and Federal Commissioner of Taxation*[70] and did not follow *Cronulla-Sutherland Leagues Club*. Deputy President Gerber ruled that since it was formed the Tweed Heads Bowls Club had been dedicated to a substantial degree the promotion of lawn bowls and recently indoor bowls. This was despite some activities being social but common to most sports clubs. The significant revenues created from poker machines were largely used for developing the club's facilities and sporting facilities. The main object of the club was the encouragement of promotion of the sport of bowls.[71]

Justice Hill was the trial judge in *Cronulla-Sutherland Leagues Club* and was once again the judge at first instance in the 1997 case *St Mary's Rugby League Club Ltd v The Commissioner of Taxation*.[72] His Honour said that while the law is settled there can be difficulties for the Commissioner of Taxation or a club in applying the law as many sporting club start as advancing sport but due to the taxation exemption the club grows, specifically in relation to income that can further the sporting activities such as poker machines, alcohol sales and bingo.[73] The Court distinguished the taxpayer from the Cronulla-Sutherland Leagues Club on several grounds. Members of the St Mary's Rugby League Club were drawn to it due its interest in rugby league, control of the entity vested in the directors of the company who were footballers or life members, there were two clubs in *Cronulla-Sutherland* where the taxpayer club did not have a rugby team while South Sydney was established for and continued to run junior and senior rugby league football teams and the constitution, activities, history and control of South Sydney indicate the main purpose of the club was the encouragement or promotion of rugby league.[74]

Re South Sydney Junior Rugby League Club Ltd and Commissioner of Taxation[75] was determined in 2006 and involved a leagues club that distributed a percentage of profits to a junior rugby league and the South Sydney Rabbitohs in the National Rugby League. The

[67] Ibid 26 (Foster J).
[68] Ibid 25 (Beaumont J).
[69] *Terranora Lakes Country Club v Federal Commissioner of Taxation* (1993) 25 ATR 294, 296 (Hill J), *St Mary's Rugby League Club Ltd v The Commissioner of Taxation* (1997) BC9702883, Unreported Judgments of the Federal Court of Australia, 1 (Hill J).
[70] (1992) 24 ATR 1068.
[71] Ibid 1082-1084 (Deputy President Gerber).
[72] (1997) BC9702883, Unreported Judgments of the Federal Court of Australia.
[73] Ibid 2 (Hill J).
[74] Ibid 8 (Hill J).
[75] (2006) BC200601475, Unreported Judgment, Administrative Appeals Tribunal.

Administrative Appeals Tribunal refused to distinguish the taxpayer sports club from the Cronulla-Sutherland Leagues Club[76] on the basis it was as successful as Cronulla-Sutherland and that it had a very large membership that offered a large range of activities, facilities and entertainment that was subsidised. Entertainment and catering were subsidised by large revenues from poker machines. The Tribunal also found that the board of directors had an interest in rugby league but there was no evidence of any involvement in rugby league by the members and that the members were primarily interested in the benefits of membership of the club. Further, Deputy President Block held that the club's facilities were utilised by non-members who were interested only in the club's facilities.[77]

E *Not-for-profits and the principle of mutuality*

The principle of mutuality applies to the membership of organisations, and it is based on the proposition that an entity cannot derive income from itself, that is, membership fees are not income. Mutuality is when members contribute money to a common fund for their mutual benefit, there has been a derivation of income and any surplus given to members is not income but rather members receiving their money back.[78] Mutuality holds that income is only derived from external sources and internal sources of income are not assessable for income tax.[79] The principle is a common law rule that is recognised to some degree in s 59-35 of the *Income Tax Assessment Act*, though mutuality is not explicitly recognised in Australian taxation legislation.[80] Mutuality has its origins in *Styles (Surveyors of Taxes) v New York Life Insurance Company*[81] and the High Court followed this decision in *Bohemians Club v Acting FCT*.[82] The courts have held the principle of mutuality to be based on organisations who form not to derive profits or gains but achieve a benefit for all their members through a mutual contribution.[83] The mutuality principle applies to all entities and not just sporting organisations. Even if a sporting club is ineligible for the sports exemption in s 50-45 they can still rely on the mutuality principle to receive the income tax exemption.[84] Also, the mutuality principle does not prevent
revenues from outside the organisation (in sport television rights, merchandise sales, non-member ticket sales, etc) from being classed as income.

F *The Charities Act and Not-for-profits Commission*

Under the *Income Tax Assessment Act* a not-for-profit entity can be a 'registered charity' under the *Australian Charities and Not-for-profits Commission Act*.[85] The Australian Charities and Not-for-profits Commission can register entities as particular types and subtypes of not-for-profit entities and the Commissioner can also revoke the registration of

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[76] Ibid [102] (Deputy President Block).
[77] Ibid [101] (Deputy President Block).
[78] O'Connell (n 3) 289-290.
[79] Nathalie Love, 'The Relevance of the Mutuality Principle within the Non-Profit Sector' (2007) 13(1) *Third Sector Review* 57, 57.
[80] Ibid 62.
[81] (1889) 14 App Cas 381.
[82] (1918) 24 CLR 334.
[83] Love (n 79) 62.
[84] *Cronulla Sutherland Leagues Club Ltd v Commissioner of Taxation* (1990) BC9003405, Unreported Judgments of Federal Court of Australia, 15 (Beaumont J).
[85] *Income Tax Assessment Act 1997* (Cth), s 995-1.

entities.[86] Registration is a prerequisite for an entity to obtain some Commonwealth tax concessions[87] and exemptions, benefits and concessions under other Australian laws.[88] The Australian Charities and Not-for-profits Commission maintains a register known as the Australian charities and not-for-profits register which contains the registered entity's name, contact details, ABN, type of entity registered, date of effect of registration and the entity's governing rules.[89]

The Australian Charities Report produced data on registered charities which is useful for analysing sports not-for-profits in Part B. There are various sizes of charities. Extra small charities have total revenue of less than $50,000, small charities have total revenue of less than $500,000, medium charities have revenues that range between $250,000 and $1 million, large charities have total revenues of $1 million to $10 million, very large charities have revenues between $10 million and $100 million and extra-large charities have revenues that exceed $100 million. Of the registered charities 30.9 per cent are extra small, 21 per cent small, 14.6 per cent medium, 13.5 per cent large, 4.4 per cent very large and 0.5 per cent extra-large. There were 15 per cent of charities whose size was unknown.[90]

III The Not-for-Profit Status of the Australian Football League and its Clubs

Part III will now examine the not-for-profit status of the AFL and its 18 member clubs. Registration by the Not-for-profits Commission and whether clubs can distribute their profits to members under their constitutions will be explored. The revenues of the AFL and clubs will also be set out and whether other industries with large revenues are treated as not-for-profit entities. It can be argued that the AFL and its clubs no longer need the government support and tax concessions that were perhaps justified between the 1950s and 1980s. The AFL and the clubs are wealthy entities with significant income that is not being taxed. There are also issues about the social harms caused by gambling and the reliance of the AFL and some clubs on the gambling industry for revenue.[91] Part III will also assess these and other arguments against the AFL and clubs receiving tax exemption status and look at justifications for retaining the exemption.

A *The Australian Football League, its clubs and status with the Not-for-profits Commission*

The register for the Australian Charities and Not-for-profits Commission contains all charities registered under the *Australian Charities and Not-for-profits Commission Act*.[92] A search of the register reveals that neither the AFL nor its clubs are registered charities. However a number of clubs have registered foundations. The Collingwood Football Club,

[86] *Australian Charities and Not-for-profits Act 2012* (Cth), s 20-5(1).
[87] Ibid s 20-5(2).
[88] Ibid s 20-5(3).
[89] Ibid s 40-5(1)(a).
[90] Australian Charities Report, 10th edition, 20.
[91] Ibid 282.
[92] See Australian Charities and Not-for-profits Commission, 'Search for a charity' <https://www.acnc.gov.au/charity/charities>.

Hawthorn Football Club, St Kilda Football Club and Essendon Football Club all have registered charities.[93]

B *Distribution of profits and Australian Football League and club constitutions*

For the AFL and its clubs to have not-for-profit status with the ATO they cannot distribute their profits to members, officers, directors or trustees or disperse a surplus or their assets to members upon winding up. Essentially a not-for-profit cannot have equity. This is known as the non-distribution constraint and is a key characteristic of not-for-profits.[94] To determine whether the AFL and clubs can distribute any profit to members it is necessary to look at the league and club constitutions. In a sign of the governance of AFL clubs, only eight clubs make their constitutions available on their websites. Adelaide Football Club, Brisbane Football Club, Carlton Football Club, Collingwood Football Club, Essendon Football Club, Melbourne Football Club, Richmond Football Club and the Western Bulldogs Football Club all publish their constitutions on their websites. The AFL's constitution is not available on its website but via the internet. These constitutions will now be examined and used as a representative group for the other ten AFL clubs.

In order to attain not-for-profit status the constitutions of all eight clubs and the AFL prohibits the payment or distribution of profits, income, dividend or assets to members.[95] The income and property of the club and the AFL can only be applied to the promotion and objects of the club and league as set out in the constitution.[96] Such clauses ensure the clubs and AFL have not-for-profit aims in order to receive tax concessions. The objects of the AFL are to conduct the men's and women's AFL competitions and to promote and encourage football and football matches in Australia and elsewhere.[97] The Adelaide Football Club constitution will be used as an example of the promotion and objects clause in AFL club constitutions. The Adelaide Football Club has four objects and powers for which it was established: football and sporting, social and facilities, administration and community.[98] The football and sporting objectives of the club include developing and maintaining the ideals of the Adelaide Football Club, promoting the playing of Australian football in Australia and specifically in South Australia, managing employment contracts with professional footballers

[93] Australian Charities and Not-for-profits Commission, 'Search for a charity', 'football' search <https://www.acnc.gov.au/charity/charities?search=football&items_per_page=50>.

[94] Henry B Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89(5) *Yale Law Journal* 835, 838.

[95] Australian Football League Constitution, 14 March 2018, article 7, Constitution of the Adelaide Football Club Limited, last amended 5 March 2024, article 5(b), Constitution of Brisbane Bears - Fitzroy Football Club Limited, adopted by members on 22 February 2023, article 1.2(g), Constitution of Carlton Football Club Ltd, amended 22 February 2022, article 13.5, Constitution Collingwood Football Club Limited, article 3(b), Constitution of Essendon Football Club, amended 15 December 2022, article 29(b), Constitution of Footscray Football Club Limited, article 6.2, Constitution of Melbourne Football Club Limited, article 1.5 and Richmond Football Club Constitution, amended December 2021, article 17.

[96] Australian Football League Constitution, 14 March 2018, article 5, Constitution of the Adelaide Football Club Limited, last amended 5 March 2024, article 5(a), Constitution of Brisbane Bears - Fitzroy Football Club Limited, adopted by members on 22 February 2023, article 1.2(g), Constitution of Carlton Football Club Ltd, amended 22 February 2022, article 13.5, Constitution Collingwood Football Club Limited, article 3(a), Constitution of Essendon Football Club, amended 15 December 2022, article 29(a), Constitution of Footscray Football Club Limited, article 6.1, Constitution of Melbourne Football Club Limited, article 1.5 and Richmond Football Club Constitution, amended December 2021, article 17.

[97] Australian Football League Constitution, 14 March 2018, article 4.

[98] Constitution of the Adelaide Football Club Limited last amended 5 March 2024, article 4.

and staff in relation to Adelaide Football Club's teams and joining the AFL.[99] The community objective of the Adelaide Football Club is to support any charitable or public institution that the board approves.[100] In the event a club or the AFL is wound up any remaining surplus cannot be distributed to members but instead transferred to an institution which has similar objects to the club's objects and who is also a not-for-profit that cannot distribute its income and assets to members.[101] The Richmond Football Club constitution does not address what happens to any surplus and assets upon winding up of the club.[102]

C *Charitable activities of the Australian Football League and its clubs*

An issue identified by O'Connell is whether professional leagues and clubs really encourage sport or instead provide entertainment.[103] While the AFL and its clubs provide entertainment, they engage in significant charitable activities, including the promotion of sport. In 2023 the AFL had 526,000 registered participants in community and professional competitions. Women and girls make up 20 per cent of community football participants. In 2022 the AFL committed to investing 10 per cent of revenues into community football, which totalled $67 million in 2023. Community camps returned in 2023 after the Covid-19 pandemic and all clubs visited regional communities in February and March. The AFL had a national inclusion carnival for male footballers with an intellectual disability and also the AFL wheelchair national championships. The Telstra Footy Country Fund provides regional clubs with $8 million over four years. Since 2008 the Toyota Good for Footy program has raised $11 million for community football.[104] Regional and metropolitan football clubs can apply for $20,000 grants to make volunteering easier, diversify participation and make football inclusive.[105] The AFL appointed a leadership advisory group in 2023 to deliver the women and girls action plan for community football with the aim to create equal opportunities to play, coach, umpire, officiate and administer the game.[106] The AFL also runs the Auskick program for junior footballers aged five to 12 years and in 2023 it had 125,000 participants across Australia.[107]

AFL clubs conduct a number of charitable activities. For example, the Fremantle Football Club has the Purple Hands Foundation that supports at risk and disadvantaged youth.[108] Geelong Football Club runs several charitable programs. The GMHBA Healthy Heroes has 110 schools in Geelong, Colac and Warrnambool, where 7,612 grade 3 and 4 students improved their health and wellbeing literacy. In 2023 BioCats had 1,380 grade 5 and 6

[99] Ibid article 4(a).
[100] Ibid article 4(d).
[101] Australian Football League Constitution, 14 March 2018, article 108, Constitution of the Adelaide Football Club Limited, last amended 5 March 2024, article 6(d), Constitution of Brisbane Bears - Fitzroy Football Club Limited, adopted by members on 22 February 2023, article 24.2, Constitution of Carlton Football Club Ltd, amended 22 February 2022, article 13.4, Constitution Collingwood Football Club Limited, article 25(c), Constitution of Essendon Football Club, amended 15 December 2022, article 35(b)(c), Constitution of Footscray Football Club Limited, article 7.4 and Constitution of Melbourne Football Club Limited, article 28.
[102] See Richmond Football Club Constitution, amended December 2021.
[103] O'Connell (n 3) 281.
[104] Australian Football League, AFL Annual Report 2023, 68-69.
[105] Ibid 37.
[106] Ibid 38.
[107] Australian Football League Victoria, 'Auskick Participation Hits All-Time National Record', 24 August 2023 <https://www.aflvic.com.au/news/auskick-participation-hits-all-time-national-record-277462>.
[108] Fremantle Football Club, Purple Hands Foundation <https://www.fremantlefc.com.au/purple-hands>.

students in Geelong, Warrnambool, Casterton and Merino engage in the maths, science and health of the AFL and students were GPS tested and participated in AFL themed challenges. Read the Play is a program for 1,076 young people that focuses on mental health.[109] Since 2016 the Geelong Cats Foundation has raised $22 million for learning and development opportunities, reconciliation and education and alternative pathways for players.[110] The Western Bulldogs Foundation was established in 2023 and has raised over $5.5 million for philanthropic initiatives in football, community and heritage.[111] In 2023 the foundation had 3,585 people participate in community programs in health and wellbeing, youth leadership and diversity.[112]

The tax exemption given to the AFL and its clubs under s 50-45 of the *Income Tax Assessment Act* can be justified on the basis of the charity work they undertake. As demonstrated the AFL and clubs promote sport, Australian rules football and the associated health benefits of physical activity and team sport. The AFL has 526,000 registered players in community and professional competitions and now invests 10 per cent of revenues into community football. The size of the Australian football community is greater than 526,000 when administrators, coaches, volunteers, supporters and umpires are taken into account. Sport has a positive impact on the lives of all of these groups of people and contributes constructively to society. The AFL has an inclusion policy to improve the opportunities for girls and women in all facets of Australian football. The clubs are also active in running community programs for many parts of society, including children and disadvantaged people.

D *The revenues of the Australian Football League*

This article will now demonstrate that the tax exemption given to the AFL is not justified based on the size of the league's revenues. The AFL's revenues of over $1 billion puts it in Australia's 30 largest charities by revenue (Macquarie University's $935,299 revenues to the Victoria Catholic Education Authority's $3.26 billion in revenue)[113] and 0.5 per cent of extra-large charities with total revenues of more than $100 million.[114] In 2023 the AFL had operating revenue of $1.06 billion (an increase of 12.2 per cent), $667,050 operating surplus, $126,860 net profit, $27.7 million underlying operating profit, total assets of $725 million and net assets of $441,099.[115] Revenues consisted of $443.23 million in broadcasting and media, $415.29 million in commercial operations, $102.63 million in stadium development grants, $33.21 million in game development, $35.59 million in other revenue, $16.58 million in football operations and $16 million in advertising.[116]

Payments to players and clubs make up more than half of the AFL's expenditure. Player payments totalled $280.86 million or approximately $15 million per club.[117] In addition the players received $41.49 million through payments to the Australian Football League Players' Association. The AFL paid $395.75 million to its clubs, $86.68 million was spent on game

[109] Geelong Football Club, Geelong Annual Report 2023, 43.
[110] Ibid 43.
[111] Western Bulldogs, Western Bulldogs Financial Report 2023, 10.
[112] Ibid 11.
[113] Australian Charities Report, 10th edition, 60.
[114] Ibid 20.
[115] Australian Football League, AFL Annual Report 2023, 153.
[116] Ibid 158.
[117] Ibid 148.

development and $394.21 million was attributed to operating expenses.[118] In addition $14.4 million was spent on infrastructure for elite and community football facilities and stadium redevelopments.[119]

E *The revenues of the Australian Football League clubs*

Like the AFL the member clubs of the league earn revenues that do not justify the tax exemption under s 50-45 of the *Income Tax Assessment Act*. Table 1 sets out the revenues, profits and total assets for AFL clubs in 2023. This table is based on information in club 2023 financial reports.[120]

Table 1 - AFL club revenues, profits and assets for 2023[121]

AFL Club	Total Revenue	Profit/Loss	Total Assets
Adelaide Football Club	$57.55 million	$1.07 million profit	$27.43 million
Brisbane Football Club	$82.70 million	$3.20 million profit	$95.87 million
Carlton Football Club	$93.28 million	$3.30 million profit	$110.60 million
Collingwood Football Club	$86.87 million	$7.56 million profit	$82.45 million
Essendon Football Club	$72.92 million	$579,777 loss	$73.59 million
Fremantle Football Club	$71.59 million	$1.63 million profit	$29.42 million
Geelong Football Club	$69.23 million	$760,829 profit	$12.44 million
Gold Coast Football Club	$51.61 million	$1.71 million loss	$7.43 million
Greater Western Sydney Football Club	$51.09 million	$3.47 million loss	$19.49 million
Hawthorn Football Club	$55.22 million	$1.43 million profit	$115.24 million

[118] Ibid 148.
[119] Ibid 38.
[120] Club financial reports can be obtained from most club websites or Sports Industry AU, 2023 Annual Reports <https://www.footyindustry.com/2023-annual-reports/>.
[121] This table is composed of data from the financial reports of clubs contained in the 2023 financial reports. Copies of the club financial reports are on file with the author.

Melbourne Football Club	$56.37 million	$3.05 million profit	$11.03 million
North Melbourne Football Club	$50.60 million	$269,853 profit	$29.71 million
Port Adelaide Football Club	$50.39 million	$15.57 million profit	$61.78 million
Richmond Football Club	$105.70 million	$2.33 million profit	$84.30 million
St Kilda Football Club	$60.02 million	$1.74 million profit	$56.39 million
Sydney Football Club	$61.79 million	$10.93 million profit	$106.88 million
West Coast Football Club	$68.31 million	$1.87 million profit	$128.52 million
Western Bulldogs Football Club	$52.42 million	$26.27 million profit	$118.44 million

Club revenues in 2023 ranged from $50.39 million at Port Adelaide Football Club to $105.70 million at Richmond Football Club. The average revenue was $66 million per club. Accounting for 30 to 58 per cent of revenues was football expenses of an average $30 million. Most of the revenue is spent and clubs either make a small loss or a modest net profit. Three clubs made losses in 2023: Essendon Football Club $579,777, Gold Coast Football Club $1.71 million and Greater Western Sydney Giants Football Club $3.47 million. Average profits were less than $10 million and ranged from $269,853 to $7.56 million. Outliers were Sydney Football Club at $10.93 million, Port Adelaide Football Club at $15.57 million and the Western Bulldogs at $26.27 million (this was due to a grant of $38.22 million to develop Whitten Oval). Based on charity size 17 clubs would be classed as very large and the Richmond Football Club as extra-large. AFL clubs are also wealthy, having total assets of between $7.43 million and $128.52 million.

Some analysis of the 2023 financial reports of AFL clubs is needed. Contributing to Essendon's loss was a $757,047 loss from its gambling operations.[122] A few clubs have large cash reserves, raising concerns over whether these clubs are spending their revenues on the public benefit and the promotion of sport. Hawthorn Football Club had cash reserves of $70.34 million[123] and Richmond Football Club had cash reserves of $43.66 million.[124] The West Coast Eagles Football Club made $54.08 million from investments.[125] The Western

[122] Essendon Football Club, Essendon Annual Report 2023, 17.
[123] Hawthorn Football Club, Hawthorn Financial Report 2023, 21.
[124] Richmond Football Club, Richmond Financial Report, 10.
[125] West Coast Eagles Football Club, West Coast Eagles Financial Report 2023, 17.

Bulldogs Football Club incurred $7.43 million in a legal judgment and associated costs.[126] This matter is related to a child sex offender in the club during the 1980s and 1990s and a court ordered the club pay $5.9 million to the victim.[127]

F *Does the Australian Football League and its clubs require government assistance?*

The revenues of the AFL and clubs raises questions as to whether government assistance in the form of tax concessions is needed. The position of these entities can be contrasted to community sports clubs and leagues who have small revenue streams and for whom the exemption in s 50-45 was presumably targeted at. In assessing the financial position of the AFL and the clubs it is important to draw a distinction between revenue and profit. While the AFL in 2023 had operating revenue of $1.06 billion, it only had a $667,050 operating surplus, $126,860 net profit and $27.7 million underlying operating profit. Similarly, club revenues in 2023 ranged from $50 million to $105 million but three clubs made losses between $579,777 and $3.47 million and average club profits were small and were between $269,853 and $15 million. While total revenues indicate the AFL and its clubs do not need government assistance, the profits of the entities are relatively small as most income is spent on operating expenses, thus pointing to the potential need for tax exempt status.

G *Are other industries with large revenues tax exempt not-for-profits?*

It is worthwhile to consider whether other industries with large revenues are treated as not-for-profits exempt from tax laws. As discussed above Australia's 30 largest registered charities by revenue received between Macquarie University's $935,299 and the Victoria Catholic Education Authority's $3.26 billion. Of these 30 entities there were 13 universities, four Catholic school trusts and the Roman Catholic Archdiocese of Brisbane.[128]

The university sector is similar to the AFL in terms of revenue and 40 of Australia's 41 universities are registered charities. The highest income earners are the University of Sydney who made $3.15 billion in revenue, the University of Melbourne's $2.99 billion and Monash University's $2.74 billion.[129] Almost all of the universities are public universities and O'Connell argues the tax concession issue is that public universities in reality are part of government and therefore should not be exempt like public hospitals.[130] However it is worth noting that many government bodies are tax exempt.

O'Connell posits that some agricultural entities with large revenues that are registered charities should not enjoy tax exemptions. Co-Operative Bulk Handling Ltd is a Western Australian grain supply cooperative that is a registered charity with exemption from the *Income Tax Assessment Act*. In 2022 the cooperative had gross revenue of $1.1 billion, a surplus of $216 million and assets of $1.9 billion. O'Connell argues Co-Operative Bulk

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[126] Western Bulldogs Football Club, Western Bulldogs Financial Report 2023, 19.
[127] Kristian Silva, 'AFL club Western Bulldogs ordered to pay $5.9 million to child sex abuse victim Adam Kneale', *ABC News*, 9 November 2023 <https://www.abc.net.au/news/2023-11-09/afl-western-bulldogs-child-sexual-abuse-compensation/103085628>.
[128] Australian Charities Report, 10th edition, 60.
[129] Ibid.
[130] O'Connell (n 3) 286.

Handling Ltd is a grain supply cooperative that is run for the benefit of member growers and that it does not have charitable purposes.[131]

H *The Australian Football League's relationship with the sports gambling industry*

One of the strongest arguments against the AFL and its clubs receiving tax exemption is the sport's relationship with the gambling industry and resulting revenues. Gambling in Australia is widespread. In 2022 72.8 per cent of Australians gambled and 33.8 per cent bet on sport.[132] Australians are estimated to annually lose $25 billion in sports gambling.[133] In addition to these losses the social ills of gambling include the adverse health and well-being of society, addiction, problem gamblers and underage betting. Also, the gambling industry has been labelled a predatory industry as one third of all bets are placed by problem gamblers.[134] Gambling advertising is prevalent when watching an AFL game and related programs and the weekly games on the AFL and AFL Women's ('AFLW') apps have the odds from Sports Bet. The AFL benefits from the $287 million sports betting agencies spend on advertising.[135] In addition to sponsorship the AFL receives an undisclosed percentage of gambling revenues.[136] The AFL has been criticised for promoting bets that have an 85 per cent fail rate and at the same time receiving a share of the generated revenues.[137] The ten Victorian clubs signed up to the Victorian Responsible Gambling Foundation's 'Love the Game, Not the Odds' program,[138] a responsible gambling campaign where the clubs pledged to not accept gambling sponsorship.[139] Crown Casino challenged this commitment when it offered to sponsor Victorian clubs in the lead up to the 2023 season. North Melbourne Football Club, Carlton Football Club and St Kilda Football Club all entertained Crown's offer but did not sign up.[140] Some non-Victorian clubs receive gambling sponsorship. Since 2023 Tabcorp has sponsored the Greater Western Sydney Giants Football Club and the

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[131] Ibid 274.

[132] Australian Institute of Health and Welfare, Gambling in Australia, 7 September 2023 <https://www.aihw.gov.au/reports/australias-welfare/gambling>.

[133] Mark Rigby, 'Young gamblers losing more as social media presence of sports betting agencies grows', *ABC News*, 19 April 2023 <https://www.abc.net.au/news/2023-04-19/young-gamblers-increase-sports-betting-advertisments/102236398>.

[134] Paul Karp and Josh Butler, 'A third of Australian bets found to be placed by problem gamblers amid warning of 'predatory' industry', *The Guardian*, 25 June 2024 <https://www.theguardian.com/australia-news/article/2024/jun/25/number-of-australian-problem-gamblers-placing-bets-with-predatory-companies-revealed-in-poll>.

[135] Rigby (n 133).

[136] Henry Belot, 'AFL receives cut of gambling turnover outside sponsorship, inquiry hears', *The Guardian*, 4 April 2023 <https://www.theguardian.com/australia-news/2023/apr/04/afl-receives-cut-of-gambling-turnover-outside-sponsorship-inquiry-hears>.

[137] Henry Belot, 'AFL criticized for promoting series of bets that have 85% loss rate for gamblers', *The Guardian*, 21 September 2023 <https://www.theguardian.com/australia-news/2023/sep/21/afl-criticised-for-promoting-series-of-bets-that-have-85-loss-rate-for-gamblers>.

[138] Love the Game Not the Odds, <https://lovethegame.vic.gov.au>.

[139] Victorian Responsible Gambling Foundation, 'Vic clubs renew vow to rid AFL of sports betting sponsorship', 11 March 2022 <https://responsiblegambling.vic.gov.au/about-us/news-and-media/vic-clubs-renew-vow-to-rid-afl-of-sports-betting-sponsorship/>.

[140] Pat McGrath and Sarah Curnow, 'Crown Casino offers sponsorship to Victorian AFL clubs that have vowed to refuse gambling cash', *ABC News*, 25 February 2023 <https://www.abc.net.au/news/2023-02-25/crown-woos-victorian-afl-clubs-with-sponsorship-deals/102021564>.

Brisbane Football Club.[141] The close relationship between the AFL and the sports betting industry is demonstrated by former AFL chief executive officer Gillon McLachlan being appointed in June 2024 the chief executive officer of Tabcorp.[142]

I *Australian Football League club ownership of poker machines*

Despite commitment to the Love the Game campaign, AFL clubs until recently invested in poker machine venues and some clubs still have poker machines. The associated social harms resulting from poker machines raises concerns over the historic tax exemption received by clubs and the purported public benefit of clubs. North Melbourne Football Club was the first Victorian club to sell pokers in 2008 and in 2016 it was the only club without pokers. Collingwood sold its 156 machines in 2018 and in July 2022 Hawthorn Football Club sold its two poker machine venues. Despite these divestures Carlton Football Club, Essendon Football Club, Richmond Football Club and St Kilda Football Club earned a collective $40 million from poker machines in 2022/2023. Carlton Football Club earned $19.1 million from 290 machines at four venues, Richmond Football Club earned $4.6 million from 97 machines at the Wantirna Club, St Kilda Football Club earned $1.8 million from 83 machines at its Moorabbin base and Essendon Football Club received $14.7 million in revenue from 190 machines at two venues.[143] The profits of poker machines can be distinguished from sports clubs in New South Wales, where either one per cent or one and a half per cent of poker machine profits must be distributed to charities under community development and support expenditure.[144]

J *Remuneration of Australian Football League executives*

The remuneration of AFL executives is another argument against the AFL receiving tax exemption status. The non-distribution of profits for not-for-profits is arguably designed to prevent employees and directors from receiving excessive salaries[145] and requires limits on the pay of firm insiders.[146] Steinberg and Galle identify that that the distribution of profits to people who control an entity raises similar concerns on opportunism as surplus distributions to investors. If managers pay themselves a salary that is a large percentage of cash flows, then their incentive to create cash flows raises the same opportunism issue for equity distribution.[147] Former AFL chief executive officer Andrew Demetriou received a salary of

[141] Paul Sakkal, 'What ban? NRL, AFL clubs sign gambling sponsorships', *The Sydney Morning Herald*, 26 December 2023 <https://www.smh.com.au/politics/federal/what-ban-nrl-afl-clubs-sign-gambling-sponsorships-20231222-p5etbk.html>.
[142] Amelia McGuire and Calum Jaspan, 'Former AFL boss Gillon McLachlan appointed Tabcorp chief', *The Sydney Morning Herald*, 17 June 2024 <https://www.smh.com.au/business/companies/former-afl-boss-gill-mclachlan-appointed-as-tabcorp-ceo-20240617-p5jma0.html>.
[143] Henry Belot, 'Victorian AFL clubs raked in $40 million from poker machines last financial year', *The Guardian*, 6 September 2023 <https://www.theguardian.com/australia-news/2023/sep/06/victorian-afl-clubs-raked-in-40m-from-poker-machines-last-financial-year>.
[144] *Re South Sydney Junior Rugby League Club Ltd and Commissioner of Taxation* (2006) BC200601475, Unreported Judgment, Administrative Appeals Tribunal, [59].
[145] Myles McGregor-Lowndes, 'An overview of the not-for-profit sector' in Matthew Harding (ed) *Research Handbook on Not-For-Profit Law* (2018) 131, 134, Richard Steinberg and Brian Galle, 'A law and economics perspective on nonprofit organizations' in Matthew Harding (ed) *Research Handbook on Not-For-Profit Law* (2018) 16, 16.
[146] Steinberg and Galle (n 146) 32.
[147] Ibid.

$4.38 million in 2013.[148] Demetriou's replacement Gillon McLachlan earned a salary of $1.3 million in 2015,[149] the last time the AFL publicly released the salary of its chief executive. In 2022 11 AFL executives were paid $11.8 million.[150] These exorbitant salaries divert the profits of the AFL from its not-for-profit activities and are in part possible due to the government subsidy. It can be argued that the government should not be subsidising organisations with such large payrolls but instead allow the AFL to provide competitive salaries once it has received exempt status. Hansmann observed that the payment of net profits through inflated salaries is a way not-for-profits can distribute their income and circumvent the non-distribution constraint.[151] Another issue in the wages of executives of not-for-profits is defining excessive remuneration, which would require the government to either construct a pay scale for not-for-profit managers or establish a comparison group for a set of managers.[152] However it could be argued that these salaries are justified on the basis the AFL is running a billion dollar business.

IV REFORMS TO THE TAX STATUS OF THE AUSTRALIAN FOOTBALL LEAGUE AND ITS CLUBS

This article will now conclude by setting out reforms to the tax regulation of the AFL and its clubs. Potential reforms include amending the s 50-45 sports exemption, taxing the non-charitable business profits of the league and clubs and treating the AFL and clubs like charities by requiring that they benefit the public. In addition the new ATO self-reporting for sports clubs to that was introduced in 2024 will be looked at and the requirement in s 51-1 of the *Income Tax Assessment Act* that exempt entities can still be required to lodge an income tax return.

A *Amending the s 50-45 sports exemption*

The revenues of the AFL and its clubs, the relationship with the gambling industry and the remuneration of executives raises the question as to whether the sports exemption in s 50-45 of the *Income Tax Assessment Act* needs to be abolished. Such a reform would disadvantage small community sports clubs and leagues with low-income streams who benefit from the sports exemption. An alternative is to amend s 50-45 so that it is limited to community sports, a position adopted in the United Kingdom.[153] This seems to be a fair reform that distinguishes between community and professional sport and provides government assistance to entities who require the financial help.

B *Taxing sports income that fall outside the public benefit*

[148] Nathan Schmook, 'AFL CEO Andrew Demetriou paid $3.8 million', *AFL*, 4 March 2014 <https://www.afl.com.au/news/108965/afl-ceo-andrew-demetriou-paid-38-million-in-2013>.
[149] Travis King, 'Demetriou, McLachlan earn combined $3.3 million salary', *AFL*, 4 March 2015 <https://www.afl.com.au/news/51464/demetriou-mclachlan-earn-combined-33-million-salary>.
[150] Sports Business Journal (n 18).
[151] Hansmann (n 94) 844, 875.
[152] Steinberg and Galle (n 146) 33.
[153] O'Connell (n 3) 282.

An alternative to amending s 50-45 is taxing sports income that falls outside the public benefit and promotion of sport and that is essentially derived from purely commercial activities. The United States provides some guidance as it has a long policy of taxing the unrelated business income of not-for-profits which is commercial income that is not connected to the core non-profit activity of charities.[154] The unrelated business income tax ('UBIT') is a tax on the unrelated business income of charities,[155] which extends to potentially exempt activities that are conducted in a commercial way.[156] Some arguments exist against imposing the UBIT on not-for-profits. The UBIT is said to eliminate unfair competition between tax paying entities and charities but this argument fails to recognise that the exemption does not apply to the costs of production. Another argument is that charities that generate income erode the tax base. A further argument is that the UBIT imposes high compliance costs on charities as they must differentiate between charitable and commercial income.[157]

The introduction of a UBIT in Australia has some merit. A UBIT was proposed by the Gillard Government in the 2011-2012 budget through the Better Targeting for Not-For-Profit Tax Concession reforms. After consultation with the not-for profit sector the implementation of the reforms in January 2013 was delayed to July 2014.[158] However the reforms did not eventuate as they were shelved by the new Abbot Government and deemed to be not required.[159] In the context of the AFL a UBIT would fairly treat the league and clubs who increasingly engage in commercial activities outside their charitable activities with a public benefit without removing the tax exemption. For example, a UBIT would tax the profits of clubs with poker machines, the West Coast Eagles Football Club's substantial investment profits and the profits of the AFL and clubs not related to promoting football.

C *Treat sports like charities*

Another possible reform is to treat exempt sports in a similar manner to charities. Under the common law and legislation the charitable purpose of an entity is relevant for charities. The common law sets out the purposes of a charity as being the relief of poverty, advancement of education, advancement of religion or any other purpose beneficial to the community.[160]

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[154] Fiona Martin and Timothy M Todd, 'The Income Tax Exemption of Charities and the Tax Deductibility of Charitable Donations: The United States and Australia Compared' (2018) 33(4) *Australian Tax Forum* 667, 668.
[155] *Inland Revenue Code of 1986*, U.S. Code, title 26, sections 511 to 514.
[156] Martin and Todd (n 154) 684.
[157] Ibid 685-686.
[158] Joint Media Release for the Honourable David Bradbury MP, Assistant Treasurer, Minister Assisting for Financial Services & Superannuation and Minister for Competition Policy and Consumer Affairs and Mark Butler MP, Minister for Social Inclusion, Later start date fir better targeting of not-for-profit tax concessions, 31 January 2013 <https://ministers.treasury.gov.au/ministers/david-bradbury-2012/media-releases/later-start-date-better-targeting-not-profit-tax>. For discussion on the proposed reforms see Micah Burch, 'Australia's Proposed Unrelated Commercial Activities Tax: Lessons from the U.S. UBIT' (2012) 7(1) *Journal of the Australasian Tax Teachers Association* 21, Joyce Chia and Miranda Stewart, 'Doing Business to Do Good: Should We Tax the Business Profits of Not-for-Profits' (2012) 33(2) *Adelaide Law Review* 335 and Annette Morgan and Dale Pinto, 'The Current State of Play Relating to Not-for-profit Tax Concessions in Australia and a Glimpse of What May Lie Ahead for These Concessions' (2011) 13 *Not-for-Profit Organisations* 33.
[159] Media Release for Senator the Hon Mathias Cormann, Minister for Finance, More Progress in Restoring Integrity in the Tax System, 13 May 2014 <https://ministers.finance.gov.au/financeminister/media-release/2014/05/13/more-progress-restoring-integrity-tax-system>.
[160] *Commissioners for Special Purposes of Income Tax v Pemsels* [1891] AC 531, 583.

This definition dates back to British legislation and the preamble to the 1601 *Statute of Charitable Uses*.[161] For an entity to be classed as a charity the common law also requires it to be established for the benefit of the public or a significant section of the public.[162] At common law the High Court deemed the promotion of sport is not charitable.[163] Similarly, the *Charities Act 2013* (Cth) does not include sport as a charitable purpose, which is limited to advancing health,[164] social or public welfare,[165] culture[166] and the security of Australia.[167] Under the *Charities Act* the common law definition of charity was expanded and a charity must have a purpose that is for the public benefit,[168] examples of which include preventing and relieving sickness or disease, advancing education, relieving poverty, caring for the aged and people with disabilities and advancing religion.[169] These examples of public benefit also meet the definition of charitable purpose under the *Charities Act*, along with the purpose of advancing religion, culture, protecting human rights, preventing the suffering of animals and advancing the natural environment.[170]

The s 50-45 exemption for sports could be amended to require sports have a public benefit and treat sports like charities. This would replicate the common law and statutory position of charities and require sports to do more than promote a sport or game. Such a reform may require the AFL and some clubs to change their relationship with the gambling industry in order to retain not-for-profit status. It is therefore likely to meet some resistance from the AFL and clubs due to the impact on revenue.

D *The new self-reporting requirement for sporting organisations*

The income tax exemption for the AFL and its clubs is no longer guaranteed. On March 2024 the ATO announced that not-for-profits with an active Australian business number must submit a self-review to self-assess as to whether the exemption applies.[171] The reform specifically applies to sporting clubs, societies and associations by requiring annual reporting to be eligible for the s 50-45 exemption. The first report was to be submitted between 1 July and 31 October 2024. The self-reporting mandates that the AFL and its clubs report the sporting organisation's main purpose and its governing documents and complete an early self-review to ensure it is eligible to be income tax exempt.[172] These requirements are a check that the sporting organisation's main purpose is the promotion of a sport or game as

[161] 43 Eliz 1.
[162] *Re Compton* [1945] 1 All ER 198, 205-206, *Royal National Agricultural & Industrial Association v Chester* (1974) 48 ALJR 304, *Central Bayside General Practice Association Ltd v Commissioner of State Revenue of the State of Victoria* 228 CLR 169.
[163] *Royal National Agricultural and Industrial Association v Chester* (1974) 3 ALR 486, 489, relying on the British cases of *Re Nottage* [1895] 2 Ch 649 and *Peterborough Royal Foxhound Show Society v Commissioners of Inland Revenue* [1936] 2 KB 497.
[164] *Charities Act 2013* (Cth), s 14.
[165] Ibid s 15.
[166] Ibid s 16.
[167] Ibid s 17
[168] Ibid s 6.
[169] Ibid s 7.
[170] Ibid s 12.
[171] Australian Taxation Office, New reporting requirements for not-for-profits, 27 March 2024 <https://tv.ato.gov.au/media/bi9or7orfgpdsm>.
[172] Australian Taxation Office, Changes in reporting requirements for sporting organisations, 21 June 2024 <https://www.ato.gov.au/businesses-and-organisations/not-for-profit-organisations/not-for-profit-newsroom/changes-in-reporting-requirements-for-sporting-clubs>.

required in s 50-45. It is unclear what the purpose of the new self-reporting requirements are because the ATO and the government have not publicly stated their rationale for the change. However it can be assumed the reforms were introduced to prevent rorting of the tax exemption by sports clubs and leagues. The AFL and its clubs will now have to annually demonstrate that they are promoting Australian rules football and not engaging in general commercial activities or providing entertainment.

E *The filing of tax returns by sports entities with a sports exemption*

In addition to the AFL and the clubs having an income tax exemption that is now based on the ability to meet the ATO's new self-reporting provisions, it is possible that these entities still need to submit an income tax return with the ATO. Under the *Income Tax Assessment Act* ordinary and statutory income that is exempt from income tax can be subject to exceptions or special conditions,[173] including the ATO Commissioner still requiring the exempt entity to lodge a tax an income tax return.[174] Thus the AFL and its clubs can be required by the ATO to lodge an income tax return even though they enjoy the sports exemption. Such a move would place an additional reporting requirement on the AFL and the 18 clubs as they currently produce audited financial reports for their annual general meeting.

V CONCLUSION

The AFL and its 18 member clubs enjoy tax exemption status as not-for-profits entities under s 50-45 of the *Income Tax Assessment Act*. While the league and the clubs are not registered charities, they are all treated as not-for-profits through the sports exemption. It can be argued that the sports exemption was not intended for entities such as the AFL who has annual revenues of over $1 billion nor the clubs with revenues of between $50 million and $100 million. Based on revenue these entities do not need government support in the form of tax concessions. Strengthening the argument against tax exemption is that the AFL and its clubs have a close relationship with the gambling industry that undermines their ability to benefit the public. In addition the AFL pays exorbitant salaries to executives that should not result from its tax-exempt status, with the league's top executives being paid a combined $11 million. Competitive salaries are more appropriate for an entity that is subsidised by the government as a not-for-profit. This article has suggested reforms such as amending the s 50-45 exemption to only cover community clubs and leagues, taxing the commercial income of not-for-profits that relate to ordinary business income and treating sports as charities and requiring them to benefit the public. It is important to note that the AFL and club tax exemption is no longer guaranteed due to the new self-reporting to the ATO. The tax treatment of professional sports entities such as the AFL and its clubs needs to be reconsidered in light of the revenues these entities generate, the relationship with the betting industry and executive remuneration.

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[173] *Income Tax Assessment Act 1997* (Cth), s 51-1.
[174] Ibid s 51-1, note 1.

REVISITING VAT COMPLIANCE COSTS AND ASSOCIATED BURDEN: A REVIEW

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Abstract

This paper explores VAT compliance costs and associated burdens, a topic of paramount importance in tax policy evaluation and reform. Tax compliance costs, which encompass the financial and non-financial burdens taxpayers face in meeting their tax obligations, present significant challenges, particularly in developing countries. Our analysis of the literature on the VAT compliance cost burden and the issues related to complying with the VAT regime in India, compared with developed nations (especially Australia), provides a foundation for understanding the tax landscape. With the advent of the Goods and Service Tax (GST) in India, comprehending the compliance burden faced by taxpayers has become even more critical. We have evaluated the performance of the Indian VAT system compared to other nations, considering factors such as tax law complexity, administrative requirements, the capabilities of the tax departments in meeting taxpayers' services and compliance needs, and monetary costs. Furthermore, we delve into policy options and interventions that could alleviate or reduce the VAT compliance burden.

Keywords: Value added tax, Compliance burden, Compliance Cost, India, Australia.

JEL Codes: H21, H25, H26.

I INTRODUCTION

Tax is the most important source of government revenue. It could be raised by expanding the tax base, improving tax efficiency, encouraging compliance, and increasing tax rates. Enhancing participation in any tax regime by bringing more eligible taxpayers under the tax net is crucial as it expands the tax base and improves a country's tax environment/morale.[1] Participation in the tax regime means that individuals, businesses, or entities must comply with its laws and regulations. This includes fulfilling obligations such as filing tax returns, reporting income or profits, and paying taxes owed as per the rules. Participation in any tax regime depends on several factors, and the cost of tax compliance is one of them. Therefore, the objective of the paper is two-folded: (i) to provide a review of the literature on

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[1]Eva Hofmann, Erik Hoelzl and Erich Kirchler, 'Preconditions of voluntary tax compliance: Knowledge and evaluation of taxation, norms, fairness, and motivation to cooperate' (2008) 216(4) *Journal of Psychology* 209.

compliance costs or burden and (ii) to compare VAT compliance burden in India vis-à-vis the average of lower-middle, upper-middle and high-income countries (especially Australia). This research is not only crucial for understanding the factors influencing compliance cost/burden but also has the potential to significantly influence tax policy evaluation and reform, offering insights into areas where processes can be simplified to reduce compliance costs or burdens and improve voluntary tax compliance.

Compliance costs of taxes, often referred to as the 'hidden costs of taxation',[2] emerged as one of the essential aspects of tax policy research since the early 1970s. It is important to note the difference between the terms 'tax compliance cost' and 'tax compliance burden,' which are often used interchangeably in literature. Tax compliance costs measure the tax compliance burden in monetary terms, while the tax compliance burden is broader, qualitative, and multi-dimensional. It is not a single numerical estimate of costs; however, it is a vector of many quantitative and qualitative factors.[3] For instance, taxpayers (individuals or sole traders) experience psychological stress when dealing with complex tax-related matters. A tax system with high compliance costs may not necessarily result in higher tax revenue if taxpayers find ways to avoid or evade taxes due to the complexity or burdensome nature of the tax system. Conversely, a tax system with lower compliance costs may lead to higher revenue collection if it encourages greater voluntary compliance and reduces opportunities for tax evasion. Perhaps the estimation of compliance burden allows the tax researchers to analyse, in greater depth, several qualitative aspects of how the existing tax regime may impact taxpayers. Therefore, the study reviews the empirical literature on the elements of tax compliance costs and compliance burden. The study will provide insights into components and factors influencing compliance cost/burden. Studying compliance costs/burdens of complying with tax regulations is crucial for policymakers to understand the burden placed on businesses, especially small and medium enterprises (SMEs), which might struggle with complex tax compliance requirements. The present study will help policymakers and tax departments to identify areas where processes can be simplified, ultimately reducing compliance costs or burdens and improving voluntary tax compliance. In this study, we also compare the tax compliance burden of the Indian VAT regime vis-à-vis the Australian VAT/GST regime.

Before the introduction of GST in India on 1 July 2017, the Indian VAT system was complex and fragmented. The jurisdiction of taxation power (on manufacturing) overlapped between the Union (federal) and state (subnational) governments. This complexity could have been a significant factor in businesses staying out of India's VAT regime. Before the GST, the union government had taxation power on goods up to the manufacturing stage. States used to levy state VAT on value addition beyond manufacturing (i.e., wholesale and retail trades). However, being the first point seller, manufacturers were also subject to the state VAT system. They used to pay state VAT on the CenVAT (Central VAT) paid value of the goods for intra-state sales and Central Sales Tax (CST) on inter-state sales.[4] States used to allow input tax credits to manufacturers and traders for intra-state purchases of inputs and capital goods. The union government used to collect services tax, and there was provision for cross-

[2] Cedric Thomas Sandford, *Hidden Costs of Taxation* (Institute for Fiscal Studies, 1973).

[3] Zu Yige, Chris Evans and Richard Krever, 'The VAT compliance Burden in the UK: A comparative assessment' (2020) 356(3) *British Tax Review* 354.

[4] Though CST is a central tax, since the introduction of CST from 1957, CST is collected and retained by the States where inter-state trade originates (exporting States). This was making the Indian VAT system origin based. It has been replaced by Integrated GST (IGST) since 1 July 2017 for goods which are subsumed into GST. CST is still prevalent for goods which are either kept out of the GST system (alcoholic beverages for human consumption) and/or waiting for the GST council's recommendation for a date on which GST will be levied on them (petroleum crude, high speed diesel, motor spirit, natural gas and aviation turbine fuel).

utilisation of CenVAT and services tax credit (since 2004-05). However, there was no provision for cross-utilisation of input tax credit (ITC) between the state VAT and services tax or vice-versa before the GST. There was no harmonisation in the tax rules, regulations, tax rate structure and administrative practices in the state VAT system across states. The state VAT system was origin-based; interstate sales were used to attract Central Sales Tax (CST) at the origin state, and some states used to collect entry tax on inter-state purchases. Though there was a provision for ITC adjustment against CST sales at the origin state, there was no provision for adjusting CST credit in the destination state for inter-state procurements of inputs and capital goods. Also, some states had no provision for adjusting entry tax credit with state VAT liability. Both state and Central VAT systems had multiple tax rates, many exemptions, exclusions (e.g., gasoline, diesel, aviation turbine fuel, crude petroleum, natural gas), and differences in the registration threshold across taxes (e.g., CenVAT, services tax, state VAT). Also, states kept some standalone services out of the state VAT system (e.g., entertainment tax, taxes on lottery, betting and gambling, advertisement tax). GST is a comprehensive multi-stage value-added tax (VAT) system encompassing various taxes on goods and services from the union and state indirect tax bases. Indian GST is a dual VAT system with concurrent taxation power for the union (federal) and state (provincial or sub-national) governments.

The VAT/GST system is now a widely implemented taxation system worldwide, with around 170 countries and territories having implemented a VAT system. This global prevalence underscores the relevance of the study's findings to a broad audience. However, the design and structural features of the VAT system vary across countries, leading to complexities (e.g., multiple tax rates, exemptions, accounting basis of adjusting input tax credit, and sector/industry-specific rules) and associated compliance burdens. The multiple rate structure and the dual VAT system introduce a level of complexity that can be burdensome for some businesses, especially for SMEs. Compliance costs are a significant disincentive for SMEs (particularly informal enterprises) to stay inside the tax system. For example, in 2015-16, around 78.63 per cent of the eligible unincorporated enterprises in India were not registered under the state VAT/Sales tax system. The estimated VAT compliance costs were around 4.35 per cent of the average annual turnover and 3.87 per cent of the average general business costs in India.[5] Bangladesh's estimated VAT compliance cost was around 2 per cent of the annual total turnover.[6] The burden of VAT compliance costs persists worldwide.

Compliance costs and burdens associated with the VAT/GST system could be one of the reasons why many enterprises choose to stay out of the VAT/GST regime in India. Though India has embraced GST since 1 July 2017, assessing the compliance burden of the VAT/Sales tax regime, as it was prevailing before the introduction of the GST, could be helpful. The VAT and GST differ only in coverage. Some aspects of the compliance burden in the GST regime have only increased for a section of taxpayers (e.g., the frequency of tax returns in a financial year).[7]

In this paper, we compare the compliance burden of the Indian VAT system with the average compliance burden of lower-income, middle-income, and high-income countries (especially

[5] Sacchidananda Mukherjee and Shivani Badola, 'Estimation of VAT Compliance costs of unincorporated enterprises in India: unit-level analysis' (2022) 57(2) *Indian Economic Review* 421.

[6] Nahida Faridy, Richard Copp, Brett Freudenberg and Tapan Sarker, 'Complexity, compliance costs and non-compliance with VAT by small and medium enterprises in Bangladesh: Is there a relationship?' (2014) 29(2) *Australian Tax Forum* 281.

[7] Sacchidananda Mukherjee and R. Kavita Rao, 'Decades of Indirect Tax Reforms in India: A Journey towards Goods and Service Tax (GST)', in R. Kavita Rao and Sacchidananda Mukherjee (eds.), *Evolution of Goods and Services Tax in India*, (Cambridge University Press, 2019) 7.

Australia). Australia's GST regime, introduced on 1 July 2000, is relatively straightforward compared to India's,[8] as it has a rate of 10 per cent applied uniformly across most goods and services. This simplicity is one of the hallmarks of the Australian GST, which aims to minimise the compliance burden on businesses. Studying India's VAT/GST compliance burden vis-à-vis Australia could help Indian GST set the policy goals for future reforms. The comparison of India's VAT regime with Australia's GST regimes would highlight differences in complexity and compliance costs. India's multi-tiered GST structure, which aims to address the progressivity of the GST system,[9] might result in higher compliance burdens due to its complexity and frequent changes in the rules and regulations.[10] In contrast, Australia's single-rate GST system provides a model of simplicity which might result in lower compliance costs and administrative burdens for businesses. However, existing studies show increasing GST compliance costs in Australia despite having a uniform tax structure across most goods and services.[11] So, the analysis would be helpful for the Australian tax department as they will get insights on compliance costs and burdens associated with their single rate structure of the VAT/GST regime.

II MEASURING TAX COMPLIANCE COST AND ASSOCIATED BURDEN

Literature on tax compliance costs dates back to the first half of the 20th century when Haig examined the compliance costs of taxation for American corporations.[12] It took three and a half decades to see the subsequent research on the topic when Sandford estimated tax compliance costs of the UK's VAT system.[13] During the 1970s to the 1990s, a stream of literature emerged on estimating tax compliance costs, primarily concentrated in Europe and the UK.[14] The study by Sandford et al examines the cost of compliance with the VAT system and other taxes in the UK during the 1970s and 1980s.[15] Following Sandford's work, several researchers and organisations explored the concept of tax compliance costs by developing new methodologies (adding new components of the costs) and improving survey design.

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[8] Michael B. Evans, 'GST: where to next? (2020) 18(1) *eJournal of Tax Research* 45*;* Binh Tran-Nam, 'The Goods and Services Tax (GST): The public value of a contested reform', in Joannah Luetjens, Michael Mintrom and Paul 't Hart (eds.), *Successful Public Policy: Lessons from Australia and New Zealand*, (ANU Press, The Australian National University, 2019) 235; James A. Giesecke, and Nhi H. Tran, 'The National and Regional Consequences of Australia's Goods and Services Tax' (2018) 94(306) *Economic Record* 255; Satya Poddar and Ehtisham Ahmand, 'GST reforms and intergovernmental considerations in India' (Working Paper No. 1/2009, Department of Economic Affairs, Ministry of Finance, March, 2009).

[9] Sacchidananda Mukherjee, 'Is GST Regressive in India? Distribution of Tax Burden across Consumer Groups' (2024) 59(24) *Economic and Political Weekly* 103.

[10] Diva Mehta and Sacchidananda Mukherjee, 'Emerging issues in GST law and procedures: An Assessment' (Working Paper No. 347, National Institute of Public Finance and Policy, August 2021).

[11] Chris Evans, Pauline Lignier and Binh Tran-Nam, 'Tax Compliance Costs for the Small and Medium Enterprise Business Sector: Recent Evidence from Australia' (Discussion Paper No. 003-13, Tax Administration Research Centre, University of Exeter Business School, September 2013); Phil Lignier, Chris Evans and Binh Tran-Nam, 'Tangled up in tape: The continuing tax compliance plight of the small and medium enterprise business sector' (2014) 29(2) *Australian Tax Forum* 217.

[12] Robert M. Haig, 'The Cost to business Concerns of Compliance with tax laws' (1935) 24 *Management Review* 323.

[13] Cedric Thomas Sandford (n 2).

[14] Ibid

[15] Cedric Thomas Sandford, Michael Godwin and Peter J. Hardwick, *Administrative and Compliance Costs of Taxation* (Fiscal Publications 1989).

According to Sandford et al, the compliance cost is "the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities".[16] Hence, tax compliance costs include the costs of remitting, collecting, and accounting for tax purposes and acquiring information and knowledge about the tax rates or tax systems.[17] For instance, the existing literature has divided the tax compliance costs into three components, i.e. money costs, time costs, and psychological costs. The components associated with each cost are presented in Table 1.

Table 1: Components of Tax Compliance Costs

Components of Compliance Costs	Studies
Major Costs of Tax Compliance	
Payment is made to acquire services from external advisors solely for tax-related activities (legal advisors, tax agents, tax auditing, or investment advisors/financial advisors).	Palil et al. (2013); Evans et al. (2013); Susila and Pope (2012); Chattopadhyay and Das-Gupta (2002); Das-Gupta (2003); Hansford et al. (2003); Slemrod and Venkatesh (2002); Abdul-Jabbar and Pope (2008); Eichfelder and Hechtner (2018); Blaufus et al. (2014); Evans et al. (2014).
The cost incurred is in maintaining books of accounts, records, etc.	Palil et al. (2013); Evans et al. (2013); Das-Gupta (2003); Hansford et al. (2003); Slemrod and Venkatesh (2002)
Time Valuation (Time spent by a manager, accountant, accounting staff, administrative staff, etc., on tax compliance activities OR Time spent on tax computation, tax planning, tax appeal, or tax objections).	Abdul-Jabbar and Pope (2008); Evans et al. (2013); Palil et al. (2013); Susila and Pope (2012); Chattopadhyay and Das-Gupta (2002); Das-Gupta (2003); Slemrod and Venkatesh (2002); Abdul-Jabbar and Pope (2008); Yilmaz and Coolidge (2013); Eichfelder and Hechtner (2018); Blaufus et al. (2014); Evans et al. (2014)
Additional Costs of Tax Compliance	
Tax materials	Palil et al. (2013);
Travelling expenses	Palil et al. (2013); Susila and Pope (2012); Chattopadhyay and Das-Gupta (2002); Das-Gupta (2003); Abdul-Jabbar and Pope (2008)
Stationary, photocopying, etc.	Palil et al. (2013); Susila and Pope (2012); Chattopadhyay and Das-Gupta (2002); Das-Gupta (2003); Abdul-Jabbar and Pope (2008)
Office Space at market rental value, general supplies, etc.	Chattopadhyay and Das-Gupta (2002); Das-Gupta (2003)
Human Resource Training	Palil et al. (2013); Das-Gupta (2003);
Computers or any other electronic equipment	Chattopadhyay and Das-Gupta (2002)*
Computer hardware or software costs	Das-Gupta (2003); Hansford et al. (2003); Eichfelder and Hechtner (2018); Blaufus et al. (2014)

[16] Ibid
[17] Ibid

Staff Salaries/Wages/Allowances (particularly for tax compliance activities)	Susila and Pope (2012); Das-Gupta (2003); Yilmaz and Coolidge (2013)
Communication costs	Hansford et al. (2003); Abdul-Jabbar and Pope (2008)
Psychological Costs (e.g. cost of anxiety)	Faridy et al. (2016); Hansford et al. (2003);
Benefits of Tax Compliance	
Benefits of complying with the tax regime (Cash Flow benefits or tax-deductibility or Managerial benefits)	Susila and Pope (2012); Chattopadhyay and Das-Gupta (2002) ; Das-Gupta (2003); Evans et al. (2014)**

Note: *- Computer costs for completing and submitting TDS returns.[18] **- The focus is mainly on managerial benefits.
Source: Mukherjee and Badola.[19]

The money costs refer to the expenditure incurred on taking services of tax advisers (accountants, tax agents, legal practitioners, and investment advisers), expenses incurred on purchasing tax-related books or guides, communication expenses, and other incidental costs. The time costs refer to the time spent on preparing tax returns, collecting and maintaining information related to outward and inward supplies, assessing the available input tax credits, accessing and validating third-party information reported to the tax department, validating taxes reported to be withheld with actual tax deductions, paying taxes to the tax department, etc. Several studies capture time costs in monetary terms.[20] Some studies have considered other non-monetary costs, such as psychological costs, that can arise as a result of anxiety in dealing with tax-related complex matters. However, only a few studies have considered psychological costs in estimating tax compliance costs.[21] Other social and non-monetary costs could also be a part of tax compliance costs. However, such costs are usually ignored because they are difficult to measure. For instance, a change in the tax rate, such as the

[18] Arindam Das-Gupta, 'The Income Tax Compliance Cost of Corporations in India, 2000-01' (2003) *SSRN Electronic Journal* <https://ssrn.com/abstract=466041 or http://dx.doi.org/10.2139/ssrn.466041>.
[19] Mukherjee and Badola (n 5).
[20] Angelo Di Legge et al, 'Tax Compliance costs for SMEs- An update and a complement –Final Report' (Publication Office of the European Commission, January 2022) <untitled (europa.eu)>; Sebastian Eichfelder and Frank Hechtner, 'Tax compliance costs: Cost burden and cost reliability' (2018) 46(5) *Public Finance Review* 764; Noor Sharoja Binti Sapiei et al, 'Compliance Costs and the Behaviour of SMEs with the Implementation of GST in Malaysis', (2017) 11(S2) *International Journal of Economics and Management* 379; Wollela Abehodie Yesegat, Jacqueline Coolidge and Laurent Olivier Corthay, 'Tax compliance costs in developing countries: Evidence from Ethiopia' (2017) 15(1) *eJournal of Tax Research* 77; Ranjana Gupta and Adrian Sawyer, 'The costs of compliance and associated benefits for small and medium enterprises in New Zealand: Some recent findings' (2015) 30(1) *Australian Tax Forum* 135; Kay Blaufus, Sebastian Eichfelder and Jochen Hundsdoerfer, 'Income tax compliance costs of working individuals: Empirical evidence from Germany' (2014) 42(6) *Public Finance Review* 800; Chris Evans, Ann Hansford, John Hasseldine, Pauline Lignier, Sharon Smulders and François Vaillancourt, 'Small Business and Tax Compliance Costs: A Cross-Country Study of Managerial Benefits and Tax Concessions' (2014) 12(2) *eJournal of Tax Research* 453; Idawati Ibrahim, 'The compliance time costs of Malaysian personal income tax system: E-filers vs. manual-filers', (2014) 164 *Procedia-Social and Behavioral Sciences* 522.
[21] Nahida Faridy, Brett Freudenberg, Tapan Sarker and Richard Copp, 'The hidden compliance cost of VAT: An exploration of psychological and corruption costs of VAT in a developing country' (2016) 14(1) *eJournal of Tax Research* 166; Uwe Dulleck et al, 'Tax compliance and psychic costs: Behavioral experimental evidence using a physiological marker' (2016) 134 *Journal of Public Economics* 9; Ann Hansford, John Hasseldine, and Carole Howorth, 'Factors affecting the costs of UK VAT compliance for small and medium-sized enterprises' (2003) 21(4) *Environment and Planning C: Government and Policy* 479.

introduction of a higher rate of VAT on a particular range of goods, can cause a trader to stop stocking those goods (to keep tax affairs simple), hence inconveniencing customers who have to travel to buy those goods and probably pay more because of the reduction in the competition which gives rise to a cost of tax compliance.[22] However, such costs are rarely captured in compliance cost studies. Moreover, the managerial and cash flow benefits offset total compliance costs.[23] So, net compliance cost is the difference between the total tax compliance costs (gross tax compliance costs) and the benefits received due to complying with the tax rules and regulations (including the cash flow benefits,[24] tax-deductibility benefits,[25] and managerial benefits[26]).

Several issues are involved in measuring "tax compliance cost", and the inseparability of costs between general business activities and tax compliance activities is one of them.[27] There are some standard functions and associated costs that businesses incur to carry out day-to-day business-related activities (core business or accounting costs) and activities related to tax compliance (tax compliance costs). Hence, there exists a possibility of some overlap between business/ accounting costs and tax compliance costs. For instance, Mukherjee and Badola observe that separating capital costs (e.g., asset costs related to information and communication technology) associated with regular business activities from those related to tax compliance is challenging.[28] In other words, it is difficult to segregate computer equipment costs for core business or accounting purposes and to meet tax complying requirements. This problem of disentanglement or joint cost problems gives rise to uncertainty and imprecision in the identification and estimation of tax compliance costs. This leads Evans and Krever to conclude that most tax compliance cost estimates are only indicative at best if there is no definitional certainty.[29] However, streams of literature still exist that try to estimate tax compliance costs (VAT in particular), given several assumptions and limitations. A list of empirical studies estimating tax compliance costs is presented in Table A.1 in the Appendix. In selecting the studies, we consider only empirical studies estimating tax compliance costs (specifically VAT/GST) and apply econometric models to identify factors affecting tax compliance costs. We select only those studies published in peer-reviewed journals or by multi-later development organisations (e.g., the World Bank) since 2000. Chattopadhyay and Das-Gupta and Vishnuhadevi present a comprehensive list of studies on tax compliance costs.[30]

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[22] Chris Evans and Richard Krever, 'Counting the Costs of VAT Compliance', in Robert F. van Brederode (ed.), *Virtues and Fallacies of VAT: An Evaluation after 50 Years* (Kluwer Law International 2021) 125-150.

[23] Cedric Thomas Sandford et al (n 15).

[24] Cash flow benefits arise due to the difference between the time when the taxes are collected by taxpayers and the time when it is actually handed over to the tax authorities. Binh Tran-Nam et al. 'Tax compliance costs: Research Methodology and Empirical Evidence from Australia' (2000) 53(2) *National Tax Journal* 229.

[25] Tax deductibility benefits arise because of tax deductions for some of the compliance costs incurred by the business tax payers. Binh Tran-Nam et al. (n 24).

[26] Managerial benefits include the benefits derived by the taxpayers (particularly business taxpayers) with the proper record keeping of the accounts which help them in getting managerial accounting information for business and decision making purposes. Binh Tran-Nam et al. (n 24)

[27] Maarten Adriaan Allers, *Administrative and compliance costs of taxation and public transfers in the Netherlands* (Wolters-Noordhoff, 1994); Mukherjee and Badola (n 5); Evans and Krever (n 22).

[28] Mukherjee and Badola (n 5).

[29] Evans and Krever (n 22).

[30] Saumen Chattopadhyay and Arindam Das-Gupta, 'The Compliance Cost of the Personal Income Tax and its Determinants' (Project Report, National Institute of Public Finance and Policy, 2024) <stdy_prsnltax-libre.pdf (d1wqtxts1xzle7.cloudfront.net)>; Sakthivel Vishnuhadevi, 'Administrative and compliance costs of value added tax (VAT): A review' (2021) 26(2) *Review of Development and Change* 179.

III VAT COMPLIANCE COST: A REVIEW

Studies into tax compliance costs have considered a range of different types of taxes, including VAT (Value Added Tax), Personal Income Tax (PIT), GST (Goods and Services Tax), or all taxes together (direct and indirect taxes) (refer to Table A.1). Different approaches have been adopted to define the nature of tax compliance costs and to estimate the magnitude or size of the cost. As we can see from Table A.1, the source of data for most of the studies is the primary survey, which includes face-to-face interviews, telephonic interviews, and emails and now, with increasing penetration of information technology, digital surveys have come into existence to replace postal surveys (refer to Table A.1).[31] However, results based on primary surveys are not always conclusive because of the low response rate (Table A.1). The primary survey response rate reported in the studies ranges from 0.9 per cent to 25.1 per cent (except 47.5 per cent in New Zealand).[32] Studies based on secondary sources of information are also limited, as surveys often do not capture all the cost components required to estimate tax compliance costs.[33]

The common observation from the literature review indicates that VAT compliance costs are high and significant, regressive in nature, and not reducing with time.[34] It has been argued in the literature that the burden of compliance costs associated with Value Added Tax (VAT)/ Sales Tax regime is relatively higher for smaller enterprises, i.e. smaller enterprises are bearing the disproportionate cost of complying with the tax regime which discourages them take VAT registration.[35] Several other studies also show the regressive nature of the compliance costs for developed countries, e.g., the United Kingdom,[36] Australia,[37] and the United States of America.[38] In Table 2, we present the findings of VAT compliance costs studies. The findings of Chittenden et al. for the U.K., Eichfelder, and Hechtner for Belgium, Plamondon and Zussman for Canada and Evans et al. for Australia clearly show the highly regressive pattern of compliance costs (VAT particularly).[39] Furthermore, for developing and transitional countries (such as South Africa, Vietnam, Ukraine, Yemen, Peru, Nepal, Kenya,

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[31] Chris Evans et al, Comparative taxation: why tax systems differ (Fiscal Publications 2017) <Comparative Taxation: Why tax systems differ — Aston Research Explorer>

[32] Inland Revenue, 'Measuring the tax compliance costs of small and medium-sized businesses- a benchmark survey: Final Report (Colimar Brunton Report, June 2005).

[33] Mukherjee and Badola (n 5).

[34] Mukherjee and Badola (n 5); Vishnuhadevi (n 30); Evans et al (n 11).

[35] Sandford et al (n 15); Philip Lignier and Chris Evans, 'The rise and rise of tax compliance costs for the small business sector in Australia' (2012) 27(3) *Australian Tax Forum* 615; Jan Pavel and Leoš Vítek, 'Tax compliance costs: Selected post-transitional countries and the Czech Republic' (2014) 12 *Procedia Economics and Finance* 508; Robert E. Plamondon and David Zussman, 'The compliance costs of Canada's major tax systems and the impact of single administration' (1998) 46(4) *Canadian Tax Journal* 761; Eichfelder and Hechtner (n 20).

[36] John Hasseldine and Ann Hansford, 'The compliance burden of VAT: Further evidence from the UK. (2002) 17(4) *Australian Tax Forum* 369.

[37] Jeff Pope, 'The Compliance Costs of major taxes in Australia', in C.T. Sandford (Ed.), *Tax compliance costs: Measurement and policy* (Fiscal Publications, 1995) 101-125; Chris Evans and Michael Walpole, 'Compliance Costs and Taxation Impact Statements' (1997) 13 *Australian Tax Forum* 227; Lignier and Evans (n 35).

[38] Joel Slemrod and Varsha Venkatesh, 'The Income Tax Compliance Cost of Large and Mid-Size Businesses' (Working Paper No. 914, Ross School of Business Working Paper Series, University of Michigan, September 2002).

[39] Francis Chittenden, Saleema Kuaser and Panikkos Poutziouris, 'Tax regulation and small business in the USA, UK, Australia and New Zealand' (2003) 21(1) *International Small Business Journal* 93; Eichfelder and Hechtner, (n 20); Plamondon and Zussman (n 35), Evans et al (n 11).

and Uzbekistan, etc.), the World Bank Group conducted large-scale semi-structured questionnaire surveys from 2006 to 2011 to measure the compliance costs associated with the VAT, income tax, and payroll tax. The study also found extremely regressive compliance cost patterns (including VAT) in the developing world, where small businesses incurred tax compliance costs of up to 15 per cent or more of turnover.[40] Furthermore, Evans et al. compare Australia's tax compliance costs between 1995 and 2012. Since GST was implemented after 1995 (in July 2000), the study found an increase in gross compliance costs from 1995 to 2012.[41] The gross tax compliance costs incurred by the SMEs show a 150 per cent increase in constant dollar terms since 1995.[42] Another study by Evans et al. finds that the GST or VAT continues to cause the highest tax compliance costs in Australia, the United Kingdom, Canada, and South Africa.[43]

However, while examining other qualitative indicators of compliance burden (refer to Table 3), we observed that despite the high compliance costs noted by Evans et al.,[44] Australia managed to reduce the compliance burden concerning the number and frequency of administrative requirements and the capabilities of the revenue departments in providing taxpayers services and compliance needs of taxpayers.[45] In the next section, we discuss factors influencing the tax compliance burden.

Table 2: VAT/GST Compliance Costs (for U.K., Belgium, Canada and Australia)

UK			**Canada**		**Belgium**		**Australia**	
Turnover Bands	Turnover bands adjusted for inflation	VAT compliance costs (% of turnover)	Sales Volume	Tax Compliance Cost as % of Sales Volume*	Business Class	Costs per Revenue (%)	Business Category	Average gross compliance cost per A$1,000 of turnover
£0- £20,499	£0- £33,999	1.94	Under $50,000	5.65	Self-Employed	13.77	Micro (A$)	A$75.84
£20,500-£49,999	£34,000-£82,999	0.78	$50,000-$99,999	3.34	Small Enterprises	5.95	Small (A$)	A$14.09
£50,000-£99,999	£83,000-£165,999	0.52	$100,000-$249,999	2.18	Medium Enterprises	1.22	Medium (A$)	A$3.34
£100,000-£499,999	£166,000-£832,999	0.42	$250,000-$499,999	1.23	Large Enterprises	0.10		
£500000-£999999	£ 833,000-£1,664,999	0.26	$500,000-$999,999	0.76				
£ 1,000,000-£9,999,999	£16,65,000-£16,649,000	0.04	$1 million-$2 million	0.37				
			$2 million-$5 million	0.22				

[40] Jacqueline Coolidge, 'Findings of tax compliance cost survey in developing countries' (2012) 10(2) *eJournal of Tax Research* 250.
[41] Evans et al (n 11).
[42] Ibid.
[43] Evans et al (n 20).
[44] Evans et al (n 11).
[45] Richard Highfield et al, 'Diagnosing the VAT compliance burden: A cross-country assessment' (Report, UNSW Business School/Taxation and Business Law, Australia's Global University, October 2019). <http://dx.doi.org/10.2139/ssrn.3726376>.

£10,000,000+	£16,650,000+	0.003	$5 million +	0.15				

Note: *This is for Small and Medium Enterprises in Canada, and it includes the compliance costs associated with the federal, provincial, and territorial taxes (as well as the Goods and Service Tax).
Source: Chittenden et al for the U.K., Eichfelder and Hechtner for Belgium, Plamondon and Zussman for Canada, and Evans et al for Australia. [46]

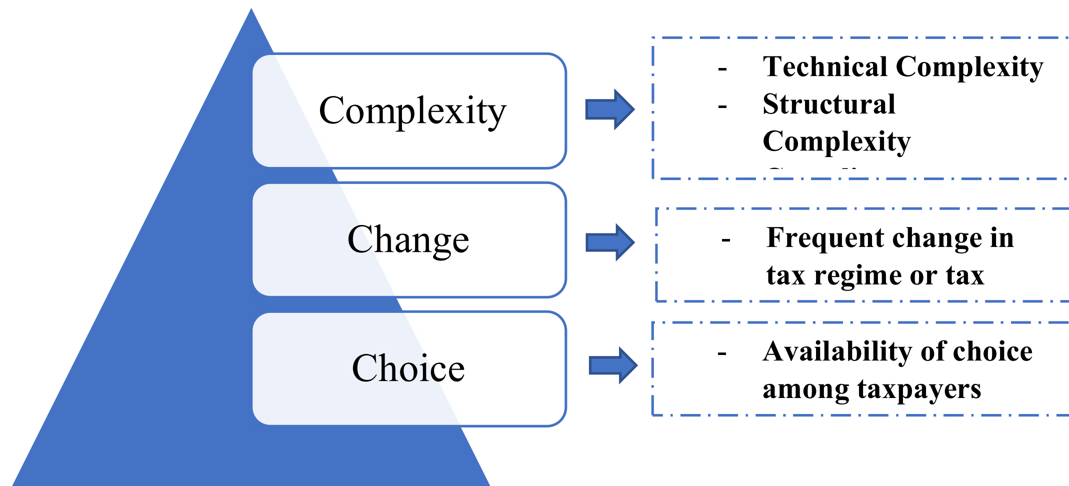
A *Factors Influencing the VAT Compliance Burden*

As we have noted, the size of an enterprise is a determining factor of the VAT compliance cost, whereas the smaller enterprises bear the disproportionate cost of tax compliance. The other possible factors influencing compliance costs include the economies of scale, type of industry,[47] number of entities registered with VAT/GST, country in which the business operates, nature of the business structure, out-sourcing of the tax function to professional intermediaries, and the existence of cross country trade.[48] However, apart from the businesses' size and characteristics (operational and economic), other factors also influence the compliance costs and the associated compliance burden. The possibility of a high compliance burden depends on the complexities of the tax system, "frequent changes" in the tax system,[49] and the choice or option available to taxpayers to opt for a simplified tax compliance regime (e.g., composition scheme).[50] These three factors- tax complexities, frequent changes in the tax laws, regulations and administrative provisions, and the availability of simplified tax compliance options-are the main drivers associated with VAT compliance costs (Figure 1).[51]

Complexity: The tax system's complexity can be understood in three layers, viz., technical, structural, and compliance.[52] Technical complexities are associated with the understanding or comprehensibility of legislative provisions. Structural complexity relates to how tax laws are interpreted and applied, which can influence the certainty and manipulability of legislative provisions. These two combined layers of complexities refer to the overall difficulty by which law is read or understood, applied, and resolved (if cases of disputes at court). The third layer of complexity, "compliance complexity", relates to various administrative requirements to comply with the tax regime, such as record-keeping and form-completing tasks. This layer of complexities is described as 'grit in the system' where the taxpayer interacts with the revenue authority at a day-to-day or operational level.

[46] Chittenden et al (n 39); Eichfelder and Hechtner (n 20); Plamondon and Zussman (n 35); Evans et al (n 20).
[47] It could be linked to backward and forward linkages of industries.
[48] Evans and Krever (n 22).
[49] Evans et al (n 11).
[50] Evans and Krever (n 22).
[51] Ibid.
[52] Edward J. McCaffery, 'The Holy Grail of Tax Simplification', (1990) 5 *Wisconsin Law Review* 1267.

Figure 1: Drivers of Compliance Burden



Source: Evans and Krever[53]

Change: Frequent changes in the tax system or tax legislation require time for taxpayers to comprehend new provisions and, hence, to comply with them.[54] Therefore, the frequency of changes in the tax regimes or provisions can significantly impact the compliance burden. There is a notion that "an old tax is a good tax", which says that changes are not always welcomed and stakeholders prefer the status quo. As changes interfere with the smooth operation of the tax administrative machinery that intermediates the interactions between taxpayers and revenue authorities, it takes time to cope.

Choice: Another critical determinant of the tax compliance burden is the availability of optional tax compliance regimes for small businesses.[55] The choice given to taxpayers to opt for a simplified tax compliance regime could reduce the compliance burden and make the tax system equitable. The availability of an optional tax compliance system reduces the compliance burden and VAT liability. The presence of substituting factors, such as permitting tax deferral or presumed input tax entitlements in the simplified compliance system, reduces VAT liability.[56] However, too many choices can be less than optimal. If businesses have choices/ options to move among alternatives freely, they might double their compliance costs in each tax period to determine their tax liability under each available option.[57]

In line with the above three main drivers of compliance burden (complexity, change, and choice), we will compare the compliance burden associated with the Indian VAT regime vis-à-vis the average of lower-middle, upper-middle and high-income countries (especially Australia) in the upcoming section.

IV METHODOLOGY

[53] Evans and Krever (n 22).
[54] Coolidge (n 40).
[55] Yige Zu, Chris Evans and Richard Krever. 'The VAT compliance Burden in the UK: A comparative assessment' (2020) 356(3) *British Tax Review* 354.
[56] Ibid.
[57] Evans and Krever (n 22).

A *Design of the VAT Diagnostic Tool*

Numerous attempts have been made by professional firms, independent research groups, and research organisations to measure the complexity or compliance burdens of tax systems. A KPMG study has developed a new approach to accurately estimate the VAT compliance burden. i.e., a "VAT diagnostic tool" that considers a comprehensive list of the drivers of compliance burden at the individual country level.[58] The survey of 47 advanced and developing countries with a VAT system of indirect taxation[59] helps various other studies to estimate the compliance costs burden of a particular country vis-à-vis other remaining countries.[60]

Highfield et al identify the following factors as VAT-diagnostic tools influencing compliance burden:[61]

(i) Factor A: Tax law complexity and burden resulting from core elements of VAT policy
(ii) Factor B: The number and frequency of administrative requirements to comply
(iii) Factor C: Revenue body capabilities in meeting taxpayers' service and compliance needs
(iv) Factor D: Monetary costs and benefits associated with the act of complying

A comprehensive list of 27 indicators across four factors is presented in Table 3:

Table 3: VAT Compliance Cost- Drivers and Indicators

VAT Diagnostic tool to assess Compliance Burden Drivers and Indicators	**Range***	**India's Score**	**Australia's Score**
Factor A: Tax law complexity and burden			
Complexity of VAT rate structure	1-4	4	2
Scale of reduced rates & exemptions	1-4	4	4
Use of cash records by specified small businesses	1-4	4	1
Use of rules for prescribed industries that simplify calculations of VAT liabilities	1-4	3	3
VAT registration as % of Business Taxpayers	1-8	1	7
Optionality (availability of optional regimes to small businesses)	1-4	2	4
Total unweighted score (min & max)	(6-28)	18	21
Normalised Weighted Score**		5.217	6.086
Factor B: Number and frequency of administrative requirements to comply			
Electronic VAT registration	1-4	1	1

[58] Highfield et al (n 45).
[59] Ibid.
[60] Zu et al. (n 55); Yan Xu and Richard Krever, 'VAT Compliance Burdens in the OECD and China' (2021) 3 *British Tax Review* 328.
[61] Highfield et al (n 45).

VAT Diagnostic tool to assess Compliance Burden Drivers and Indicators	Range*	India's Score	Australia's Score
Staggered VAT payment periods for small businesses	1-3	1	1
Staggered return filing periods for small businesses	1-3	1	1
Information requirements of a typical VAT return	1-4	4	1
Documentation requirements for exported goods and services		1	1
Other reporting requirements (in addition to the VAT return –e.g. statistical data)	1-4	2	1
Use of electronic invoices between businesses	1-4	3	1
Provision of copies of VAT invoices to the revenue body	1-3	1	1
Record retention period	1-3	2	2
The number of VAT verification actions	1-3	3	1
The level of disputed VAT assessments	1-4	3	2
Total unweighted score (min & max)	(11-38)	22	13
Normalised Weighted Score		7.552	4.462
Factor C: Capabilities of revenue body in meeting taxpayers' services and compliance needs			
Website of revenue body	1-3	1	1
Phone enquiry services by revenue body	1-4	3	2
Support for newly registered businesses	1-4	4	2
Online VAT payment facilities by revenue body	1-4	1	1
Online VAT filing services by revenue body	1-4	1	1
Quality of revenue body online transaction services	1-4	2	2
Refunding of excess VAT payments by revenue body	1-4	4	1
Private ruling services by revenue body	1-3	3	1
Total unweighted score (min & max)	(8-30)	19	11
Normalised Weighted Score		4.999	2.894
Factor D: Monetary Costs and Benefits associated with the act of complying			
The payment of interest on delayed refunds	1-4	4	1
Aggregate value of annual VAT refunds	1-5	1	5
Total unweighted score (min & max)	(2-9)	5	6
Normalised Weighted Score		0.519	0.623

Note: *- The higher the score, the higher the compliance burden; **- Weights are generated as per the 'geometric' mean computation of weightings given by the participating researchers for each factor (for more details on compliance burden indicators and weight generation, please refer to Appendix 1 and 2). [62]
Source: Compiled from Highfield et al. [63]

Based on the findings of Highfield et al, we evaluate the VAT compliance burden of India vis-à-vis other lower-middle, upper-middle, and high-income countries, specifically Australia.[64] Mukherjee and Badola estimate the monetary costs associated with state VAT

[62] Ibid
[63] Ibid
[64] Ibid

compliance in India.[65] Since the study is based on a secondary source of information, it suffers from limitations in covering components of compliance costs and taxpayers (limited to unincorporated enterprises only). Considering all qualitative and quantitative factors, as presented in Table 3, is essential to comment on the VAT compliance burden of a country. Due to a lack of comprehensive data for developing countries, studies evaluating compliance cost in general and compliance with the VAT/GST system in particular are sparse (Appendix Table A.1). Highfield et al present indicators of various aspects of VAT compliance burden (including qualitative aspects) across a few developed and developing countries.[66] Though the coverage of countries in the study is skewed towards high-income countries (developed countries), the data presented in the study is beneficial for evaluating the performance of the Indian VAT system vis-à-vis other nations.

V Results and Discussion

A *Factor A: Tax law complexity and burden resulting from core elements of VAT policy*

This factor is linked with the degree of complexity and compliance burden arising because of the core elements of the VAT policy framework. Six indicators of Factor A (refer to Table 3) capture the direct impact on compliance costs.[67] Taking into account survey ratings across the range of identified indicators, the most influencing drivers of compliance costs in 2017 for India were - the presence of multiple rate structures, scale of reduced rates and exemptions, limited use of cash basis for estimating VAT liabilities, restricted use of simple rules for prescribed industries in estimation of VAT liabilities, and VAT registration obligations. For instance, the initial indicator measures complexity regarding the "number of rates in the tax system". The presence of multiple rates increases the compliance burden by creating more borderlines. In Australia, the GST system has only one rate. The second indicator, "percentage of the tax base lost to reduced rates and exemptions," relates to the extent of concessions given in the VAT law. It is expected that the larger the scope of goods and services subject to concessions, the more likely the classification problems and, hence, the greater the compliance burden. However, this also presents an opportunity to reduce the compliance burden by reconsidering the scope of concessions. Similarly, as described earlier, the presence of choice among taxpayers increases the tax complexity. As we can see from Figure A.1 in the Appendix, the compliance burden with the Indian VAT system used to be higher than the average in upper-middle and lower-middle-income countries and lower than the average in high-income countries (more specifically, Australia). Indicators associated with Factor A indicate the presence of multiple rate structures and the high revenue impact of reduced rates and exemptions. The indicators also capture tax law complexities and the compliance burden arising from core elements of the Indian VAT policy.

B *Factor B: Number and frequency of administrative requirements to comply*

[65] Mukherjee and Badola (n 5).
[66] Highfield et al (n 45).
[67] Cedric Thomas Sandford, 'The Administrative and Compliance Costs of Taxation: Lessons from the United Kingdom' (1985) 15 *Wellington Law Review* 199; Sandford et al (n 15); Sijbren Cnossen, 'Administrative and Compliance Costs of the VAT: A Review of the Evidence' (1994) 8(20) *Tax Notes International* 1649; Kathrin Bain et al, 'The internal costs of VAT compliance: Evidence from Australia and the United Kingdom and suggestions for mitigation' (2015) 13(1) *eJournal of Tax Research* 158.

This factor is linked to administrative obligations or events arising under the VAT law, such as registration, record-keeping, filing returns, paying taxes, audits, and disputes. There are 11 indicators under Factor B (refer to Table 3). For instance, the first indicator measures the percentage of businesses which can register electronically. The compliance burden is expected to be significantly reduced with electronic registration compared to filing a registration application on paper or physically visiting the tax office. Online registration reduces the burden on businesses and paves the way for a more efficient and streamlined VAT system. There may be a lack of robust evidence on the impact of technology adoption (mainly electronic registration) on VAT compliance costs.[68] The second indicator is related to the number of times (frequency) that a taxpayer has to pay VAT liabilities in a financial year. The higher the frequency of filing tax returns or payment obligations, the higher the compliance costs.[69] Hence, to reduce the compliance burden of small companies (having turnover of up to $2.3 million), Vietnam has changed monthly to quarterly reporting.[70] Ukraine has reduced its frequency of payments from 28 to 5; Macedonia FYR and Azerbaijan have reduced the frequency of payments to 7 from 29 and 18, respectively.[71] Similarly, in Tajikistan, the filing and payment frequency for corporate income tax and VAT has decreased from 69 to 31 since the online filing of tax returns and payments.[72] The third indicator includes the information requirement of a typical VAT return. It records the information needed for filing tax returns, i.e. the number of boxes/fields (with less than ten boxes, 11-20 boxes, 21-30 boxes, or above 30 boxes) that business taxpayers must typically complete for the VAT return process. As the information requirement increases, so does the compliance burden. Other indicators include documents or reporting requirements, the number of VAT verification actions, etc. The higher the number of documents or VAT verification actions required, the higher the compliance burden. India's compliance burden related to Factor B was comparatively higher than the average of high-income countries (such as Australia, Canada, New Zealand, Singapore, Norway, Denmark, and China) and lower-middle-income countries. However, it was lower than the upper-middle-income countries (Figure A.2 in the Appendix). The other important indicator contributing to the relatively higher compliance burden of the Indian VAT system was related to furnishing data in returns. Highfield et al. observed over 30 boxes or fields to be furnished while filing a typical VAT return in India.[73] Other significant drivers were the number of VAT verification actions, which accounts for over 10 per cent of the registered VAT payer population, and the level of disputed VAT assessments, which accounts for over 10 per cent of the number of VAT verifications in India. With the introduction of GST, certain tax administration functions (e.g., registration, return filing, payments) are moved into an online centralised system maintained by the GST Network (GSTN). Both the Union and state tax administrations administer the GST, but taxpayers have to deal with any one of the tax administrations at any point in time. This has resulted in a change in the tax environment that taxpayers face. Assessing the compliance burden related to the GST regime in India would be helpful. Undoubtedly, the number and frequency of administrative requirements to comply with the GST system has increased for a section of taxpayers. Australia has exceptionally low scores for Factor B vis-à-vis other countries (Figure A.2 in the Appendix). This implies that the

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[68] Sharon Smulders and Chris Evans, 'Mitigating VAT compliance costs-A developing country perspective' (2017) 32(2) *Australian Tax Forum* 283.

[69] Ibid

[70]World Bank Group and PwC, *Paying taxes* (2016), <https://www.pwc.com/gx/en/paying-taxes-2016/paying-taxes-2016.pdf>.

[71] World Bank Group and PWC, *Paying taxes* (2015), <https://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2015-low-resolution.pdf>.

[72] Ibid.

[73] Highfield et al (n 45)

administrative requirement to comply with the Australian GST system is lower than in many countries. In Australia, the VAT/GST return process is relatively streamlined, typically requiring the completion of not more than ten boxes/fields.

C *Factor C: Capabilities of revenue body in meeting taxpayers' services and compliance needs*

This factor emphasises how each country's tax department helps taxpayers to comply with their tax obligations. Factor C comprises eight indicators capturing the nature and quality of taxpayers' services, e.g., comprehensiveness of the tax department's website, the ability to provide timely VAT refunds, and the quality of phone inquiry services. Theoretically, it has been argued that the provisions of such services tend to reduce tax law complexities and the associated compliance burden. Within this factor, India again was found to have a relatively higher compliance burden than the average score of country groups by income. Australia, once again, has exceptionally lower scores than the average score of country groups by income (Figure A.3 in the Appendix). The major contributing factors in India include unsatisfactory phone inquiry services and negligible support for newly registered businesses. However, after the introduction of GST implementation, the performance of taxpayers' services has yet to be assessed.

D *Factor D: Monetary Costs and Benefits of Tax Compliance*

This factor is associated with the monetary costs and benefits of complying with the VAT regime. The indicators measure the aggregate value of annual VAT refunds and provisions for paying interest to taxpayers for delayed refunds. However, as considered in this framework, the cost components differ from those generally considered for compliance cost studies (refer to Table 1). Compliance costs of the Indian VAT system are neither very high nor very low. In India, monetary costs associated with complying are higher than the average of upper-middle and lower-middle-income countries and lower than those of Australia and high-income countries (Figure A.4 in the Appendix). Regarding monetary costs and benefits with VAT/GST compliance, Australia's score is higher than the average of lower- and upper-middle-income countries, including India.

The compliance burden index ranks 47 developed and developing countries per their compliance burden score. The results show that 15 countries, e.g., Argentina, Colombia, France, Italy, Kenya, Poland, Spain, Belgium, Brazil, Belgium, Luxembourg, and Turkey, performed poorly in the overall compliance burden index.[74] India is neither the best-performing nor the worst-performing country in the overall compliance burden index. However, compared to Australia, India needs to reduce the compliance burden associated with the number and frequency of administrative requirements to comply. More importantly, the urgency and importance of enhancing the capabilities of the tax departments to meet taxpayers' services and compliance needs is emphasised. Similarly, Australia needs to work on reducing the monetary costs associated with the compliance of the GST regime.

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[74] VAT system of each country is assessed (rated) against 27 indicators and a normalised weighted score is assigned for each country. Score obtained by each country is converted into a 'compliance burden index' by applying 10-point scale, where index rating 1 reflects a VAT system with very low/minimal compliance burden while rating 10 reflects VAT system with very significant compliance burden. Highfield et al (n 45).

VI MITIGATING VAT COMPLIANCE BURDEN

This section explores policy options/strategies/ interventions that could help mitigate or reduce the VAT compliance burden. Some countries' experience shows that specific policy measures effectively reduce the compliance burden. In contrast, others could be more problematic regarding their impact on compliance costs and resulting behavioural responses of taxpayers.

A *Registration Thresholds*

To mitigate the compliance cost/ burden significantly and reduce the regressiveness of the VAT compliance cost, the typical response is to adopt a high VAT registration threshold. This means that enterprises below a specific annual turnover are not required to be registered under the VAT or are not required to remit the VAT on sales. However, unregistered taxpayers cannot claim input tax credits. As per the compliance cost and burden perspectives, the optimal threshold is when increased revenue from the VAT exceeds the compliance costs of taxpayers and the administrative costs of tax administrations.[75] Therefore, most countries have VAT registration thresholds to reduce compliance and administrative costs. [76]

Registration threshold for the VAT varies across countries and can significantly impact the compliance cost. For instance, Italy had the highest VAT exemption threshold on September 2023, i.e. $134,920, followed by France and the United Kingdom at $131,286 and $125,000, respectively (Figure 2). Turkey and Spain are exceptions among the European countries with no registration threshold for the VAT. Therefore, all businesses are required to be registered in the VAT system.[77] It is generally assumed that higher registration thresholds effectively reduce the compliance burden.[78] Keeping this issue in mind and considering the demands often raised by the MSME (Micro, Small and Medium Enterprises) sector, India has also increased the threshold for GST registration. The registration threshold of the GST has raised from INR 2 million to INR 4 million (INR 2 million for the Himalayan and North-Eastern States) in FY2019-20 for taxpayers supplying goods (INR 2 million for service providers in major states). Bulgaria has also increased the VAT registration threshold from January 2023.[79] Sweden has also increased the VAT registration threshold from SEK 30,000 to SEK 80,000 in July 2022. [80] In Australia, the registration threshold was AUD 50,000 in 2007, which increased to AUD 75,000 and remained the same over the last decade.[81] Many other developing countries follow this trend and have increased the VAT thresholds over the years. For example, Ghana first set the threshold at US$20,000 in 1995; however, with a failed VAT

[75] Michael Keen and Jack Mintz, 'The Optimal threshold for a value-added tax' (2004) 88 (3-4) *Journal of Public Economics* 559.
[76] Thomas Locher, 'VAT Exemption Threshold in Europe', (*Tax Foundation*, July 2021) <https://taxfoundation.org/vat-exemption-thresholds-europe-2021/>.
[77] OECD, 'VAT/GST: Registration/Collection Thresholds' (OECD database under taxes on consumption, 2023) <https://www.oecd.org/tax/tax-policy/tax-database/>.
[78] Evans and Krever, (n 22).
[79] Orbitax, 'Bulgaria Confims Increase in Social Security Contribution Rates for 2024' (*Orbitax*, September 2023) <https://www.orbitax.com/news/archive.php/Bulgaria-Confirms-Increase-in--51425>.
[80] OECD (n 77).
[81] Ibid.

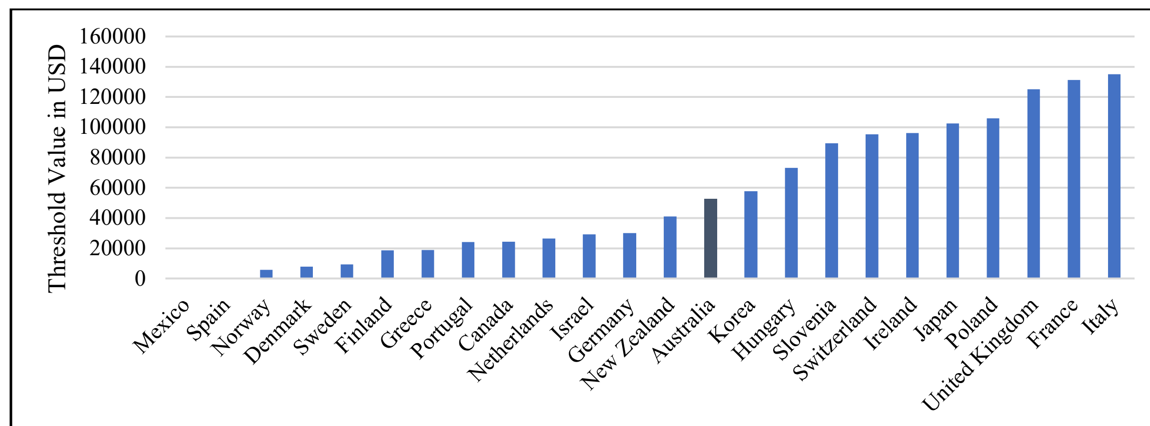
trial, it was increased to US$75,000 in 1999. Bangladesh has also increased the threshold from BDT 8 million to BDT 30 million in 2019.[82]

A higher threshold may reduce the tax base and incentivise large businesses to split operations into multiple entities to avoid VAT registration. Businesses may underreport sales or produce less output to avoid VAT registration.[83] However, problems with a high threshold might be small relative to the savings in compliance and administrative costs associated with registering small businesses in the VAT system. Being prominent in numbers, small businesses generate a low aggregate level of value addition and, hence, lower tax liability (or tax payments). The standard recommendations often emphasise a single threshold applied across all industries, as multiple thresholds are difficult to administer. The choice of a VAT registration threshold also depends on its impact on the overall progressiveness of a VAT system and should be evaluated in this context.

[82] Orbitax, 'Update-Bangladesh VAT and Other 2019-2020 Budget Measures- Orbitax Tax News & Alerts' (*Orbitax,* July 2019). <Update - Bangladesh VAT and Other 2019-2020 Budget Measures — Orbitax Tax News & Alerts>.

[83] Yige Zu, 'VAT/GST thresholds and small businesses: Where to draw the line' (2018) 66(2) *Canadian Tax Journal* 309.

Figure 2: VAT Registration Threshold (as of September 2023)



Note: Exchange rates for conversion into USD are Purchasing Power Parity (PPP) rates for GDP 2021.
Source: OECD Database[84]

B *Exemptions: A Fallacy of VAT*

'Exemption' refers to the freedom from duty, liability, or other requirements.[85] However, VAT exemptions do not meet the criteria of this definition since under the VAT system- an exemption means that the supplier of goods does not have to charge VAT on the exempted supply but is not allowed to claim an input tax credit (ITC) for the VAT paid on purchases of inputs related to the exempt supply. In other words, exempted supplies are taxed on their inputs. Therefore, the exemption "breaks the chain of credit and refund, leading to an element of production taxation".[86] Tax on inputs is a cost factor for the business, leading to tax cascading. This goes against the general purpose of a VAT that should be neutral amongst businesses. The denial of the ITC has only fiscal reasons, not any systematic justifications, highlighting a lack of rationality in the current tax system.[87] A transaction is considered free of VAT only when the output is tax-exempt, and the business can claim input tax credits (ITC). Such exemptions with deductions are generally known as "zero rating".[88] They only apply for cross-border transactions to ensure compatibility with the destination principle. Exempt supplies put pressure on enterprises in the form of input VAT that cannot be recovered, which results in increased costs. Depending on the market condition (price elasticity of supply and demands), enterprises may pass on the higher costs in terms of higher prices of exempted goods and services to the downstream of the value chain. Therefore, exemption leads to tax cascading. On the contrary, when a supply is subject to VAT, the right to deduct input VAT is triggered. This gives the supplier complete tax relief and reduces the

[84] <vat-gst-annual-turnover-concessions-ctt-trends.xlsx (live.com)>
[85] Bryan A. Garner, Black's Law Dictionary (Standard ed., Thomas Reuters, 2019).
[86] Ian Crawford, Michael Keen and Stephen Smith, 'Value added tax and excises' in *Dimensions of Tax Design: The Mirrlees Review (*Oxford University Press, 2010) 275, 305.
[87] Marianne Steurer, 'VAT and Direct Tax Policy on Exemptions', in Sebastian Pfeiffer and Marlies Urspprung-Steindl (eds), *Global Trends in VAT/GST and Direct Taxes* (Linde Verlag, 2015) 89.
[88] Christian Knotzer and Sebastian Pfeiffer, 'Exemptions in VAT: A theoretical overview of Traditional and Modern VAT system', 'Exemptions in VAT: A Theoretical Overview of Traditional and Modern VAT system', in Robert F. van Brederode (ed.), *Virtues and Fallacies of VAT: An Evaluation after 50 Years* (Kluwer Law International 2021) 97.

VAT to accounting entries. The use of tax exemptions in the VAT system is extensive and diverse.

There are some benefits linked in favour of exemptions in a VAT system. Tax exemptions are generally used to reduce the regressiveness of the VAT, lower the price of certain essentials, encourage consumption, and facilitate tax administration functions.[89] However, the distorting effects of VAT exemption far outweigh its benefits. The major is the denial of input tax credit, which is supposed to be the primary purpose of VAT. Moreover, exemptions lead to classification and delimitation issues. It is not always easy for taxpayers or tax administration to determine whether a transaction or taxpayer falls within a particular exemption, resulting in increased compliance and administrative costs. Similarly, allocating input VAT to taxable (deductible) and exempt (not deductible) transactions is complex for businesses with taxable and exempt supplies, which might increase administrative and compliance costs. [90] The case for applying for VAT exemptions (or reduced VAT rates) is often weak, as the literature on indirect taxations finds no redistributive role for reduced rates when other more direct tax instruments are available.[91] The existing literature indicates that reduced VAT rates are not an effective and well-targeted approach for supporting lower-income households or making the VAT system progressive. In contrast, cash transfer programs (though still imperfect) demonstrate greater targeting in assisting those with lower incomes.[92] Likewise, reduced VAT rates are not well targeted to encourage the consumption of merit goods due to the ad valorem nature of the VAT.[93] The Indian state VAT system was also not free from shortcomings, as it was characterised by a narrow tax base, a plethora of exemptions, multiple rate structures (at least four), cascading of taxes due to non-inclusion of certain goods (e.g., gasoline, diesel, aviation turbine fuel, crude petroleum, natural gas, electricity), and breaking down of the ITC chain when inter-state transactions are involved in any supply chain. However, introducing GST has significantly changed the nature and scope of tax administration for the Union and states in India. However, at the start of the GST regime, there were demanding tax compliance requirements.[94]

Overall, the presence of indistinct borderlines, in-laws with different rates, exempt suppliers, or domestic zero-rated supplies drives the VAT compliance burden.[95] Therefore, emerging literature suggests abolishing exemptions, subjecting businesses to zero-rating, or, as a compromise, giving businesses the option to treat exempt transactions as supplies subject to VAT.[96]

C *Tax Administrative Practices*

[89] Ibid.
[90] Crawford et al (n 86).
[91] Alastiar Thomas, 'VAT Rate Structures in Theory and Practice' (Policy Research Working Paper No. 10677, World Bank Group- Macroeconomics, Trade and Investment Global Practice, January 2024); Rita de la Feria and Artur Swistak, 'Designing a Progressive VAT' (Working Paper No. WP/24/78, International Monetary Fund, April 2024).
[92] Thomas (n 91)
[93] Ibid
[94] Sacchidananda Mukherjee, 'India: The Challenges of Implementing VAT in a Federal State' in Robert F. van Brederode (ed.), *Virtues and Fallacies of VAT: An Evaluation after 50 Years*, (Kluwer Law International, 2021) 575.
[95] Evans and Krever (n 22).
[96] Knotzer and Pfeiffer (n 88).

The mobilisation of tax revenues depends on institutional capacity, especially in countries with high levels of non-compliance. In developing countries, non-compliance with the tax system is comparatively higher than in developed countries.[97] Administrative practice changes can significantly impact tax compliance costs in several ways.[98] Best tax administrative practices, e.g., clear and straightforward regulations, efficient and user-friendly filing systems, risk-based auditing, technology integration, timely and transparent communication between tax authorities and taxpayers about changes in the VAT laws, regular review/ feedback to ensure ongoing improvements in the administrative framework, could reduce compliance costs of taxpayers.

The relationship between compliance and administrative costs is often direct, moving in the same direction. Both types of costs increase when tax laws are poorly designed and administered. However, well-designed and managed regulations can significantly reduce the compliance burden for businesses dealing with the VAT. As discussed earlier, the number and frequency of administrative requirements to comply are essential for reducing the VAT compliance burden. For instance, factors such as the frequency of reporting and filing of tax returns, the number of documents required to be submitted, costs of audit appeals and litigation, or technological solutions adopted are critical for examining the compliance cost burden. However, it is often argued that taxes such as VAT/GST are usually related to higher tax compliance costs as these transaction-based taxes require extensive or comprehensive record keeping and reporting.[99] Electronic filing may be convenient for enterprises, but available evidence does not show that the compliance burden is reduced with e-filing in European countries.[100] To some extent, increased compliance costs can be avoided by adopting technological solutions (e.g., pre-filled tax returns based on third-party information and/or e-invoicing). However, there is no firm evidence of the impact of technology adoption on VAT compliance costs.[101] According to Smulders and Evans, there is mixed evidence on the actual role of technology in reducing the cost of tax compliance in both developed and developing countries.[102] Therefore, it is still a matter of debate whether the burden of compliance costs can be reduced by implementing computerised methods of record keeping, e-flings, e-invoicing, etc.

Furthermore, the modern trend towards a risk-based approach in tax administration is typically underpinned by effective audit strategies by tax authorities. Audits and investigations can take many forms, from low-profile investigations that take no further action to full-scale investigations that lead to fraud prosecution.[103] A well-balanced and focused audit program aimed at improving the effectiveness of the audit process, such as introducing a dedicated VAT audit department/division, training and up-skilling of audit

[97] Cyril Chimilila and Vincent Leyaro, 'Tax administration Capabilities and Revenue Extraction Efficiency in Sub-Saharan Africa: Evidence from a Panel Stochastic Frontier Model' (2022) 7(2) *Journal of Tax Administration* 51.

[98] Evans and Krever (n 22); Sebastian Eichfelder and Francois Vaillancourt, 'Tax compliance costs: A review of cost burdens and cost structures' (Discussion Paper No. 178, Arbeitskreis Quantitative Steuerlehre (arqus), November 2014).

[99] Cedric Thomas Sandford et al, 'Costs and Benefits of VAT', (Heinemann Educational Books, 1981).

[100] Olaf Buske et al, 'Study on tax compliance costs for SMEs- Final Report' (KPMG Report, Publications Office of the European Union, November 2018) < Study on tax compliance costs for SMEs - Publications Office of the EU (europa.eu)>

[101] Smulders and Evans (n 68).

[102] Ibid

[103] Margaret Mckerchar and Chris Evans, 'Sustaining growth in developing economies through improved taxpayer compliance: Challenges for policy makers and revenue authorities' (2009) 7(2) *eJournal of Tax Research* 171.

staff, and using technology that can help mobilise more revenues, are essential for tax administration perspective.

VII CONCLUSION

The study provides a literature review on tax compliance costs and the associated burden in complying with the tax regime (mainly VAT). The study suggests that compliance costs and burden are two different concepts where the former measures the burden in monetary terms, and the latter is broader, more qualitative and multidimensional. The literature on VAT compliance costs suggests difficulties in measuring it. The major is the inseparability of costs between general business activities and tax compliance activities. However, despite having measurable issues, several studies tried to estimate the tax compliance costs (VAT in particular). VAT compliance costs are significantly high and regressive in developed and developing nations. There has been emerging literature on measuring the VAT compliance cost for developing nations, but the data capturing possible factors influencing VAT compliance costs/burden still needs to be improved. In developed nations, especially those in OECD countries, data availability is generally less of an issue compared to developing countries. We noticed that developed countries conducted/funded various primary surveys to evaluate the VAT compliance costs/burden. For example, a large-scale survey was conducted in Australia in 2013 to evaluate tax compliance costs, and the Australian Research Council funded it in collaboration with the Institute of Chartered Accountants in Australia.[104] In India, conducting thorough surveys to assess the VAT/GST compliance burden is essential for better understanding compliance costs or burdens. The factors discussed in the present study would be helpful for future surveys/studies to evaluate the VAT/GST compliance burden.

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[104] Evans et al (n 11).

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