STEPHEN BARKOCZY

FOUNDATIONS OF TAXATION LAW

15TH EDITION

CAMBRIDGE

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Designed as a guide for law and business students as well as tax practitioners, the text blends policy issues, taxation theory, black letter law and commercial practice into a succinct general principles text.

Topics are presented in a logical and structured order and are cross-referenced to specific provisions in the legislation and relevant cases so that readers are able to easily find the source of the law. The text includes approximately 400 examples as well as dozens of diagrams and tables that condense the law and help clarify difficult concepts.

This edition contains expanded technical and policy discussion of several areas of law. It has been substantially revised and restructured to take account of the many important legislative reforms, case law developments and announcements that have occurred over the last 24 months. Some of the new topics covered include:

- the March and October 2022 and May 2023 Budget announcements
- the OECD's two-pillar solution on global tax reform
- the corporate collective investment vehicle regime
- the proposed tax on earnings on superannuation balances over $3m
- the skills and training and technology investment boosts
- the small business energy incentive
- the digital games tax offset
- the share buy-back reforms
- the ATO Charter
- the state and territory land tax, payroll tax and stamp duty changes
- the new ruling on residency tests for individuals
- the multinational tax transparency reporting rules
- the public beneficial ownership register requirements, and
- the denial of deductions for payments to associates for intangibles in low corporate tax jurisdictions.

Stephen Barkoczy is a Professor in the Faculty of Law at Monash University.

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FOREWORD TO THE FIRST EDITION

Foundations of Taxation Law is an impressively ambitious project impressively executed. The aim of the book is said in the preface to be to provide a 'concise' introduction to the policy, principles and practice of the Australian federal taxation system. Anyone acquainted with that system will appreciate how large and difficult a task that is. Stephen Barkoczy has brought to bear many years of teaching and practice in tax in the production of this substantial contribution to the literature on tax law, policy and practice in Australia. His teaching skills are evident in the exposition of complex and difficult issues in a systematic and clear language reflecting the kinds of questions which students might frequently have asked him. The text, however, is thoroughly informed by many years of practice and experience in tax law, policy and practice. The value of this book lies not only in its clarity and breadth of coverage. Readers will find throughout the book further references to pursue in more detail the many concepts and issues considered by the author. Teachers in taxation will undoubtedly find useful as a teaching tool both the text and the many detailed further references. They will also find particularly useful the study questions helpfully provided throughout the text at the end of various sections. They are designed to assist students in their understanding of the issues explained in the text and, as a teaching tool, will be very useful to the other teachers of taxation in Australia as a vehicle for discussion and application of principles.

It is particularly heartening to see a text of this kind directed to the student. There are many texts on tax law for practitioners designed, with varying degrees of success, to provide practical answers to difficult problems. Some publications for practitioners can do little more to assist the practitioner than gather together as much relevant information as possible and provide some statement of the law. *Foundations of Taxation Law* is directed to a different kind of enquiry, namely, that of the student wishing to understand what the rules are about. Tax law has developed over the years to become a complex system of many interacting rules. The complexity and size of the rules makes its teaching as a system a difficult task. The practitioner consulting a practice text or commentary may be presumed to have sufficient knowledge before looking up the text. For the student the task is different and more difficult. It is that enterprise that Stephen Barkoczy has undertaken with impressive results in this text.

On a personal note, it is particularly gratifying that this text should be written by one's own former student of many years ago. The text is a great credit to the author and I commend it to students of taxation in Australia.

The Hon. Tony Pagone AM KC

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PREFACE

AIMS AND OBJECTIVES

Taxation law is a vast and complex area of law that is continually evolving. As a consequence, it can be an overwhelming and challenging subject to study and research. The aim of this book is to provide a guide to the policy, principles and practice that underpin the Australian taxation system. The book focuses on the key components covered in many introductory and advanced taxation law courses studied at Australian universities. It is designed to be used by undergraduate and postgraduate students as well as students undertaking professional qualifications with accounting bodies, law societies and the Taxation Institute of Australia. The book is also intended to serve as a general reference guide for taxation academics and researchers, as well as practising lawyers and accountants who require a succinct and user-friendly explanation of fundamental taxation law concepts.

CONTENT AND STRUCTURE

The main emphasis of the book is on Commonwealth taxes, particularly income tax, goods and services tax, fringe benefits tax and superannuation taxes. It also examines various state and territory taxes, as well as a number of levies and charges. The book is divided into 13 parts containing 41 chapters. To make the book more accessible to readers, I have adopted the approach of focusing on general principles. My objective is to provide a broad overview of the foundations of the taxation system rather than an exhaustive explanation of all its intricate principles and exceptions. In this regard, I have been selective in the topics covered and have intentionally divided them into 'consumable chunks' that can be easily digested by a reader. At the same time, I have tried to ensure that the book addresses most areas of general importance and does not over-simplify the law or skirt around harder issues. The book is therefore more comprehensive than many other introductory guides and goes into deeper detail on several topics. I have purposely tackled difficult areas of law that I believe are of significant practical importance and are not always adequately covered in other general books. For instance, the book has detailed chapters dealing with topics such as superannuation, employee share schemes, consolidated groups, investment incentives, business restructures, international taxation, Double Taxation Agreements, base erosion and profit shifting, accruals taxation and the taxation of financial transactions. Although these areas are outside the scope of most basic tax courses, they are important for advanced courses and are critical for obtaining a broad understanding of the Australian taxation regime. They are also particularly important areas for academics and practitioners.

While the book does not purport to provide a complete picture of Australia's tax laws, it covers a lot of ground, including discussion of many hundreds of legislative provisions, cases and rulings. The discussion in the chapters should serve as a solid set of principles around which readers can progressively build their general understanding of the law. The discussion should also provide a useful road map for navigating the complex web of interconnected provisions in the tax legislation and for making sense of the extensive body of case law in the field. Hopefully, by using this

book, readers will be able to tread more confidently through the tax law maze and be able to better 'see the wood for the trees'.

The book is the product of many years of researching, practising and lecturing in the field of taxation law, and it undoubtedly demonstrates my own biases about what I think is important for students, academics and practitioners to understand about the subject. I have tried to blend policy issues, taxation theory, technical 'black letter law' and commercial practice into a succinct, principled text. Although the book is primarily a legal text, it does not focus exclusively on legal issues. The discussion also touches on a wide range of social, economic, political and international comparative issues. Taxation law, perhaps more than any other area of law, is affected by these broader considerations, and I firmly believe that it needs to be approached with these perspectives in mind.

In writing the book, I have been conscious of the pressures placed on students and practitioners who have to grapple with large amounts of complex information located in different places in short time frames. For this reason, I have endeavoured to develop topics in a logical and structured order and clearly signpost and break up core concepts into their constituent elements. I have also extensively cross-referenced the discussion to specific legislative provisions and cases so that readers are able to easily find the source of the law. The book is peppered with examples, diagrams and tables that condense the law and help clarify difficult concepts.

QUESTIONS, ONLINE RESOURCES AND LECTURER SLIDES

To assist students with their exam preparation, the book contains a set of questions at the end of each chapter that are linked to the topics covered in that chapter. The questions test fundamental issues that students need to understand in order to properly grasp key concepts. They can also be used by lecturers as a basis for tutorial discussions. The questions have been designed in such a way that they examine core issues from both a practical (calculation and problem-based) perspective as well as a conceptual (theoretical and policy-based) perspective.

Online resources are available on the Cambridge University Press Higher Education website at www.cambridge.org/highereducation/isbn/9781009458832/resources. Student resources are freely available and include a list of references to selected government reports, taxation rulings, books and articles for those interested in conducting further research. The list of references should be particularly useful to students conducting research for their assignments. Lecturers can also gain access to a set of over 1,000 PowerPoint slides that are directly cross-referenced to topics covered in the chapters. The slides are designed as a handy teaching aid and can be obtained once your account is granted access.

CHANGES IN THE 15TH EDITION

This book has evolved considerably over the years. The 15th edition has undergone considerable restructuring and has been substantially revised to take account of many important legislative reforms, case law developments, administrative changes and policy announcements that have occurred over the last 24 months. It contains extensive analysis of the March and October 2022 and May 2023 Budget measures as well as discussion of many important new developments, such as the introduction of the new corporate collective investment vehicle regime, the skills and training and technology investment boosts and the digital games tax offset. There is also detailed discussion of the proposed new tax on earnings on superannuation balances over $3m and the proposed share buy-back reforms. The new ATO Charter, which replaces the Taxpayers' Charter, is examined as well as various land tax, payroll tax and stamp duty changes.

Special attention has been devoted to a number of significant international tax developments, including the ATO's new ruling on residency tests for individuals and the OECD's landmark two-pillar solution on global tax reform. There is also discussion of the proposed multinational tax transparency reporting and public beneficial ownership register requirements as well as the proposed anti-avoidance rule that denies significant global entities deductions for payments to associates for intangibles in low corporate tax jurisdictions.

The book contains discussion of dozens of additional cases, including recent decisions, such as *Adcon Resources Vic Pty Ltd v FC of T*; *Aurizon Holdings Ltd v FC of T; FC of T v Balasubramaniyan*; *B&F Investments Pty Ltd v FC of T*; *Bosanac v FC of T*; *FC of T v Carter & Ors; Cerrah v TPB Construction*; *Forestry, Maritime, Mining and Energy Union & Anor v Personnel Contracting Pty Ltd*; *Del Castillo v FC of T*; *Dua v FC of T*; *FFYS v FC of T*; *Hornsby Shire Council v Cth & Anor*; *Gough & Anor v TPB*; *FC of T v Guardian AIT Pty Ltd ATF Australian Investment Trust*; *Guttikonda & Anor v FC of T*; *H&B Auto Repair Centre Pty Ltd v FC of T*; *DFC of T v Huang*; *Hyder & Ors v FC of T*; *JHKW v FC of T*; *JMC Pty Ltd v FC of T*; *Kais Jewellery (Syd) Pty Ltd v FC of T*; *Khanna v FC of T*; *Lakes Oil NL v ISA*; *FC of T v Landcom*; *Logic Accountants & Tax Professionals Pty Ltd & Anor v TPB*; *Messenger Media and Information Technology Pty Ltd v FC of T*; *Plaskitt v TPB*; *FC of T v PricewaterhouseCoopers*; *Shaw v FC of T*; *Stark v FC of T*; *Thanabalasingam v TPB*; *Tomkinson v TPB*; *TPB v Ordiales*; *TPB v Williams*; *FC of T v Virgin Australia Airlines Pty Ltd*; *R v Willmott*; *Wood v FC of T*; *Worsley v TPB* and *YDXM v FC of T*.

There is also expanded policy and technical discussion of several areas of law as well as many new and updated examples, questions and diagrams. Certain topics have been consolidated and the chapter order has been reorganised and streamlined. Unless otherwise stated, the discussion in the book is generally based on the law in force as at July 2023.

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Stephen Barkoczy
November 2023

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Stephen Barkoczy is a Professor in the Faculty of Law at Monash University and Chair of the Innovation Investment Committee of Industry Innovation and Science Australia. He is also a member of the International Faculty of the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business. Stephen has published, practised and lectured widely in the areas of taxation, superannuation and venture capital investment law. He is the author/co-author of many books and the recipient of numerous teaching awards, including the 2008 Prime Minister's Award for Australian University Teacher of the Year.

KEY TO ABBREVIATIONS

A$	Australian dollars
AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
AATA	*Administrative Appeals Tribunal Act 1975*
ABA	Additional Benefits Agreement
ABN	Australian Business Number
ABS	Australian Bureau of Statistics
AC	Appeal Cases (House of Lords)
ACA	Allocable cost amount
ACC	Australian Crime Commission
ACCC	Australian Competition and Consumer Commission
ACCU	Australian carbon credit unit
ACNC	Australian Charities and Not-for-profits Commission
ACT	Australian Capital Territory
ADF	Approved deposit fund
ADI	Authorised deposit-taking institution
ADJRA	*Administrative Decisions (Judicial Review) Act 1977*
AFC	Applicable functional currency
AFCA	Australian Financial Complaints Authority
AFM	Available fraction method
AFOF	Australian fund of funds
AFP	Australian Federal Police
AFSL	Australian financial services licence
AFTS	Australia's Future Tax System
AGD	Attorney-General's Department
AGS	Australian Government Solicitor
All ER	All England Law Reports
AMIT	Attribution managed investment trusts
AMLCTFA	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006*
AMLCTFR	*Anti-Money Laundering and Counter-Terrorism Financing Rules*
ANTS	A New Tax System
APA	Advance pricing arrangement
APRA	Australian Prudential Regulation Authority
ARFN	Australian registered fund number
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
AT	Australian Tax
ATC	Australian Tax Cases
ATD	Australian Tax Decisions
ATI	Adjusted tainted income

ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
BAS	Business Activity Statement
BCT	Business continuity test
BEPS	Base erosion and profit shifting
BTO	Beneficiary tax offset
BTWG	Business Tax Working Group
CA	*Customs Act 1901*
CCIV	Corporate collective investment vehicle
CFC	Controlled foreign corporation
CFE	Controlled foreign entity
CGC	Commonwealth Grants Commission
CGT	Capital gains tax
CLR	Commonwealth Law Reports
COAG	Council of Australian Governments
COT	Continuity of ownership test
CPB	Capital protected borrowing
CPI	Consumer Price Index
CR	Class Ruling
CRS	Common reporting standard
CSF	Crowd source funding
CTA	*Customs Tariff Act 1995*
DA	*Domicile Act 1982*
DASP	Departing Australia superannuation payment
DBTP	Death benefit termination payment
DGTO	Digital games tax offset
DICTO	Dependant invalid and carer tax offset
DIS	Decision Impact Statement
DPP	Director of Public Prosecutions
DPT	Diverted profits tax
DTA	Double Taxation Agreement
EA	*Excise Act 1901*
ECCT	Excess concessional contributions tax
EDCI	Eligible designated concession income
ENCCT	Excess non-concessional contributions tax
ERF	Emissions Reduction Fund
ESIC	Early stage innovation company
ESS	Employee share scheme
ESVCLP	Early stage venture capital limited partnership
ETA	*Excise Tariff Act 1921*
ETBT	Excess transfer balance tax
ETP	Employment termination payment
ETS	Emissions trading scheme
EU	European Union
EVCI	Eligible venture capital investment
FATCA	*Foreign Account Tax Compliance Act*
FBT	Fringe benefits tax
FBTA	*Fringe Benefits Tax Act 1986*

FBTAA	*Fringe Benefits Tax Assessment Act 1986*
FBTACA	*Fringe Benefits Tax (Application to the Commonwealth) Act 1986*
FC of T	Federal Commissioner of Taxation
FCR	Federal Court Reports
FDT	Franking deficit tax
FIF	Foreign investment fund
FITO	Foreign income tax offset
FLA	*Family Law Act 1975*
FLP	Foreign life assurance policy
FMD	Farm Management Deposit
FRE	Forex realisation event
FRG	Forex realisation gain
FRL	Forex realisation loss
FTC	Foreign tax credit
G20	Group of 20 Finance Ministers and Central Bank Governors
GDP	Gross domestic product
GFC	Global financial crisis
GIC	General interest charge
GloBE	Global anti-base erosion
GST	Goods and services tax
GST Regs	*A New Tax System (Goods and Services Tax) Regulations 2019*
GSTA	*A New Tax System (Goods and Services Tax) Act 1999*
GSTD	Goods and Services Tax Determination
GSTICA	*A New Tax System (Goods and Services Tax Imposition—Customs) Act* 1999
GSTIEA	*A New Tax System (Goods and Services Tax Imposition—Excise) Act 1999*
GSTIGA	*A New Tax System (Goods and Services Tax Imposition—General) Act 1999*
GSTR	Goods and Services Tax Ruling
GSTTA	*A New Tax System (Goods and Services Tax Transition) Act 1999*
HELP	Higher Education Loans Program
HESA	*Higher Education Support Act 2003*
HFE	Horizontal fiscal equalisation
IAS	Instalment Activity Statement
ICIJ	International Consortium of Investigative Journalists
ID	Interpretative Decision
IGT	Inspector-General of Taxation
IGTO	Inspector-General of Taxation and Taxation Ombudsman
IIR	Income inclusion rule
IISA	Industry Innovation and Science Australia
IMF	International Monetary Fund
IMR	Investment manager regime
IPO	Initial public offering
IRDA	*Industry Research and Development Act 1986*
IRS	Internal Revenue Service
ISA	Innovation and Science Australia
IT	Income Tax Ruling
ITA	*Income Tax Act 1986*
ITAA22	*Income Tax Assessment Act 1922*
ITAA36	*Income Tax Assessment Act 1936*

ITAA97	*Income Tax Assessment Act 1997*
ITAR15	*Income Tax Assessment (1936 Act) Regulation 2015*
ITAR21	*Income Tax Assessment (1997 Act) Regulations 2021*
ITC	Input tax credit
ITDIRWTA	*Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*
ITRA	*Income Tax Rates Act 1986*
ITTPA	*Income Tax (Transitional Provisions) Act 1997*
ITZ	Indirect tax zone
JITSIC	Joint International Tax Shelter Information Centre
LBTP	Life benefit termination payment
LCBTO	Loss carry back tax offset
LCR	Law Companion Ruling
LCT	Luxury car tax
LCTA	*New Tax System (Luxury Car Tax) Act 1999*
LCTICA	*A New Tax System (Luxury Car Tax Imposition—Customs) Act 1999*
LCTIEA	*A New Tax System (Luxury Car Tax Imposition—Excise) Act 1999*
LCTIGA	*A New Tax System (Luxury Car Tax Imposition—General) Act 1999*
LIC	Listed investment company
LITO	Low-income tax offset
LLC	Limited liability company
LTBR	Long-term bond rate
MAP	Mutual agreement procedure
MBLA	*Major Bank Levy Act 2017*
MEC	Multi-entry consolidated
MIS	Managed investment scheme
MIT	Managed investment trust
ML	Medicare levy
MLA	*Medicare Levy Act 1986*
MLI	*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*
MLS	Medicare levy surcharge
MLSFBA	*A New Tax System (Medicare Levy Surcharge—Fringe Benefits) Act 1999*
MNE	Multinational enterprise
MRRT	Minerals resource rent tax
MRRTA	*Minerals Resource Rent Tax Act 2012*
MT	Miscellaneous Taxation Ruling
NAI	Notional attributable income
NFRC	National Federation Reform Council
NRAS	National Rental Affordability Scheme
NSW	New South Wales
NT	Northern Territory
NZLR	New Zealand Law Reports
OBU	Offshore banking unit
OECD	Organisation for Economic Cooperation and Development
OECD MTC	OECD *Model Tax Convention on Income and on Capital*
PAYG	Pay As You Go
PDF	Pooled development fund
PDV	Post, digital and visual

PE	Permanent establishment
PR	Product Ruling
PRRT	Petroleum resource rent tax
PRRTAA	*Petroleum Resource Rent Tax Assessment Act 1987*
PRRTICA	*Petroleum Resource Rent Tax (Imposition—Customs) Act 2012*
PRRTIEA	*Petroleum Resource Rent Tax (Imposition—Excise) Act 2012*
PRRTIGA	*Petroleum Resource Rent Tax (Imposition—General) Act 2012*
PS LA	Practice Statement Law Administration
PSB	Personal services business
PSE	Personal services entity
PSI	Personal services income
PST	Pooled superannuation trust
PTG	Policy Transition Group
QAPE	Qualifying Australian production expenditure
QFA	Qualifying forex account
R&D	Research and development
RBA	Running balance account
RBL	Reasonable benefit limit
RBT	Review of Business Taxation
RPS	Redeemable preference shares
RSA	Retirement savings account
RSAA	*Retirement Savings Accounts Act 1997*
RSAR	*Retirement Savings Account Regulations 1997*
RSE	Registrable superannuation entity
RSPT	Resource super profits tax
SAM	Simplified accounting method
SAPTO	Seniors and pensioners tax offset
SBE	Small business entity
SBSCH	Small Business Superannuation Clearing House
SBT	Same business test
SCD	Superannuation Contributions Determination
SCR	Superannuation Contributions Ruling
SENCCTA	*Superannuation (Excess Non-Concessional Contributions Tax) Act 2007*
SETBTIA	*Superannuation (Excess Transfer Balance Tax) Imposition Act 2016*
SG	Superannuation guarantee
SGAA	*Superannuation Guarantee (Administration) Act 1992*
SGC	Superannuation guarantee charge
SGCA	*Superannuation Guarantee Charge Act 1992*
SGCLIEA	*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
SGD	Superannuation Guarantee Determination
SGR	Superannuation Guarantee Ruling
SHASA	Superannuation Holding Account Special Account
SISA	*Superannuation Industry (Supervision) Act 1993*
SISR	*Superannuation Industry (Supervision) Regulations*
SME	Small and medium sized enterprise
SMSF	Self managed superannuation fund
SMSFR	Self Managed Superannuation Funds Ruling
SR (NSW)	State Reports (New South Wales)

SSA	*Social Security Act 1991*
SSSCCIA	*Superannuation (Sustaining the Superannuation Contribution Concession) Imposition Act 2013*
STP	Single touch payroll
STTR	Subject to tax rule
TAA	*Taxation Administration Act 1953*
TAR17	*Taxation Administration Regulations 2017*
TASA	*Tax Agent Services Act 2009*
TBRL	Temporary budget repair levy
TCSA	Tax cost setting amount
TD	Taxation Determination
TFN	Tax file number
TIEA	Tax Information Exchange Agreement
TLIP	Tax Law Improvement Project
TOFA	Taxation of financial arrangements
TPB	Tax Practitioners Board
TPRS	Taxable Payments Reporting System
TR	Taxation Ruling
TSA	Tax sharing agreement
UN	United Nations
UN MTC	United Nations *Model Tax Convention Between Developed and Developing Countries*
UPE	Ultimate parent entity
US MTC	United States *Model Income Tax Convention*
UTPR	Undertaxed payment rule
VAT	Value added tax
VCA	*Venture Capital Act 2002*
VCLP	Venture capital limited partnership
VCMP	Venture capital management partnership
WET	Wine equalisation tax
WETA	*New Tax System (Wine Equalisation Tax) Act 1999*
WETICA	*A New Tax System (Wine Equalisation Tax Imposition—Customs) Act 1999*
WETIEA	*A New Tax System (Wine Equalisation Tax Imposition—Excise) Act 1999*
WETIGA	*A New Tax System (Wine Equalisation Tax Imposition—General) Act 1999*

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PART A

INTRODUCTION TO TAXATION AND AUSTRALIA'S TAX SYSTEM

1 TAXATION PRINCIPLES AND THEORY

[1.1] Introduction

Taxation is an ancient and ubiquitous concept that forms one of the central pillars around which civilisation has been built. In his 1925 treatise, *Taxation in Australia*, Stephen Mills noted that one of the certainties of history is that 'no structural society has ever arisen without taxation'. Taxation plays a critical role in society and has the capacity to affect the lives of everyone within it. As the United States Supreme Court observed in *Dobson v Commissioner* (1943) 320 US 489 (at 494–495): 'No other branch of law touches human activities at so many points'.

History vividly highlights that while taxation has brought great prosperity to nations, it has also fuelled bitter conflicts. Taxation can invoke passionate emotions in people about their rights and obligations and is a topic on which rational people often have diametrically opposed views. Ultimately, taxation is a powerful instrument that governments use to fund their activities and shape their economies. Without it, they would not be able to survive. While the features of taxation have evolved considerably over the years, taxation remains a fundamental characteristic of the modern nation state and an integral part of the overarching architecture that lies behind the economic systems of every developed country in the world. Its inescapable and pervasive nature was recognised long ago by Benjamin Franklin who famously wrote: 'In this world nothing can be said to be certain but death and taxes'.

What is taxation?

The *Oxford English Dictionary* defines a 'tax' as:

> A compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc.

One of the earliest Australian judicial pronouncements on the notion of taxation is found in *R v Barger* (1908) 6 CLR 41, where Griffith CJ, Barton and O'Connor JJ said (at 68):

> The primary meaning of 'taxation' is raising money for the purposes of government by means of contributions from individual persons.

Taxes come in a variety of forms and are also known by different names, such as duties, levies, tariffs and charges. The etymology of the word 'tax' can be traced to the Latin word *taxare*, meaning evaluate, estimate, or assess.

Taxation is the principal means by which governments raise revenue. Without taxation, governments would be unable to finance their operations or deliver the many public goods and services they provide to the community. Other ways that governments can raise revenue include:

- charging fees for rendering services or granting licences
- imposing fines for breaches of the law, and
- generating returns from their assets and investments.

Taxes are a special kind of impost that can be distinguished from fees and fines on the basis that they are imposed on the community at large and are not specifically connected with the receipt of any particular services, the granting of any special rights or privileges, or the breach of any law by the payer. Taxpayers are compelled by law to pay taxes and are obliged to do so even though they may not necessarily receive any direct benefits in return. In *Architecture of Australia's Tax and Transfer System*, the Australian Treasury recognised (at 11):

> A core characteristic of a tax is that there is no clear and direct link between the payment of the tax and the provision of goods and services to the taxpayer. The funds that the government raises from taxes may be used to provide goods or services to the community as a whole, and this may provide a benefit to the taxpayer, but the payment will still be considered a tax if there is no direct relationship between the amount of the payment and the benefit to the taxpayer.

Similar observations were made by the Australian Bureau of Statistics in *Australian System of Government Finance Statistics: Concepts, Sources and Methods*, where it is noted that although 'taxpayers expect provision of government services in return for the taxes they pay', there is 'usually no direct link between taxes paid by an individual taxpayer and the government services consumed by that taxpayer'.

What is taxation law?

Taxation law is the body of law that governs an entity's liability to pay tax to the government. It covers the rules that establish the incidence of tax and the tax base (ie who and what is subject to tax). It also extends to the rules relating to the administration and enforcement of the tax system, including the rules dealing with the collection and recovery of tax.

Australia, like other developed countries, has a vast body of taxation law. The primary source of this law is found in the many thousands of pages of tax legislation enacted by the Commonwealth, state and territory parliaments and the many hundreds of cases handed down by the courts and tribunals that have interpreted the statutory provisions over the years. Australia's extensive body of statute and common law is complemented by a broad array of administrative rulings, guidelines, and practice statements issued by the relevant revenue authorities.

Australia's taxation laws operate subject to the *Commonwealth Constitution* and the terms of its international treaties, including many Double Taxation Agreements ('DTAs') entered into with foreign countries.

Why study taxation law?

Taxation law is an extremely important and useful area of law to study, but is also incredibly challenging because of its voluminous nature, technical complexity and constant reform. Taxation law is particularly worth studying because of its wide social and economic impact and its practical relevance to all sorts of commercial transactions. It also raises interesting theoretical, ethical and philosophical issues, making it a discipline worth examining for purely academic purposes.

Taxation law does not operate in a vacuum. It intersects with many other areas of law, including aspects of commercial law, property law, corporate law and administrative law. Taxation is the major source of finance for most governments, and it affects all sorts of employment, business and investment dealings. In the commercial world, taxation is of great importance as it heavily influences the ways that entities are structured, investments are held and arrangements are financed. It is, frankly, impossible to properly appreciate how the government and the economy function without understanding basic notions of taxation. Each day, many millions of transactions are entered into that have taxation consequences.

Taxation is also a topical current affairs issue that features prominently in the media—stories relating to taxation appear frequently in daily newspapers and news broadcasts. The financial press, in particular, is peppered with articles on taxation. The pervasive nature of taxation means that it intrudes on many aspects of everyday life. It is therefore not surprising that people have strong and passionate views about taxation and that it is a perennial political issue that has the capacity to polarise public opinion. History vividly illustrates that taxation policies have the capacity to make or break governments and that good tax policies can lead to economic prosperity, while bad tax policies can result in social and political unrest.

On a personal level, having knowledge and skills in taxation law can be beneficial as it opens up many employment opportunities in the tax profession (in both the public and private sectors) as well as in related fields of law, accounting, business and finance. Understanding how the tax system works helps people run their businesses, plan their personal finances and comply with their reporting and other obligations under the law. Taxation awareness also provides people with a better appreciation of political and economic issues and enables them to engage more effectively in public debate in these areas.

What is the aim of this book?

This book introduces the policy, principles and practices that underpin the Australian tax system. It is designed to be used by students studying taxation law and as a general reference guide for taxation academics, researchers and practitioners. The aim of the book is to explain the foundations of Australian taxation law in a clear, concise, straightforward and structured manner without oversimplifying the law or avoiding discussion of complex concepts that have important practical ramifications.

More than 100 different taxes are levied in Australia. This book focuses on Commonwealth taxes, particularly income tax, goods and services tax ('GST'), fringe benefits tax ('FBT') and a range of superannuation taxes. It also touches on some of the main state, territory and local government taxes.

Although the book is designed as a legal text, it does not just present the reader with a bunch of technical rules. The objective is to place taxation law in its proper commercial context and to synthesise the legal analysis with discussion of related social, political, economic and policy issues. By weaving in these broader perspectives, taxation law can be better understood, and its practical relevance better appreciated.

How is this book structured?

This book is divided into 13 parts, consisting of 41 chapters. Each chapter commences with a broad introduction to the topics covered, followed by a detailed discussion of the core legal principles. Although the chapters deal with discrete topics, they are closely linked and comprehensively cross-referenced to show how the rules interrelate. The chapters are peppered with diagrams, tables and examples to synthesise the law, explain complex concepts and illustrate practical situations. There is also a set of questions at the end of each chapter that test many of the key issues covered.

The book is supported by online resources, available on the Cambridge University Press Higher Education website at www.cambridge.org/highereducation/isbn/9781009458832/resources. Student resources are freely available and include a list of references to selected government reports, taxation rulings, books and articles for those interested in conducting further research. In addition, a set of over 1,000 PowerPoint slides that are directly cross-referenced to topics covered in the chapters are available to lecturers who use the book, along with answers and worked examples to all end-of-chapter questions.

Conceptual framework for studying taxation law

Before launching into a detailed examination of how Australia's tax system works, it is useful to first establish a conceptual framework for studying taxation law. In particular, it is important to recognise the historical setting in which taxes have operated and the kinds of taxes that have been levied by governments over the years. It is also important to understand the basic structural features of taxes as well as the jurisdictional constraints and international settings in which they operate. As taxation has wide-ranging social, political, economic and policy dimensions, these aspects also need to be considered in parallel with any legal analysis. This chapter canvasses some of these broader issues and lays the theoretical foundations for the detailed technical discussion contained in the rest of the book.

[1.2] Historical background

Taxation is deeply rooted in history. Records of taxation date back in antiquity to the times of the earliest civilisations. Evidence of taxation can be found on an inscription on an ancient Sumerian tablet from the city of Lagash (located in what is now Iraq) which warns: 'You can have a Lord, you can have a King, but the man to fear is the tax collector'. The Bible also contains many notable references to taxation. The following passage from Paul's *Epistle to the Romans* (13:7–8) is a good example:

> Pay to all what is owed to them: taxes to whom taxes are owed, revenue to whom revenue is owed, respect to whom respect is owed, honour to whom honour is owed.

While it is impossible to precisely determine when the first taxes commenced to be levied, it is clear that by the times of the ancient Egyptians, taxation was already well established in society. During the reign of the Pharaohs, taxes were collected by public officials, called *scribes*, on behalf of the Pharaoh's chief minister, known as the *vizier*. Taxes were paid in kind and levied on items such as grains from harvests, livestock and cooking oil. The ancient Egyptians also paid taxes with their own labour by working on construction projects like the pyramids and serving in the army.

In ancient Greece, the concept of benefaction was deeply rooted in society and the wealthy proudly made voluntary payments, known as *liturgies*, to fund public projects. In times of crisis, such as war, an additional wealth tax, known as *eisphorá*, was levied. The ancient Greeks also collected customs duties at their harbours and levied excise duties on products such as olive oil. They also paid taxes on their slaves and levied a per capita 'poll tax', known as *metoikion*, on foreigners.

The ancient Chinese also had their own unique tax system. Various kinds of agriculture, land and poll taxes were imposed during the Shang, Zhou, Qin and Han dynasties. It was usually the role of

local magistrates, who were appointed by the imperial court, to collect taxes in their regions. Like the ancient Egyptians, the ancient Chinese also paid taxes with their labour by working on projects like the Great Wall and providing military service to their emperors.

During the Roman Empire, customs duties (*portoria*), sales taxes (*centesima rerum venalium*), land taxes (*tributum soli*) and poll taxes (*tributum capitis*) all featured prominently. In addition, there were also inheritance taxes (*vicesima hereditatium*) and taxes on owners who freed their slaves (*vicesima libertatis*). Taxation was largely decentralized and many early taxes were collected by *publicani* who were professional 'tax farmers' that bid at auctions for the right to collect taxes in the provinces and had the right to retain any excess for themselves.

In medieval England, the main taxes were property taxes, such as the *geld* and *tallage*, and death and inheritance taxes, such as the *heriot* and *relief*. These taxes were imposed alongside other peculiar feudal taxes, such as the *scutage* (which was payable by knights to commute military service owed to their lords) and the *merchet* (which was payable by serfs for a woman's right to marry). The famous *Domesday Book*, commissioned by William the Conqueror in 1086, was the first recorded survey of property holdings in England and was expressly undertaken for the purpose of assessing taxes.

Although taxes are nowadays usually paid in money, this has not always been the case, especially before the wide use of currency as a medium of exchange. In the Middle Ages, for example, it was common for peasants to pay taxes by contributing a percentage of their crops and agricultural produce to their landlords. This often left the poor with little to live off and even led to uprisings like the English Peasants Revolt of 1381. It also contributed to the creation of legendary stories, such as that of Robin Hood who, with his Merry Men from Sherwood Forest, stole back taxes collected by the Sheriff of Nottingham so that they could be returned to the poor. Another well-known tale is that of Lady Godiva who rode naked on horseback through the centre of town to persuade her husband, Leofric, the Earl of Mercia, to lower taxes on the people of Coventry.

During the Middle Ages, taxes were also levied by religious orders. The ancient *tithe*, which can trace its origins back to biblical times, is an example of such a tax. This tax derives its name from the old English word for 'one-tenth', as it originally involved a contribution of one-tenth of a person's earnings (usually taken from the produce from their land). People who did not pay the *tithe* to the Catholic Church were at risk of excommunication. While nowadays it is usually only governments that raise taxes, it is interesting to note that religious taxes still exist in some places. An example is the *Kirchenbeitrag* levied by the Catholic Church on its members in Austria.

Over the years, almost every kind of product has been taxed in some form or another, including even the most basic commodities, such as sugar and salt. The fact that taxes can be imposed on virtually anything is vividly illustrated by bizarre taxes such as the urine tax (*vectigal urinae*), which was first imposed by the Roman emperor Nero, and later his successor Vespasian, in the first century AD. Urine was a valuable commodity as it contained ammonia and could be used in a number of chemical processes, including cleaning garments, tanning leather and fertilizing crops. The tax was payable on the purchase of urine collected from public sewers. Vespasian's son, Titus, allegedly criticised his father for imposing such a disgusting tax, to which his farther famously responded by holding up a gold coin and remarking '*pecunia non olet!*' (money does not stink!).

Another colourful illustration of an unusual tax is the beard tax levied in Russia during the time of Peter the Great. The tax required men to pay for the right to have a beard and was part of the Tsar's efforts in modernising Russian society to fit more into line with Western Europe. A token was issued to those who paid the tax (which could be as high as 100 rubles for wealthy merchants). Those who refused to pay the tax or produce a token could be forcibly shaved in public.

The English window tax levied between 1696 and 1851 is yet another peculiar tax. The tax was imposed on property owners and was payable at rates that varied according to the number of windows in a dwelling. The aim was to tax the wealthy, who were more likely to have larger houses with more windows. Critics, however, cynically viewed it as a tax on daylight, and some property owners

simply bricked up their windows to avoid the tax. Earlier on, between 1662 and 1689, a hearth tax (also known as a 'chimney tax') was levied in England at the rate of two shillings for every hearth or stove in a dwelling. The origins of the hearth tax date back to the Byzantine Empire where a similar tax, known as *kapnikon*, was levied on households.

History contains many examples that demonstrate the effects taxation can have on behaviour. A good illustration is the Dutch property tax levied during the 16th and 17th centuries, which was calculated according to the width of buildings. Not surprisingly, this led to the construction of many narrow multi-storey houses that are characteristic of the ones still seen today alongside the canals in Amsterdam.

It is fascinating to note that there have even been great archaeological discoveries related to taxation. The most notable example is the famous Rosetta Stone discovered by a French soldier serving under Napoleon near the Nile. The Rosetta Stone, which has been prominently displayed at the British Museum since the early 1800s, contains inscriptions in Egyptian hieroglyphics, Demotic script and ancient Greek. The inscriptions were the key to deciphering hieroglyphics, which ultimately unveiled to the modern world many of the hidden mysteries of ancient Egypt. Less well known, however, is the fact that the Rosetta Stone contained a decree recording a tax immunity granted by King Ptolemy V to the priesthood. This led Alvin Rabushka from the Hoover Institute at Stanford University to quip: 'Which is why, of course, it was engraved in stone and not written on papyrus.'

[1.3] Kinds of taxes

Income tax

The most important and widely imposed modern tax is income tax. As its name suggests, income tax is a tax on income (ie earnings). Income tax was first introduced in Great Britain in 1799 by Prime Minister William Pitt to fund the war against Napoleon. The tax was repealed for a short time in the early 1800s following the signing of the *Treaty of Amiens*. However, renewed fighting resulted in Henry Addington, who had replaced William Pitt as Prime Minister, reintroducing income tax in 1803. Income tax continued to be levied until 1816 (one year after Napoleon's defeat by the Duke of Wellington at the Battle of Waterloo). It was subsequently reintroduced for budgetary reasons in 1842 by Robert Peel and it has continued to be levied in the United Kingdom ever since.

The introduction of income tax was radical and controversial at the time. Taxing income was regarded by many as an inappropriate intrusion by government into the personal affairs of its citizens, and was criticised as being a tax on the fruits of labour that discouraged work. Despite these objections, income tax was found to be an effective and practical way to raise revenue. Personal income tax is now levied by almost every country in the world (some notable exceptions include the Bahamas, the United Arab Emirates, the Cayman Islands, Oman, Qatar, Monaco, Brunei and Vanuatu).

One of the first countries to follow the United Kingdom in imposing income tax was the United States, which levied income tax from 1862 to 1872 to pay for the Civil War. Congress reintroduced income tax in 1894. However, the United States Supreme Court held in *Pollock v Farmers' Loan & Trust Co* (1895) 157 US 429 that the legislation imposed a 'direct tax' and therefore breached the provisions of the Constitution, which required direct taxes to be apportioned among the states. This eventually led to the *Sixteenth Amendment to the Constitution* in 1913, which allows Congress to levy income tax without apportionment among the states. Income tax is the bedrock of the United States tax system and has been the largest single source of federal revenue for many decades. Income tax is also levied by more than 40 states and is, subject to certain limitations, generally allowed as a deduction in calculating federal income tax.

In Australia, income tax was introduced by the Commonwealth in 1915 to support the country's World War I effort. Earlier on, the colonies (which subsequently became the states) had already

introduced their own income taxes. The Commonwealth and the states levied income tax in parallel until the middle of World War II, when the Commonwealth took over the income tax field as a consequence of the introduction of its Uniform Tax Scheme [4.2]. Ever since, income tax has remained Australia's major source of federal tax revenue.

Although Australia was influenced by the United Kingdom's income tax laws, Australia did not adopt the United Kingdom's 'schedular' model for its legislation. Under the United Kingdom legislation amounts were only taxed if they fell within one of six schedules. The schedules covered items such as rents from land and buildings (sch A), farming profits (sch B), interest and annuities from public funds (sch C), trading and professional profits and income not covered by the other schedules (sch D), employment income, annuities and pensions (sch E) and dividend income (sch F). Each schedule had its own computation rules. As a result, different rates of tax could be charged on different categories of income, and deductions relating to one category of income could not be applied against income of another category.

By contrast, Australia's income tax legislation does not use schedules to assess taxpayers. Instead, income tax is simply levied on a taxpayer's 'taxable income', which is calculated as the taxpayer's 'assessable income' less 'deductions' [8.4]. Different rates of tax do not apply to different categories of income and there are no general quarantining rules which specify that deductions relating to particular categories of income can only be applied against income of the same category. Australia's income tax legislation is therefore based on a 'global' model, as it generally allows all kinds of income and deductions to be set off against each other. For historical and constitutional reasons, Australia's income tax laws are not all contained in one Act. Instead, there are several distinct pieces of income tax legislation, including the *Income Tax Assessment Act 1997* ('*ITAA97*') and the *Income Tax Assessment Act 1936* ('*ITAA36*'), which determine how a taxpayer's taxable income is calculated, and the *Income Tax Act 1986* ('ITA') and the *Income Tax Rates Act 1986* ('*ITRA*'), which impose income tax and set out the rates of tax payable [8.2].

Despite the underlying structural differences between the Australian and United Kingdom income tax legislation, Australia has nevertheless borrowed certain concepts from the United Kingdom. Most importantly, like the United Kingdom, Australia distinguishes between 'income' and 'capital' amounts, and the Australian courts have drawn considerably on the United Kingdom jurisprudence in this area to help characterise various receipts. Australia also followed the United Kingdom in introducing a statutory CGT regime, which forms an integral part of its overarching income tax system [17.1].

Consumption taxes

In addition to income tax, most countries also impose some form of consumption tax. A consumption tax is a tax whose economic incidence falls on the consumer (eg through the increased cost of goods or services). It is the antithesis of income tax, as it taxes consumption rather than earnings.

The most widely encountered consumption tax is value added tax ('VAT'). VAT was first imposed in France in 1954 and has been adopted throughout the European Union ('EU'). It is a requirement for EU membership that Member States impose VAT at a minimum rate of at least 15% (reduced rates are allowed for certain supplies).

Australia began to levy its own version of VAT, known as goods and services tax ('GST'), on 1 July 2000 [7.1]. Interestingly, it was the last of the Organisation for Economic Cooperation and Development ('OECD') countries to do so (apart from the United States, which still does not have a VAT/GST).

VAT/GST is directed at taxing the value that has been added to the supply of goods and services. Registered entities (which include most entities that carry on business) charge VAT/GST on supplies they make and are generally allowed credits for VAT/GST charged on their acquisitions. The cost of VAT/GST is ultimately borne by end consumers who are not registered and, therefore, not entitled to credits for the VAT/GST charged on their acquisitions.

VAT/GST may be contrasted with sales tax, which is a much older and more traditional form of consumption tax. Sales tax is imposed on the sale of goods and is payable by the seller, who adds the tax to the price charged for the goods so that the burden of the tax is ultimately passed on to the purchaser. In the United States, many states impose retail sales tax. To ensure that this tax is charged only on retail sales and not on wholesale sales, registered persons who acquire goods for resale (ie not for their own consumption) provide a resale certificate to the seller, which enables them to acquire the goods free of sales tax.

In 1930, Australia introduced a wholesale sales tax. The tax was levied at the last point of wholesale sale of goods (eg from wholesaler to retailer). From the point of view of end consumers, wholesale sales tax was a 'hidden tax', as it was charged by wholesalers rather than retailers. The cost of the tax was nevertheless embedded in the price of the goods charged by retailers. As a result of the introduction of GST, wholesale sales tax was repealed from 1 July 2000. One of the main reasons for replacing sales tax with GST was that GST is levied on a much broader base, as it applies to the supply of goods and services (not just to the sale of goods).

Other taxes

A wide range of other kinds of taxes are also levied around the world. For example, many countries impose customs duties (on the importation and exportation of goods) and excise duties (on the production and manufacture of goods).

It is also common for countries to levy land taxes (on the ownership of real estate) and estate duties (on the assets of deceased estates). These taxes are forms of wealth taxes as they are levied on the value of a person's property. There are also several kinds of employment taxes, including payroll taxes (on the payment of wages) and fringe benefits taxes (on the provision of non-salary remuneration). In addition, there are many varieties of transactional taxes, such as stamp duties (on the execution of certain documents), gambling taxes (on betting at casinos, races and lotteries), financial taxes (on bank deposits and withdrawals), bed taxes (on accommodation provided in hotels) and road taxes (on the use of highways).

Some countries also impose taxes on profits from the exploitation of their natural resources. In 1987, Australia introduced a petroleum resource rent tax ('PRRT') on profits from petroleum projects [4.3]. In 2012, the Gillard Labor Government introduced a minerals resource rent tax ('MRRT') on profits from iron ore and coal mining projects [5.6]. At the same time, it also introduced a carbon tax on large greenhouse gas emitters to combat climate change [5.6]. The Abbott Liberal–National Coalition Government, however, abolished both the MRRT and carbon tax in 2014.

Mix of taxes

As each nation has the sovereign right to determine its own tax system, virtually anything can be made the subject of taxation. In *R v Barger* (1908) 6 CLR 41, Griffith CJ, Barton and O'Connor JJ recognised (at 68):

> The power to tax necessarily involves the power to select the subjects of taxation. In the case of things the differentiation or selection is, in practice, usually made by reference to objective facts or attributes of the subject matter, so that all persons or things possessing those attributes are liable to the tax. The circumstance that goods come from abroad or from a particular foreign country, or that particular processes or persons have been employed in their production, or that they possess certain ingredients, are instances of attributes which have been chosen for the purpose of differentiation.

Ultimately, each country determines who and what it subjects to tax and the particular attributes of its tax system. Each country inevitably adopts its own mix of taxes designed to suit its particular needs

and circumstances. While there are many similarities between tax systems around the world, there are also many differences in the ways that taxes can operate, making each country's tax system unique.

[1.4] Functions of taxation

Taxation's revenue-raising function

The most important and immediately recognisable role of taxation is its revenue-raising role. It is widely acknowledged that without taxation, a government would not be able to properly function. As the United States Supreme Court said in *Nicol v Ames* (1899) 173 US 509 (at 515):

> The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to a natural man. It is not only the power to destroy, but the power to keep alive.

At the most basic level, taxes redirect economic resources from citizens to governments for use in their spending programs. Taxation therefore involves diverting wealth from the private sector to the public sector. Governments use revenue raised from taxes to fund the public service and defence force, to provide a legal system and law enforcement, to construct roads and airports, to run hospitals and education institutions, and to pay social security benefits. Without taxation, governments could not provide their citizens with the many kinds of goods and services that they have come to expect. Government spending is often justified on the basis that in a capitalist society, certain 'merit' goods and services may not necessarily be adequately provided by the free-market, and it is therefore both necessary and appropriate for the government to intervene and provide these things to make society a better place.

Taxation's social and political functions

It is important to understand that taxation is a powerful political engineering device that governments can use as either a 'carrot' or a 'stick' to promote their objectives. For instance, in Australia, the Federal Government provides a range of tax concessions under various 'tax expenditure programs' [1.5] to encourage particular kinds of investment, such as private retirement savings under the superannuation regime [19.1]. On the other hand, it imposes excise duties on cigarettes, not only to raise revenue, but also to discourage smoking and thereby reduce the nation's health costs. Similarly, it imposes the MLS on high-income earners who do not have private health insurance to encourage them to take out appropriate cover in order to lessen the burden on the publicly funded health system [8.8]. The benefit of a concession or the burden of taxation can thus be a useful tool in sculpting social behaviour.

Taxation's economic functions

Taxation also has important microeconomic ramifications. For instance, taxing particular goods adds to their cost, making them more expensive than similar kinds of untaxed goods. Taxation can therefore be used to modify consumer behaviour by encouraging spending on one product rather than another. Governments around the world have frequently used taxation to protect their domestic industries by taxing imported goods more heavily than locally produced goods. This provides the local goods with a competitive advantage over the imported goods which, in turn, encourages spending on local products. A government's ability to tax goods will, of course, be subject to its obligations under any international agreements it has entered into (eg under the World Trade Organization's General Agreement on Tariffs and Trade).

Governments also often use taxation as a macroeconomic device to speed up or slow down their countries' economies. Higher taxation usually leads to less spending as taxpayers have less

disposable income. This typically has a deflationary effect on the economy. Lower taxation, on the other hand, usually results in increased spending as taxpayers have more disposable income. This, in turn, can have an inflationary effect on the economy.

Taxation's redistribution function

Taxation can also operate as a mechanism for creating economic equality between citizens. It can be used by governments to make their citizens richer or poorer. A tax system that taxes the rich so that the government can give to the poor promotes a more egalitarian society, redistributing wealth among citizens, which can result in a more level 'playing field'.

A more cynical way of looking at taxation is that it is simply a form of state-based confiscation which interferes with individual freedoms and rights. Some people complain that they pay a lot of tax, but get little direct benefits in return from the government. However, this kind of argument fails to recognise the fact that taxation enables a government to provide a range of services that can benefit society as a whole, and therefore make the state a better place to live. For instance, although some taxpayers might not directly use the public health system, they indirectly benefit from it as other members of society are cared for and public health, in general, is protected. Likewise, people without children should not complain that their taxes are being used to fund schools and universities, as public education has broad-ranging spillover benefits for the community.

Without taxation, living conditions within a country would be quite different. It would be up to each person to provide for themselves, since no one could rely on state-funded goods and services. Society would be more polarised, and wealth more concentrated. Those less able to support themselves would suffer, and the community as a whole would arguably be worse off.

Perspectives on taxation

Ultimately, taxation is one of the greatest powers a government has over its citizens. From a government's perspective, taxation enables the state to benefit from the fortunes of its citizens and the enterprises that they carry on. From a citizen's perspective, taxation is a cost of undertaking transactions, owning property, carrying on business and earning income. While taxation is one of the major factors that can affect a citizen's wealth, it also pays for the privileges associated with the kind of society in which they live. Accordingly, although taxation has been cynically described by some as a form of 'legalised robbery', it is more appropriate to view taxation, as Sabine observed in *A Short History of Taxation*, as 'part of the price of civilisation'. In the words of Justice Oliver Wendell Holmes (Jr) in *Compania General de Tabacos De Filipinas v Collector of Internal Revenue* (1927) 275 US 87 (at 100): 'Taxes are what we pay for civilized society.'

[1.5] Tax expenditures

In addition to its obvious revenue-raising function, governments also use their tax systems to provide incentives and financial assistance. Professor Surrey, in his seminal work, *Pathways to Tax Reform: The Concept of Tax Expenditures*, identified this aspect of the tax system as the system of 'tax expenditures'. Surrey recognised that tax systems contain two conceptually and functionally distinct components. One of these comprises the provisions that make up the 'normative tax structure' (ie the 'benchmark tax system' for collecting revenue) and the other comprises the provisions designed to effect government spending (ie the system of 'tax expenditures').

Tax expenditures may in turn be divided into two broad categories:

- 'tax incentives' (designed to induce certain activities or behaviour), and
- 'tax concessions' (designed to provide welfare assistance to those in need).

Tax expenditures are deviations from the benchmark tax system that are designed to benefit targeted taxpayers. They can be delivered in a number of ways. For instance, under the income tax system, tax expenditures may be provided to taxpayers by granting them special tax exemptions, tax deductions, tax offsets or reduced tax rates [27.1]. In addition, taxpayers may be provided with timing benefits. For example, they may be allowed to defer bringing income to account until a future year or be allowed to bring forward deductions into the current year. They may also be granted additional time to pay tax, allowing them more time to use the money they have earned.

Tax expenditure reporting

The Commonwealth Government has traditionally published annual *Tax Benchmarks and Variations Statements* (formerly known as *Tax Expenditures Statements*). In 2023, it published its *Tax Expenditures and Insights Statement*. These publications provide detailed information on the Government's tax expenditures as required under s 16 of the *Charter of Budget Honesty Act 1998*. They are designed to increase transparency and allow greater scrutiny of the tax system. In particular, they provide data on tax benchmarks and variations to such benchmarks. Tax benchmarks represent the standard taxation treatments that apply to similar taxpayers or activities. Special tax treatments may give rise to a positive or negative variation from the benchmark. A positive variation reduces tax payable relative to the benchmark. A negative variation increases tax payable relative to the benchmark. Tax incentives and concessions are positive variations as they reduce the tax that would otherwise be payable by taxpayers under the benchmark tax system.

A 'revenue forgone' approach is generally used to measure the cost of positive variations. This approach essentially compares the difference in tax paid as a result of the provision of a particular tax concession relative to the tax that would have been paid under the benchmark tax system if the tax concession had not been available (assuming taxpayer behaviour remained unchanged). A 'revenue gain' approach is also sometimes used to measure the cost of certain tax concessions. This approach takes into account potential changes in taxpayer behaviour that would arise if a tax concession were abolished.

Tax expenditure programs

Over the years, tax expenditures have become more prevalent in Australia, and several intricate tax expenditure programs have been developed by the Federal Government. Some of the main tax expenditure programs examined in this book include:

- the superannuation program (which provides tax incentives to encourage retirement savings) [19.2]
- the early stage investors ('ESI'), pooled development fund ('PDF'), venture capital limited partnership ('VCLP') and early stage venture capital limited partnership ('ESVCLP') programs (which provide tax incentives to encourage venture capital investment) [27.2]–[27.4]
- the research and development ('R&D') program (which provides tax incentives to encourage research and development activities) [27.5], and
- the film production program (which provides tax incentives to encourage Australian film production) [27.6].

The rationale for introducing these programs is that they address market failures and promote private investment in areas considered to be publicly desirable.

Tax expenditures are also provided to support specific categories of taxpayers. For instance, to support farmers, the Government provides a range of tax incentives to people who carry on 'primary production businesses' [25.2]. Likewise, to support taxpayers who operate small businesses, a range of special tax concessions are provided to small business entities ('SBEs') [8.7].

Tax expenditures may also be used to achieve broader economic objectives. For example, to stimulate economic activity during the global financial crisis ('GFC') and the COVID-19 pandemic, the Government provided a range of temporary tax incentives [1.13].

Tax expenditures clearly come at a cost as governments collect less revenue from those taxpayers who benefit from the concessions. Australia's largest tax expenditures are the CGT main residence exemption [17.11] and the superannuation concessions [19.2]. Together, these concessions make up more than half the estimated cost of all Australia's tax expenditures.

Tax expenditures versus direct spending

It is important to realise that there is arguably no difference between providing tax concessions and providing subsidies or grants—both are forms of government spending. Collecting less tax because a concession is in place ultimately achieves the same result as collecting ordinary amounts of tax under the benchmark tax system and then redistributing the revenue as subsidies or grants. While the subsidy or grant is a 'direct' form of government spending, tax expenditures are an 'indirect' form of government spending.

Arguments for and against tax expenditure programs

Advocates of tax expenditure programs argue that they are efficient as they overcome 'double handling' issues (ie the government does not need to first collect tax and then distribute it as a subsidy or grant). Instead, the government simply collects less tax from those who enjoy the benefit of the relevant tax expenditure. However, others argue that such programs are often poorly targeted and can provide benefits to unintended recipients. In this regard, it is sometimes said that the tax law is a 'blunt' instrument for achieving a government's policy objectives.

Furthermore, where tax expenditures are provided in the form of income tax exemptions or deductions, the value of such concessions differs between taxpayers depending on their respective tax rates. Taxpayers subject to higher tax rates stand to benefit more than taxpayers on lower tax rates, and this produces what Surrey referred to as an undesirable 'upside-down effect'.

Another significant argument against tax expenditures is that they add considerably to the volume and complexity of the tax law. Tax expenditures create exceptions to general rules, and these exceptions inevitably increase the size of the tax legislation and reduce its simplicity. The fact that tax expenditures are 'hidden' in the tax legislation also means that they may be confused with the provisions that make up the benchmark tax system and may be overlooked when reforms are being considered. Many critics of tax expenditures argue that because they are embedded within the tax law, they are less visible and therefore often escape the same rigorous scrutiny that other government spending programs experience. As a consequence, their effectiveness in achieving policy objectives may not be as closely monitored and this can result in inefficient and costly programs remaining in existence.

[1.6] Structural features of taxes

Although taxes vary greatly in their design and coverage, most taxes share four basic structural features:

1. **Taxpayers**. Each tax regime subjects particular 'taxpayers' to tax. Taxpayers are the legal entities (eg individuals or companies) who are liable to pay the tax and who are penalised if it is not paid. In Australia, income tax is payable by 'income earners' [8.4], GST is payable by 'suppliers' and 'importers' [7.3] and FBT is payable by 'employers' [18.2].
2. **Tax base**. Each tax regime has its own 'tax base'. The tax base consists of some form of property, transaction, activity or concept upon which the tax is imposed. In Australia, income tax is

imposed on 'taxable income' [8.4], GST is imposed on 'taxable supplies' and 'taxable importations' [7.3] and FBT is imposed on 'fringe benefits taxable amounts' [18.2].

3. **Tax periods**. Each tax regime has its own 'tax periods'. Taxpayers are required to pay tax on amounts that fall within the tax base during the relevant period. The tax period can be of any length of time (eg a month, a quarter, or a year). In Australia, the income tax period is the 'income year' (ie the 'financial year'—1 July to 30 June) [8.3]. Monthly or quarterly tax periods apply in the case of GST [7.4]. An annual period that runs from 1 April to 31 March applies in respect of FBT [18.2].
4. **Tax rates**. Each tax regime has its own 'tax rates' which are applied to the relevant tax base. Depending on the nature of the tax and the kind of taxpayer involved, tax rates may be set at a single rate (ie flat rate) or at differing rates (eg rates that vary with the level of the tax base). In Australia, companies generally pay income tax at the flat rate of 30%, unless they are 'base rate entities', in which case they pay income tax at the flat rate of 25% [22.3]. Individuals, on the other hand, pay income tax at progressive 'marginal rates' of up to 45%, and they are also generally required to pay the Medicare levy at the rate of 2% ('ML') if they are residents [8.8]. GST is imposed at a flat rate of 10% [7.3]. FBT is imposed at a flat rate of 47% [18.2].

Proportional, progressive and regressive taxes

Taxes may be described as being either 'proportional', 'progressive' or 'regressive':

- **Proportional taxes**. These taxes (also known as 'flat' taxes) are imposed at the same rate on all taxpayers. In Australia, the GST is an example of a proportional tax—it is levied at a flat rate of 10%.
- **Progressive taxes**. These taxes are imposed at rates that increase with the amount of the tax base. In Australia, income tax is an example of a progressive tax—individuals pay income tax at rates that increase depending on the amount of their taxable income.
- **Regressive taxes**. These taxes are imposed at rates that decrease with the amount of the tax base and are quite rare.

Direct and indirect taxes

In describing taxes, economists often distinguish between 'direct' and 'indirect' taxes:

- **Direct tax**. A tax is a direct tax if the economic burden of the tax is borne by the person who pays the tax.
- **Indirect tax**. A tax is an indirect tax if the person who pays the tax is able to pass the economic burden of the tax on to third parties.

The cost of income tax is borne by the person who earns the income and is therefore a direct tax. In contrast, the cost of GST, although paid by the supplier of goods or services, is ultimately borne by the consumer through the increased price charged for those goods or services by the supplier and is therefore an indirect tax.

[1.7] Tax systems and national stability

The design of a country's tax system and the way taxation revenue is collected and redistributed reflect much about a country's values and the demands and expectations of its citizens. The amount of taxes collected from a citizen less the amount of benefits the citizen obtains from the redistribution of taxation revenue ultimately affects the citizen's wealth and prosperity. The 'tax-transfer' system therefore has a direct bearing on living standards.

In designing tax systems, governments obviously need to focus on ensuring that they collect the desired amount of revenue. However, they also need to consider a broad range of social, economic

and political factors to ensure that this is done in the most effective way. As the Finance Minister of King Louis XIV, Jean Baptiste Colbert, cynically observed:

> The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing.

It is widely accepted that a country's tax system underpins its social, economic and political stability. Governments that impose taxes that are perceived to be 'unfair' are often faced with political strife. At the extreme, even wars have erupted over disputes about taxation. The famous phrase 'no taxation without representation' encapsulated the complaints of the American colonists in the mid-1700s. The colonists argued that taxes were imposed by Great Britain without their consent as they were not represented in the British Parliament. One of the events that sparked the American Revolution was the Boston Tea Party in 1773, which was a revolt against Great Britain over its import tariffs.

Taxation was also a contributing factor to the demise of the *Ancien Régime* in France, where the cost of wars and extravagant spending by the monarchy over the years had put pressure on the royal budget. During the *Ancien Régime*, society was divided into three classes: the 'first estate' (the clergy), the 'second estate' (the nobility) and the 'third estate' (the commoners). It was the third estate that bore the brunt of taxation, as the first and second estates were largely exempt from most taxes. One of the most unpopular taxes was the *taille*, which had been introduced by Charles VII in the fifteenth century to pay for the Hundred Years' War. The *taille* was a land tax payable by peasants and therefore fell disproportionately on the poorest members of society. French citizens were also subject to the *capitation*, which was a poll tax levied on all adults other than the clergy. Another unpopular tax was the *vingtième*, which was introduced by Louis XV in 1749 and levied at the rate one-twentieth of a person's income. The *taille*¸ *capitation* and *vingtième* were all abolished following the French Revolution in 1789.

The American and French Revolutions highlight how protests against taxation can spill over into civil unrest and result in great social change. Another famous example is the legendary Salt March led by Mahatma Gandhi in 1930. The march was an act of peaceful civil disobedience (*satyagraha*) against Britain's monopoly on the manufacture and sale of salt in India. Under the *Salt Act 1882*, Indians were forced to buy salt, which was subject to tax, from the colonial government even though salt was freely available from the sea. Gandhi and his followers marched over 200 miles from Sabarmati Ashram to Dandi on the Arabian Sea to protest against the tax. When he got to Dandi, Gandhi defiantly picked up some salty sand from the sea and proclaimed that with this act he was 'shaking the foundations of the British Empire'. The *satyagraha* encouraged others across India to defy the law and resulted in over 60,000 people, including Gandhi, being arrested. The Salt March was widely regarded as an important catalyst for uniting Indians and one of the first steps in paving the path to India's independence in 1947.

Events such as those described above demonstrate that governments need to take great care in who and what they decide to tax. History vividly highlights that it is in a government's interests to develop tax systems that are popular (or at least acceptable) in the eyes of the community that bears the burden of payment. There are many notable instances of unpopular taxes that have created problems for governments. A good illustration is the 'community charge' (better known as the 'poll tax') introduced by Britain's Conservative Government in the late 1980s. The poll tax was designed to fund local government and replaced a rates system imposed on the rental value of housing. It was imposed at a flat rate per person with some limited exemptions. The tax was viewed by a large portion of the British population as manifestly unfair, and it prompted mass protests and riots which ultimately contributed to Margaret Thatcher's resignation as Prime Minister in 1990.

Governments usually tread cautiously before introducing new taxes as politicians are acutely aware that taxation is unpopular. Ultimately, in democratic countries, it is the citizens who will have

the last say about taxes as they have the power to vote governments out of office. As a general rule, the community will accept taxation more willingly if it sees the justification for a tax and considers that its level is appropriate and the burden is shared fairly among those who are liable to pay it. Although most citizens would naturally prefer to pay as little tax as possible, they have also come to expect a certain level of government services and generally accept that taxes play a critical role in funding such things.

[1.8] Australia's economy and the design of its tax system

Australia is a developed country that is known for its strong rule of law, stable political system and open economy. It is a member of the OECD and plays an active role in international forums, such as the G20, WTO and APEC. The country has enjoyed one of the highest living standards in the world and, until the outbreak of the COVID-19 pandemic, benefited from over 100 consecutive quarters of economic growth without a recession. Australia also traditionally performs well on many global indicators—it is ranked 5th in the United Nations' Human Development Index, 14th in the World Bank's Ease of Doing Business Rankings and 20th in the Central Intelligence Agency's GDP (Purchasing Power Parity) Rankings. It is also one of the few countries in the world that has a 'AAA' credit rating from all three major credit rating agencies (Standard & Poor's, Moody's and Fitch). The continuing challenge is to maintain these standards in the rapidly changing and competitive international economic environment.

Black swan events

Although Australia is widely regarded as a 'lucky country', it is a part of the global economy and can be exposed to 'black swan' events at any time. This has been vividly highlighted by the COVID-19 pandemic, which created a huge contraction in economic activity around the world and plunged many countries, including Australia, into recession in 2020. The pandemic created unprecedented global turmoil, resulted in national borders being closed and wiped off hundreds of billions of dollars from the value of international financial markets. International travel, trade and commerce came to a virtual halt, and many jobs were lost as businesses were shut down and supply and demand chains were disrupted. The unprecedented scale of the crisis forced many governments, including the Australian Government, to launch expensive stimulus packages to try to cushion the impact of the virus on their economies.

In its January 2021 *World Economic Outlook Update*, the International Monetary Fund ('IMF') described the COVID-19 pandemic as 'a crisis like no other' and estimated that global growth would contract by approximately 3.3% in 2020. Because of Australia's border closures, strict quarantining rules and geographic isolation, it was able to control exposure to the virus better than most countries. The disruption caused by the pandemic has, nevertheless, been profound.

In its April 2023 *World Economic Outlook Update*, the IMF projected that global growth would fall from 3.4% in 2022 to 2.8% in 2023 and then rise to 3.0% in 2024. Factors that have affected global growth include supply disruptions, lockdowns in China and significant inflation concerns. The IMF has nevertheless predicted that global inflation has peaked and it expects the rate to fall from 8.7% in 2022 to 7% in 2023 and then to 4.9% in 2024.

Even before the outbreak of the pandemic, the world economy was only just really recovering from the 2008 GFC. In Europe, countries such as Greece, Italy, Portugal and Spain have been struggling with high levels of debt. Banks have also generally been adopting tighter lending practices, making it harder for businesses to raise finance. Over the last couple of years, interest rates have been rising as central banks try to curb inflation brought about by a long period of low interest rates and quantitative easing policies. This has put added pressure on many borrowers and adds to the risk of a global recession. Despite the lessons learned from the GFC, recent events indicate that the world

banking system is again showing signs of stress. In 2023, Silicon Valley Bank in the United States failed, and this sparked fears of further contagion which jittered financial markets.

International events, such as the United Kingdom's departure from the EU and the threat of trade wars, particularly between the United States and China, have also fuelled economic uncertainty. The war in Ukraine, which resulted in economic sanctions against Russia, spooked financial markets and added to recession fears. Not only has the war destabilised and fragmented the world economy, but it has also led to a humanitarian crisis. In addition, ongoing geopolitical tensions elsewhere in the world, such as in the Middle East, South China Sea, Korean Peninsula and Kashmir border continue to have the potential to result in flashpoints that can rapidly escalate and disrupt international markets and trade at any time.

Mining, tourism and education

Australia's economic future is inextricably entwined with international events and business and investment conditions. Its economic future will, no doubt, be heavily influenced by how its major trading partner, China, recovers from the COVID-19 pandemic and whether it can continue its trajectory of economic growth. Australia is rich in natural resources, such as iron ore, coal, natural gas, gold, silver, copper, nickel and zinc. Iron ore and coal, in particular, are Australia's leading exports, and the country therefore benefited greatly during the mining boom. Higher commodity prices leading up to 2008, fuelled particularly by demand from China, resulted in mining companies making increased profits, which translated into greater tax revenues from the mining industry. However, increased supply coupled with the economic slowdown caused by the GFC led to a subsequent weakening of commodity prices. Although the iron ore price regained some momentum during 2000 to 2022, it was showing signs of weakness again in mid-2023. It is therefore not clear whether a strong iron ore price is sustainable in the long term. A weakening economic growth outlook in China presents downside risk for commodity prices and this would have a negative effect on Australia's terms of trade. If commodity prices fall, Australia will not be able to continue to rely as heavily as it has in the past on revenue from mining companies to drive economic growth.

Australia's economic prosperity is also heavily dependent on tourism. Statistics from Tourism Australia indicate that in 2018/19, tourism directly employed 660,000 Australians (5% of the workforce) and was Australia's fourth-largest exporting industry. During this period, 9.3 million international visitors arrived in Australia and spent $44.6 billion. Australia's tourism industry was severely hit by the COVID-19 pandemic as international travel literally 'fell off a cliff'. In April 2019, there were 700,400 arrivals into Australia, whereas in April 2020 this figure dropped to 2,260, representing a staggering 99.7% fall. While Australia has reopend its borders, its tourism industry is still recovering from the effects of the pandemic.

Prior to the COVID-19 pandemic, Australia provided education to over 600,000 international students (Australian Government, *International Student Data*, April 2020). The pandemic affected international enrolments and placed pressures on education institutions that relied on overseas students for funding. The fall in international student numbers during the COVID-19 crisis resulted in job losses in the education sector and had damaging flow-on effects for the broader Australian economy. Fortunately, for the January–December 2022 period, Australia's international student numbers had risen to 619,371, which is 8% more than in the same period in the previous year (Australian Government, *International Student Data*, December 2022). As education is the country's fourth largest export, it is important to ensure that the country remains a key destination for international study in the wake of the crisis.

Science and technology

To succeed in the twenty-first century and stay ahead of many rapidly advancing developing countries, Australia needs to be a leading knowledge-based economy. Science and technology have become more important than ever and are key drivers of economic growth. As Innovation and Science

Australia noted in its 2018 report, *Australia 2030: Prosperity through Innovation—A Plan for Australia to Thrive in the Global Innovation Race*:

> Australia needs to find new sources of growth and improve productivity to maintain our standard of living. The biggest growth opportunities will come from knowledge intensive companies that innovate and export, as they are the most profitable, competitive and productive.

Although Australia has a reputation for being a 'clever country' with good universities and talented researchers that have developed many ground-breaking inventions and technologies, the reality is that it has often failed to capitalise on these opportunities. Many Australian discoveries end up being commercialised overseas with profits going offshore. Australia needs to ensure that its innovation ecosystem supports talented entrepreneurs to develop new businesses and commercialise their innovations. This requires investment in R&D and the development of a domestic venture capital market large enough to meet the financing needs of Australia's entrepreneurs. While Australia has attempted to address some of these challenges through various initiatives, such as the Turnbull Government's 2015 *National Innovation and Science Agenda* [5.7], it still has a long way to go to compete with thriving innovation hubs like Silicon Valley, New York, Shenzhen, Singapore and Tel Aviv.

Electronic economy

Australia, like many other countries, is also confronting the challenge of dealing with cross-border digital transactions. The electronic economy has become more important than ever and its growth comes with increasing challenges for digital security. Threats of cyberattacks and online scams are always lurking in the background. The electronic economy also places stresses on Australia's tax system and exposes it to the risk of revenue leakage. Technological developments contribute to the ease with which taxpayers can mobilise capital and transfer it offshore. Transactions involving cryptocurrencies, such as Bitcoin, cause particular concern because they are difficult to trace and can facilitate tax evasion and money laundering.

Ageing population

Like many other Western countries, Australia is also confronting the demographic challenges of an ageing population. An ageing population means a shrinking proportion of people in the workforce who are able to earn income and pay taxes and an increasing proportion of older people who are expected to live longer and require costly healthcare and welfare support. In its *2023 Intergenerational Report*, the Australian Government predicted that life expectancy at birth would increase from 81.3 years for men and 85.2 years for women in 2022/23 to 87.0 years for men and 89.5 years for women in 2062/63. The percentage of Australians aged 65 years and older is expected to rise from 17% in 2022/23 to 23% in 2062/63. At the same time, the proportion of the population participating in the workforce is projected to decline from 66.6% in 2022/23 to 63.8% in 2062/63.

Having an ageing population means that the Government needs to ensure that it has the right policies to encourage people to save for their retirement. If retirees do not have sufficient private savings, they will need to rely on public pensions for support. This can be extremely costly to provide and places additional pressure on the Government to raise taxes. Ensuring that Australia has an effective retirement income strategy is therefore critical. While Australia has a well-established and broad-based superannuation system, the reality is that many people approaching retirement do not have sufficient superannuation savings. Recent global shocks, such as the GFC and COVID-19 pandemic, have adversely affected superannuation savings making it harder for superannuation funds to generate returns, which jeopardises retirement lifestyles. At the same time, the cost of providing superannuation concessions to encourage retirement savings is expensive and the Government needs to ensure that the system remains fiscally sustainable.

Climate change

As Australia is the driest inhabited continent on the planet, it is also likely to incur significant costs in coping with climate change. Evidence of this is found in the 2019/20 'Black Summer' bushfire crisis (which burnt over 45 million acres of land and destroyed over 2,000 homes) and the 2022 NSW and Queensland floods (which resulted in over 25,000 homes and businesses being flooded). Adverse environmental and ecological issues can negatively impact many sectors, including agriculture, which supports a significant portion of the Australian workforce and is critical for the nation's food security and exports.

To combat climate change, the Labor Government is seeking to boost renewable energy so that Australia can transition from its dependence on fossil fuels. However, this transition will be challenging given that Australia has traditionally relied heavily on coal and gas for its energy needs. It is, nevertheless, critical in helping reduce Australia's greenhouse gas emissions and achieve its obligations under the Paris Agreement, which is a binding international treaty that came into force in 2016 and has been entered into by over 190 members of the United Nations Framework Convention on Climate Change. The goal of the Paris Agreement is to keep the rise in mean global temperature to well below 2°C above pre-industrial levels. The aim is to reach 'net-zero' emissions (ie a balance between greenhouse gas emissions produced and greenhouse gas emissions removed from the atmosphere) by 2050.

Infrastructure, housing, cost of living and employment

Being a large country with a population of only about 25 million people, Australia also faces unique challenges in maintaining and upgrading its vast national infrastructure. The cost of transporting goods as well as building roads, railways, ports, power grids, pipelines and communication systems is likely to be higher in Australia than in smaller, more densely populated countries. At the same time, housing affordability issues in the large capital cities where the population is concentrated place pressure on younger families who often struggle to acquire their first home.

Household debt in Australia has been increasing and rising interest rates during 2022 and 2023 have contributed to cost of living pressures, particularly for those people with large mortgages. Increased levels of unemployment during the peak of the COVID-19 crisis also placed great strains on the community and increased the risk of people defaulting on their loans. In its July 2020 *Economic and Fiscal Update*, the Government noted that 709,000 jobs were lost in the June 2020 quarter, and it forecast the unemployment rate to peak at around 9.25% in the December 2020 quarter. Fortunately, the 2021 Budget Papers revealed that thanks to the Government's $291 billion stimulus package, which included expensive subsidies like the fortnightly 'JobKeeper Payment' [6.3], Australia's employment levels were stronger than originally expected. This was subsequently confirmed in Australian Bureau of Statistics ('ABS') figures, which indicate that the unemployment rate for May 2023 was 3.5% (ABS, *Labour Force, Australia, May 2023*). This rate is even lower than the 5.1% rate in February 2020, immediately before the pandemic hit Australia. Unemployment reached its highest levels of 7.4% at the peak of the pandemic in mid-2020.

Government debt and fiscal sustainability

An important issue confronting Australia, like many other countries around the world, is that it has been facing rising levels of government debt. When the Rudd Labor Government was elected in 2007, it inherited a surplus of $39.958 billion from the Howard Coalition Government. However, over the Rudd and Gillard Labor Government periods, this surplus turned into a deficit. According to the 2023 Budget Papers, government net debt had reached $159.594 billion (10.4% of GDP) in 2012/13 and $209.559 billion (13.1% of GDP) in 2013/14. Net debt continued to grow during the Abbott, Turnbull and Morrison Coalition Government periods, with net debt rising from $245.817

billion (15.1% of GDP) in 2014/15 to $515.650 billion (22.3% of GDP) in 2021/22. Not surprisingly, the massive stimulus initiatives implemented by the Morrison Government to support the Australian economy during the COVID-19 crisis contributed significantly to this debt. The following table shows net debt levels and their percentage of Australia's GDP over recent years.

Financial Year	Net debt	Percentage of GDP
2012/13	$159.594 billion	10.4%
2013/14	$209.559 billion	13.1%
2014/15	$245.817 billion	15.1%
2015/16	$303.467 billion	18.3%
2016/17	$322.320 billion	18.3%
2017/18	$341.961 billion	18.6%
2018/19	$373.566 billion	19.2%
2019/20	$491.217 billion	24.8%
2020/21	$592.221 billion	28.5%
2021/22	$515.650 billion	22.3%
2022/23 (estimate)	$548.581 billion	21.6%

Bourgeoning net debt places Australia's 'fiscal sustainability' at risk. The *2023 Intergenerational Report* defines fiscal sustainability as 'the Government's ability to manage its finances so it can meet its spending commitments, now and in the future'. Fiscal sustainability is important for maintaining economic stability, improving economic performance and ensuring future generations do not inherit an unmanageable tax burden for government services provided to the current generation.

While Australia's net debt as a percentage of GDP is relatively moderate by international standards, it places pressure on future budgets. As Australia has a 'fiat currency' (ie a currency that is not backed by a commodity like gold), modern monetary theorists argue that it can simply repay its debt by 'printing money'. Mainstream macroeconomic theorists, however, criticise this approach saying that it devalues the currency and leads to inflation. They argue that the conventional and more prudent way for governments to address their debt issues is to either increase revenue through taxation or decrease spending.

Policy decisions affecting the design of Australia's tax system

The many issues and challenges outlined above need to be carefully considered in policy decisions affecting the design of the Australian tax system. In making these decisions, the threats of international tax competition also need to be taken into account. If Australia does not have an internationally competitive tax system, it will struggle to attract foreign investment, which is vital for providing capital to industry and generating employment. Many countries in the region have lower tax rates than Australia and offer generous investment incentives, which may encourage businesses to relocate overseas. At the same time, Australia needs to protect its tax base from international tax avoidance practices, especially those employed by large multinational enterprises that seek to divert their profits through tax havens. It therefore needs a robust tax system with rules that are difficult to circumvent coupled with effective enforcement measures to ensure that Australia collects its fair share of tax. Unless Australia has a 'good' tax system, living standards and the country's future economic prosperity are likely to suffer.

[1.9] Features of a good tax system

In his famous 1776 treatise *The Wealth of Nations*, Adam Smith, the renowned Scottish economic philosopher, expressed the following views about taxation:

- The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
- The tax each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, and the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.
- Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it.
- Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

Smith's 'maxims' have become foundation stones for the design of a good tax system and are still often referred to today by policymakers. Whether or not a tax system is 'good' obviously involves a qualitative judgment. Although people naturally have different opinions about what constitutes a good tax system, there are some generally accepted criteria by which tax systems may be evaluated. These criteria, evolving out of Smith's work, have been extensively discussed in the academic literature and closely analysed in government papers and reports, such as the Asprey Committee's *Full Report* (1975), Treasury's *Reform of the Australian Tax System: Draft White Paper* (1985) and the Review of Business Taxation's *A Tax System Redesigned* (1999). The following discussion outlines some commonly articulated views regarding tax system design and focuses on what are, arguably, the key attributes of a good tax system.

Fiscal and policy objectives

Obviously, one of the key measures by which a tax system is judged is whether it meets the government's fiscal targets. A good tax system should collect the amount of revenue that the government has set out to collect; otherwise, it will fail in its primary objective. From a government's perspective, it is vital that the cost of its spending programs is balanced against the revenue it receives. In this regard, governments need to be able to forecast the amount of tax they will collect each year and predict how variables, such as economic factors, may impact on revenue collection. If their estimates are incorrect, they risk falling into funding deficits.

The difficulties that governments face in predicting tax revenue can be illustrated by a simple example. Suppose a government imposes a fuel excise at a flat rate on petroleum products. If oil prices rise during the year, revenue will increase (resulting in a windfall), but if oil prices drop during the year, revenue will be lower (resulting in a shortfall). As oil prices depend on extraneous economic factors, many of which are outside a government's control, it is impossible to know exactly how much tax will be collected. Governments therefore need to take account of a range of variables when undertaking their fiscal modelling.

The Commonwealth, state and territory governments publish annual Budget Statements that contain economic data, including details of their respective revenues and expenditures. These statements also contain their fiscal outlooks for coming years based on various assumptions. If the economic modelling in these statements is wrong, they may miss their forecasts. Governments that do not collect sufficient revenue from their taxes inevitably end up having to either borrow money to fund their spending programs or cut the services they provide their citizens.

A good tax system is, however, not just about collecting the right amount of revenue. It should also operate in harmony with the government's broader socio-economic policy agenda. Ideally, a

country's tax system should support the government to achieve optimal outcomes, such as increased productivity, employment growth, improved welfare and higher living standards. A country's tax system should also not unduly interfere with the advancement of the country's broader economic imperatives, such as boosting national savings, encouraging investment and supporting business activity.

Simplicity, certainty and stability

Most people would agree that simplicity and certainty are desirable features of a good tax system. If these criteria are not met, taxpayers will find it difficult to comply with the tax laws and apply them to their specific circumstances. Likewise, revenue authorities will find it difficult to administer and enforce the tax laws. Ideally, tax laws should be clear, unambiguous and uncomplicated. They should therefore not be bogged down in complex and voluminous legislation that is difficult to comprehend or navigate. Ultimately, taxpayers and revenue authorities should be able to identify the incidence of tax and calculate tax liabilities with ease and certainty.

Unfortunately, the reality is that tax laws are often highly complex and they are frequently criticised for this reason. Australia's income tax legislation, in particular, is notorious for containing many long and cryptic technical provisions that are difficult to understand. Even senior judges have been open critics of the legislation. In an article appearing on the front page of the *Australian Financial Review* on 21 January 2011, Justice Keane (a former High Court Justice) was reported as saying: 'Opening the *Tax Act* is like entering the door of a parallel universe.'

The Federal Government has acknowledged that the Australian tax system is too complicated. In its 2015 *Re:think* discussion paper, it identified a number of reasons for this, stating (at 2):

> One reason is the prevalence of tax concessions aimed at assisting particular groups. Another reason is the regular 'patching' of the law to fix narrow problems or provide certainty for taxpayers and transactions without fully considering consequences for the system as a whole. Overly risk-averse attitudes from policy advisers and administrators, combined with complex legislative drafting styles, have also led to complexity.

Complexity in the tax system is problematic as it can divert time and resources away from productive activities. Governments should therefore strive to simplify their tax systems where possible. It is also prudent for them to periodically review their tax laws to ensure that they continue to meet their fiscal and policy objectives. Where a country's tax laws are failing to have their desired effect, they should be amended or repealed. It is, nevertheless, also important to recognise that continual reform of a country's tax system can contribute to uncertainty about its operation. It is therefore generally desirable for a country to maintain relatively stable tax laws, as this allows business and investment decisions to be made with confidence. Frequently changing tax laws can have a negative impact on the economy, as taxpayers will be reluctant to make commercial and financial decisions where their tax impact is not clear.

Transparency and integrity

It is widely accepted that a good tax system should be transparent. Revenue authorities have considerable statutory responsibilities and powers, and their actions should be closely monitored by government and be subject to parliamentary scrutiny. At the same time, tax laws should be administered free of political interference and in accordance with the rule of law. Revenue authorities should interpret and apply tax laws consistently, so that taxpayers in similar circumstances are treated equally. While it is important that revenue authorities can readily enforce tax laws if they are breached, the rights of taxpayers also need to be closely protected. As there is often a great imbalance between the resources of revenue authorities to prosecute tax disputes and the capabilities of taxpayers to defend themselves, it is imperative that taxpayers are treated fairly and

not denied natural justice. In particular, taxpayers should be able to contest their tax assessments before the courts if they believe they have been incorrectly assessed.

It is also desirable for taxation statistical data to be readily accessible, as this helps promote transparency in the tax system and foster community engagement. The availability of up-to-date and accurate statistics enables a tax system to be analysed and evaluated by academics and other commentators, who may be able to identify issues that need to be addressed. This can contribute significantly to future tax reform.

A good tax system also needs to be robust and resilient to ensure that it is not open to abuse. A country's tax laws should therefore be designed in such a way that they are difficult to avoid or evade. A tax system with loopholes will not be respected by taxpayers and will result in revenue leakage, as some people will inevitably choose to exploit the weaknesses in the system. To protect the government's revenue base, tax laws need to be drafted tightly so they cannot be easily manipulated. Appropriate anti-avoidance rules in the legislation can provide added protection and serve as an integrity measure to prevent abuse of the general provisions. In addition, to ensure compliance, it is important for tax laws to be vigorously enforced. Tax administrators and law enforcement agencies need to have appropriate resources and powers to pursue and prosecute tax cheats.

Efficiency and flexibility

Another generally accepted feature of a good tax system is that it should be efficient, in the sense that it should have low collection and compliance costs. Taxes that are expensive for a government to collect, or cumbersome, time-consuming or costly for taxpayers to comply with, are inefficient, as they divert resources from productive activities. In designing an optimal tax system, government efficiency requirements should be carefully balanced against taxpayer compliance obligations to ensure that the tax laws operate both fairly and effectively. The Australian Government in its 2015 *Re:think* tax discussion paper noted that the annual cost of administering the Commonwealth tax system was around $3.6 billion and that taxpayer compliance costs were around $40 billion.

Linked to the concept of efficiency is the concept of flexibility. A good tax system should be able to cope with, and where necessary, respond to, changes in economic circumstances without requiring major overhauls. For example, if a tax system is not broad-based and is skewed towards taxing commodities, then a fall in commodity prices will have a major impact on revenue collection. For this reason, governments usually impose many different kinds of taxes with broad tax bases to spread risk. Having a broad tax mix also ensures the burden of taxation is spread more widely among the community and does not fall disproportionately on only certain persons. However, having many different kinds of taxes adds to the overall complexity of the tax system and increases compliance costs for taxpayers. Governments should bear this in mind in deciding on their overall tax mix.

Neutrality

It is often argued that a good tax system should be neutral, in the sense that it should not distort commercial decisions or skew the market mechanism. Taxes can interfere with the way markets operate, as they affect the cost of the activities or products upon which they are imposed. Tax laws that increase or decrease the attractiveness of one arrangement ahead of another can alter the way taxpayers choose to organise their affairs. A tax imposed on a particular product discourages spending on that product and makes similar products which are not taxed, or are taxed to a lesser extent, more attractive. For instance, if a tax is imposed on black shoes but not white shoes, consumers may buy more white shoes than black shoes, even if they actually prefer the latter. Likewise, taxing one kind of legal structure more concessionally than another is likely to lead to greater adoption of the preferentially taxed structure as a business or investment vehicle.

A tax system that contains inherent biases can affect market efficiency and result in tax considerations, rather than commercial considerations, driving economic activity and business decisions. This can have an adverse impact on a country's economic competitiveness and produce distorted commercial outcomes. To ensure that taxes do not drive a wedge between optimal business and investment decisions, they should generally have a neutral effect on similar kinds of underlying business and investment choices. However, the reality is that, in practice, many tax systems have built-in structural biases. For example, in Australia, resident individuals are generally fully assessed on interest earned from bank deposits, but are generally only assessed on half the capital gains made from investments that have been held for at least 12 months [17.8]. As a consequence, capital gains are treated more concessionally than income gains.

Governments nevertheless often intentionally design tax systems not to be neutral in order to achieve specific policy objectives. For instance, they may tax imported goods specifically to support locally produced products. Strictly, any tax will operate to discourage the activity upon which it is imposed, and any tax incentive will encourage the activity in relation to which it is provided. Tax expenditures, in particular, are often used to address market failures. For example, the Australian Government's ESVCLP program was introduced to address the failure of the market to provide venture capital to Australian early-stage businesses [27.4]. Investments made under this program benefit from tax exemptions and tax offsets that are not available for other kinds of investments.

While it is generally accepted that a tax system should not influence business decisions unnecessarily, fiscal neutrality is not something a government should pursue at all costs. In specific situations it may be appropriate to impose taxes or provide tax incentives for particular activities. A fiscal bias may be justified where a valid reason to change taxpayer behaviour exists. For instance, if the market is not operating at its optimal level, taxes or tax expenditures may be necessary to improve economic efficiency. A government may also have wider political or social goals that might best be achieved by creating distortions in the tax system. For example, it might consider that the best way of stopping its citizens from smoking—thereby reducing national health costs—is to tax cigarettes to make them less affordable.

Equity

Of the many hallmarks of a good tax system, the most important is generally considered to be equity. Equity is critical not only on moral grounds, but also because it is more likely that taxpayers will respect and support their tax system if it is perceived to be fair. It is widely accepted that taxpayers should bear responsibility for their appropriate share of the overall tax burden of the country in which they live, do business or make investments. This is often expressed as the simple principle that 'each taxpayer should pay their fair share of tax'. What is 'fair' between a wide range of taxpayers is, however, not necessarily straightforward. It ultimately depends on an equitable sharing of responsibilities between members of society, judged by reference to the general standards and norms of that society. Different interest groups and generations within society may have quite different perspectives on this subject, and their values may gradually shift over time. The reality is that fairness, like beauty, lies in the eye of the beholder.

It is generally acknowledged that the concept of equity has two important dimensions—horizontal equity and vertical equity. A tax is described as 'horizontally equitable' if people in similar economic circumstances are treated similarly. For instance, if A and B each derive $40,000 of income, they should each pay the same amount of tax. In contrast, a tax is described as 'vertically equitable' if people in different economic circumstances are treated differently, with those who are better off bearing a greater share of the burden. For instance, if A derives $100,000 of income and B derives $30,000 of income, A should pay more tax than B.

The notion of vertical equity is also sometimes referred to as the 'ability-to-pay' concept. According to this concept, the level of taxation should be linked to a person's wealth. Vertical equity

is justified on the basis that those who have benefited the most from living in a particular country should contribute the most to their government. Some people, however, dispute this, arguing that to be fair, the level of taxation should be measured by reference to the degree of services and benefits a particular person receives from the government rather than their capacity to pay tax. But this argument ignores the fact that taxation is a social contribution imposed on the citizens of a state for the benefit of the state as a whole, rather than for the benefit of particular individuals.

Ultimately, the extent to which a tax is viewed as equitable depends on community perceptions. As a general rule, taxes are more readily accepted if the burden is spread widely among the community rather than directed at only specific groups. Taxes that adversely affect certain members of the community more than others are generally viewed unfavourably, particularly where the criterion of vertical equity is not satisfied (ie where the burden is placed on those less able to pay).

While flat taxes are administratively convenient, and may seem to be fair in that they are levied at the same rate on all taxpayers, they do not take a person's ability to pay into account. Flat taxes can operate regressively, as they impose a relatively greater burden on the income of poorer members of society than the wealthier ones. An example of a flat tax is the GST, which is presently imposed at a standard rate of 10% [7.1]. This tax is arguably more directly felt by poorer members of society. For instance, assume that because of the introduction of GST, the price of certain goods that previously cost $100 increases by 10%. The extra $10 payable represents a greater slice of a poor person's income than a rich person's income.

In contrast to the flat-rate GST, Australia has a progressive income tax system as the rates of tax increase with the level of a person's taxable income [8.8]. Income tax is therefore designed to fall more heavily on those with a greater ability to pay. However, in practice, it is not always easy to achieve fairness. For instance, while two people earning $100,000 may pay the same amount of income tax, one of those people might be single, while the other may have several children and a spouse to support. Accordingly, the burden of the tax is not felt uniformly by these two economic units.

[1.10] The tax unit

One of the basic issues to consider in the design of any tax system is who should be the subject of taxation. In other words, who is the appropriate 'tax unit' (ie taxpayer)?

Individuals and families

The Australian income tax system treats each individual as a separate tax unit. By taxing individuals rather than families, the income of spouses is not aggregated and taxed as if they were a single taxpayer, or split equally between them. Instead, each person pays tax as a separate unit on their own taxable income. This is the case, even though they may pool their resources.

In calculating a person's income tax liability, there is generally no account taken of any dependants whom they are required to support. A person with children does not pay income tax at lower rates than a person without children. Instead, support for families is available through the Department of Human Services, which provides means-tested social security payments such as the Family Tax Benefit and the Child Care Subsidy. The concept of a family is, however, not totally irrelevant for income tax purposes. A person may, for instance, be able to benefit from tax offsets for maintaining certain dependants [8.9]. Special thresholds and phase-in arrangements also exist for families in respect of the ML and MLS [8.8].

Legal entities and their members

As business and investment income is often earned through legal structures (eg partnerships, trusts and companies), governments need to consider how best to tax the income earned by these entities.

Should they be treated as separate taxpayers, or should their ultimate owners (the individuals who hold membership interests in the entities) be taxed instead?

Australia generally treats partnerships and trusts as 'flow-through entities', which means their income is not taxed at the entity level, but rather in the hands of their members. As a result, partnerships and trusts do not give rise to a separate taxing point. Instead, they simply operate as conduits. It is, therefore, usually the respective partners [23.3] or beneficiaries [24.5] who are taxed.

In contrast, Australia generally treats companies as 'opaque entities', which means that they are taxed as separate taxpayers from their members (eg shareholders). To prevent double taxation of corporate profits—once in the hands of the company and again when they are distributed to shareholders as dividends—Australia has adopted an 'imputation system' which provides resident shareholders with credits for Australian income tax paid by resident companies on their underlying profits [22.6].

[1.11] Sovereign right to tax

Each nation has the sovereign right to design its own tax system. Subject to any restrictions imposed under their respective constitutions, governments are generally free to determine the nature and scope of their country's tax laws and the persons whom they subject to tax.

Enactment, administration and adjudication of tax laws

A country's tax laws are made by its appropriate legislative body and its tax system is administered by its relevant revenue authority. In Australia, federal tax legislation is enacted by the Commonwealth Parliament under its powers in the *Constitution* [3.4] and the federal tax system is administered by the ATO, which is headed by the Commissioner of Taxation [6.3].

Disputes between taxpayers and revenue authorities concerning the application of a country's tax laws are litigated before the country's tribunals and courts. In Australia, Commonwealth tax disputes are heard, at first instance, by the Administrative Appeals Tribunal ('AAT') or the Federal Court. Appeals from these decisions may be available to the Full Federal Court and (with special leave) the High Court [38.5].

Some countries, such as the United States and Canada, have established specialist Tax Courts that deal exclusively with tax disputes. Specialist Tax Courts do not exist in Australia. The principal reason traditionally advanced for establishing such courts is that since tax legislation is so technical and complex, it is appropriate that tax cases should be heard by judges with special expertise in the field (see S Chapple, 'Income Tax Dispute Resolution: Can We Learn from Other Jurisdictions?' (1999) 2 *JAT* 312). Certain prominent Australian judges have, however, rejected the need for such courts on the basis that it is preferable for judges hearing tax disputes to have general law expertise to ensure that tax law is not divorced from the ordinary commercial and legal environment (see D Hill, 'Great Expectations: What Do We Expect from Judges in Tax Cases?' (1995) 69 *ALJ* 992). It has been pointed out that there is a risk that specialists may be too 'inward looking', and that knowledge of other areas of law can 'spark ideas' which someone with only limited or specialised expertise may not perceive (see M Kirby, 'Hubris Contained: Why a Separate Australian Tax Court should be Rejected' (2007) 42 *TIA* 161).

Fiscal convergence and divergence

While the tapestry of a country's tax system is a sovereign issue, countries are inevitably influenced by one another in designing their tax rules. Globalisation has contributed to increasing economic integration and fiscal convergence among nations. It is therefore not surprising to find many broad similarities between tax systems around the world. This is especially the case where countries have formal links (eg through membership of international organisations such as the OECD). Each country's tax system is, nevertheless, unique, and its architecture ultimately depends on the individual

approach the country has adopted. While international influences often play an important part in the broad design of a country's tax rules, the tax policies it ultimately adopts will be most heavily influenced by its own particular social, political and economic factors.

Close economic and political relations between nations can help foster 'tax harmonisation' (ie the adoption of similar, although not necessarily identical, tax laws within different jurisdictions). Tax harmonisation can lead to economic and administrative efficiencies, but is usually difficult to achieve in practice, as it requires a coordinated approach to taxation policy between nations that often have competing interests.

Tax harmonisation is perhaps most evident in the EU, where it is a requirement of membership that each Member State impose VAT at the rate of at least 15% (reduced rates are allowed for certain supplies). In recent years, the EU has also had a limited degree of success in harmonising direct taxes (eg certain aspects of corporate and savings taxes). It is, however, extremely difficult to achieve broad-based tax harmonisation within the EU, as it does not have any general taxation powers of its own—these powers remain with the individual Member States. The introduction of 'directives' in the field of taxation requires unanimity of the EU Council of Ministers, composed of the 27 National Ministers of each of the Member States. Progress towards further integration of European taxes therefore remains a slow and drawn-out process.

One area where there has been significant cooperation between countries recently is in their approach to tackling the problem of international tax avoidance and tax evasion. This has been largely due to work undertaken by the OECD under its base erosion and profit shifting ('BEPS') project [33.3]. Many countries have adopted various actions recommended by the OECD to deal with the problem. For example, 100 jurisdictions have signed a new multilateral convention to upgrade their tax treaties to tackle BEPS [32.4]. In addition, over 130 jurisdictions have agreed to enter into a two-pillar agreement on international tax reform which will re-allocate the profits of the largest multinational enterprises to those countries where the profits are earned and ensure that they are subject to a minimum corporate tax rate of at least 15% [33.6].

[1.12] Jurisdiction to tax

General jurisdictional rules

Most countries' tax systems are based on a set of general rules that define the jurisdictional limits of their respective tax laws. A country's general jurisdictional rules may be cast narrowly or widely and often operate subject to numerous exceptions. The following discussion outlines the two main jurisdictional approaches used by countries around the world in relation to income tax. At the heart of these approaches is the requirement that there be some clear nexus between the taxing jurisdiction and either the taxpayer (the 'tax subject') or the income-generating transaction (the 'tax object').

- **Territorial (source-based) jurisdictional rules**. The narrow 'territorial' approach to income taxation focuses on the source of the income. Countries that adopt this approach only tax income sourced within their geographic borders, irrespective of where the taxpayer resides.
- **Worldwide (residence-based) jurisdictional rules**. The wider 'worldwide' approach to income taxation focuses on the taxpayer's country of residence. Countries that adopt this broader approach tax their residents on both their domestic and foreign source income, but only tax foreign residents on their locally sourced income.

Justifications for territorial and worldwide jurisdictional rules

The territorial and worldwide approaches to taxation produce different economic efficiencies. A territorial approach promotes 'capital import neutrality', as investments made in the source country are treated in the same manner regardless of where the investor resides. A worldwide approach

promotes 'capital export neutrality', as it does not influence an investor's decision about where to make investments (ie at home or abroad).

The territorial approach to taxation can be justified on the basis that there is an economic connection between the taxpayer and the taxing jurisdiction. It is based on a link between the income earned and the source country. This link may exist for a variety of reasons, including the fact that the business or employment activities take place in the source country, or the property that generates the income is located there. A territorial approach is defensible on the grounds that it is fair that persons who benefit from earning income in a particular country should also contribute to the country's costs of providing the economic environment that enables their income-earning activities to take place.

The worldwide approach to taxation can be justified on the basis that there is a personal connection between the taxpayer and the taxing jurisdiction. It is founded on the rationale that, as residents of a particular country are usually based in the country and benefit from the broad range of public goods and services provided by their government, it is appropriate to tax them on their worldwide income, as these things support their way of life and overall economic activities, both locally and abroad. Moreover, as residents usually have a personal allegiance to the country in which they choose to reside, and are usually entitled to derive benefits from their government that are not necessarily also available to foreigners (eg various forms of social security), it is possible to justify applying wider jurisdictional rules to them.

Credits for foreign taxes to prevent double taxation

The practical problem with the worldwide approach is that it leads to double taxation, since a taxpayer's foreign income is taxed not only in their country of residence but also in the source country. To alleviate this problem, it is common for countries that adopt the worldwide approach to grant their residents credits for tax paid on foreign income in the source country. However, if credits for foreign taxes were granted in excess of the tax paid in the country of residence, the excess credits could be utilised to reduce the tax payable on the resident's domestic income. Accordingly, to counteract erosion of their domestic tax bases, countries generally cap credits for foreign taxes so that they cannot exceed the amount of tax that would otherwise be payable on the foreign income in the country of residence.

Australia's general jurisdictional rules and exceptions

Australia's general jurisdictional rules are based on the worldwide approach and are discussed in Chapter 30. Accordingly, Australian residents are generally taxed on their worldwide income, while foreign residents are generally taxed only on their Australian-sourced income [30.1]. At the same time, to prevent double taxation, Australia also provides a credit, known as the 'foreign income tax offset', for foreign taxes paid on income that is also assessed in Australia [31.3].

It is important to understand that while Australia's income tax laws are based on the worldwide approach, Australia does not have a 'pure' worldwide system of taxation, as its jurisdictional rules operate subject to numerous exceptions [31.4]–[31.10].

Like Australia, most developed countries tax their resident individuals on their worldwide income. The United States is a special case, as it not only taxes its residents on a worldwide basis but also taxes non-residents who are United States citizens on a worldwide basis. This results in the United States having one of the broadest jurisdictional rules of any developed country. To mitigate double taxation, United States citizens who reside outside the United States and are physically present in foreign countries for at least 330 days during any 12-month period may exclude a portion (up to US$120,000 for 2023) of their foreign income provided they lodge United States tax returns.

In contrast to Australia, jurisdictions that adopt the much narrower territorial approach to taxation, such as Singapore, Malaysia and the Special Administrative Regions of Hong Kong and Macau,

generally only tax income that is sourced within the jurisdiction. Residents of these jurisdictions do not therefore generally pay tax on foreign income in their country of residence.

International taxation agreements

A country's general jurisdictional rules operate subject to the terms of any international tax agreements it has entered into with other countries. In practice, these agreements are made after lengthy negotiations between the respective governments. They are typically bilateral in nature, as it is much more difficult to achieve multilateral agreements. For this reason, these treaties are often referred to as 'Double Taxation Agreements' ('DTAs').

One of the main functions of DTAs is to address the problem of double taxation, which is widely recognised as a major impediment to cross-border trade and investment. In the field of income tax, double taxation arises where more than one country asserts taxing rights over the same income. For instance, this can easily occur in respect of business profits—both the country in which the taxpayer is a resident and the country in which the income is earned may seek to tax the profits. The country of residence may seek to tax the profits on the basis of a worldwide approach to taxation, while the country of source may seek to tax the profits on the basis of a territorial approach to taxation.

To prevent double taxation of income, one of the countries needs to surrender its taxing rights in favour of the other country. The problem is that countries naturally want to protect their revenue bases and are reluctant to unilaterally give up their taxing rights. Nevertheless, in order to promote international trade and investment, they may be prepared to surrender their taxing rights if appropriate reciprocal arrangements are in place. DTAs provide the framework for these arrangements. They also contain special tie-breaker rules that operate where a taxpayer would otherwise be a dual resident.

The main way that DTAs deal with the problem of double taxation is by allocating taxing rights between the respective countries (referred to as 'Contracting States') according to a set of agreed principles that are set out in the DTAs. Where both the country of residence and the country of source share taxing rights, the DTAs usually require the country of residence to provide relief in the form of a credit for the payment of foreign tax.

DTAs also contain exchange of information clauses designed to assist tax authorities in the relevant countries to administer their respective tax laws and prevent tax avoidance and tax evasion.

Australia has entered into DTAs with more than 40 countries. These DTAs are broadly based on the OECD *Model Tax Convention on Income and on Capital* and are examined in Chapter 32. Australia has also entered into Additional Benefits Agreements ('ABAs') and Tax Information Exchange Agreements ('TIEAs') with a number of jurisdictions with which it does not have DTAs. ABAs are essentially mini DTAs that only cover a limited number of topics [32.3]. TIEAs, on the other hand, are special bilateral agreements that contain rules for exchanging tax and financial information [33.2].

International tax enforcement

It is important to recognise that while countries have the sovereign right to determine the jurisdictional scope of their tax laws and can enact legislation that imposes liabilities on foreigners who earn income within their territories, it is quite another matter for governments to enforce their tax laws against such persons. As foreigners reside outside a country's borders and may have all their assets located abroad, it can be difficult to recover taxes from them. There is a general principle that countries do not enforce each other's tax laws (*Government of India, Ministry of Finance (Revenue Division) v Taylor* [1955] AC 491). This principle was recognised in *Rothwells Limited (In Liquidation) v Connell* 93 ATC 5106, where the Supreme Court of Queensland Court stated (at 5113) that it was 'a settled rule of private international law that the courts do not assist the enforcement of foreign revenue laws, or claims made under those laws'. To address this issue, many countries, including Australia, have entered into bilateral and multilateral international tax enforcement arrangements [33.10].

Withholding taxes

To avoid international tax enforcement issues from arising, many countries impose withholding taxes on certain payments made to foreigners. Entities that make such payments are generally required to withhold tax from the payments and remit the tax to their revenue authorities on behalf of the foreigners. Australia imposes withholding taxes on a range of payments made to foreigners (including, dividends, interest and royalties) [31.11].

[1.13] Level of taxation

It is difficult to compare the overall level of taxation in one country with that in another country as the mix of taxes in each country is often quite different. In order to determine how heavily a country's citizens are taxed, it is necessary to take account of all kinds of taxes imposed at every level of government—federal, state and local.

When comparing the level of taxation in Australia with that in other countries, it is simplistic merely to focus on the rates of tax imposed in each jurisdiction. Obviously, the amount of revenue collected by a government from a particular tax will also depend on a range of other factors, including whom it subjects to tax and how broadly its tax base is defined. For example, while CGT forms part of the Australian income tax base, not all countries around the world impose CGT. Countries that do not have a general CGT regime therefore have a much narrower tax base. It is worth noting that a number of countries located close to Australia in the Asia–Pacific region do not have a general CGT regime, including Singapore, Malaysia and New Zealand. By way of way contrast, capital gains are taxed in countries such as the United States and the United Kingdom. However, these countries' tax regimes differ from Australia's. For instance, in the United States, individuals pay different rates of tax on their short-term and long-term capital gains. Short-term capital gains arise on assets held for a year or less and are taxed at ordinary rates of up to 37%; while long-term capital gains arise on assets held for longer than a year and are taxed at concessional rates of up to 20%. Australia, on the other hand, imposes CGT at ordinary income tax rates, but generally provides individuals with a 50% discount on capital gains made on assets held for at least 12 months [17.8]. There are also many differences in CGT exemptions and reliefs. In the United Kingdom, for example, resident individuals generally only pay CGT on their overall capital gains above the 'annual exempt amount' (£6,000 for 2023/24). No corresponding allowance exists in Australia.

Australia's tax expenditure programs are also quite different from those in other countries. For instance, Australia provides tax concessions to encourage activities such as retirement savings, research and development, local film production and venture capital investment. Similar kinds of tax expenditure programs are not necessarily available in other jurisdictions. On the other hand, foreign countries may offer other forms of tax incentives that are not available in Australia. For instance, countries such as Singapore and Malaysia provide 'tax holidays' (ie exemptions from tax for specific periods) to encourage the establishment of pioneer enterprises and to promote the development of various industries. The vast differences that exist between tax systems make it very difficult to compare regimes.

Data on levels of taxation

Comparative data on levels of taxation be found in the OECD's *Revenue Statistics 1965–2021*, which measures tax revenue as a percentage of GDP for OECD countries. Measuring tax-to-GDP ratios is the traditional way of comparing the relative levels of taxes raised across different countries as it takes account of the size of their respective economies. It is interesting to note that Australia's tax-to-GDP ratio for 2020 was 28.5%, which was well below the OECD average of 33.6%. This suggests that Australia imposes a relatively lower tax burden than many other nations. In 2020, 7 OECD countries had tax-to-GDP ratios above 40%, namely Denmark (47.1%), France (45.3%), Italy (42.7%),

Belgium (42.5%), Sweden (42.3%), Austria (42.2%) and Finland (41.8%). The OECD countries that had tax-to-GDP ratios below Australia were South Korea (27.7%), Switzerland (27.5%), the United States (25.8%), Turkiye (23.9%), Costa Rica (22.7%), Ireland (19.9%), Chile (19.4%), Colombia (18.8%) and Mexico (17.8%).

Balancing level of taxation against provision of services

The level of taxation imposed by a government needs to be balanced against the level of services the government seeks to provide its citizens. Greater revenue raised from taxes allows a government to provide more public services. Taxpayers who complain about a lack of government services such as public hospital beds, childcare facilities, or funded university places need to recognise that these things come at a significant cost. If citizens want more government services, they need to be prepared to pay more taxes. As the OECD's *Revenue Statistics 1965–2021* indicate, Scandinavian countries are among the highest tax-to-GDP ratio countries. These countries, however, traditionally have a more socially orientated outlook than many other countries and are well known for their generous pension and welfare systems. A government's ability to provide social services comes at a cost, and it is not surprising that this is usually largely funded out of taxation revenue.

Increasing and decreasing levels of taxation

Governments may require different levels of taxation revenue at different times. For instance, in times of crisis, such as war or natural disaster, they may need to impose higher levels of taxation than they would impose at other times. Additional revenue may also be required to pay for major public infrastructure projects, such as the construction of freeways, telecommunication networks and hospitals. Governments may also be forced to increase taxes to repay their borrowings. This situation was recently faced by the Greek Government, which had to increase taxation as well as curb public spending (including controversially cutting government pensions) in order to address its sovereign debt crisis and comply with its Eurozone bailout conditions. These austerity measures placed considerable pressure on Greek citizens, who ultimately bore the cost of bailing out their government. Not surprisingly, this created much internal turmoil and resulted in protests and riots around the country. One of the most noticeable tax reforms was the increase of Greece's VAT rate from 21% to 24%. Greece was, however, not alone in increasing its VAT rate—several other countries adversely affected by the GFC also increased their VAT rates, including Hungary, Iceland, Ireland, Italy, Portugal, Spain and the United Kingdom. The cost of large stimulus packages, like those introduced by many countries around the world to counter the economic effects of the COVID-19 pandemic, is also likely to place pressure on governments to increase taxes in the future.

Governments can increase taxation by raising tax rates and widening their tax bases. They can also benefit from bringing forward the time at which tax is collected in order to gain early access to the revenue. Governments can also reduce tax spending by limiting the incentives and concessions provided under their tax expenditure programs. However, when governments increase taxation and cut back on tax expenditures it can have a negative effect on the country's economy, as it generally results in decreased private spending and investment. Paradoxically, this can dampen overall government revenues, as there may be fewer transactions to tax.

Reducing the level of taxation, on the other hand, encourages private spending and therefore stimulates the broader economy. During the GFC, several governments around the world introduced temporary tax incentives to encourage economic activity. One example was the introduction of the investment allowance in Australia, which provided a 'bonus deduction' at rates that ranged from 10% to 50% for entities that incurred eligible expenditure on tangible depreciating assets. To qualify for the bonus deduction, a taxpayer must have committed to investing in the asset during the period

13 December 2008 to 31 December 2009 (ie the height of the slowdown). The incentive, therefore, encouraged taxpayers to bring forward spending on income-producing assets that they may have otherwise deferred on account of the uncertainty caused by the crisis.

A broad range of temporary tax incentives were also recently introduced by many governments around the world to combat the economic effects of the COVID-19 pandemic (see OECD, *Tax Policy Reforms 2021: Special Edition on Tax Policy During the COVID-19 Pandemic*). Australia, for example, introduced various capital allowance incentives, including an incentive to allow businesses with annual turnover of less than $5 billion to fully expense the cost of their eligible depreciating assets [15.2].

By actively intervening in their economies during the GFC and COVID-19 crises, governments were simply applying the economic theories of John Maynard Keynes as set out in his seminal 1936 treatise, *The General Theory of Employment, Interest and Money*. Keynes advocated that increased government expenditures and lower taxes can stimulate demand and thwart a recession. In essence, governments were using fiscal stimulus measures to influence aggregate demand in order to prevent an economic slump.

Finally, it is also important to recognise that reducing the level of taxation makes a country more attractive to foreign investors. This, in turn, can provide a range of related economic benefits, such as enhanced business and employment opportunities. Through increased foreign investment, a country's pool of potential taxpayers is also broadened. Thus, when considering the level of taxation and the form it will take, governments need to carefully weigh up several factors, including the effect taxation has on a country's international competitiveness.

[1.14] QUESTIONS

1. What kinds of taxes were imposed in ancient times and what are the main kinds of taxes imposed today?
2. Is it correct to say that the only role of taxation is to raise government revenue? If taxation has other functions, what are they?
3. What is a 'tax expenditure program'? Provide some examples of such programs. What are some of the criticisms faced by such programs?
4. What structural features do tax systems have in common?
5. Provide some historical example of where taxation has led to national instability.
6. What are the characteristics of a 'good' tax system and what are some of the issues facing Australia that should be taken into account in designing its tax system?
7. Discuss the difference between a 'flow-through entity' and an 'opaque entity'.
8. Which bodies make, administer and adjudicate a country's tax laws?
9. How do Australia's general jurisdictional rules operate?
10. Why is it difficult to compare the levels of taxation in different countries? What benefits may flow from reducing the level of taxation?

TAX LAW RESEARCH AND INTERPRETATION

2

[2.1] Introduction

Taxation law is a vast and dynamic area of law that intersects with many other areas of law and is never static. Australia has dozens of tax statutes containing thousands of pages of complex and interconnected legislative provisions. In addition, the Australian courts and tribunals have handed down hundreds of significant tax decisions over the years. Many of these cases involve complex commercial factual situations that raise thorny legal issues.

Taxation law is also continually evolving and being reformed. Every year, several Bills are introduced into the Commonwealth, state and territory legislatures to address technical issues, fix loopholes, vary tax rates, alter incentives and adjust tax bases. It is therefore not surprising that one of the many challenges faced in studying and practising taxation law is keeping up with the constant barrage of changes and locating up-to-date legal resources.

This chapter introduces the primary sources of taxation law in Australia; namely, statute and common law [2.2]. It also outlines the main kinds of rulings and advice documents issued by the ATO [2.3]. These documents are important as they set out the Commissioner's views on the operation of the law and, in certain cases, can be binding. The chapter also discusses the vast range of secondary reference material that can be used to assist in researching and resolving tax problems [2.4]. It also identifies some of the key websites that are useful for conducting tax research [2.5]. The chapter concludes with a discussion of some basic rules of statutory interpretation, which are critical for understanding and applying tax legislation [2.6].

[2.2] Primary sources of tax law

Statute

Taxation is a creature of statute, rather than common law. Legislation is therefore the primary source of tax law. In Australia, tax legislation is enacted by the Commonwealth, state and territory legislatures. The Commonwealth Parliament's legislative powers are found in the *Commonwealth Constitution* and the process involved in enacting legislation is discussed at [3.3]. There are dozens of different tax and related statutes that make up the Commonwealth legislative scheme. These Acts span thousands of pages and contain many thousands of complex and technical interconnected provisions. The Office of Parliamentary Counsel, established under the *Parliamentary Counsel Act 1970* (Cth), has the role of drafting Commonwealth legislation and publishing such laws. Australia's tax

laws are being continuously reformed with many Bills introduced into Parliament each year. Tax legislation is also complemented by a broad range of subordinate legislative instruments, including many different regulations and determinations [3.3]. There is, arguably, no other area of law that is as complex or as legislatively fertile as tax law.

Common law

Tax laws enacted by the Commonwealth, state and territory legislatures are interpreted by the courts in the many cases that come before them each year. Tax cases typically involve disputes between a particular taxpayer and either the Commissioner of Taxation (in matters involving Commonwealth taxes) or the relevant Commissioners of State or Territory Revenue (in matters involving state and territory taxes). These disputes usually concern the way in which specific provisions in the legislation apply to particular transactions, and arise because taxpayers and tax administrators have different interpretations of the law. Over time, a large body of case law concerning the interpretation of tax legislation has been developed by the courts. The amount of tax litigation is not surprising given that tax disputes often concern the operation of complex provisions and involve large sums of money. The common law is therefore, together with the tax legislation, an important source of law.

Doctrine of precedent

In reading any court decision, it is important to be aware of the doctrine of precedent (*stare decisis*). This doctrine requires courts to follow earlier decisions when making their rulings and was developed to promote consistency and certainty in the application of the law by the courts. According to the doctrine, the *ratio decidendi* of a higher court in a court hierarchy is 'binding' on a lower court in the same hierarchy. The *ratio decidendi* is the court's reasons for its decision in the particular case. It forms the legal principle derived from the judgment in the case which can then be applied to similar cases. While the *ratio decidendi* of a higher court must be followed by lower courts in the same court hierarchy, the *ratio decidendi* of a court in another court hierarchy (eg a foreign court) does not need to be followed, but may nevertheless have 'persuasive' authority. A court must make a ruling on a particular point of law for a *ratio decidendi* to arise and it is possible for one case to give rise to a number of separate *ratios*.

Ratio decidendi should be distinguished from *obiter dicta* which consist of comments made by judges in passing that are not essential or directly relevant to the decision in a case. *Obiter dicta* are not binding and only have persuasive authority. In practice, the weight that a court will give to *obiter dicta* will typically depend on the reputation of the judge who has made the comments and the jurisdiction and seniority of the court on which that judge sits. It is possible, and indeed common, for *obiter dicta* in one case to later form the basis of the *ratio decidendi* of another case (ie where it is applied by the court in arriving at its decision in the subsequent case).

It is important to understand, however, that the *ratio decidendi* of a case will not be binding on a lower court if the decision can be distinguished on some ground (eg due to material factual differences in the cases). Much time is therefore often spent in court arguing whether or not a particular decision is applicable. Even slight variations in factual situations may produce different legal outcomes. In some situations, there may be conflicting precedents that require a court to draw distinctions between cases to determine which decision is the most appropriate to follow.

Court hierarchy

In the Australian federal tax jurisdiction, the basic hierarchy of courts (from highest to lowest) is as follows:

- High Court (consisting of up to seven judges—the current members of the High Court are Gageler CJ, Beech-Jones, Gordon, Edelman, Steward, Gleeson and Jagot JJ)
- Full Court of the Federal Court (consisting of three judges), and
- Federal Court (consisting of one judge).

The Administrative Appeals Tribunal ('AAT'), which is strictly an administrative body as opposed to a judicial body, also hears tax cases. The *Taxation Administration Act 1953* (Cth) ('*TAA*') gives the AAT the power to review certain decisions (including reviewable objection decisions) made by the Commissioner of Taxation. Reviews are conducted in accordance with the rules set out in the *Administrative Appeals Tribunal Act 1975* (Cth) ('*AATA*') as modified by the *TAA*. Taxpayers may appeal tribunal decisions to the Federal Court on questions of law (s 44 *AATA*). The way in which the appeal process operates is examined at [38.5].

Reports

Decisions of the federal courts and tribunals can be accessed online [2.5] and are also reported in law reports, such as:

- *Australian Tax Cases* ('ATC'), which contain reports of AAT, Federal Court and High Court tax decisions handed down since 1969
- *Australian Tax Decisions* ('ATD'), which contain reports of tax decisions handed down between 1930 and 1969
- *Australian Tax Reports* ('ATR'), which contain reports of AAT, Federal Court and High Court tax decisions
- *Federal Court Reports* ('FCR'), which contain authorised reports of Federal Court decisions, and
- *Commonwealth Law Reports* ('CLR'), which contain authorised reports of High Court decisions.

[2.3] Taxation rulings and advice

The ATO publishes a broad range of advice and guidance documents outlining the Commissioner's views on the operation of the tax laws. The main form of formal advice comes in the form of 'rulings'. Since 1 July 1992, a 'binding ruling system' has operated in Australia [38.4]. Under this system, the Commissioner can issue 'public rulings' advising on the way a relevant provision in the tax law applies to entities generally or to a class of entities. The Commissioner can also issue 'private rulings' to taxpayers who request them about how the tax law applies to their existing or proposed schemes. Public and private rulings must be in writing and must state that they are public or private rulings.

The Commissioner is generally bound to apply the law as set out in a binding ruling unless he is satisfied that the ruling is incorrect and disadvantages the taxpayer, in which case he may apply the law in a way that is more favourable to the taxpayer (provided he is not prevented from doing so by any legal time limits). Taxpayers who rely on a binding ruling are protected from having to pay any tax shortfall (ie underpaid tax), penalties or interest in respect of the matters covered in the ruling if it turns out that the ruling is incorrect.

There are several different kinds of binding public rulings, which each have a distinct prefix, year and identification number. The rulings are sometimes updated by addenda, and may be withdrawn. The main kinds of binding public rulings are contained in the following series:

- **Taxation Rulings ('TRs').** These rulings are the principal series of binding public rulings. They cover many different topics, including income tax and FBT. An example of a taxation ruling is TR 2008/2, which provides guidance on income tax issues relating to activities in the horse industry.
- **GST Rulings ('GSTRs').** These rulings are used to provide guidance on GST. An example of a GST ruling is GSTR 2006/9, which deals with the meaning of the term 'supply' for GST purposes.
- **Product Rulings ('PRs').** These rulings are usually sought by promoters of investment products such as managed investment schemes ('MISs'). They are typically attached to the prospectus accompanying the schemes to provide certainty to potential investors about the ATO's views on the tax implications of the particular products being marketed. An example of a product ruling

is PR 2008/63, relating to the 2009 Timbercorp Forestry Project. Product rulings overcome the need for each investor in the scheme to individually apply for a private ruling. Provided the scheme is carried out as described in the product ruling, investors are able to rely on the ruling. The product rulings system is explained further in PR 2007/71.

- **Class Rulings ('CRs').** These rulings are sought by entities on the tax effect of particular arrangements on a class of taxpayers. Class rulings are often sought by companies to advise their shareholders of the ATO position on capital management and restructuring issues, such as share buy-backs, takeovers and demergers. An example of a class ruling is CR 2008/10, which deals with the tax consequences for Coca-Cola Amatil's shareholders of an off-market share buy-back undertaken by the company. As with product rulings, class rulings overcome the need for each shareholder to individually seek a private ruling about the arrangement. The class rulings system is explained further in CR 2001/1.
- **Law Companion Rulings ('LCRs').** These rulings set out the ATO's views on how recently enacted tax laws apply. They are usually developed at about the same time as a Bill is being drafted and are designed to provide certainty about the application of new laws. The law companion guidelines system is explained further in LCR 2015/1.

The ATO also issues determinations, which are typically shorter than most rulings and generally only address specific questions. The following determinations are binding on the Commissioner: Taxation Determinations ('TDs') and GST Determinations ('GSTDs').

Rulings and determinations issued before the binding ruling system was introduced (on 1 July 1992) are not binding on the Commissioner. This includes the old Income Tax Rulings ('ITs'). The ATO also publishes a range of non-binding superannuation rulings and determinations, such as Superannuation Guarantee Rulings ('SGRs'), Self-Managed Superannuation Fund Rulings ('SMSFRs'), Superannuation Guarantee Determinations ('SGDs'), Superannuation Contribution Determinations ('SCDs') and Self-Managed Superannuation Fund Determinations ('SMSFDs'). While taxpayers that rely on non-binding rulings are not protected from having to pay any tax shortfall, they are generally protected against having to pay certain penalties and, if they relied on the document reasonably and in good faith, they are also generally protected from having to pay interest.

The ATO also publishes Interpretative Decisions ('IDs'), which set out the way it has interpreted the law in particular instances, and Decision Impact Statements ('DISs'), which set out its views on the outcome of particular court and tribunal decisions. Furthermore, to provide guidance on ATO administrative practices and assist ATO staff in performing their duties, the ATO issues Practice Statements Law Administration ('PS LA'). More recently, the ATO has started to publish Practical Compliance Guidelines ('PCGs'), which provide broad guidance on significant administrative and compliance issues. IDs, DISs, PS LAs and PCGs are not binding on the Commissioner. They are, nevertheless, made publicly available for information and transparency purposes.

A large amount of general advice is also published on the ATO website. This includes bulletins, guidelines, taxpayer alerts, policy statements, media releases and consultative documents. Over the years, the ATO has also produced useful guidebooks and manuals detailing the practical operation of the tax laws (eg *Guide to the Debt and Equity Tests* and *Consolidation Reference Manual*). Practical information can also be obtained from ATO publications designed to assist taxpayers in compiling their tax returns (eg *Individual Tax Return Instructions*).

[2.4] Taxation reference material

In addition to legislation, cases and ATO rulings and advice, a vast array of secondary reference material can be used to research and resolve taxation issues. Some of the main kinds of publications that are frequently used by taxation practitioners, scholars and policymakers are discussed below.

Government publications

From time to time, the Government releases various papers, reports, research documents and exposure drafts in order to foster public awareness of an issue or as part of its consultative processes. For example, it is common for Treasury to issue an Exposure Draft Bill for public comment and submissions on important proposed alterations to the tax laws before a Bill is formally introduced into Parliament. The Exposure Draft Bill is usually accompanied by an Explanatory Memorandum. Likewise, the Bill that is eventually introduced into Parliament will also typically have its own Explanatory Memorandum. These documents are extremely useful as they explain how proposed laws are intended to operate and can assist with interpreting complex legislative provisions.

Many government publications also contain useful policy information and reform recommendations, which often form the basis of future tax laws. In the late 1990s, the Review of Business Taxation [5.4] published two important discussion papers (*A Strong Foundation* (1998) and *A Platform for Consultation* (1999)) as well as a major report recommending reforms to the Australian business tax system (*A Tax System Redesigned* (1999)). A number of significant papers and reports were also produced by the Henry Tax Review [5.5]. This included *Architecture of Australia's Tax and Transfer System* (2008) and *Australia's Future Tax System—Report to the Treasurer* (2009). More recently, the Abbott Government published its *Re:think* (2015) discussion paper [5.7].

Board of Taxation publications

The Board of Taxation, which is an advisory board that assists the Government in the development and implementation of the tax laws, has also published several interesting papers and reports over the years, including the following:

- *International Taxation—A Report to the Treasurer* (2003)
- *A Tax Transparency Code—A Report to the Treasurer* (2016)
- *Reforming Individual Tax Residency Rules—A Model for Modernisation* (2019), and
- *Review of GST on Low Value Imported Goods* (2021).

Professional publications

Professional bodies, such as those listed below, also produce a variety of tax publications:

- Taxation Institute of Australia
- Australian Tax Research Foundation
- Corporate Taxpayers' Association
- Chartered Accountants Australia and New Zealand
- Law societies in states and territories
- Law Council of Australia, and
- CPA Australia.

These bodies often make submissions or release consultative documents or research papers concerning various tax matters.

In addition, many law and accounting firms (particularly the larger firms) produce their own publications dealing with aspects of taxation law. These publications often have a useful practical focus.

Academic and professional journals and conference papers

Journal articles and conference papers are an excellent secondary research resource as they usually contain a focused and critical analysis of particular topics. The main specialist Australian tax journals are listed below.

Australian Tax Journals	
Australian Tax Forum	*Journal of the Australasian Tax Teachers Association*
Australian Tax Review	*Revenue Law Journal*
CCH Tax Week	*Taxation in Australia*
eJournal of Tax Research	*Tax Specialist*
Journal of Australian Taxation	*Weekly Tax Bulletin*

Tax articles can also be found in university law reviews (eg *Melbourne University Law Review*), law journals (eg *Australian Law Journal*) and accounting journals (eg *Charter*). Tax papers are also frequently presented at conferences conducted throughout the year by various professional bodies, including the Taxation Institute of Australia and CPA Australia. These papers often have a highly practical and current focus. Tax papers are also presented at academic conferences such as those conducted by the Australasian Tax Teachers Association and the Accounting Association of Australia and New Zealand. These papers are often more theoretical and policy-orientated in nature.

Journal and conference papers can be accessed via databases such as the Attorney-General's Information Service ('AGIS'), the Australian Public Affairs Information Service ('APAIS') and the Social Science Research Network ('SSRN').

Textbooks and casebooks

Textbooks are perhaps the most useful starting point in conducting tax research as they enable the reader to gain an overview and basic understanding of a particular issue. Textbooks usually provide a conceptual framework and introduction to the law and a structured discussion of the relevant legislation, cases and rulings in the area. There is also often a critical analysis and synthesis of the legal principles covered. The most widely used and comprehensive annually updated Australian taxation law textbooks designed for practitioners are Wolters Kluwer, *Australian Master Tax Guide*, and R Deutsch, M Friezer, I Fullerton, P Hanley and T Snape, *Australian Tax Handbook*. There are also several textbooks that focus on specialist areas, such as GST (eg P McCouat, *Australian Master GST Guide* and I Murray Jones, *Australian GST Handbook*) and superannuation (eg J Leow and S Murphy, *Australian Master Superannuation Guide* and S Jones, *Australian Superannuation Handbook*). The Australian Tax Research Foundation also publishes useful books containing in-depth research studies on particular taxation law topics.

Casebooks can also play a useful part in tax research. Casebooks generally provide the reader with the basic facts of a case as well as critical parts of the leading judgments (eg S Barkoczy, C Rider, J Baring and N Bellamy, *Australian Tax Casebook* (2021)). Some casebooks go beyond merely providing summaries and extracts of cases to also include commentary and questions (eg G Cooper, M Dirkis, M Stewart and R Vann, *Income Taxation Commentary and Materials* (2022)).

International resources

While the tax laws of each country vary dramatically, there are many common issues. For instance, many countries adopt similar concepts of income and deductions. They also usually base their jurisdictional rules on similar principles (eg residence and source) and have broadly similar kinds of international tax regimes (eg transfer pricing, accruals and withholding tax regimes). Likewise, many principles of tax theory are of universal concern—policy issues, such as what are the features of a good tax system and how should tax avoidance be tackled, are generally relevant to all jurisdictions. It is also interesting to look at alternative tax systems for comparative purposes. Foreign tax systems may provide useful benchmarking data and provide innovative ideas for tax reform. For these reasons, it is appropriate in many cases to extend one's research beyond Australia and investigate the

international literature. This includes using books published by international publishers like Wolters Kluwer, LexisNexis and Thomson Reuters as well as those published by international organisations such as the OECD and the International Bureau of Fiscal Documentation. It also involves using specialist international tax journals such as the following:

International Tax Journals	
American Journal of Tax Policy	*Florida Tax Review*
Asia-Pacific Tax Bulletin	*Houston Business and Tax Law Journal*
ATA Journal of Legal Tax Research	*Intertax*
British Tax Review	*International Tax Journal*
Bulletin for International Taxation	*International Tax Review*
Canadian Current Tax	*New Zealand Journal of Taxation Law and Policy*
Canadian Tax Journal	*Pittsburgh Tax Review*
Columbia Journal of Tax Law	*Tax Law Review*
EC Tax Journal	*Tax Lawyer*
EC Tax Review	*Tax Notes International*
European Taxation	*VAT Monitor*
Fiscal Studies	*Virginia Tax Review*

[2.5] Online and electronic resources

Useful tax and related legal information from Australia and around the world can be obtained via the internet. For instance, many of the articles in the overseas journals mentioned at [2.4] can be conveniently accessed electronically using databases such as *LexisNexis*, *Westlaw*, *Kluwer Law Online* and the *IBFD Tax Research Platform*.

Without doubt, one of the most useful practical research tools is Wolters Kluwer's *CCH IntelliConnect*, which is an electronic database that provides access to a number of products, including the *Master Tax Guide* and a range of more detailed encyclopaedic services. These services contain key source material (eg legislation, cases and rulings) and extensive commentary regarding the law. *CCH IntelliConnect* allows rapid searches across numerous products and is particularly user-friendly as references are linked by hypertext. Another useful electronic library service is *Checkpoint*, which provides access to an array of tax and related publications published by Thomson Reuters.

The following table lists some useful websites for conducting tax research.

Australian Government	
Australian Border Force	www.abf.gov.au
Australian Business Register	www.abr.business.gov.au
Australian Charities and Not-for-profits Commission	www.acnc.gov.au
Australian Parliament	www.aph.gov.au
Australian Prudential Regulation Authority	www.apra.gov.au
Australian Securities and Investment Commission	www.asic.gov.au
Australian Taxation Office	www.ato.gov.au
Australian Transaction Reports and Analysis Centre	www.austrac.gov.au

Board of Taxation	www.taxboard.gov.au
Industry Innovation and Science Australia	www.industry.gov.au
Inspector-General of Taxation	www.igt.gov.au
myGov	www.my.gov.au
Tax Practitioners Board	www.tpb.gov.au
Treasury	www.treasury.gov.au/review
Australian Federal Courts and Tribunals	
High Court	www.hcourt.gov.au
Federal Court	www.fedcourt.gov.au
Administrative Appeals Tribunal	www.aat.gov.au
State and Territory Revenue Agencies	
ACT Revenue Office	www.revenue.act.gov.au
Queensland Office of State Revenue	www.treasury.qld.gov.au
Revenue NSW	www.revenue.nsw.gov.au
RevenueSA	www.revenuesa.sa.gov.au
RevenueWA	www.finance.wa.gov.au
State Revenue Office of Tasmania	www.sro.tas.gov.au
State Revenue Office Victoria	www.sro.vic.gov.au
Territory Revenue Office	www.treasury.nt.gov.au
Foreign Revenue Agencies	
Canada Revenue Agency	www.cra-arc.gc.ca
Hong Kong Inland Revenue Department	www.ird.gov.hk
Inland Revenue Authority of Singapore	www.iras.gov.sg
New Zealand Inland Revenue	www.ird.govt.nz
United Kingdom HM Revenue and Customs	www.hmrc.gov.uk
United States Internal Revenue Service	www.irs.gov
Legal Research Sites	
Australasian Legal Information Institute	www.austlii.edu.au
Federal Register of Legislation	www.legislation.gov.au
World Legal Information Institute	www.worldlii.org
Australian Tax Law Publishers	
Cambridge University Press	www.cambridge.org
Thomson Reuters	www.thomsonreuters.com.au
Wolters Kluwer	www.wolterskluwer.com/en_au
Australian Professional Bodies	
Association of Superannuation Funds of Australia Ltd	www.superannuation.asn.au
CPA Australia	www.cpaaustralia.com.au
Chartered Accountants Australia and New Zealand	www.charteredaccountantsanz.com

Law Council of Australia	www.lawcouncil.asn.au
National Tax and Accountants' Association	www.ntaa.com.au
Tax Institute	www.taxinstitute.com.au
Australian Law Firms	
Allens	www.allens.com.au
Ashurst	www.ashurst.com
Clayton Utz	www.claytonutz.com
Corrs Chambers Westgarth	www.corrs.com.au
Herbert Smith Freehills	www.herbertsmithfreehills.com
King & Wood Mallesons	www.kwm.com
MinterEllison	www.minterellison.com
Australian Accounting and Tax Advisory Firms	
BDO	www.bdo.com.au
Deloitte	www.deloitte.com.au
Ernst and Young	www.ey.com/en_au
KPMG	www.kpmg.com.au
Pitcher Partners	www.pitcher.com.au
PricewaterhouseCoopers	www.pwc.com.au
International Organisations	
International Bureau of Fiscal Documentation	www.ibfd.org
International Monetary Fund	www.imf.org
Organisation for Economic Co-operation and Development	www.oecd.org
Tax Justice Network	www.taxjustice.net

[2.6] Statutory interpretation

As taxation law is a creature of statute, statutory interpretation (ie the process of ascertaining the meaning of words and phrases used in legislation) is a critical aspect of everyday tax practice. Unfortunately, language is not always a precise tool for conveying ideas and there are often different views on the meaning of words in a statute. This is particularly the case where a statute deals with difficult technical concepts, such as those relating to taxation.

Legislative intention

It is for the courts to rule on the interpretation of tax legislation and, in doing so, they are required to give effect to the intention of Parliament as expressed by the terms of the statute. In *Cooper Brookes (Wollongong) Pty Ltd v FC of T* 81 ATC 4292, Mason and Wilson JJ recognised (at 4305) that the object 'is to ascertain the legislative intention by reference to the language of the instrument viewed as a whole'. Their Honours went on to explain that 'in performing that task, the courts look to the operation of the statute according to its terms and to legitimate aids to construction'.

In *Project Blue Sky v Australian Broadcasting Authority* (1998) 194 CLR 355, the High Court explained (at 381) that 'the process of construction must always begin by examining the context of the provision that is being construed'. The High Court noted that statutes consist of verbal formulas, where the literal meaning of words is not always the same as their legal meaning. In elaborating on this point, McHugh, Gummow, Kirby and Hayne JJ said (at 384):

> Thus, the duty of a court is to give the words of a statutory provision the meaning that the legislature is taken to have intended them to have. Ordinarily, that meaning (the legal meaning) will correspond with the grammatical meaning of the provision. But not always. The context of the words, the consequences of a literal or grammatical construction, the purpose of the statute or the canons of construction may require the words of a legislative provision to be read in a way that does not correspond with the literal or grammatical meaning.

The importance of reading words in their proper context, rather than in isolation, was recognised long ago in *Metropolitan Gas Co v Federated Gas Employees' Industrial Union* (1924) 35 CLR 449, where Isaacs and Rich JJ emphasised (at 455) that a 'canon of interpretation' was that 'every passage in a document must be read, not as if it were entirely divorced from its context, but as part of the whole instrument'.

More recently, in *Construction, Forestry, Maritime, Mining and Energy Union v Australian Building and Construction Commissioner* [2020] FCAFC 192, Allsop CJ explained (at [4]):

> Meaning is to be ascribed to the text of the statute, read in its context. The context, general purpose and policy of the provision and its consistency and fairness are surer guides to meaning than the logic of the construction of the provision.

In *Zheng v Cai* (2009) 239 CLR 446, the High Court stated (at 455) that attributing legislative intention is 'something of a fiction' that does not involve the attribution of a 'collective mental state to legislators' but rather 'the application of rules of interpretation accepted by all arms of government in the system of representative democracy'.

Ultimately, a statute has the meaning that Parliament intended it to have. The High Court in *Lacey v Attorney-General* (Qld) (2011) 242 CLR 573 explained (at 592) that this meaning is ascertained by reference to 'the rules of construction, common law and statutory, which have been applied to reach the preferred results and which are known to parliamentary drafters and the courts'. The High Court went on to state:

> The application of the rules will properly involve the identification of a statutory purpose, which may appear from an express statement in the relevant statute, by inference from its terms and by appropriate reference to extrinsic materials. The purpose of a statute is not something which exists outside the statute. It resides in its text and structure, albeit it may be identified by reference to common law and statutory rules of construction.

The following discussion introduces some of the basic statutory and common law rules that have been developed over the years to assist with the interpretation of legislation. However, before examining these rules, it is worth noting the words of Pearce in *Statutory Interpretation in Australia* (2019) who states (at 136):

> Legislation is, at its heart, an instrument of communication. For this reason, many of the so-called rules or principles of interpretation are no more than common-sense and grammatical aids that are applicable to any document by which one person endeavours to convey a message to another. Any inquiry into the meaning of an Act should therefore start with the question: 'What message is the legislature trying to convey in this communication?'

Legislative rules of statutory interpretation

The *Acts Interpretation Act 1901* contains a number of rules and presumptions for interpreting Commonwealth legislation. Some of the more important provisions in the Act are outlined below:

- **Acts read subject to the *Constitution*.** Section 15A states that every Act 'shall be read and construed subject to the *Constitution*, and so as not to exceed the legislative power of the Commonwealth'. Where any enactment would otherwise be in excess of that power 'it shall nevertheless be a valid enactment to the extent to which it is not in excess of that power'.
- **Construction that promotes the purpose or object of the Act.** Section 15AA states that in interpreting a provision of an Act, 'a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object'.
- **Use of extrinsic material.** Section 15AB states that if any material not forming part of an Act is capable of assisting in ascertaining the meaning of a provision in the Act, consideration may be given to that material to:
  (a) confirm that the meaning of the provision is the ordinary meaning conveyed by the text taking into account its context and the purpose or object underlying the Act, or
  (b) determine the meaning of the provision when: (i) the provision is ambiguous or obscure; or (ii) the ordinary meaning conveyed by the text taking into account its context and the purpose or object underlying the Act leads to a result that is manifestly absurd or is unreasonable.

  Material that may be considered for the purposes of s 15AB includes:
  – documents attached to the Act
  – reports of a Royal Commission, Law Reform Commission or committee of inquiry or other similar body laid before Parliament before enactment
  – treaties or other international agreements referred to in the Act
  – explanatory memoranda relating to the Bill containing the provision, or any other relevant document, laid before Parliament by a Minister before enactment
  – Ministerial speeches made to Parliament moving the Bill, and
  – materials in the Journals of the Senate, Votes and Proceedings of the House of Representatives or in any official record of debates in Parliament.

  Only material existing at the time the relevant legislation was enacted should be considered under s 15AB. As Williams J of the Supreme Court of Queensland stated in *FC of T v Bill Wissler (Agencies) Pty Ltd* 85 ATC 4626 (at 4631):

  > I do not read s 15AB of the Acts Interpretation Act as permitting the Court to consider a statement made at a later point of time (say when the legislation was being amended) in order to discern the intention of the legislature when the original statute was passed. It is much easier to be wise after the legislation has been applied in practice and scrutinised by the courts. Such belated statements of legislative intent could hardly ever affect the proper construction of the language used in the statute.

- **Changes to style.** Section 15AC states that where an Act has expressed an idea in a particular form of words and a later Act appears to have expressed the same idea in a different form of words for the purpose of using a clearer style, the ideas shall not be taken to be different merely because different forms of words were used.
- **Relevance of examples.** Section 15AD states that where an Act includes an example of the operation of a provision, the example shall not be taken to be exhaustive and, if the example is inconsistent with the provision, the provision prevails.

Common law rules of statutory interpretation

Over the years, the courts have also devised a number of approaches to assist with the interpretation of legislation, including the following three basic rules:

1. **The literal rule.** The literal rule is the basic approach for interpreting legislation. According to this rule, the words of legislation are to be interpreted according to their natural and ordinary meaning. The essence of the literal rule was expressed by Higgins J in *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129 at (161) as follows:

   > The fundamental rule of interpretation, to which all others are subordinate, is that a statute is to be expounded according to the intent of the Parliament that made it; and that intention has to be found by an examination of the language used in the statute as a whole. The question is, what does the language mean; and when we find what the language means, in its ordinary and natural sense, it is our duty to obey that meaning, even if we think the result to be inconvenient or impolitic or improbable.

2. **The golden rule.** The golden rule is used where the literal rule produces an absurd, irrational, capricious or unjust outcome. It qualifies the literal rule and allows courts to interpret legislation in a common-sense way that avoids these results. The origins of the golden rule can be found in *Grey v Pearson* (1857) 10 ER 1216, where Lord Wensleydale stated (at 1234) that in construing statutes:

   > the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified, so as to avoid that absurdity and inconsistency, but no farther.

3. **The mischief rule.** The mischief rule requires a court to interpret legislation in a way that addresses the mischief, harm or defect that the legislature intended to remedy. This rule is another qualification to the literal rule and can be traced back more than five centuries to the Court of Exchequer's decision in *Heydon* (1584) 76 ER 637. It is considered by many to be the origins of the modern 'purposive approach' discussed further below.

Traditional approach to interpreting tax legislation

The traditional approach adopted by the Australian courts to interpreting tax legislation, particularly around the time that Sir Garfield Barwick was Chief Justice of the High Court (1964–1981), was to use a strict literal approach. This approach is evident from his Honour's remarks in *FC of T v Westraders Pty Limited* 80 ATC 4357 (at 4358–4359):

> It is for the Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. The function of the Court is to interpret and apply the language in which the Parliament has specified those circumstances. The Court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament which is discoverable from the language used by the Parliament. It is not for the Court to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve, though not expressed in the actual language employed . . . Parliament having prescribed the circumstances which will attract tax, or provide occasion for its reduction or elimination, the citizen has every right to mould the transaction into which he is about to enter into a form which satisfies the requirements of the statute. It is nothing to the point that he might have attained the

> same or a similar result as that achieved by the transaction into which he in fact entered by some other transaction, which, if he had entered into it, would or might have involved him in a liability to tax, or to more tax than that attracted by the transaction into which he in fact entered. Nor can it matter that his choice of transaction was influenced wholly or in part by its effect upon his obligation to pay tax. Of course, the transaction must not be a pretence obscuring or attempting to supplant some other transaction into which in fact the taxpayer had earlier entered. Again, the freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society.

Underpinning the strict literal approach is the basic principle that the intention to impose a tax must be shown by clear and unambiguous language and should not be inferred from ambiguous words. Gibbs CJ referred to this principle in *Western Australian Trustee Executor & Agency Co Ltd v C of ST (WA)* 80 ATC 4567 (at 4571):

> The established rule that no tax can be imposed on a subject by an Act of Parliament without words which clearly show an intention to lay the burden upon him does not mean that the court will strive to find loopholes where none are apparent; the words of the Act must be given a fair and reasonable construction, without leaning one way or the other. However, although, if the terms of the Act plainly impose the tax they should be given effect, equally if they do not reveal a clear intention to do so the liability should not be inferred from ambiguous words.

The courts have been prepared to depart from the literal meaning of a provision where doing so would give effect to the clear intention of Parliament. This occurred in *Cooper Brookes (Wollongong) Pty Ltd v FC of T* 81 ATC 4292, where a majority of the High Court construed a former poorly drafted anti-avoidance rule dealing with the carry forward of corporate losses according to its intent rather than its literal meaning so that its operation would not be 'capricious' or 'irrational'. Mason and Wilson JJ stated (at 4306):

> If the judge applies the literal rule it is because it gives emphasis to the factor which in the particular case he thinks is decisive . . . .
>
> On the other hand, when the judge labels the operation of the statute as 'absurd', 'extraordinary', 'capricious', 'irrational' or 'obscure' he assigns a ground for concluding that the Legislature could not have intended such an operation and that an alternative interpretation must be preferred. But the propriety of departing from the literal interpretation is not confined to situations described by these labels. It extends to any situation in which for good reason the operation of the statute on a literal reading does not conform to the legislative intent as ascertained from the provisions of the statute, including the policy which may be discerned from those provisions.

Modern approach to interpreting tax legislation

The modern approach to interpreting legislation is to adopt a construction that promotes the purpose or object of the statute. This 'purposive approach' is supported by s 15AA of the *Acts Interpretation Act* and requires the courts to have regard to the broader context of the legislation from the outset and not just when an ambiguity arises. In *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, Brennan CJ, Dawson, Toohey and Gummow JJ stated (at 408):

> the modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses 'context' in its widest sense to include such things as the existing state of the law and the mischief which . . . one may discern the statute was intended to remedy.

In *Fox v Commissioner for Superannuation (No 2)* (1999) 88 FCR 416, Black CJ referred to this passage and explained (at 419–420):

> It was once thought that a statutory provision was to be interpreted literally unless its terms disclosed an ambiguity of meaning, in which case regard could be had to its context in order to discern the intention behind the provision's enactment and thereby resolve the ambiguity. This, however, is contrary to the modern approach to statutory interpretation…
>
> It follows that context must be considered at the beginning of any inquiry into the meaning of a statute, regardless of the apparent clarity of the literal terms of the relevant provision itself…
>
> Where a conflict exists between the constructions of a provision revealed by two principles of interpretation—here, by a literal reading and a purposive reading—a court 'must proceed with its primary task of extracting the intention of the legislature from the fair meaning of words by which it has expressed that intention', remembering always the mischief that the provision was enacted to address…

More recently, the modern approach was summarised by the High Court in *Sztal v Minister for Immigration and Border Protection* (2017) 262 CLR 362, where Keifel CJ, Nettle and Gordon JJ stated (at 368):

> The starting point for the ascertainment of the meaning of a statutory provision is the text of the statute whilst, at the same time, regard is had to its context and purpose… Context should be regarded at this first stage and not at some later stage and it should be regarded in its widest sense… This is not to deny the importance of the natural and ordinary meaning of a word, namely how it is ordinarily understood in discourse, to the process of construction. Considerations of context and purpose simply recognise that, understood in its statutory, historical or other context, some other meaning of a word may be suggested, and so too, if its ordinary meaning is not consistent with the statutory purpose, that meaning must be rejected.

Legal maxims

To assist in working out the meaning of particular words or phrases in a statute that may be ambiguous or unclear, the courts have often relied on various guiding principles that have been expressed in Latin maxims. The principles reflect a logical and common-sense approach to interpreting the language of a statute and are founded on basic grammatical and syntactic rules. Some commonly encountered maxims are outlined below:

- ***Noscitur a sociis***. This maxim supports a contextual approach to interpretation. It stands for the principle that a word or phrase should take its meaning from associated or accompanying words or phrases. In his 1937 book, *Law & Other Things*, Lord Macmillan vividly expressed the maxim as 'words of a feather flock together'. An illustration of where the maxim was applied is found in *Montgomerie v CIR (NZ)* (1965) 14 ATD 102, where the Supreme Court of New Zealand had to consider whether income of a trust had been 'applied' for the purposes of a provision in a New Zealand tax statute that contained the words 'pays or applies'. Barrowclough CJ said (at 107): 'The word "applied" is used in conjunction with "paid" and whilst of course it must have a somewhat different connotation, nevertheless, *noscitur a sociis*, and in my opinion the income cannot be said to be "applied" unless there is some dealing with it that is akin to payment—some parting with the possession and control of it.'
- ***Ejusdem generis***. This maxim means 'of the same kind'. It stands for the principle that where there is a list of specific things followed by a more general thing, the meaning given to the general thing should be restricted to cover the same class of things that are included in the specific

list. In *R v Regos* (1947) 74 CLR 613, Latham CJ explained that under this rule, 'general words may be restricted to the same genus as the specific words that precede them'. For example, in *Canwan Coals Pty Ltd v FC of T* 74 ATC 4231, the Supreme Court of NSW considered the phrase 'a railway, road, pipe-line or other facility' in a former *ITAA36* provision. It relied on the *ejusdem generis* rule to construe the words 'other facility' as referring only to those facilities upon which, or through which, relevant goods might be moved or conveyed. A reserve storage facility was therefore not such a facility, as it was not used for transport.

- ***Expressio unius est exclusio alterius***. This maxim can be translated as 'the expression of one is at the exclusion of others'. It suggests that where one class of thing is mentioned in a statute, then other classes of the same thing that are not mentioned should be excluded. Although this maxim can be useful in certain cases, the courts have warned that it should be applied with caution (see eg *FC of T v Barnes Development Pty Ltd* 2009 ATC ¶20-121; *State of Tasmania v Cth* (1901) 1 CLR 329; *Houssein v Under Secretary of Industrial Relations and Technology* (1982) 148 CLR 88).
- ***Generalia specialibus non derogant***. This maxim means 'the general does not detract from the specific'. Based on this maxim, a specific provision in a statute should override a general provision in the statute where those provisions are in conflict. The maxim has been considered in a number of tax cases, including the High Court decision in *FC of T v Gulland* 85 ATC 4765. In *Barker v Edger* [1898] AC 748, the Privy Council explained (at 754) that the maxim operates as follows: 'whenever there is a particular enactment and a general enactment in the same statute, and the latter, taken in its most comprehensive sense, would overrule the former, the particular enactment must be operative, and the general enactment must be taken to affect only the parts of the statute to which it may properly apply'.

It is important not to view the above maxims as rigid and inflexible rules, but rather as simply aids to construction. As Higgins J said in *Bank Officials' Association (South Australian Branch) v Savings Bank of South Australia* (1923) 32 CLR 276 (at 299), the maxims 'merely afford presumptions' and 'merely aid us in taking our bearings in the movement of our reason'.

The difficulty in relying on the maxims was noted in *Chief Executive Officer of Customs v Biocontrol Ltd* [2006] FCA 107, where the Federal Court warned that the *ejusdem generis* rule is 'no more than a guide to interpretation' that should be 'used cautiously'. Young J said (at [46]):

> There will be occasions when it is not appropriate to apply the rule having regard to the context and purpose of the particular statutory provision. There will also be occasions where the descriptive terms that precede the general words are so varied that it is futile to search for a single genus or class that can be of assistance in giving meaning to the general words. Conversely, there will be occasions where it is both sensible and appropriate to give meaning to the general words by identifying the class or genus that is indicated by the preceding particular words. All in all, the surest approach is to give meaning to general words which follow particular words in a statutory provision by determining the meaning of those words in their context and by reference to the purpose of the provision, in the same way as meaning is given to other words in a statute.

Defined terms and common expressions

Where legislation defines a particular term, the term must obviously be interpreted in accordance with its technical statutory definition. It is, therefore, important when interpreting legislation to check whether it contains any express definitions. Most tax statutes have lengthy definition sections. Examples of such provisions in Australia's tax statutes include: s 6 *ITAA36*, s 995-1 *ITAA97*, s 195-1 *GSTA* and s 136 *FBTAA*. Terms that are not specifically defined in the legislation should ordinarily be given their natural meanings.

When reading statutes, it is also important to note the distinctions that are generally drawn between commonly used expressions, such as the following:

- **'May' and 'shall'.** The word 'may' usually confers a discretionary power (ie it indicates that something is permissible or optional). The word 'shall', on the other hand, usually imposes an obligation or duty (ie it indicates that something is mandatory or compulsory).
- **'Means' and 'includes'.** The word 'means' indicates that a term has an exhaustive and restricted definition and that no other meaning can be attributed to it (ie it confines the scope of a definition). The word 'includes', on the other hand, indicates that a term has meanings outside those things specifically mentioned (ie it enlarges the scope of a definition).
- **'And' and 'or'.** The word 'and' when used in a list of words or phrases indicates that the words or phrases are to be read conjunctively (ie as cumulative requirements). The word 'or' when used in a list of words or phrases indicates that the words or phrases are to be read disjunctively (ie as alternatives).

[2.7] QUESTIONS

1. What are the primary sources of tax law?
2. What kinds of rulings does the ATO issue? What is the difference between a binding and a non-binding ruling?
3. Discuss the main kinds of secondary resource materials available for undertaking tax research. What are some of the main Australian tax journals?
4. Visit the ATO website—what kinds of information does it contain? Visit the parliamentary website—what tax Bills are currently before Parliament?
5. In what circumstances does s 15AB of the *Acts Interpretation Act 1901* (Cth) permit material that does not form part of an Act to be used to assist in ascertaining the meaning of a provision in the Act?
6. Explain the different connotations of the words 'means' and 'includes' when used in a definition provision. Provide some examples from the *ITAA97*.

CONSTITUTIONAL FRAMEWORK OF THE AUSTRALIAN TAX SYSTEM 3

[3.1] Introduction

In order to properly appreciate the framework in which Australia's tax laws operate, it is necessary to understand Australia's system of government and the constitutional setting within which the tax system functions. This chapter discusses how Australia's federal system of government evolved and how sovereign power is shared between the Commonwealth and states [3.2]. It also examines the *Commonwealth Constitution* [3.3] and focuses on the following provisions:

- s 51(ii) (which deals with the Commonwealth Parliament's taxation power) [3.4]
- s 53 (which deals with the Senate's powers in relation to taxation laws) [3.5]
- s 55 (which deals with the nature of laws imposing taxation) [3.6]
- s 81 and s 83 (which deal with the Consolidated Revenue Fund and appropriations of money from Treasury) [3.7]
- s 90 (which deals with the power to impose customs and excise duties) [3.8]
- s 96 (which deals with grants of financial assistance to the states) [3.9], and
- s 114 (which deals with the imposition of taxes on property belonging to the states) [3.10].

[3.2] Australian system of government

Australia has been inhabited by First Nations people for over 50,000 years. In 1788, Australia was colonised by Britain when Governor Phillip arrived with the First Fleet in Botany Bay to establish New South Wales ('NSW') as a penal colony. NSW was subsequently divided into a number of additional independent colonies: namely, Tasmania, originally called Van Diemen's Land (in 1825), South Australia (in 1836), Victoria (in 1851) and Queensland (in 1859). Western Australia originated as a separate free colony (in 1829). As the colonies were 'British settlements', the existing laws of Britain were transplanted, insofar as they were applicable, to the colonies under the 'doctrine of received law'. The British colonisers treated Australia as *terra nullius* (ie a land belonging to nobody) and did not recognise the existence of any customary laws of the First Nations people.

STEPHEN BARKOCZY

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- the proposed tax on earnings on superannuation balances over $3m
- the skills and training and technology investment boosts
- the small business energy incentive
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- the new ruling on residency tests for individuals
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FOREWORD TO THE FIRST EDITION

Foundations of Taxation Law is an impressively ambitious project impressively executed. The aim of the book is said in the preface to be to provide a 'concise' introduction to the policy, principles and practice of the Australian federal taxation system. Anyone acquainted with that system will appreciate how large and difficult a task that is. Stephen Barkoczy has brought to bear many years of teaching and practice in tax in the production of this substantial contribution to the literature on tax law, policy and practice in Australia. His teaching skills are evident in the exposition of complex and difficult issues in a systematic and clear language reflecting the kinds of questions which students might frequently have asked him. The text, however, is thoroughly informed by many years of practice and experience in tax law, policy and practice. The value of this book lies not only in its clarity and breadth of coverage. Readers will find throughout the book further references to pursue in more detail the many concepts and issues considered by the author. Teachers in taxation will undoubtedly find useful as a teaching tool both the text and the many detailed further references. They will also find particularly useful the study questions helpfully provided throughout the text at the end of various sections. They are designed to assist students in their understanding of the issues explained in the text and, as a teaching tool, will be very useful to the other teachers of taxation in Australia as a vehicle for discussion and application of principles.

It is particularly heartening to see a text of this kind directed to the student. There are many texts on tax law for practitioners designed, with varying degrees of success, to provide practical answers to difficult problems. Some publications for practitioners can do little more to assist the practitioner than gather together as much relevant information as possible and provide some statement of the law. *Foundations of Taxation Law* is directed to a different kind of enquiry, namely, that of the student wishing to understand what the rules are about. Tax law has developed over the years to become a complex system of many interacting rules. The complexity and size of the rules makes its teaching as a system a difficult task. The practitioner consulting a practice text or commentary may be presumed to have sufficient knowledge before looking up the text. For the student the task is different and more difficult. It is that enterprise that Stephen Barkoczy has undertaken with impressive results in this text.

On a personal note, it is particularly gratifying that this text should be written by one's own former student of many years ago. The text is a great credit to the author and I commend it to students of taxation in Australia.

The Hon. Tony Pagone AM KC

CONTENTS

PREFACE

AIMS AND OBJECTIVES

Taxation law is a vast and complex area of law that is continually evolving. As a consequence, it can be an overwhelming and challenging subject to study and research. The aim of this book is to provide a guide to the policy, principles and practice that underpin the Australian taxation system. The book focuses on the key components covered in many introductory and advanced taxation law courses studied at Australian universities. It is designed to be used by undergraduate and postgraduate students as well as students undertaking professional qualifications with accounting bodies, law societies and the Taxation Institute of Australia. The book is also intended to serve as a general reference guide for taxation academics and researchers, as well as practising lawyers and accountants who require a succinct and user-friendly explanation of fundamental taxation law concepts.

CONTENT AND STRUCTURE

The main emphasis of the book is on Commonwealth taxes, particularly income tax, goods and services tax, fringe benefits tax and superannuation taxes. It also examines various state and territory taxes, as well as a number of levies and charges. The book is divided into 13 parts containing 41 chapters. To make the book more accessible to readers, I have adopted the approach of focusing on general principles. My objective is to provide a broad overview of the foundations of the taxation system rather than an exhaustive explanation of all its intricate principles and exceptions. In this regard, I have been selective in the topics covered and have intentionally divided them into 'consumable chunks' that can be easily digested by a reader. At the same time, I have tried to ensure that the book addresses most areas of general importance and does not over-simplify the law or skirt around harder issues. The book is therefore more comprehensive than many other introductory guides and goes into deeper detail on several topics. I have purposely tackled difficult areas of law that I believe are of significant practical importance and are not always adequately covered in other general books. For instance, the book has detailed chapters dealing with topics such as superannuation, employee share schemes, consolidated groups, investment incentives, business restructures, international taxation, Double Taxation Agreements, base erosion and profit shifting, accruals taxation and the taxation of financial transactions. Although these areas are outside the scope of most basic tax courses, they are important for advanced courses and are critical for obtaining a broad understanding of the Australian taxation regime. They are also particularly important areas for academics and practitioners.

While the book does not purport to provide a complete picture of Australia's tax laws, it covers a lot of ground, including discussion of many hundreds of legislative provisions, cases and rulings. The discussion in the chapters should serve as a solid set of principles around which readers can progressively build their general understanding of the law. The discussion should also provide a useful road map for navigating the complex web of interconnected provisions in the tax legislation and for making sense of the extensive body of case law in the field. Hopefully, by using this

book, readers will be able to tread more confidently through the tax law maze and be able to better 'see the wood for the trees'.

The book is the product of many years of researching, practising and lecturing in the field of taxation law, and it undoubtedly demonstrates my own biases about what I think is important for students, academics and practitioners to understand about the subject. I have tried to blend policy issues, taxation theory, technical 'black letter law' and commercial practice into a succinct, principled text. Although the book is primarily a legal text, it does not focus exclusively on legal issues. The discussion also touches on a wide range of social, economic, political and international comparative issues. Taxation law, perhaps more than any other area of law, is affected by these broader considerations, and I firmly believe that it needs to be approached with these perspectives in mind.

In writing the book, I have been conscious of the pressures placed on students and practitioners who have to grapple with large amounts of complex information located in different places in short time frames. For this reason, I have endeavoured to develop topics in a logical and structured order and clearly signpost and break up core concepts into their constituent elements. I have also extensively cross-referenced the discussion to specific legislative provisions and cases so that readers are able to easily find the source of the law. The book is peppered with examples, diagrams and tables that condense the law and help clarify difficult concepts.

QUESTIONS, ONLINE RESOURCES AND LECTURER SLIDES

To assist students with their exam preparation, the book contains a set of questions at the end of each chapter that are linked to the topics covered in that chapter. The questions test fundamental issues that students need to understand in order to properly grasp key concepts. They can also be used by lecturers as a basis for tutorial discussions. The questions have been designed in such a way that they examine core issues from both a practical (calculation and problem-based) perspective as well as a conceptual (theoretical and policy-based) perspective.

Online resources are available on the Cambridge University Press Higher Education website at www.cambridge.org/highereducation/isbn/9781009458832/resources. Student resources are freely available and include a list of references to selected government reports, taxation rulings, books and articles for those interested in conducting further research. The list of references should be particularly useful to students conducting research for their assignments. Lecturers can also gain access to a set of over 1,000 PowerPoint slides that are directly cross-referenced to topics covered in the chapters. The slides are designed as a handy teaching aid and can be obtained once your account is granted access.

CHANGES IN THE 15TH EDITION

This book has evolved considerably over the years. The 15th edition has undergone considerable restructuring and has been substantially revised to take account of many important legislative reforms, case law developments, administrative changes and policy announcements that have occurred over the last 24 months. It contains extensive analysis of the March and October 2022 and May 2023 Budget measures as well as discussion of many important new developments, such as the introduction of the new corporate collective investment vehicle regime, the skills and training and technology investment boosts and the digital games tax offset. There is also detailed discussion of the proposed new tax on earnings on superannuation balances over $3m and the proposed share buy-back reforms. The new ATO Charter, which replaces the Taxpayers' Charter, is examined as well as various land tax, payroll tax and stamp duty changes.

Special attention has been devoted to a number of significant international tax developments, including the ATO's new ruling on residency tests for individuals and the OECD's landmark two-pillar solution on global tax reform. There is also discussion of the proposed multinational tax transparency reporting and public beneficial ownership register requirements as well as the proposed anti-avoidance rule that denies significant global entities deductions for payments to associates for intangibles in low corporate tax jurisdictions.

The book contains discussion of dozens of additional cases, including recent decisions, such as *Adcon Resources Vic Pty Ltd v FC of T*; *Aurizon Holdings Ltd v FC of T; FC of T v Balasubramaniyan*; *B&F Investments Pty Ltd v FC of T*; *Bosanac v FC of T*; *FC of T v Carter & Ors; Cerrah v TPB Construction*; *Forestry, Maritime, Mining and Energy Union & Anor v Personnel Contracting Pty Ltd*; *Del Castillo v FC of T*; *Dua v FC of T*; *FFYS v FC of T*; *Hornsby Shire Council v Cth & Anor*; *Gough & Anor v TPB*; *FC of T v Guardian AIT Pty Ltd ATF Australian Investment Trust*; *Guttikonda & Anor v FC of T*; *H&B Auto Repair Centre Pty Ltd v FC of T*; *DFC of T v Huang*; *Hyder & Ors v FC of T*; *JHKW v FC of T*; *JMC Pty Ltd v FC of T*; *Kais Jewellery (Syd) Pty Ltd v FC of T*; *Khanna v FC of T*; *Lakes Oil NL v ISA*; *FC of T v Landcom*; *Logic Accountants & Tax Professionals Pty Ltd & Anor v TPB*; *Messenger Media and Information Technology Pty Ltd v FC of T*; *Plaskitt v TPB*; *FC of T v PricewaterhouseCoopers*; *Shaw v FC of T*; *Stark v FC of T*; *Thanabalasingam v TPB*; *Tomkinson v TPB*; *TPB v Ordiales*; *TPB v Williams*; *FC of T v Virgin Australia Airlines Pty Ltd*; *R v Willmott*; *Wood v FC of T*; *Worsley v TPB* and *YDXM v FC of T*.

There is also expanded policy and technical discussion of several areas of law as well as many new and updated examples, questions and diagrams. Certain topics have been consolidated and the chapter order has been reorganised and streamlined. Unless otherwise stated, the discussion in the book is generally based on the law in force as at July 2023.

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Stephen Barkoczy
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KEY TO ABBREVIATIONS

A$	Australian dollars
AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
AATA	*Administrative Appeals Tribunal Act 1975*
ABA	Additional Benefits Agreement
ABN	Australian Business Number
ABS	Australian Bureau of Statistics
AC	Appeal Cases (House of Lords)
ACA	Allocable cost amount
ACC	Australian Crime Commission
ACCC	Australian Competition and Consumer Commission
ACCU	Australian carbon credit unit
ACNC	Australian Charities and Not-for-profits Commission
ACT	Australian Capital Territory
ADF	Approved deposit fund
ADI	Authorised deposit-taking institution
ADJRA	*Administrative Decisions (Judicial Review) Act 1977*
AFC	Applicable functional currency
AFCA	Australian Financial Complaints Authority
AFM	Available fraction method
AFOF	Australian fund of funds
AFP	Australian Federal Police
AFSL	Australian financial services licence
AFTS	Australia's Future Tax System
AGD	Attorney-General's Department
AGS	Australian Government Solicitor
All ER	All England Law Reports
AMIT	Attribution managed investment trusts
AMLCTFA	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006*
AMLCTFR	*Anti-Money Laundering and Counter-Terrorism Financing Rules*
ANTS	A New Tax System
APA	Advance pricing arrangement
APRA	Australian Prudential Regulation Authority
ARFN	Australian registered fund number
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
AT	Australian Tax
ATC	Australian Tax Cases
ATD	Australian Tax Decisions
ATI	Adjusted tainted income

ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
BAS	Business Activity Statement
BCT	Business continuity test
BEPS	Base erosion and profit shifting
BTO	Beneficiary tax offset
BTWG	Business Tax Working Group
CA	*Customs Act 1901*
CCIV	Corporate collective investment vehicle
CFC	Controlled foreign corporation
CFE	Controlled foreign entity
CGC	Commonwealth Grants Commission
CGT	Capital gains tax
CLR	Commonwealth Law Reports
COAG	Council of Australian Governments
COT	Continuity of ownership test
CPB	Capital protected borrowing
CPI	Consumer Price Index
CR	Class Ruling
CRS	Common reporting standard
CSF	Crowd source funding
CTA	*Customs Tariff Act 1995*
DA	*Domicile Act 1982*
DASP	Departing Australia superannuation payment
DBTP	Death benefit termination payment
DGTO	Digital games tax offset
DICTO	Dependant invalid and carer tax offset
DIS	Decision Impact Statement
DPP	Director of Public Prosecutions
DPT	Diverted profits tax
DTA	Double Taxation Agreement
EA	*Excise Act 1901*
ECCT	Excess concessional contributions tax
EDCI	Eligible designated concession income
ENCCT	Excess non-concessional contributions tax
ERF	Emissions Reduction Fund
ESIC	Early stage innovation company
ESS	Employee share scheme
ESVCLP	Early stage venture capital limited partnership
ETA	*Excise Tariff Act 1921*
ETBT	Excess transfer balance tax
ETP	Employment termination payment
ETS	Emissions trading scheme
EU	European Union
EVCI	Eligible venture capital investment
FATCA	*Foreign Account Tax Compliance Act*
FBT	Fringe benefits tax
FBTA	*Fringe Benefits Tax Act 1986*

FBTAA	*Fringe Benefits Tax Assessment Act 1986*
FBTACA	*Fringe Benefits Tax (Application to the Commonwealth) Act 1986*
FC of T	Federal Commissioner of Taxation
FCR	Federal Court Reports
FDT	Franking deficit tax
FIF	Foreign investment fund
FITO	Foreign income tax offset
FLA	*Family Law Act 1975*
FLP	Foreign life assurance policy
FMD	Farm Management Deposit
FRE	Forex realisation event
FRG	Forex realisation gain
FRL	Forex realisation loss
FTC	Foreign tax credit
G20	Group of 20 Finance Ministers and Central Bank Governors
GDP	Gross domestic product
GFC	Global financial crisis
GIC	General interest charge
GloBE	Global anti-base erosion
GST	Goods and services tax
GST Regs	*A New Tax System (Goods and Services Tax) Regulations 2019*
GSTA	*A New Tax System (Goods and Services Tax) Act 1999*
GSTD	Goods and Services Tax Determination
GSTICA	*A New Tax System (Goods and Services Tax Imposition—Customs) Act* 1999
GSTIEA	*A New Tax System (Goods and Services Tax Imposition—Excise) Act 1999*
GSTIGA	*A New Tax System (Goods and Services Tax Imposition—General) Act 1999*
GSTR	Goods and Services Tax Ruling
GSTTA	*A New Tax System (Goods and Services Tax Transition) Act 1999*
HELP	Higher Education Loans Program
HESA	*Higher Education Support Act 2003*
HFE	Horizontal fiscal equalisation
IAS	Instalment Activity Statement
ICIJ	International Consortium of Investigative Journalists
ID	Interpretative Decision
IGT	Inspector-General of Taxation
IGTO	Inspector-General of Taxation and Taxation Ombudsman
IIR	Income inclusion rule
IISA	Industry Innovation and Science Australia
IMF	International Monetary Fund
IMR	Investment manager regime
IPO	Initial public offering
IRDA	*Industry Research and Development Act 1986*
IRS	Internal Revenue Service
ISA	Innovation and Science Australia
IT	Income Tax Ruling
ITA	*Income Tax Act 1986*
ITAA22	*Income Tax Assessment Act 1922*
ITAA36	*Income Tax Assessment Act 1936*

ITAA97	*Income Tax Assessment Act 1997*
ITAR15	*Income Tax Assessment (1936 Act) Regulation 2015*
ITAR21	*Income Tax Assessment (1997 Act) Regulations 2021*
ITC	Input tax credit
ITDIRWTA	*Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*
ITRA	*Income Tax Rates Act 1986*
ITTPA	*Income Tax (Transitional Provisions) Act 1997*
ITZ	Indirect tax zone
JITSIC	Joint International Tax Shelter Information Centre
LBTP	Life benefit termination payment
LCBTO	Loss carry back tax offset
LCR	Law Companion Ruling
LCT	Luxury car tax
LCTA	*New Tax System (Luxury Car Tax) Act 1999*
LCTICA	*A New Tax System (Luxury Car Tax Imposition—Customs) Act 1999*
LCTIEA	*A New Tax System (Luxury Car Tax Imposition—Excise) Act 1999*
LCTIGA	*A New Tax System (Luxury Car Tax Imposition—General) Act 1999*
LIC	Listed investment company
LITO	Low-income tax offset
LLC	Limited liability company
LTBR	Long-term bond rate
MAP	Mutual agreement procedure
MBLA	*Major Bank Levy Act 2017*
MEC	Multi-entry consolidated
MIS	Managed investment scheme
MIT	Managed investment trust
ML	Medicare levy
MLA	*Medicare Levy Act 1986*
MLI	*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*
MLS	Medicare levy surcharge
MLSFBA	*A New Tax System (Medicare Levy Surcharge—Fringe Benefits) Act 1999*
MNE	Multinational enterprise
MRRT	Minerals resource rent tax
MRRTA	*Minerals Resource Rent Tax Act 2012*
MT	Miscellaneous Taxation Ruling
NAI	Notional attributable income
NFRC	National Federation Reform Council
NRAS	National Rental Affordability Scheme
NSW	New South Wales
NT	Northern Territory
NZLR	New Zealand Law Reports
OBU	Offshore banking unit
OECD	Organisation for Economic Cooperation and Development
OECD MTC	OECD *Model Tax Convention on Income and on Capital*
PAYG	Pay As You Go
PDF	Pooled development fund
PDV	Post, digital and visual

PE	Permanent establishment
PR	Product Ruling
PRRT	Petroleum resource rent tax
PRRTAA	*Petroleum Resource Rent Tax Assessment Act 1987*
PRRTICA	*Petroleum Resource Rent Tax (Imposition—Customs) Act 2012*
PRRTIEA	*Petroleum Resource Rent Tax (Imposition—Excise) Act 2012*
PRRTIGA	*Petroleum Resource Rent Tax (Imposition—General) Act 2012*
PS LA	Practice Statement Law Administration
PSB	Personal services business
PSE	Personal services entity
PSI	Personal services income
PST	Pooled superannuation trust
PTG	Policy Transition Group
QAPE	Qualifying Australian production expenditure
QFA	Qualifying forex account
R&D	Research and development
RBA	Running balance account
RBL	Reasonable benefit limit
RBT	Review of Business Taxation
RPS	Redeemable preference shares
RSA	Retirement savings account
RSAA	*Retirement Savings Accounts Act 1997*
RSAR	*Retirement Savings Account Regulations 1997*
RSE	Registrable superannuation entity
RSPT	Resource super profits tax
SAM	Simplified accounting method
SAPTO	Seniors and pensioners tax offset
SBE	Small business entity
SBSCH	Small Business Superannuation Clearing House
SBT	Same business test
SCD	Superannuation Contributions Determination
SCR	Superannuation Contributions Ruling
SENCCTA	*Superannuation (Excess Non-Concessional Contributions Tax) Act 2007*
SETBTIA	*Superannuation (Excess Transfer Balance Tax) Imposition Act 2016*
SG	Superannuation guarantee
SGAA	*Superannuation Guarantee (Administration) Act 1992*
SGC	Superannuation guarantee charge
SGCA	*Superannuation Guarantee Charge Act 1992*
SGCLIEA	*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
SGD	Superannuation Guarantee Determination
SGR	Superannuation Guarantee Ruling
SHASA	Superannuation Holding Account Special Account
SISA	*Superannuation Industry (Supervision) Act 1993*
SISR	*Superannuation Industry (Supervision) Regulations*
SME	Small and medium sized enterprise
SMSF	Self managed superannuation fund
SMSFR	Self Managed Superannuation Funds Ruling
SR (NSW)	State Reports (New South Wales)

SSA	*Social Security Act 1991*
SSSCCIA	*Superannuation (Sustaining the Superannuation Contribution Concession) Imposition Act 2013*
STP	Single touch payroll
STTR	Subject to tax rule
TAA	*Taxation Administration Act 1953*
TAR17	*Taxation Administration Regulations 2017*
TASA	*Tax Agent Services Act 2009*
TBRL	Temporary budget repair levy
TCSA	Tax cost setting amount
TD	Taxation Determination
TFN	Tax file number
TIEA	Tax Information Exchange Agreement
TLIP	Tax Law Improvement Project
TOFA	Taxation of financial arrangements
TPB	Tax Practitioners Board
TPRS	Taxable Payments Reporting System
TR	Taxation Ruling
TSA	Tax sharing agreement
UN	United Nations
UN MTC	United Nations *Model Tax Convention Between Developed and Developing Countries*
UPE	Ultimate parent entity
US MTC	United States *Model Income Tax Convention*
UTPR	Undertaxed payment rule
VAT	Value added tax
VCA	*Venture Capital Act 2002*
VCLP	Venture capital limited partnership
VCMP	Venture capital management partnership
WET	Wine equalisation tax
WETA	*New Tax System (Wine Equalisation Tax) Act 1999*
WETICA	*A New Tax System (Wine Equalisation Tax Imposition—Customs) Act 1999*
WETIEA	*A New Tax System (Wine Equalisation Tax Imposition—Excise) Act 1999*
WETIGA	*A New Tax System (Wine Equalisation Tax Imposition—General) Act 1999*

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PART A

INTRODUCTION TO TAXATION AND AUSTRALIA'S TAX SYSTEM

1 TAXATION PRINCIPLES AND THEORY

[1.1] Introduction

Taxation is an ancient and ubiquitous concept that forms one of the central pillars around which civilisation has been built. In his 1925 treatise, *Taxation in Australia*, Stephen Mills noted that one of the certainties of history is that 'no structural society has ever arisen without taxation'. Taxation plays a critical role in society and has the capacity to affect the lives of everyone within it. As the United States Supreme Court observed in *Dobson v Commissioner* (1943) 320 US 489 (at 494–495): 'No other branch of law touches human activities at so many points'.

History vividly highlights that while taxation has brought great prosperity to nations, it has also fuelled bitter conflicts. Taxation can invoke passionate emotions in people about their rights and obligations and is a topic on which rational people often have diametrically opposed views. Ultimately, taxation is a powerful instrument that governments use to fund their activities and shape their economies. Without it, they would not be able to survive. While the features of taxation have evolved considerably over the years, taxation remains a fundamental characteristic of the modern nation state and an integral part of the overarching architecture that lies behind the economic systems of every developed country in the world. Its inescapable and pervasive nature was recognised long ago by Benjamin Franklin who famously wrote: 'In this world nothing can be said to be certain but death and taxes'.

What is taxation?

The *Oxford English Dictionary* defines a 'tax' as:

> A compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc.

One of the earliest Australian judicial pronouncements on the notion of taxation is found in *R v Barger* (1908) 6 CLR 41, where Griffith CJ, Barton and O'Connor JJ said (at 68):

> The primary meaning of 'taxation' is raising money for the purposes of government by means of contributions from individual persons.

Taxes come in a variety of forms and are also known by different names, such as duties, levies, tariffs and charges. The etymology of the word 'tax' can be traced to the Latin word *taxare*, meaning evaluate, estimate, or assess.

Taxation is the principal means by which governments raise revenue. Without taxation, governments would be unable to finance their operations or deliver the many public goods and services they provide to the community. Other ways that governments can raise revenue include:

- charging fees for rendering services or granting licences
- imposing fines for breaches of the law, and
- generating returns from their assets and investments.

Taxes are a special kind of impost that can be distinguished from fees and fines on the basis that they are imposed on the community at large and are not specifically connected with the receipt of any particular services, the granting of any special rights or privileges, or the breach of any law by the payer. Taxpayers are compelled by law to pay taxes and are obliged to do so even though they may not necessarily receive any direct benefits in return. In *Architecture of Australia's Tax and Transfer System*, the Australian Treasury recognised (at 11):

> A core characteristic of a tax is that there is no clear and direct link between the payment of the tax and the provision of goods and services to the taxpayer. The funds that the government raises from taxes may be used to provide goods or services to the community as a whole, and this may provide a benefit to the taxpayer, but the payment will still be considered a tax if there is no direct relationship between the amount of the payment and the benefit to the taxpayer.

Similar observations were made by the Australian Bureau of Statistics in *Australian System of Government Finance Statistics: Concepts, Sources and Methods*, where it is noted that although 'taxpayers expect provision of government services in return for the taxes they pay', there is 'usually no direct link between taxes paid by an individual taxpayer and the government services consumed by that taxpayer'.

What is taxation law?

Taxation law is the body of law that governs an entity's liability to pay tax to the government. It covers the rules that establish the incidence of tax and the tax base (ie who and what is subject to tax). It also extends to the rules relating to the administration and enforcement of the tax system, including the rules dealing with the collection and recovery of tax.

Australia, like other developed countries, has a vast body of taxation law. The primary source of this law is found in the many thousands of pages of tax legislation enacted by the Commonwealth, state and territory parliaments and the many hundreds of cases handed down by the courts and tribunals that have interpreted the statutory provisions over the years. Australia's extensive body of statute and common law is complemented by a broad array of administrative rulings, guidelines, and practice statements issued by the relevant revenue authorities.

Australia's taxation laws operate subject to the *Commonwealth Constitution* and the terms of its international treaties, including many Double Taxation Agreements ('DTAs') entered into with foreign countries.

Why study taxation law?

Taxation law is an extremely important and useful area of law to study, but is also incredibly challenging because of its voluminous nature, technical complexity and constant reform. Taxation law is particularly worth studying because of its wide social and economic impact and its practical relevance to all sorts of commercial transactions. It also raises interesting theoretical, ethical and philosophical issues, making it a discipline worth examining for purely academic purposes.

Taxation law does not operate in a vacuum. It intersects with many other areas of law, including aspects of commercial law, property law, corporate law and administrative law. Taxation is the major source of finance for most governments, and it affects all sorts of employment, business and investment dealings. In the commercial world, taxation is of great importance as it heavily influences the ways that entities are structured, investments are held and arrangements are financed. It is, frankly, impossible to properly appreciate how the government and the economy function without understanding basic notions of taxation. Each day, many millions of transactions are entered into that have taxation consequences.

Taxation is also a topical current affairs issue that features prominently in the media—stories relating to taxation appear frequently in daily newspapers and news broadcasts. The financial press, in particular, is peppered with articles on taxation. The pervasive nature of taxation means that it intrudes on many aspects of everyday life. It is therefore not surprising that people have strong and passionate views about taxation and that it is a perennial political issue that has the capacity to polarise public opinion. History vividly illustrates that taxation policies have the capacity to make or break governments and that good tax policies can lead to economic prosperity, while bad tax policies can result in social and political unrest.

On a personal level, having knowledge and skills in taxation law can be beneficial as it opens up many employment opportunities in the tax profession (in both the public and private sectors) as well as in related fields of law, accounting, business and finance. Understanding how the tax system works helps people run their businesses, plan their personal finances and comply with their reporting and other obligations under the law. Taxation awareness also provides people with a better appreciation of political and economic issues and enables them to engage more effectively in public debate in these areas.

What is the aim of this book?

This book introduces the policy, principles and practices that underpin the Australian tax system. It is designed to be used by students studying taxation law and as a general reference guide for taxation academics, researchers and practitioners. The aim of the book is to explain the foundations of Australian taxation law in a clear, concise, straightforward and structured manner without oversimplifying the law or avoiding discussion of complex concepts that have important practical ramifications.

More than 100 different taxes are levied in Australia. This book focuses on Commonwealth taxes, particularly income tax, goods and services tax ('GST'), fringe benefits tax ('FBT') and a range of superannuation taxes. It also touches on some of the main state, territory and local government taxes.

Although the book is designed as a legal text, it does not just present the reader with a bunch of technical rules. The objective is to place taxation law in its proper commercial context and to synthesise the legal analysis with discussion of related social, political, economic and policy issues. By weaving in these broader perspectives, taxation law can be better understood, and its practical relevance better appreciated.

How is this book structured?

This book is divided into 13 parts, consisting of 41 chapters. Each chapter commences with a broad introduction to the topics covered, followed by a detailed discussion of the core legal principles. Although the chapters deal with discrete topics, they are closely linked and comprehensively cross-referenced to show how the rules interrelate. The chapters are peppered with diagrams, tables and examples to synthesise the law, explain complex concepts and illustrate practical situations. There is also a set of questions at the end of each chapter that test many of the key issues covered.

The book is supported by online resources, available on the Cambridge University Press Higher Education website at www.cambridge.org/highereducation/isbn/9781009458832/resources. Student resources are freely available and include a list of references to selected government reports, taxation rulings, books and articles for those interested in conducting further research. In addition, a set of over 1,000 PowerPoint slides that are directly cross-referenced to topics covered in the chapters are available to lecturers who use the book, along with answers and worked examples to all end-of-chapter questions.

Conceptual framework for studying taxation law

Before launching into a detailed examination of how Australia's tax system works, it is useful to first establish a conceptual framework for studying taxation law. In particular, it is important to recognise the historical setting in which taxes have operated and the kinds of taxes that have been levied by governments over the years. It is also important to understand the basic structural features of taxes as well as the jurisdictional constraints and international settings in which they operate. As taxation has wide-ranging social, political, economic and policy dimensions, these aspects also need to be considered in parallel with any legal analysis. This chapter canvasses some of these broader issues and lays the theoretical foundations for the detailed technical discussion contained in the rest of the book.

[1.2] Historical background

Taxation is deeply rooted in history. Records of taxation date back in antiquity to the times of the earliest civilisations. Evidence of taxation can be found on an inscription on an ancient Sumerian tablet from the city of Lagash (located in what is now Iraq) which warns: 'You can have a Lord, you can have a King, but the man to fear is the tax collector'. The Bible also contains many notable references to taxation. The following passage from Paul's *Epistle to the Romans* (13:7–8) is a good example:

> Pay to all what is owed to them: taxes to whom taxes are owed, revenue to whom revenue is owed, respect to whom respect is owed, honour to whom honour is owed.

While it is impossible to precisely determine when the first taxes commenced to be levied, it is clear that by the times of the ancient Egyptians, taxation was already well established in society. During the reign of the Pharaohs, taxes were collected by public officials, called *scribes*, on behalf of the Pharaoh's chief minister, known as the *vizier*. Taxes were paid in kind and levied on items such as grains from harvests, livestock and cooking oil. The ancient Egyptians also paid taxes with their own labour by working on construction projects like the pyramids and serving in the army.

In ancient Greece, the concept of benefaction was deeply rooted in society and the wealthy proudly made voluntary payments, known as *liturgies*, to fund public projects. In times of crisis, such as war, an additional wealth tax, known as *eisphorá*, was levied. The ancient Greeks also collected customs duties at their harbours and levied excise duties on products such as olive oil. They also paid taxes on their slaves and levied a per capita 'poll tax', known as *metoikion*, on foreigners.

The ancient Chinese also had their own unique tax system. Various kinds of agriculture, land and poll taxes were imposed during the Shang, Zhou, Qin and Han dynasties. It was usually the role of

local magistrates, who were appointed by the imperial court, to collect taxes in their regions. Like the ancient Egyptians, the ancient Chinese also paid taxes with their labour by working on projects like the Great Wall and providing military service to their emperors.

During the Roman Empire, customs duties (*portoria*), sales taxes (*centesima rerum venalium*), land taxes (*tributum soli*) and poll taxes (*tributum capitis*) all featured prominently. In addition, there were also inheritance taxes (*vicesima hereditatium*) and taxes on owners who freed their slaves (*vicesima libertatis*). Taxation was largely decentralized and many early taxes were collected by *publicani* who were professional 'tax farmers' that bid at auctions for the right to collect taxes in the provinces and had the right to retain any excess for themselves.

In medieval England, the main taxes were property taxes, such as the *geld* and *tallage*, and death and inheritance taxes, such as the *heriot* and *relief*. These taxes were imposed alongside other peculiar feudal taxes, such as the *scutage* (which was payable by knights to commute military service owed to their lords) and the *merchet* (which was payable by serfs for a woman's right to marry). The famous *Domesday Book*, commissioned by William the Conqueror in 1086, was the first recorded survey of property holdings in England and was expressly undertaken for the purpose of assessing taxes.

Although taxes are nowadays usually paid in money, this has not always been the case, especially before the wide use of currency as a medium of exchange. In the Middle Ages, for example, it was common for peasants to pay taxes by contributing a percentage of their crops and agricultural produce to their landlords. This often left the poor with little to live off and even led to uprisings like the English Peasants Revolt of 1381. It also contributed to the creation of legendary stories, such as that of Robin Hood who, with his Merry Men from Sherwood Forest, stole back taxes collected by the Sheriff of Nottingham so that they could be returned to the poor. Another well-known tale is that of Lady Godiva who rode naked on horseback through the centre of town to persuade her husband, Leofric, the Earl of Mercia, to lower taxes on the people of Coventry.

During the Middle Ages, taxes were also levied by religious orders. The ancient *tithe*, which can trace its origins back to biblical times, is an example of such a tax. This tax derives its name from the old English word for 'one-tenth', as it originally involved a contribution of one-tenth of a person's earnings (usually taken from the produce from their land). People who did not pay the *tithe* to the Catholic Church were at risk of excommunication. While nowadays it is usually only governments that raise taxes, it is interesting to note that religious taxes still exist in some places. An example is the *Kirchenbeitrag* levied by the Catholic Church on its members in Austria.

Over the years, almost every kind of product has been taxed in some form or another, including even the most basic commodities, such as sugar and salt. The fact that taxes can be imposed on virtually anything is vividly illustrated by bizarre taxes such as the urine tax (*vectigal urinae*), which was first imposed by the Roman emperor Nero, and later his successor Vespasian, in the first century AD. Urine was a valuable commodity as it contained ammonia and could be used in a number of chemical processes, including cleaning garments, tanning leather and fertilizing crops. The tax was payable on the purchase of urine collected from public sewers. Vespasian's son, Titus, allegedly criticised his father for imposing such a disgusting tax, to which his farther famously responded by holding up a gold coin and remarking '*pecunia non olet!*' (money does not stink!).

Another colourful illustration of an unusual tax is the beard tax levied in Russia during the time of Peter the Great. The tax required men to pay for the right to have a beard and was part of the Tsar's efforts in modernising Russian society to fit more into line with Western Europe. A token was issued to those who paid the tax (which could be as high as 100 rubles for wealthy merchants). Those who refused to pay the tax or produce a token could be forcibly shaved in public.

The English window tax levied between 1696 and 1851 is yet another peculiar tax. The tax was imposed on property owners and was payable at rates that varied according to the number of windows in a dwelling. The aim was to tax the wealthy, who were more likely to have larger houses with more windows. Critics, however, cynically viewed it as a tax on daylight, and some property owners

simply bricked up their windows to avoid the tax. Earlier on, between 1662 and 1689, a hearth tax (also known as a 'chimney tax') was levied in England at the rate of two shillings for every hearth or stove in a dwelling. The origins of the hearth tax date back to the Byzantine Empire where a similar tax, known as *kapnikon*, was levied on households.

History contains many examples that demonstrate the effects taxation can have on behaviour. A good illustration is the Dutch property tax levied during the 16th and 17th centuries, which was calculated according to the width of buildings. Not surprisingly, this led to the construction of many narrow multi-storey houses that are characteristic of the ones still seen today alongside the canals in Amsterdam.

It is fascinating to note that there have even been great archaeological discoveries related to taxation. The most notable example is the famous Rosetta Stone discovered by a French soldier serving under Napoleon near the Nile. The Rosetta Stone, which has been prominently displayed at the British Museum since the early 1800s, contains inscriptions in Egyptian hieroglyphics, Demotic script and ancient Greek. The inscriptions were the key to deciphering hieroglyphics, which ultimately unveiled to the modern world many of the hidden mysteries of ancient Egypt. Less well known, however, is the fact that the Rosetta Stone contained a decree recording a tax immunity granted by King Ptolemy V to the priesthood. This led Alvin Rabushka from the Hoover Institute at Stanford University to quip: 'Which is why, of course, it was engraved in stone and not written on papyrus.'

[1.3] Kinds of taxes

Income tax

The most important and widely imposed modern tax is income tax. As its name suggests, income tax is a tax on income (ie earnings). Income tax was first introduced in Great Britain in 1799 by Prime Minister William Pitt to fund the war against Napoleon. The tax was repealed for a short time in the early 1800s following the signing of the *Treaty of Amiens*. However, renewed fighting resulted in Henry Addington, who had replaced William Pitt as Prime Minister, reintroducing income tax in 1803. Income tax continued to be levied until 1816 (one year after Napoleon's defeat by the Duke of Wellington at the Battle of Waterloo). It was subsequently reintroduced for budgetary reasons in 1842 by Robert Peel and it has continued to be levied in the United Kingdom ever since.

The introduction of income tax was radical and controversial at the time. Taxing income was regarded by many as an inappropriate intrusion by government into the personal affairs of its citizens, and was criticised as being a tax on the fruits of labour that discouraged work. Despite these objections, income tax was found to be an effective and practical way to raise revenue. Personal income tax is now levied by almost every country in the world (some notable exceptions include the Bahamas, the United Arab Emirates, the Cayman Islands, Oman, Qatar, Monaco, Brunei and Vanuatu).

One of the first countries to follow the United Kingdom in imposing income tax was the United States, which levied income tax from 1862 to 1872 to pay for the Civil War. Congress reintroduced income tax in 1894. However, the United States Supreme Court held in *Pollock v Farmers' Loan & Trust Co* (1895) 157 US 429 that the legislation imposed a 'direct tax' and therefore breached the provisions of the Constitution, which required direct taxes to be apportioned among the states. This eventually led to the *Sixteenth Amendment to the Constitution* in 1913, which allows Congress to levy income tax without apportionment among the states. Income tax is the bedrock of the United States tax system and has been the largest single source of federal revenue for many decades. Income tax is also levied by more than 40 states and is, subject to certain limitations, generally allowed as a deduction in calculating federal income tax.

In Australia, income tax was introduced by the Commonwealth in 1915 to support the country's World War I effort. Earlier on, the colonies (which subsequently became the states) had already

introduced their own income taxes. The Commonwealth and the states levied income tax in parallel until the middle of World War II, when the Commonwealth took over the income tax field as a consequence of the introduction of its Uniform Tax Scheme [4.2]. Ever since, income tax has remained Australia's major source of federal tax revenue.

Although Australia was influenced by the United Kingdom's income tax laws, Australia did not adopt the United Kingdom's 'schedular' model for its legislation. Under the United Kingdom legislation amounts were only taxed if they fell within one of six schedules. The schedules covered items such as rents from land and buildings (sch A), farming profits (sch B), interest and annuities from public funds (sch C), trading and professional profits and income not covered by the other schedules (sch D), employment income, annuities and pensions (sch E) and dividend income (sch F). Each schedule had its own computation rules. As a result, different rates of tax could be charged on different categories of income, and deductions relating to one category of income could not be applied against income of another category.

By contrast, Australia's income tax legislation does not use schedules to assess taxpayers. Instead, income tax is simply levied on a taxpayer's 'taxable income', which is calculated as the taxpayer's 'assessable income' less 'deductions' [8.4]. Different rates of tax do not apply to different categories of income and there are no general quarantining rules which specify that deductions relating to particular categories of income can only be applied against income of the same category. Australia's income tax legislation is therefore based on a 'global' model, as it generally allows all kinds of income and deductions to be set off against each other. For historical and constitutional reasons, Australia's income tax laws are not all contained in one Act. Instead, there are several distinct pieces of income tax legislation, including the *Income Tax Assessment Act 1997* ('*ITAA97*') and the *Income Tax Assessment Act 1936* ('*ITAA36*'), which determine how a taxpayer's taxable income is calculated, and the *Income Tax Act 1986* ('ITA') and the *Income Tax Rates Act 1986* ('*ITRA*'), which impose income tax and set out the rates of tax payable [8.2].

Despite the underlying structural differences between the Australian and United Kingdom income tax legislation, Australia has nevertheless borrowed certain concepts from the United Kingdom. Most importantly, like the United Kingdom, Australia distinguishes between 'income' and 'capital' amounts, and the Australian courts have drawn considerably on the United Kingdom jurisprudence in this area to help characterise various receipts. Australia also followed the United Kingdom in introducing a statutory CGT regime, which forms an integral part of its overarching income tax system [17.1].

Consumption taxes

In addition to income tax, most countries also impose some form of consumption tax. A consumption tax is a tax whose economic incidence falls on the consumer (eg through the increased cost of goods or services). It is the antithesis of income tax, as it taxes consumption rather than earnings.

The most widely encountered consumption tax is value added tax ('VAT'). VAT was first imposed in France in 1954 and has been adopted throughout the European Union ('EU'). It is a requirement for EU membership that Member States impose VAT at a minimum rate of at least 15% (reduced rates are allowed for certain supplies).

Australia began to levy its own version of VAT, known as goods and services tax ('GST'), on 1 July 2000 [7.1]. Interestingly, it was the last of the Organisation for Economic Cooperation and Development ('OECD') countries to do so (apart from the United States, which still does not have a VAT/GST).

VAT/GST is directed at taxing the value that has been added to the supply of goods and services. Registered entities (which include most entities that carry on business) charge VAT/GST on supplies they make and are generally allowed credits for VAT/GST charged on their acquisitions. The cost of VAT/GST is ultimately borne by end consumers who are not registered and, therefore, not entitled to credits for the VAT/GST charged on their acquisitions.

VAT/GST may be contrasted with sales tax, which is a much older and more traditional form of consumption tax. Sales tax is imposed on the sale of goods and is payable by the seller, who adds the tax to the price charged for the goods so that the burden of the tax is ultimately passed on to the purchaser. In the United States, many states impose retail sales tax. To ensure that this tax is charged only on retail sales and not on wholesale sales, registered persons who acquire goods for resale (ie not for their own consumption) provide a resale certificate to the seller, which enables them to acquire the goods free of sales tax.

In 1930, Australia introduced a wholesale sales tax. The tax was levied at the last point of wholesale sale of goods (eg from wholesaler to retailer). From the point of view of end consumers, wholesale sales tax was a 'hidden tax', as it was charged by wholesalers rather than retailers. The cost of the tax was nevertheless embedded in the price of the goods charged by retailers. As a result of the introduction of GST, wholesale sales tax was repealed from 1 July 2000. One of the main reasons for replacing sales tax with GST was that GST is levied on a much broader base, as it applies to the supply of goods and services (not just to the sale of goods).

Other taxes

A wide range of other kinds of taxes are also levied around the world. For example, many countries impose customs duties (on the importation and exportation of goods) and excise duties (on the production and manufacture of goods).

It is also common for countries to levy land taxes (on the ownership of real estate) and estate duties (on the assets of deceased estates). These taxes are forms of wealth taxes as they are levied on the value of a person's property. There are also several kinds of employment taxes, including payroll taxes (on the payment of wages) and fringe benefits taxes (on the provision of non-salary remuneration). In addition, there are many varieties of transactional taxes, such as stamp duties (on the execution of certain documents), gambling taxes (on betting at casinos, races and lotteries), financial taxes (on bank deposits and withdrawals), bed taxes (on accommodation provided in hotels) and road taxes (on the use of highways).

Some countries also impose taxes on profits from the exploitation of their natural resources. In 1987, Australia introduced a petroleum resource rent tax ('PRRT') on profits from petroleum projects [4.3]. In 2012, the Gillard Labor Government introduced a minerals resource rent tax ('MRRT') on profits from iron ore and coal mining projects [5.6]. At the same time, it also introduced a carbon tax on large greenhouse gas emitters to combat climate change [5.6]. The Abbott Liberal–National Coalition Government, however, abolished both the MRRT and carbon tax in 2014.

Mix of taxes

As each nation has the sovereign right to determine its own tax system, virtually anything can be made the subject of taxation. In *R v Barger* (1908) 6 CLR 41, Griffith CJ, Barton and O'Connor JJ recognised (at 68):

> The power to tax necessarily involves the power to select the subjects of taxation. In the case of things the differentiation or selection is, in practice, usually made by reference to objective facts or attributes of the subject matter, so that all persons or things possessing those attributes are liable to the tax. The circumstance that goods come from abroad or from a particular foreign country, or that particular processes or persons have been employed in their production, or that they possess certain ingredients, are instances of attributes which have been chosen for the purpose of differentiation.

Ultimately, each country determines who and what it subjects to tax and the particular attributes of its tax system. Each country inevitably adopts its own mix of taxes designed to suit its particular needs

and circumstances. While there are many similarities between tax systems around the world, there are also many differences in the ways that taxes can operate, making each country's tax system unique.

[1.4] Functions of taxation

Taxation's revenue-raising function

The most important and immediately recognisable role of taxation is its revenue-raising role. It is widely acknowledged that without taxation, a government would not be able to properly function. As the United States Supreme Court said in *Nicol v Ames* (1899) 173 US 509 (at 515):

> The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to a natural man. It is not only the power to destroy, but the power to keep alive.

At the most basic level, taxes redirect economic resources from citizens to governments for use in their spending programs. Taxation therefore involves diverting wealth from the private sector to the public sector. Governments use revenue raised from taxes to fund the public service and defence force, to provide a legal system and law enforcement, to construct roads and airports, to run hospitals and education institutions, and to pay social security benefits. Without taxation, governments could not provide their citizens with the many kinds of goods and services that they have come to expect. Government spending is often justified on the basis that in a capitalist society, certain 'merit' goods and services may not necessarily be adequately provided by the free-market, and it is therefore both necessary and appropriate for the government to intervene and provide these things to make society a better place.

Taxation's social and political functions

It is important to understand that taxation is a powerful political engineering device that governments can use as either a 'carrot' or a 'stick' to promote their objectives. For instance, in Australia, the Federal Government provides a range of tax concessions under various 'tax expenditure programs' [1.5] to encourage particular kinds of investment, such as private retirement savings under the superannuation regime [19.1]. On the other hand, it imposes excise duties on cigarettes, not only to raise revenue, but also to discourage smoking and thereby reduce the nation's health costs. Similarly, it imposes the MLS on high-income earners who do not have private health insurance to encourage them to take out appropriate cover in order to lessen the burden on the publicly funded health system [8.8]. The benefit of a concession or the burden of taxation can thus be a useful tool in sculpting social behaviour.

Taxation's economic functions

Taxation also has important microeconomic ramifications. For instance, taxing particular goods adds to their cost, making them more expensive than similar kinds of untaxed goods. Taxation can therefore be used to modify consumer behaviour by encouraging spending on one product rather than another. Governments around the world have frequently used taxation to protect their domestic industries by taxing imported goods more heavily than locally produced goods. This provides the local goods with a competitive advantage over the imported goods which, in turn, encourages spending on local products. A government's ability to tax goods will, of course, be subject to its obligations under any international agreements it has entered into (eg under the World Trade Organization's General Agreement on Tariffs and Trade).

Governments also often use taxation as a macroeconomic device to speed up or slow down their countries' economies. Higher taxation usually leads to less spending as taxpayers have less

disposable income. This typically has a deflationary effect on the economy. Lower taxation, on the other hand, usually results in increased spending as taxpayers have more disposable income. This, in turn, can have an inflationary effect on the economy.

Taxation's redistribution function

Taxation can also operate as a mechanism for creating economic equality between citizens. It can be used by governments to make their citizens richer or poorer. A tax system that taxes the rich so that the government can give to the poor promotes a more egalitarian society, redistributing wealth among citizens, which can result in a more level 'playing field'.

A more cynical way of looking at taxation is that it is simply a form of state-based confiscation which interferes with individual freedoms and rights. Some people complain that they pay a lot of tax, but get little direct benefits in return from the government. However, this kind of argument fails to recognise the fact that taxation enables a government to provide a range of services that can benefit society as a whole, and therefore make the state a better place to live. For instance, although some taxpayers might not directly use the public health system, they indirectly benefit from it as other members of society are cared for and public health, in general, is protected. Likewise, people without children should not complain that their taxes are being used to fund schools and universities, as public education has broad-ranging spillover benefits for the community.

Without taxation, living conditions within a country would be quite different. It would be up to each person to provide for themselves, since no one could rely on state-funded goods and services. Society would be more polarised, and wealth more concentrated. Those less able to support themselves would suffer, and the community as a whole would arguably be worse off.

Perspectives on taxation

Ultimately, taxation is one of the greatest powers a government has over its citizens. From a government's perspective, taxation enables the state to benefit from the fortunes of its citizens and the enterprises that they carry on. From a citizen's perspective, taxation is a cost of undertaking transactions, owning property, carrying on business and earning income. While taxation is one of the major factors that can affect a citizen's wealth, it also pays for the privileges associated with the kind of society in which they live. Accordingly, although taxation has been cynically described by some as a form of 'legalised robbery', it is more appropriate to view taxation, as Sabine observed in *A Short History of Taxation*, as 'part of the price of civilisation'. In the words of Justice Oliver Wendell Holmes (Jr) in *Compania General de Tabacos De Filipinas v Collector of Internal Revenue* (1927) 275 US 87 (at 100): 'Taxes are what we pay for civilized society.'

[1.5] Tax expenditures

In addition to its obvious revenue-raising function, governments also use their tax systems to provide incentives and financial assistance. Professor Surrey, in his seminal work, *Pathways to Tax Reform: The Concept of Tax Expenditures*, identified this aspect of the tax system as the system of 'tax expenditures'. Surrey recognised that tax systems contain two conceptually and functionally distinct components. One of these comprises the provisions that make up the 'normative tax structure' (ie the 'benchmark tax system' for collecting revenue) and the other comprises the provisions designed to effect government spending (ie the system of 'tax expenditures').

Tax expenditures may in turn be divided into two broad categories:

- 'tax incentives' (designed to induce certain activities or behaviour), and
- 'tax concessions' (designed to provide welfare assistance to those in need).

Tax expenditures are deviations from the benchmark tax system that are designed to benefit targeted taxpayers. They can be delivered in a number of ways. For instance, under the income tax system, tax expenditures may be provided to taxpayers by granting them special tax exemptions, tax deductions, tax offsets or reduced tax rates [27.1]. In addition, taxpayers may be provided with timing benefits. For example, they may be allowed to defer bringing income to account until a future year or be allowed to bring forward deductions into the current year. They may also be granted additional time to pay tax, allowing them more time to use the money they have earned.

Tax expenditure reporting

The Commonwealth Government has traditionally published annual *Tax Benchmarks and Variations Statements* (formerly known as *Tax Expenditures Statements*). In 2023, it published its *Tax Expenditures and Insights Statement*. These publications provide detailed information on the Government's tax expenditures as required under s 16 of the *Charter of Budget Honesty Act 1998*. They are designed to increase transparency and allow greater scrutiny of the tax system. In particular, they provide data on tax benchmarks and variations to such benchmarks. Tax benchmarks represent the standard taxation treatments that apply to similar taxpayers or activities. Special tax treatments may give rise to a positive or negative variation from the benchmark. A positive variation reduces tax payable relative to the benchmark. A negative variation increases tax payable relative to the benchmark. Tax incentives and concessions are positive variations as they reduce the tax that would otherwise be payable by taxpayers under the benchmark tax system.

A 'revenue forgone' approach is generally used to measure the cost of positive variations. This approach essentially compares the difference in tax paid as a result of the provision of a particular tax concession relative to the tax that would have been paid under the benchmark tax system if the tax concession had not been available (assuming taxpayer behaviour remained unchanged). A 'revenue gain' approach is also sometimes used to measure the cost of certain tax concessions. This approach takes into account potential changes in taxpayer behaviour that would arise if a tax concession were abolished.

Tax expenditure programs

Over the years, tax expenditures have become more prevalent in Australia, and several intricate tax expenditure programs have been developed by the Federal Government. Some of the main tax expenditure programs examined in this book include:

- the superannuation program (which provides tax incentives to encourage retirement savings) [19.2]
- the early stage investors ('ESI'), pooled development fund ('PDF'), venture capital limited partnership ('VCLP') and early stage venture capital limited partnership ('ESVCLP') programs (which provide tax incentives to encourage venture capital investment) [27.2]–[27.4]
- the research and development ('R&D') program (which provides tax incentives to encourage research and development activities) [27.5], and
- the film production program (which provides tax incentives to encourage Australian film production) [27.6].

The rationale for introducing these programs is that they address market failures and promote private investment in areas considered to be publicly desirable.

Tax expenditures are also provided to support specific categories of taxpayers. For instance, to support farmers, the Government provides a range of tax incentives to people who carry on 'primary production businesses' [25.2]. Likewise, to support taxpayers who operate small businesses, a range of special tax concessions are provided to small business entities ('SBEs') [8.7].

Tax expenditures may also be used to achieve broader economic objectives. For example, to stimulate economic activity during the global financial crisis ('GFC') and the COVID-19 pandemic, the Government provided a range of temporary tax incentives [1.13].

Tax expenditures clearly come at a cost as governments collect less revenue from those taxpayers who benefit from the concessions. Australia's largest tax expenditures are the CGT main residence exemption [17.11] and the superannuation concessions [19.2]. Together, these concessions make up more than half the estimated cost of all Australia's tax expenditures.

Tax expenditures versus direct spending

It is important to realise that there is arguably no difference between providing tax concessions and providing subsidies or grants—both are forms of government spending. Collecting less tax because a concession is in place ultimately achieves the same result as collecting ordinary amounts of tax under the benchmark tax system and then redistributing the revenue as subsidies or grants. While the subsidy or grant is a 'direct' form of government spending, tax expenditures are an 'indirect' form of government spending.

Arguments for and against tax expenditure programs

Advocates of tax expenditure programs argue that they are efficient as they overcome 'double handling' issues (ie the government does not need to first collect tax and then distribute it as a subsidy or grant). Instead, the government simply collects less tax from those who enjoy the benefit of the relevant tax expenditure. However, others argue that such programs are often poorly targeted and can provide benefits to unintended recipients. In this regard, it is sometimes said that the tax law is a 'blunt' instrument for achieving a government's policy objectives.

Furthermore, where tax expenditures are provided in the form of income tax exemptions or deductions, the value of such concessions differs between taxpayers depending on their respective tax rates. Taxpayers subject to higher tax rates stand to benefit more than taxpayers on lower tax rates, and this produces what Surrey referred to as an undesirable 'upside-down effect'.

Another significant argument against tax expenditures is that they add considerably to the volume and complexity of the tax law. Tax expenditures create exceptions to general rules, and these exceptions inevitably increase the size of the tax legislation and reduce its simplicity. The fact that tax expenditures are 'hidden' in the tax legislation also means that they may be confused with the provisions that make up the benchmark tax system and may be overlooked when reforms are being considered. Many critics of tax expenditures argue that because they are embedded within the tax law, they are less visible and therefore often escape the same rigorous scrutiny that other government spending programs experience. As a consequence, their effectiveness in achieving policy objectives may not be as closely monitored and this can result in inefficient and costly programs remaining in existence.

[1.6] Structural features of taxes

Although taxes vary greatly in their design and coverage, most taxes share four basic structural features:

1. **Taxpayers**. Each tax regime subjects particular 'taxpayers' to tax. Taxpayers are the legal entities (eg individuals or companies) who are liable to pay the tax and who are penalised if it is not paid. In Australia, income tax is payable by 'income earners' [8.4], GST is payable by 'suppliers' and 'importers' [7.3] and FBT is payable by 'employers' [18.2].
2. **Tax base**. Each tax regime has its own 'tax base'. The tax base consists of some form of property, transaction, activity or concept upon which the tax is imposed. In Australia, income tax is

imposed on 'taxable income' [8.4], GST is imposed on 'taxable supplies' and 'taxable importations' [7.3] and FBT is imposed on 'fringe benefits taxable amounts' [18.2].

3. **Tax periods**. Each tax regime has its own 'tax periods'. Taxpayers are required to pay tax on amounts that fall within the tax base during the relevant period. The tax period can be of any length of time (eg a month, a quarter, or a year). In Australia, the income tax period is the 'income year' (ie the 'financial year'—1 July to 30 June) [8.3]. Monthly or quarterly tax periods apply in the case of GST [7.4]. An annual period that runs from 1 April to 31 March applies in respect of FBT [18.2].
4. **Tax rates**. Each tax regime has its own 'tax rates' which are applied to the relevant tax base. Depending on the nature of the tax and the kind of taxpayer involved, tax rates may be set at a single rate (ie flat rate) or at differing rates (eg rates that vary with the level of the tax base). In Australia, companies generally pay income tax at the flat rate of 30%, unless they are 'base rate entities', in which case they pay income tax at the flat rate of 25% [22.3]. Individuals, on the other hand, pay income tax at progressive 'marginal rates' of up to 45%, and they are also generally required to pay the Medicare levy at the rate of 2% ('ML') if they are residents [8.8]. GST is imposed at a flat rate of 10% [7.3]. FBT is imposed at a flat rate of 47% [18.2].

Proportional, progressive and regressive taxes

Taxes may be described as being either 'proportional', 'progressive' or 'regressive':

- **Proportional taxes**. These taxes (also known as 'flat' taxes) are imposed at the same rate on all taxpayers. In Australia, the GST is an example of a proportional tax—it is levied at a flat rate of 10%.
- **Progressive taxes**. These taxes are imposed at rates that increase with the amount of the tax base. In Australia, income tax is an example of a progressive tax—individuals pay income tax at rates that increase depending on the amount of their taxable income.
- **Regressive taxes**. These taxes are imposed at rates that decrease with the amount of the tax base and are quite rare.

Direct and indirect taxes

In describing taxes, economists often distinguish between 'direct' and 'indirect' taxes:

- **Direct tax**. A tax is a direct tax if the economic burden of the tax is borne by the person who pays the tax.
- **Indirect tax**. A tax is an indirect tax if the person who pays the tax is able to pass the economic burden of the tax on to third parties.

The cost of income tax is borne by the person who earns the income and is therefore a direct tax. In contrast, the cost of GST, although paid by the supplier of goods or services, is ultimately borne by the consumer through the increased price charged for those goods or services by the supplier and is therefore an indirect tax.

[1.7] Tax systems and national stability

The design of a country's tax system and the way taxation revenue is collected and redistributed reflect much about a country's values and the demands and expectations of its citizens. The amount of taxes collected from a citizen less the amount of benefits the citizen obtains from the redistribution of taxation revenue ultimately affects the citizen's wealth and prosperity. The 'tax-transfer' system therefore has a direct bearing on living standards.

In designing tax systems, governments obviously need to focus on ensuring that they collect the desired amount of revenue. However, they also need to consider a broad range of social, economic

and political factors to ensure that this is done in the most effective way. As the Finance Minister of King Louis XIV, Jean Baptiste Colbert, cynically observed:

> The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing.

It is widely accepted that a country's tax system underpins its social, economic and political stability. Governments that impose taxes that are perceived to be 'unfair' are often faced with political strife. At the extreme, even wars have erupted over disputes about taxation. The famous phrase 'no taxation without representation' encapsulated the complaints of the American colonists in the mid-1700s. The colonists argued that taxes were imposed by Great Britain without their consent as they were not represented in the British Parliament. One of the events that sparked the American Revolution was the Boston Tea Party in 1773, which was a revolt against Great Britain over its import tariffs.

Taxation was also a contributing factor to the demise of the *Ancien Régime* in France, where the cost of wars and extravagant spending by the monarchy over the years had put pressure on the royal budget. During the *Ancien Régime*, society was divided into three classes: the 'first estate' (the clergy), the 'second estate' (the nobility) and the 'third estate' (the commoners). It was the third estate that bore the brunt of taxation, as the first and second estates were largely exempt from most taxes. One of the most unpopular taxes was the *taille*, which had been introduced by Charles VII in the fifteenth century to pay for the Hundred Years' War. The *taille* was a land tax payable by peasants and therefore fell disproportionately on the poorest members of society. French citizens were also subject to the *capitation*, which was a poll tax levied on all adults other than the clergy. Another unpopular tax was the *vingtième*, which was introduced by Louis XV in 1749 and levied at the rate one-twentieth of a person's income. The *taille*¸ *capitation* and *vingtième* were all abolished following the French Revolution in 1789.

The American and French Revolutions highlight how protests against taxation can spill over into civil unrest and result in great social change. Another famous example is the legendary Salt March led by Mahatma Gandhi in 1930. The march was an act of peaceful civil disobedience (*satyagraha*) against Britain's monopoly on the manufacture and sale of salt in India. Under the *Salt Act 1882*, Indians were forced to buy salt, which was subject to tax, from the colonial government even though salt was freely available from the sea. Gandhi and his followers marched over 200 miles from Sabarmati Ashram to Dandi on the Arabian Sea to protest against the tax. When he got to Dandi, Gandhi defiantly picked up some salty sand from the sea and proclaimed that with this act he was 'shaking the foundations of the British Empire'. The *satyagraha* encouraged others across India to defy the law and resulted in over 60,000 people, including Gandhi, being arrested. The Salt March was widely regarded as an important catalyst for uniting Indians and one of the first steps in paving the path to India's independence in 1947.

Events such as those described above demonstrate that governments need to take great care in who and what they decide to tax. History vividly highlights that it is in a government's interests to develop tax systems that are popular (or at least acceptable) in the eyes of the community that bears the burden of payment. There are many notable instances of unpopular taxes that have created problems for governments. A good illustration is the 'community charge' (better known as the 'poll tax') introduced by Britain's Conservative Government in the late 1980s. The poll tax was designed to fund local government and replaced a rates system imposed on the rental value of housing. It was imposed at a flat rate per person with some limited exemptions. The tax was viewed by a large portion of the British population as manifestly unfair, and it prompted mass protests and riots which ultimately contributed to Margaret Thatcher's resignation as Prime Minister in 1990.

Governments usually tread cautiously before introducing new taxes as politicians are acutely aware that taxation is unpopular. Ultimately, in democratic countries, it is the citizens who will have

the last say about taxes as they have the power to vote governments out of office. As a general rule, the community will accept taxation more willingly if it sees the justification for a tax and considers that its level is appropriate and the burden is shared fairly among those who are liable to pay it. Although most citizens would naturally prefer to pay as little tax as possible, they have also come to expect a certain level of government services and generally accept that taxes play a critical role in funding such things.

[1.8] Australia's economy and the design of its tax system

Australia is a developed country that is known for its strong rule of law, stable political system and open economy. It is a member of the OECD and plays an active role in international forums, such as the G20, WTO and APEC. The country has enjoyed one of the highest living standards in the world and, until the outbreak of the COVID-19 pandemic, benefited from over 100 consecutive quarters of economic growth without a recession. Australia also traditionally performs well on many global indicators—it is ranked 5th in the United Nations' Human Development Index, 14th in the World Bank's Ease of Doing Business Rankings and 20th in the Central Intelligence Agency's GDP (Purchasing Power Parity) Rankings. It is also one of the few countries in the world that has a 'AAA' credit rating from all three major credit rating agencies (Standard & Poor's, Moody's and Fitch). The continuing challenge is to maintain these standards in the rapidly changing and competitive international economic environment.

Black swan events

Although Australia is widely regarded as a 'lucky country', it is a part of the global economy and can be exposed to 'black swan' events at any time. This has been vividly highlighted by the COVID-19 pandemic, which created a huge contraction in economic activity around the world and plunged many countries, including Australia, into recession in 2020. The pandemic created unprecedented global turmoil, resulted in national borders being closed and wiped off hundreds of billions of dollars from the value of international financial markets. International travel, trade and commerce came to a virtual halt, and many jobs were lost as businesses were shut down and supply and demand chains were disrupted. The unprecedented scale of the crisis forced many governments, including the Australian Government, to launch expensive stimulus packages to try to cushion the impact of the virus on their economies.

In its January 2021 *World Economic Outlook Update*, the International Monetary Fund ('IMF') described the COVID-19 pandemic as 'a crisis like no other' and estimated that global growth would contract by approximately 3.3% in 2020. Because of Australia's border closures, strict quarantining rules and geographic isolation, it was able to control exposure to the virus better than most countries. The disruption caused by the pandemic has, nevertheless, been profound.

In its April 2023 *World Economic Outlook Update*, the IMF projected that global growth would fall from 3.4% in 2022 to 2.8% in 2023 and then rise to 3.0% in 2024. Factors that have affected global growth include supply disruptions, lockdowns in China and significant inflation concerns. The IMF has nevertheless predicted that global inflation has peaked and it expects the rate to fall from 8.7% in 2022 to 7% in 2023 and then to 4.9% in 2024.

Even before the outbreak of the pandemic, the world economy was only just really recovering from the 2008 GFC. In Europe, countries such as Greece, Italy, Portugal and Spain have been struggling with high levels of debt. Banks have also generally been adopting tighter lending practices, making it harder for businesses to raise finance. Over the last couple of years, interest rates have been rising as central banks try to curb inflation brought about by a long period of low interest rates and quantitative easing policies. This has put added pressure on many borrowers and adds to the risk of a global recession. Despite the lessons learned from the GFC, recent events indicate that the world

banking system is again showing signs of stress. In 2023, Silicon Valley Bank in the United States failed, and this sparked fears of further contagion which jittered financial markets.

International events, such as the United Kingdom's departure from the EU and the threat of trade wars, particularly between the United States and China, have also fuelled economic uncertainty. The war in Ukraine, which resulted in economic sanctions against Russia, spooked financial markets and added to recession fears. Not only has the war destabilised and fragmented the world economy, but it has also led to a humanitarian crisis. In addition, ongoing geopolitical tensions elsewhere in the world, such as in the Middle East, South China Sea, Korean Peninsula and Kashmir border continue to have the potential to result in flashpoints that can rapidly escalate and disrupt international markets and trade at any time.

Mining, tourism and education

Australia's economic future is inextricably entwined with international events and business and investment conditions. Its economic future will, no doubt, be heavily influenced by how its major trading partner, China, recovers from the COVID-19 pandemic and whether it can continue its trajectory of economic growth. Australia is rich in natural resources, such as iron ore, coal, natural gas, gold, silver, copper, nickel and zinc. Iron ore and coal, in particular, are Australia's leading exports, and the country therefore benefited greatly during the mining boom. Higher commodity prices leading up to 2008, fuelled particularly by demand from China, resulted in mining companies making increased profits, which translated into greater tax revenues from the mining industry. However, increased supply coupled with the economic slowdown caused by the GFC led to a subsequent weakening of commodity prices. Although the iron ore price regained some momentum during 2000 to 2022, it was showing signs of weakness again in mid-2023. It is therefore not clear whether a strong iron ore price is sustainable in the long term. A weakening economic growth outlook in China presents downside risk for commodity prices and this would have a negative effect on Australia's terms of trade. If commodity prices fall, Australia will not be able to continue to rely as heavily as it has in the past on revenue from mining companies to drive economic growth.

Australia's economic prosperity is also heavily dependent on tourism. Statistics from Tourism Australia indicate that in 2018/19, tourism directly employed 660,000 Australians (5% of the workforce) and was Australia's fourth-largest exporting industry. During this period, 9.3 million international visitors arrived in Australia and spent $44.6 billion. Australia's tourism industry was severely hit by the COVID-19 pandemic as international travel literally 'fell off a cliff'. In April 2019, there were 700,400 arrivals into Australia, whereas in April 2020 this figure dropped to 2,260, representing a staggering 99.7% fall. While Australia has reopend its borders, its tourism industry is still recovering from the effects of the pandemic.

Prior to the COVID-19 pandemic, Australia provided education to over 600,000 international students (Australian Government, *International Student Data*, April 2020). The pandemic affected international enrolments and placed pressures on education institutions that relied on overseas students for funding. The fall in international student numbers during the COVID-19 crisis resulted in job losses in the education sector and had damaging flow-on effects for the broader Australian economy. Fortunately, for the January–December 2022 period, Australia's international student numbers had risen to 619,371, which is 8% more than in the same period in the previous year (Australian Government, *International Student Data*, December 2022). As education is the country's fourth largest export, it is important to ensure that the country remains a key destination for international study in the wake of the crisis.

Science and technology

To succeed in the twenty-first century and stay ahead of many rapidly advancing developing countries, Australia needs to be a leading knowledge-based economy. Science and technology have become more important than ever and are key drivers of economic growth. As Innovation and Science

Australia noted in its 2018 report, *Australia 2030: Prosperity through Innovation—A Plan for Australia to Thrive in the Global Innovation Race*:

> Australia needs to find new sources of growth and improve productivity to maintain our standard of living. The biggest growth opportunities will come from knowledge intensive companies that innovate and export, as they are the most profitable, competitive and productive.

Although Australia has a reputation for being a 'clever country' with good universities and talented researchers that have developed many ground-breaking inventions and technologies, the reality is that it has often failed to capitalise on these opportunities. Many Australian discoveries end up being commercialised overseas with profits going offshore. Australia needs to ensure that its innovation ecosystem supports talented entrepreneurs to develop new businesses and commercialise their innovations. This requires investment in R&D and the development of a domestic venture capital market large enough to meet the financing needs of Australia's entrepreneurs. While Australia has attempted to address some of these challenges through various initiatives, such as the Turnbull Government's 2015 *National Innovation and Science Agenda* [5.7], it still has a long way to go to compete with thriving innovation hubs like Silicon Valley, New York, Shenzhen, Singapore and Tel Aviv.

Electronic economy

Australia, like many other countries, is also confronting the challenge of dealing with cross-border digital transactions. The electronic economy has become more important than ever and its growth comes with increasing challenges for digital security. Threats of cyberattacks and online scams are always lurking in the background. The electronic economy also places stresses on Australia's tax system and exposes it to the risk of revenue leakage. Technological developments contribute to the ease with which taxpayers can mobilise capital and transfer it offshore. Transactions involving cryptocurrencies, such as Bitcoin, cause particular concern because they are difficult to trace and can facilitate tax evasion and money laundering.

Ageing population

Like many other Western countries, Australia is also confronting the demographic challenges of an ageing population. An ageing population means a shrinking proportion of people in the workforce who are able to earn income and pay taxes and an increasing proportion of older people who are expected to live longer and require costly healthcare and welfare support. In its *2023 Intergenerational Report*, the Australian Government predicted that life expectancy at birth would increase from 81.3 years for men and 85.2 years for women in 2022/23 to 87.0 years for men and 89.5 years for women in 2062/63. The percentage of Australians aged 65 years and older is expected to rise from 17% in 2022/23 to 23% in 2062/63. At the same time, the proportion of the population participating in the workforce is projected to decline from 66.6% in 2022/23 to 63.8% in 2062/63.

Having an ageing population means that the Government needs to ensure that it has the right policies to encourage people to save for their retirement. If retirees do not have sufficient private savings, they will need to rely on public pensions for support. This can be extremely costly to provide and places additional pressure on the Government to raise taxes. Ensuring that Australia has an effective retirement income strategy is therefore critical. While Australia has a well-established and broad-based superannuation system, the reality is that many people approaching retirement do not have sufficient superannuation savings. Recent global shocks, such as the GFC and COVID-19 pandemic, have adversely affected superannuation savings making it harder for superannuation funds to generate returns, which jeopardises retirement lifestyles. At the same time, the cost of providing superannuation concessions to encourage retirement savings is expensive and the Government needs to ensure that the system remains fiscally sustainable.

Climate change

As Australia is the driest inhabited continent on the planet, it is also likely to incur significant costs in coping with climate change. Evidence of this is found in the 2019/20 'Black Summer' bushfire crisis (which burnt over 45 million acres of land and destroyed over 2,000 homes) and the 2022 NSW and Queensland floods (which resulted in over 25,000 homes and businesses being flooded). Adverse environmental and ecological issues can negatively impact many sectors, including agriculture, which supports a significant portion of the Australian workforce and is critical for the nation's food security and exports.

To combat climate change, the Labor Government is seeking to boost renewable energy so that Australia can transition from its dependence on fossil fuels. However, this transition will be challenging given that Australia has traditionally relied heavily on coal and gas for its energy needs. It is, nevertheless, critical in helping reduce Australia's greenhouse gas emissions and achieve its obligations under the Paris Agreement, which is a binding international treaty that came into force in 2016 and has been entered into by over 190 members of the United Nations Framework Convention on Climate Change. The goal of the Paris Agreement is to keep the rise in mean global temperature to well below 2°C above pre-industrial levels. The aim is to reach 'net-zero' emissions (ie a balance between greenhouse gas emissions produced and greenhouse gas emissions removed from the atmosphere) by 2050.

Infrastructure, housing, cost of living and employment

Being a large country with a population of only about 25 million people, Australia also faces unique challenges in maintaining and upgrading its vast national infrastructure. The cost of transporting goods as well as building roads, railways, ports, power grids, pipelines and communication systems is likely to be higher in Australia than in smaller, more densely populated countries. At the same time, housing affordability issues in the large capital cities where the population is concentrated place pressure on younger families who often struggle to acquire their first home.

Household debt in Australia has been increasing and rising interest rates during 2022 and 2023 have contributed to cost of living pressures, particularly for those people with large mortgages. Increased levels of unemployment during the peak of the COVID-19 crisis also placed great strains on the community and increased the risk of people defaulting on their loans. In its July 2020 *Economic and Fiscal Update*, the Government noted that 709,000 jobs were lost in the June 2020 quarter, and it forecast the unemployment rate to peak at around 9.25% in the December 2020 quarter. Fortunately, the 2021 Budget Papers revealed that thanks to the Government's $291 billion stimulus package, which included expensive subsidies like the fortnightly 'JobKeeper Payment' [6.3], Australia's employment levels were stronger than originally expected. This was subsequently confirmed in Australian Bureau of Statistics ('ABS') figures, which indicate that the unemployment rate for May 2023 was 3.5% (ABS, *Labour Force, Australia, May 2023*). This rate is even lower than the 5.1% rate in February 2020, immediately before the pandemic hit Australia. Unemployment reached its highest levels of 7.4% at the peak of the pandemic in mid-2020.

Government debt and fiscal sustainability

An important issue confronting Australia, like many other countries around the world, is that it has been facing rising levels of government debt. When the Rudd Labor Government was elected in 2007, it inherited a surplus of $39.958 billion from the Howard Coalition Government. However, over the Rudd and Gillard Labor Government periods, this surplus turned into a deficit. According to the 2023 Budget Papers, government net debt had reached $159.594 billion (10.4% of GDP) in 2012/13 and $209.559 billion (13.1% of GDP) in 2013/14. Net debt continued to grow during the Abbott, Turnbull and Morrison Coalition Government periods, with net debt rising from $245.817

billion (15.1% of GDP) in 2014/15 to $515.650 billion (22.3% of GDP) in 2021/22. Not surprisingly, the massive stimulus initiatives implemented by the Morrison Government to support the Australian economy during the COVID-19 crisis contributed significantly to this debt. The following table shows net debt levels and their percentage of Australia's GDP over recent years.

Financial Year	Net debt	Percentage of GDP
2012/13	$159.594 billion	10.4%
2013/14	$209.559 billion	13.1%
2014/15	$245.817 billion	15.1%
2015/16	$303.467 billion	18.3%
2016/17	$322.320 billion	18.3%
2017/18	$341.961 billion	18.6%
2018/19	$373.566 billion	19.2%
2019/20	$491.217 billion	24.8%
2020/21	$592.221 billion	28.5%
2021/22	$515.650 billion	22.3%
2022/23 (estimate)	$548.581 billion	21.6%

Bourgeoning net debt places Australia's 'fiscal sustainability' at risk. The *2023 Intergenerational Report* defines fiscal sustainability as 'the Government's ability to manage its finances so it can meet its spending commitments, now and in the future'. Fiscal sustainability is important for maintaining economic stability, improving economic performance and ensuring future generations do not inherit an unmanageable tax burden for government services provided to the current generation.

While Australia's net debt as a percentage of GDP is relatively moderate by international standards, it places pressure on future budgets. As Australia has a 'fiat currency' (ie a currency that is not backed by a commodity like gold), modern monetary theorists argue that it can simply repay its debt by 'printing money'. Mainstream macroeconomic theorists, however, criticise this approach saying that it devalues the currency and leads to inflation. They argue that the conventional and more prudent way for governments to address their debt issues is to either increase revenue through taxation or decrease spending.

Policy decisions affecting the design of Australia's tax system

The many issues and challenges outlined above need to be carefully considered in policy decisions affecting the design of the Australian tax system. In making these decisions, the threats of international tax competition also need to be taken into account. If Australia does not have an internationally competitive tax system, it will struggle to attract foreign investment, which is vital for providing capital to industry and generating employment. Many countries in the region have lower tax rates than Australia and offer generous investment incentives, which may encourage businesses to relocate overseas. At the same time, Australia needs to protect its tax base from international tax avoidance practices, especially those employed by large multinational enterprises that seek to divert their profits through tax havens. It therefore needs a robust tax system with rules that are difficult to circumvent coupled with effective enforcement measures to ensure that Australia collects its fair share of tax. Unless Australia has a 'good' tax system, living standards and the country's future economic prosperity are likely to suffer.

[1.9] Features of a good tax system

In his famous 1776 treatise *The Wealth of Nations*, Adam Smith, the renowned Scottish economic philosopher, expressed the following views about taxation:

- The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
- The tax each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, and the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.
- Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it.
- Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

Smith's 'maxims' have become foundation stones for the design of a good tax system and are still often referred to today by policymakers. Whether or not a tax system is 'good' obviously involves a qualitative judgment. Although people naturally have different opinions about what constitutes a good tax system, there are some generally accepted criteria by which tax systems may be evaluated. These criteria, evolving out of Smith's work, have been extensively discussed in the academic literature and closely analysed in government papers and reports, such as the Asprey Committee's *Full Report* (1975), Treasury's *Reform of the Australian Tax System: Draft White Paper* (1985) and the Review of Business Taxation's *A Tax System Redesigned* (1999). The following discussion outlines some commonly articulated views regarding tax system design and focuses on what are, arguably, the key attributes of a good tax system.

Fiscal and policy objectives

Obviously, one of the key measures by which a tax system is judged is whether it meets the government's fiscal targets. A good tax system should collect the amount of revenue that the government has set out to collect; otherwise, it will fail in its primary objective. From a government's perspective, it is vital that the cost of its spending programs is balanced against the revenue it receives. In this regard, governments need to be able to forecast the amount of tax they will collect each year and predict how variables, such as economic factors, may impact on revenue collection. If their estimates are incorrect, they risk falling into funding deficits.

The difficulties that governments face in predicting tax revenue can be illustrated by a simple example. Suppose a government imposes a fuel excise at a flat rate on petroleum products. If oil prices rise during the year, revenue will increase (resulting in a windfall), but if oil prices drop during the year, revenue will be lower (resulting in a shortfall). As oil prices depend on extraneous economic factors, many of which are outside a government's control, it is impossible to know exactly how much tax will be collected. Governments therefore need to take account of a range of variables when undertaking their fiscal modelling.

The Commonwealth, state and territory governments publish annual Budget Statements that contain economic data, including details of their respective revenues and expenditures. These statements also contain their fiscal outlooks for coming years based on various assumptions. If the economic modelling in these statements is wrong, they may miss their forecasts. Governments that do not collect sufficient revenue from their taxes inevitably end up having to either borrow money to fund their spending programs or cut the services they provide their citizens.

A good tax system is, however, not just about collecting the right amount of revenue. It should also operate in harmony with the government's broader socio-economic policy agenda. Ideally, a

country's tax system should support the government to achieve optimal outcomes, such as increased productivity, employment growth, improved welfare and higher living standards. A country's tax system should also not unduly interfere with the advancement of the country's broader economic imperatives, such as boosting national savings, encouraging investment and supporting business activity.

Simplicity, certainty and stability

Most people would agree that simplicity and certainty are desirable features of a good tax system. If these criteria are not met, taxpayers will find it difficult to comply with the tax laws and apply them to their specific circumstances. Likewise, revenue authorities will find it difficult to administer and enforce the tax laws. Ideally, tax laws should be clear, unambiguous and uncomplicated. They should therefore not be bogged down in complex and voluminous legislation that is difficult to comprehend or navigate. Ultimately, taxpayers and revenue authorities should be able to identify the incidence of tax and calculate tax liabilities with ease and certainty.

Unfortunately, the reality is that tax laws are often highly complex and they are frequently criticised for this reason. Australia's income tax legislation, in particular, is notorious for containing many long and cryptic technical provisions that are difficult to understand. Even senior judges have been open critics of the legislation. In an article appearing on the front page of the *Australian Financial Review* on 21 January 2011, Justice Keane (a former High Court Justice) was reported as saying: 'Opening the *Tax Act* is like entering the door of a parallel universe.'

The Federal Government has acknowledged that the Australian tax system is too complicated. In its 2015 *Re:think* discussion paper, it identified a number of reasons for this, stating (at 2):

> One reason is the prevalence of tax concessions aimed at assisting particular groups. Another reason is the regular 'patching' of the law to fix narrow problems or provide certainty for taxpayers and transactions without fully considering consequences for the system as a whole. Overly risk-averse attitudes from policy advisers and administrators, combined with complex legislative drafting styles, have also led to complexity.

Complexity in the tax system is problematic as it can divert time and resources away from productive activities. Governments should therefore strive to simplify their tax systems where possible. It is also prudent for them to periodically review their tax laws to ensure that they continue to meet their fiscal and policy objectives. Where a country's tax laws are failing to have their desired effect, they should be amended or repealed. It is, nevertheless, also important to recognise that continual reform of a country's tax system can contribute to uncertainty about its operation. It is therefore generally desirable for a country to maintain relatively stable tax laws, as this allows business and investment decisions to be made with confidence. Frequently changing tax laws can have a negative impact on the economy, as taxpayers will be reluctant to make commercial and financial decisions where their tax impact is not clear.

Transparency and integrity

It is widely accepted that a good tax system should be transparent. Revenue authorities have considerable statutory responsibilities and powers, and their actions should be closely monitored by government and be subject to parliamentary scrutiny. At the same time, tax laws should be administered free of political interference and in accordance with the rule of law. Revenue authorities should interpret and apply tax laws consistently, so that taxpayers in similar circumstances are treated equally. While it is important that revenue authorities can readily enforce tax laws if they are breached, the rights of taxpayers also need to be closely protected. As there is often a great imbalance between the resources of revenue authorities to prosecute tax disputes and the capabilities of taxpayers to defend themselves, it is imperative that taxpayers are treated fairly and

not denied natural justice. In particular, taxpayers should be able to contest their tax assessments before the courts if they believe they have been incorrectly assessed.

It is also desirable for taxation statistical data to be readily accessible, as this helps promote transparency in the tax system and foster community engagement. The availability of up-to-date and accurate statistics enables a tax system to be analysed and evaluated by academics and other commentators, who may be able to identify issues that need to be addressed. This can contribute significantly to future tax reform.

A good tax system also needs to be robust and resilient to ensure that it is not open to abuse. A country's tax laws should therefore be designed in such a way that they are difficult to avoid or evade. A tax system with loopholes will not be respected by taxpayers and will result in revenue leakage, as some people will inevitably choose to exploit the weaknesses in the system. To protect the government's revenue base, tax laws need to be drafted tightly so they cannot be easily manipulated. Appropriate anti-avoidance rules in the legislation can provide added protection and serve as an integrity measure to prevent abuse of the general provisions. In addition, to ensure compliance, it is important for tax laws to be vigorously enforced. Tax administrators and law enforcement agencies need to have appropriate resources and powers to pursue and prosecute tax cheats.

Efficiency and flexibility

Another generally accepted feature of a good tax system is that it should be efficient, in the sense that it should have low collection and compliance costs. Taxes that are expensive for a government to collect, or cumbersome, time-consuming or costly for taxpayers to comply with, are inefficient, as they divert resources from productive activities. In designing an optimal tax system, government efficiency requirements should be carefully balanced against taxpayer compliance obligations to ensure that the tax laws operate both fairly and effectively. The Australian Government in its 2015 *Re:think* tax discussion paper noted that the annual cost of administering the Commonwealth tax system was around $3.6 billion and that taxpayer compliance costs were around $40 billion.

Linked to the concept of efficiency is the concept of flexibility. A good tax system should be able to cope with, and where necessary, respond to, changes in economic circumstances without requiring major overhauls. For example, if a tax system is not broad-based and is skewed towards taxing commodities, then a fall in commodity prices will have a major impact on revenue collection. For this reason, governments usually impose many different kinds of taxes with broad tax bases to spread risk. Having a broad tax mix also ensures the burden of taxation is spread more widely among the community and does not fall disproportionately on only certain persons. However, having many different kinds of taxes adds to the overall complexity of the tax system and increases compliance costs for taxpayers. Governments should bear this in mind in deciding on their overall tax mix.

Neutrality

It is often argued that a good tax system should be neutral, in the sense that it should not distort commercial decisions or skew the market mechanism. Taxes can interfere with the way markets operate, as they affect the cost of the activities or products upon which they are imposed. Tax laws that increase or decrease the attractiveness of one arrangement ahead of another can alter the way taxpayers choose to organise their affairs. A tax imposed on a particular product discourages spending on that product and makes similar products which are not taxed, or are taxed to a lesser extent, more attractive. For instance, if a tax is imposed on black shoes but not white shoes, consumers may buy more white shoes than black shoes, even if they actually prefer the latter. Likewise, taxing one kind of legal structure more concessionally than another is likely to lead to greater adoption of the preferentially taxed structure as a business or investment vehicle.

A tax system that contains inherent biases can affect market efficiency and result in tax considerations, rather than commercial considerations, driving economic activity and business decisions. This can have an adverse impact on a country's economic competitiveness and produce distorted commercial outcomes. To ensure that taxes do not drive a wedge between optimal business and investment decisions, they should generally have a neutral effect on similar kinds of underlying business and investment choices. However, the reality is that, in practice, many tax systems have built-in structural biases. For example, in Australia, resident individuals are generally fully assessed on interest earned from bank deposits, but are generally only assessed on half the capital gains made from investments that have been held for at least 12 months [17.8]. As a consequence, capital gains are treated more concessionally than income gains.

Governments nevertheless often intentionally design tax systems not to be neutral in order to achieve specific policy objectives. For instance, they may tax imported goods specifically to support locally produced products. Strictly, any tax will operate to discourage the activity upon which it is imposed, and any tax incentive will encourage the activity in relation to which it is provided. Tax expenditures, in particular, are often used to address market failures. For example, the Australian Government's ESVCLP program was introduced to address the failure of the market to provide venture capital to Australian early-stage businesses [27.4]. Investments made under this program benefit from tax exemptions and tax offsets that are not available for other kinds of investments.

While it is generally accepted that a tax system should not influence business decisions unnecessarily, fiscal neutrality is not something a government should pursue at all costs. In specific situations it may be appropriate to impose taxes or provide tax incentives for particular activities. A fiscal bias may be justified where a valid reason to change taxpayer behaviour exists. For instance, if the market is not operating at its optimal level, taxes or tax expenditures may be necessary to improve economic efficiency. A government may also have wider political or social goals that might best be achieved by creating distortions in the tax system. For example, it might consider that the best way of stopping its citizens from smoking—thereby reducing national health costs—is to tax cigarettes to make them less affordable.

Equity

Of the many hallmarks of a good tax system, the most important is generally considered to be equity. Equity is critical not only on moral grounds, but also because it is more likely that taxpayers will respect and support their tax system if it is perceived to be fair. It is widely accepted that taxpayers should bear responsibility for their appropriate share of the overall tax burden of the country in which they live, do business or make investments. This is often expressed as the simple principle that 'each taxpayer should pay their fair share of tax'. What is 'fair' between a wide range of taxpayers is, however, not necessarily straightforward. It ultimately depends on an equitable sharing of responsibilities between members of society, judged by reference to the general standards and norms of that society. Different interest groups and generations within society may have quite different perspectives on this subject, and their values may gradually shift over time. The reality is that fairness, like beauty, lies in the eye of the beholder.

It is generally acknowledged that the concept of equity has two important dimensions—horizontal equity and vertical equity. A tax is described as 'horizontally equitable' if people in similar economic circumstances are treated similarly. For instance, if A and B each derive $40,000 of income, they should each pay the same amount of tax. In contrast, a tax is described as 'vertically equitable' if people in different economic circumstances are treated differently, with those who are better off bearing a greater share of the burden. For instance, if A derives $100,000 of income and B derives $30,000 of income, A should pay more tax than B.

The notion of vertical equity is also sometimes referred to as the 'ability-to-pay' concept. According to this concept, the level of taxation should be linked to a person's wealth. Vertical equity

is justified on the basis that those who have benefited the most from living in a particular country should contribute the most to their government. Some people, however, dispute this, arguing that to be fair, the level of taxation should be measured by reference to the degree of services and benefits a particular person receives from the government rather than their capacity to pay tax. But this argument ignores the fact that taxation is a social contribution imposed on the citizens of a state for the benefit of the state as a whole, rather than for the benefit of particular individuals.

Ultimately, the extent to which a tax is viewed as equitable depends on community perceptions. As a general rule, taxes are more readily accepted if the burden is spread widely among the community rather than directed at only specific groups. Taxes that adversely affect certain members of the community more than others are generally viewed unfavourably, particularly where the criterion of vertical equity is not satisfied (ie where the burden is placed on those less able to pay).

While flat taxes are administratively convenient, and may seem to be fair in that they are levied at the same rate on all taxpayers, they do not take a person's ability to pay into account. Flat taxes can operate regressively, as they impose a relatively greater burden on the income of poorer members of society than the wealthier ones. An example of a flat tax is the GST, which is presently imposed at a standard rate of 10% [7.1]. This tax is arguably more directly felt by poorer members of society. For instance, assume that because of the introduction of GST, the price of certain goods that previously cost $100 increases by 10%. The extra $10 payable represents a greater slice of a poor person's income than a rich person's income.

In contrast to the flat-rate GST, Australia has a progressive income tax system as the rates of tax increase with the level of a person's taxable income [8.8]. Income tax is therefore designed to fall more heavily on those with a greater ability to pay. However, in practice, it is not always easy to achieve fairness. For instance, while two people earning $100,000 may pay the same amount of income tax, one of those people might be single, while the other may have several children and a spouse to support. Accordingly, the burden of the tax is not felt uniformly by these two economic units.

[1.10] The tax unit

One of the basic issues to consider in the design of any tax system is who should be the subject of taxation. In other words, who is the appropriate 'tax unit' (ie taxpayer)?

Individuals and families

The Australian income tax system treats each individual as a separate tax unit. By taxing individuals rather than families, the income of spouses is not aggregated and taxed as if they were a single taxpayer, or split equally between them. Instead, each person pays tax as a separate unit on their own taxable income. This is the case, even though they may pool their resources.

In calculating a person's income tax liability, there is generally no account taken of any dependants whom they are required to support. A person with children does not pay income tax at lower rates than a person without children. Instead, support for families is available through the Department of Human Services, which provides means-tested social security payments such as the Family Tax Benefit and the Child Care Subsidy. The concept of a family is, however, not totally irrelevant for income tax purposes. A person may, for instance, be able to benefit from tax offsets for maintaining certain dependants [8.9]. Special thresholds and phase-in arrangements also exist for families in respect of the ML and MLS [8.8].

Legal entities and their members

As business and investment income is often earned through legal structures (eg partnerships, trusts and companies), governments need to consider how best to tax the income earned by these entities.

Should they be treated as separate taxpayers, or should their ultimate owners (the individuals who hold membership interests in the entities) be taxed instead?

Australia generally treats partnerships and trusts as 'flow-through entities', which means their income is not taxed at the entity level, but rather in the hands of their members. As a result, partnerships and trusts do not give rise to a separate taxing point. Instead, they simply operate as conduits. It is, therefore, usually the respective partners [23.3] or beneficiaries [24.5] who are taxed.

In contrast, Australia generally treats companies as 'opaque entities', which means that they are taxed as separate taxpayers from their members (eg shareholders). To prevent double taxation of corporate profits—once in the hands of the company and again when they are distributed to shareholders as dividends—Australia has adopted an 'imputation system' which provides resident shareholders with credits for Australian income tax paid by resident companies on their underlying profits [22.6].

[1.11] Sovereign right to tax

Each nation has the sovereign right to design its own tax system. Subject to any restrictions imposed under their respective constitutions, governments are generally free to determine the nature and scope of their country's tax laws and the persons whom they subject to tax.

Enactment, administration and adjudication of tax laws

A country's tax laws are made by its appropriate legislative body and its tax system is administered by its relevant revenue authority. In Australia, federal tax legislation is enacted by the Commonwealth Parliament under its powers in the *Constitution* [3.4] and the federal tax system is administered by the ATO, which is headed by the Commissioner of Taxation [6.3].

Disputes between taxpayers and revenue authorities concerning the application of a country's tax laws are litigated before the country's tribunals and courts. In Australia, Commonwealth tax disputes are heard, at first instance, by the Administrative Appeals Tribunal ('AAT') or the Federal Court. Appeals from these decisions may be available to the Full Federal Court and (with special leave) the High Court [38.5].

Some countries, such as the United States and Canada, have established specialist Tax Courts that deal exclusively with tax disputes. Specialist Tax Courts do not exist in Australia. The principal reason traditionally advanced for establishing such courts is that since tax legislation is so technical and complex, it is appropriate that tax cases should be heard by judges with special expertise in the field (see S Chapple, 'Income Tax Dispute Resolution: Can We Learn from Other Jurisdictions?' (1999) 2 *JAT* 312). Certain prominent Australian judges have, however, rejected the need for such courts on the basis that it is preferable for judges hearing tax disputes to have general law expertise to ensure that tax law is not divorced from the ordinary commercial and legal environment (see D Hill, 'Great Expectations: What Do We Expect from Judges in Tax Cases?' (1995) 69 *ALJ* 992). It has been pointed out that there is a risk that specialists may be too 'inward looking', and that knowledge of other areas of law can 'spark ideas' which someone with only limited or specialised expertise may not perceive (see M Kirby, 'Hubris Contained: Why a Separate Australian Tax Court should be Rejected' (2007) 42 *TIA* 161).

Fiscal convergence and divergence

While the tapestry of a country's tax system is a sovereign issue, countries are inevitably influenced by one another in designing their tax rules. Globalisation has contributed to increasing economic integration and fiscal convergence among nations. It is therefore not surprising to find many broad similarities between tax systems around the world. This is especially the case where countries have formal links (eg through membership of international organisations such as the OECD). Each country's tax system is, nevertheless, unique, and its architecture ultimately depends on the individual

approach the country has adopted. While international influences often play an important part in the broad design of a country's tax rules, the tax policies it ultimately adopts will be most heavily influenced by its own particular social, political and economic factors.

Close economic and political relations between nations can help foster 'tax harmonisation' (ie the adoption of similar, although not necessarily identical, tax laws within different jurisdictions). Tax harmonisation can lead to economic and administrative efficiencies, but is usually difficult to achieve in practice, as it requires a coordinated approach to taxation policy between nations that often have competing interests.

Tax harmonisation is perhaps most evident in the EU, where it is a requirement of membership that each Member State impose VAT at the rate of at least 15% (reduced rates are allowed for certain supplies). In recent years, the EU has also had a limited degree of success in harmonising direct taxes (eg certain aspects of corporate and savings taxes). It is, however, extremely difficult to achieve broad-based tax harmonisation within the EU, as it does not have any general taxation powers of its own—these powers remain with the individual Member States. The introduction of 'directives' in the field of taxation requires unanimity of the EU Council of Ministers, composed of the 27 National Ministers of each of the Member States. Progress towards further integration of European taxes therefore remains a slow and drawn-out process.

One area where there has been significant cooperation between countries recently is in their approach to tackling the problem of international tax avoidance and tax evasion. This has been largely due to work undertaken by the OECD under its base erosion and profit shifting ('BEPS') project [33.3]. Many countries have adopted various actions recommended by the OECD to deal with the problem. For example, 100 jurisdictions have signed a new multilateral convention to upgrade their tax treaties to tackle BEPS [32.4]. In addition, over 130 jurisdictions have agreed to enter into a two-pillar agreement on international tax reform which will re-allocate the profits of the largest multinational enterprises to those countries where the profits are earned and ensure that they are subject to a minimum corporate tax rate of at least 15% [33.6].

[1.12] Jurisdiction to tax

General jurisdictional rules

Most countries' tax systems are based on a set of general rules that define the jurisdictional limits of their respective tax laws. A country's general jurisdictional rules may be cast narrowly or widely and often operate subject to numerous exceptions. The following discussion outlines the two main jurisdictional approaches used by countries around the world in relation to income tax. At the heart of these approaches is the requirement that there be some clear nexus between the taxing jurisdiction and either the taxpayer (the 'tax subject') or the income-generating transaction (the 'tax object').

- **Territorial (source-based) jurisdictional rules**. The narrow 'territorial' approach to income taxation focuses on the source of the income. Countries that adopt this approach only tax income sourced within their geographic borders, irrespective of where the taxpayer resides.
- **Worldwide (residence-based) jurisdictional rules**. The wider 'worldwide' approach to income taxation focuses on the taxpayer's country of residence. Countries that adopt this broader approach tax their residents on both their domestic and foreign source income, but only tax foreign residents on their locally sourced income.

Justifications for territorial and worldwide jurisdictional rules

The territorial and worldwide approaches to taxation produce different economic efficiencies. A territorial approach promotes 'capital import neutrality', as investments made in the source country are treated in the same manner regardless of where the investor resides. A worldwide approach

promotes 'capital export neutrality', as it does not influence an investor's decision about where to make investments (ie at home or abroad).

The territorial approach to taxation can be justified on the basis that there is an economic connection between the taxpayer and the taxing jurisdiction. It is based on a link between the income earned and the source country. This link may exist for a variety of reasons, including the fact that the business or employment activities take place in the source country, or the property that generates the income is located there. A territorial approach is defensible on the grounds that it is fair that persons who benefit from earning income in a particular country should also contribute to the country's costs of providing the economic environment that enables their income-earning activities to take place.

The worldwide approach to taxation can be justified on the basis that there is a personal connection between the taxpayer and the taxing jurisdiction. It is founded on the rationale that, as residents of a particular country are usually based in the country and benefit from the broad range of public goods and services provided by their government, it is appropriate to tax them on their worldwide income, as these things support their way of life and overall economic activities, both locally and abroad. Moreover, as residents usually have a personal allegiance to the country in which they choose to reside, and are usually entitled to derive benefits from their government that are not necessarily also available to foreigners (eg various forms of social security), it is possible to justify applying wider jurisdictional rules to them.

Credits for foreign taxes to prevent double taxation

The practical problem with the worldwide approach is that it leads to double taxation, since a taxpayer's foreign income is taxed not only in their country of residence but also in the source country. To alleviate this problem, it is common for countries that adopt the worldwide approach to grant their residents credits for tax paid on foreign income in the source country. However, if credits for foreign taxes were granted in excess of the tax paid in the country of residence, the excess credits could be utilised to reduce the tax payable on the resident's domestic income. Accordingly, to counteract erosion of their domestic tax bases, countries generally cap credits for foreign taxes so that they cannot exceed the amount of tax that would otherwise be payable on the foreign income in the country of residence.

Australia's general jurisdictional rules and exceptions

Australia's general jurisdictional rules are based on the worldwide approach and are discussed in Chapter 30. Accordingly, Australian residents are generally taxed on their worldwide income, while foreign residents are generally taxed only on their Australian-sourced income [30.1]. At the same time, to prevent double taxation, Australia also provides a credit, known as the 'foreign income tax offset', for foreign taxes paid on income that is also assessed in Australia [31.3].

It is important to understand that while Australia's income tax laws are based on the worldwide approach, Australia does not have a 'pure' worldwide system of taxation, as its jurisdictional rules operate subject to numerous exceptions [31.4]–[31.10].

Like Australia, most developed countries tax their resident individuals on their worldwide income. The United States is a special case, as it not only taxes its residents on a worldwide basis but also taxes non-residents who are United States citizens on a worldwide basis. This results in the United States having one of the broadest jurisdictional rules of any developed country. To mitigate double taxation, United States citizens who reside outside the United States and are physically present in foreign countries for at least 330 days during any 12-month period may exclude a portion (up to US$120,000 for 2023) of their foreign income provided they lodge United States tax returns.

In contrast to Australia, jurisdictions that adopt the much narrower territorial approach to taxation, such as Singapore, Malaysia and the Special Administrative Regions of Hong Kong and Macau,

generally only tax income that is sourced within the jurisdiction. Residents of these jurisdictions do not therefore generally pay tax on foreign income in their country of residence.

International taxation agreements

A country's general jurisdictional rules operate subject to the terms of any international tax agreements it has entered into with other countries. In practice, these agreements are made after lengthy negotiations between the respective governments. They are typically bilateral in nature, as it is much more difficult to achieve multilateral agreements. For this reason, these treaties are often referred to as 'Double Taxation Agreements' ('DTAs').

One of the main functions of DTAs is to address the problem of double taxation, which is widely recognised as a major impediment to cross-border trade and investment. In the field of income tax, double taxation arises where more than one country asserts taxing rights over the same income. For instance, this can easily occur in respect of business profits—both the country in which the taxpayer is a resident and the country in which the income is earned may seek to tax the profits. The country of residence may seek to tax the profits on the basis of a worldwide approach to taxation, while the country of source may seek to tax the profits on the basis of a territorial approach to taxation.

To prevent double taxation of income, one of the countries needs to surrender its taxing rights in favour of the other country. The problem is that countries naturally want to protect their revenue bases and are reluctant to unilaterally give up their taxing rights. Nevertheless, in order to promote international trade and investment, they may be prepared to surrender their taxing rights if appropriate reciprocal arrangements are in place. DTAs provide the framework for these arrangements. They also contain special tie-breaker rules that operate where a taxpayer would otherwise be a dual resident.

The main way that DTAs deal with the problem of double taxation is by allocating taxing rights between the respective countries (referred to as 'Contracting States') according to a set of agreed principles that are set out in the DTAs. Where both the country of residence and the country of source share taxing rights, the DTAs usually require the country of residence to provide relief in the form of a credit for the payment of foreign tax.

DTAs also contain exchange of information clauses designed to assist tax authorities in the relevant countries to administer their respective tax laws and prevent tax avoidance and tax evasion.

Australia has entered into DTAs with more than 40 countries. These DTAs are broadly based on the OECD *Model Tax Convention on Income and on Capital* and are examined in Chapter 32. Australia has also entered into Additional Benefits Agreements ('ABAs') and Tax Information Exchange Agreements ('TIEAs') with a number of jurisdictions with which it does not have DTAs. ABAs are essentially mini DTAs that only cover a limited number of topics [32.3]. TIEAs, on the other hand, are special bilateral agreements that contain rules for exchanging tax and financial information [33.2].

International tax enforcement

It is important to recognise that while countries have the sovereign right to determine the jurisdictional scope of their tax laws and can enact legislation that imposes liabilities on foreigners who earn income within their territories, it is quite another matter for governments to enforce their tax laws against such persons. As foreigners reside outside a country's borders and may have all their assets located abroad, it can be difficult to recover taxes from them. There is a general principle that countries do not enforce each other's tax laws (*Government of India, Ministry of Finance (Revenue Division) v Taylor* [1955] AC 491). This principle was recognised in *Rothwells Limited (In Liquidation) v Connell* 93 ATC 5106, where the Supreme Court of Queensland Court stated (at 5113) that it was 'a settled rule of private international law that the courts do not assist the enforcement of foreign revenue laws, or claims made under those laws'. To address this issue, many countries, including Australia, have entered into bilateral and multilateral international tax enforcement arrangements [33.10].

Withholding taxes

To avoid international tax enforcement issues from arising, many countries impose withholding taxes on certain payments made to foreigners. Entities that make such payments are generally required to withhold tax from the payments and remit the tax to their revenue authorities on behalf of the foreigners. Australia imposes withholding taxes on a range of payments made to foreigners (including, dividends, interest and royalties) [31.11].

[1.13] Level of taxation

It is difficult to compare the overall level of taxation in one country with that in another country as the mix of taxes in each country is often quite different. In order to determine how heavily a country's citizens are taxed, it is necessary to take account of all kinds of taxes imposed at every level of government—federal, state and local.

When comparing the level of taxation in Australia with that in other countries, it is simplistic merely to focus on the rates of tax imposed in each jurisdiction. Obviously, the amount of revenue collected by a government from a particular tax will also depend on a range of other factors, including whom it subjects to tax and how broadly its tax base is defined. For example, while CGT forms part of the Australian income tax base, not all countries around the world impose CGT. Countries that do not have a general CGT regime therefore have a much narrower tax base. It is worth noting that a number of countries located close to Australia in the Asia–Pacific region do not have a general CGT regime, including Singapore, Malaysia and New Zealand. By way of way contrast, capital gains are taxed in countries such as the United States and the United Kingdom. However, these countries' tax regimes differ from Australia's. For instance, in the United States, individuals pay different rates of tax on their short-term and long-term capital gains. Short-term capital gains arise on assets held for a year or less and are taxed at ordinary rates of up to 37%; while long-term capital gains arise on assets held for longer than a year and are taxed at concessional rates of up to 20%. Australia, on the other hand, imposes CGT at ordinary income tax rates, but generally provides individuals with a 50% discount on capital gains made on assets held for at least 12 months [17.8]. There are also many differences in CGT exemptions and reliefs. In the United Kingdom, for example, resident individuals generally only pay CGT on their overall capital gains above the 'annual exempt amount' (£6,000 for 2023/24). No corresponding allowance exists in Australia.

Australia's tax expenditure programs are also quite different from those in other countries. For instance, Australia provides tax concessions to encourage activities such as retirement savings, research and development, local film production and venture capital investment. Similar kinds of tax expenditure programs are not necessarily available in other jurisdictions. On the other hand, foreign countries may offer other forms of tax incentives that are not available in Australia. For instance, countries such as Singapore and Malaysia provide 'tax holidays' (ie exemptions from tax for specific periods) to encourage the establishment of pioneer enterprises and to promote the development of various industries. The vast differences that exist between tax systems make it very difficult to compare regimes.

Data on levels of taxation

Comparative data on levels of taxation be found in the OECD's *Revenue Statistics 1965–2021*, which measures tax revenue as a percentage of GDP for OECD countries. Measuring tax-to-GDP ratios is the traditional way of comparing the relative levels of taxes raised across different countries as it takes account of the size of their respective economies. It is interesting to note that Australia's tax-to-GDP ratio for 2020 was 28.5%, which was well below the OECD average of 33.6%. This suggests that Australia imposes a relatively lower tax burden than many other nations. In 2020, 7 OECD countries had tax-to-GDP ratios above 40%, namely Denmark (47.1%), France (45.3%), Italy (42.7%),

Belgium (42.5%), Sweden (42.3%), Austria (42.2%) and Finland (41.8%). The OECD countries that had tax-to-GDP ratios below Australia were South Korea (27.7%), Switzerland (27.5%), the United States (25.8%), Turkiye (23.9%), Costa Rica (22.7%), Ireland (19.9%), Chile (19.4%), Colombia (18.8%) and Mexico (17.8%).

Balancing level of taxation against provision of services

The level of taxation imposed by a government needs to be balanced against the level of services the government seeks to provide its citizens. Greater revenue raised from taxes allows a government to provide more public services. Taxpayers who complain about a lack of government services such as public hospital beds, childcare facilities, or funded university places need to recognise that these things come at a significant cost. If citizens want more government services, they need to be prepared to pay more taxes. As the OECD's *Revenue Statistics 1965–2021* indicate, Scandinavian countries are among the highest tax-to-GDP ratio countries. These countries, however, traditionally have a more socially orientated outlook than many other countries and are well known for their generous pension and welfare systems. A government's ability to provide social services comes at a cost, and it is not surprising that this is usually largely funded out of taxation revenue.

Increasing and decreasing levels of taxation

Governments may require different levels of taxation revenue at different times. For instance, in times of crisis, such as war or natural disaster, they may need to impose higher levels of taxation than they would impose at other times. Additional revenue may also be required to pay for major public infrastructure projects, such as the construction of freeways, telecommunication networks and hospitals. Governments may also be forced to increase taxes to repay their borrowings. This situation was recently faced by the Greek Government, which had to increase taxation as well as curb public spending (including controversially cutting government pensions) in order to address its sovereign debt crisis and comply with its Eurozone bailout conditions. These austerity measures placed considerable pressure on Greek citizens, who ultimately bore the cost of bailing out their government. Not surprisingly, this created much internal turmoil and resulted in protests and riots around the country. One of the most noticeable tax reforms was the increase of Greece's VAT rate from 21% to 24%. Greece was, however, not alone in increasing its VAT rate—several other countries adversely affected by the GFC also increased their VAT rates, including Hungary, Iceland, Ireland, Italy, Portugal, Spain and the United Kingdom. The cost of large stimulus packages, like those introduced by many countries around the world to counter the economic effects of the COVID-19 pandemic, is also likely to place pressure on governments to increase taxes in the future.

Governments can increase taxation by raising tax rates and widening their tax bases. They can also benefit from bringing forward the time at which tax is collected in order to gain early access to the revenue. Governments can also reduce tax spending by limiting the incentives and concessions provided under their tax expenditure programs. However, when governments increase taxation and cut back on tax expenditures it can have a negative effect on the country's economy, as it generally results in decreased private spending and investment. Paradoxically, this can dampen overall government revenues, as there may be fewer transactions to tax.

Reducing the level of taxation, on the other hand, encourages private spending and therefore stimulates the broader economy. During the GFC, several governments around the world introduced temporary tax incentives to encourage economic activity. One example was the introduction of the investment allowance in Australia, which provided a 'bonus deduction' at rates that ranged from 10% to 50% for entities that incurred eligible expenditure on tangible depreciating assets. To qualify for the bonus deduction, a taxpayer must have committed to investing in the asset during the period

13 December 2008 to 31 December 2009 (ie the height of the slowdown). The incentive, therefore, encouraged taxpayers to bring forward spending on income-producing assets that they may have otherwise deferred on account of the uncertainty caused by the crisis.

A broad range of temporary tax incentives were also recently introduced by many governments around the world to combat the economic effects of the COVID-19 pandemic (see OECD, *Tax Policy Reforms 2021: Special Edition on Tax Policy During the COVID-19 Pandemic*). Australia, for example, introduced various capital allowance incentives, including an incentive to allow businesses with annual turnover of less than $5 billion to fully expense the cost of their eligible depreciating assets [15.2].

By actively intervening in their economies during the GFC and COVID-19 crises, governments were simply applying the economic theories of John Maynard Keynes as set out in his seminal 1936 treatise, *The General Theory of Employment, Interest and Money*. Keynes advocated that increased government expenditures and lower taxes can stimulate demand and thwart a recession. In essence, governments were using fiscal stimulus measures to influence aggregate demand in order to prevent an economic slump.

Finally, it is also important to recognise that reducing the level of taxation makes a country more attractive to foreign investors. This, in turn, can provide a range of related economic benefits, such as enhanced business and employment opportunities. Through increased foreign investment, a country's pool of potential taxpayers is also broadened. Thus, when considering the level of taxation and the form it will take, governments need to carefully weigh up several factors, including the effect taxation has on a country's international competitiveness.

[1.14] QUESTIONS

1. What kinds of taxes were imposed in ancient times and what are the main kinds of taxes imposed today?
2. Is it correct to say that the only role of taxation is to raise government revenue? If taxation has other functions, what are they?
3. What is a 'tax expenditure program'? Provide some examples of such programs. What are some of the criticisms faced by such programs?
4. What structural features do tax systems have in common?
5. Provide some historical example of where taxation has led to national instability.
6. What are the characteristics of a 'good' tax system and what are some of the issues facing Australia that should be taken into account in designing its tax system?
7. Discuss the difference between a 'flow-through entity' and an 'opaque entity'.
8. Which bodies make, administer and adjudicate a country's tax laws?
9. How do Australia's general jurisdictional rules operate?
10. Why is it difficult to compare the levels of taxation in different countries? What benefits may flow from reducing the level of taxation?

TAX LAW RESEARCH AND INTERPRETATION

2

[2.1] Introduction

Taxation law is a vast and dynamic area of law that intersects with many other areas of law and is never static. Australia has dozens of tax statutes containing thousands of pages of complex and interconnected legislative provisions. In addition, the Australian courts and tribunals have handed down hundreds of significant tax decisions over the years. Many of these cases involve complex commercial factual situations that raise thorny legal issues.

Taxation law is also continually evolving and being reformed. Every year, several Bills are introduced into the Commonwealth, state and territory legislatures to address technical issues, fix loopholes, vary tax rates, alter incentives and adjust tax bases. It is therefore not surprising that one of the many challenges faced in studying and practising taxation law is keeping up with the constant barrage of changes and locating up-to-date legal resources.

This chapter introduces the primary sources of taxation law in Australia; namely, statute and common law [2.2]. It also outlines the main kinds of rulings and advice documents issued by the ATO [2.3]. These documents are important as they set out the Commissioner's views on the operation of the law and, in certain cases, can be binding. The chapter also discusses the vast range of secondary reference material that can be used to assist in researching and resolving tax problems [2.4]. It also identifies some of the key websites that are useful for conducting tax research [2.5]. The chapter concludes with a discussion of some basic rules of statutory interpretation, which are critical for understanding and applying tax legislation [2.6].

[2.2] Primary sources of tax law

Statute

Taxation is a creature of statute, rather than common law. Legislation is therefore the primary source of tax law. In Australia, tax legislation is enacted by the Commonwealth, state and territory legislatures. The Commonwealth Parliament's legislative powers are found in the *Commonwealth Constitution* and the process involved in enacting legislation is discussed at [3.3]. There are dozens of different tax and related statutes that make up the Commonwealth legislative scheme. These Acts span thousands of pages and contain many thousands of complex and technical interconnected provisions. The Office of Parliamentary Counsel, established under the *Parliamentary Counsel Act 1970* (Cth), has the role of drafting Commonwealth legislation and publishing such laws. Australia's tax

laws are being continuously reformed with many Bills introduced into Parliament each year. Tax legislation is also complemented by a broad range of subordinate legislative instruments, including many different regulations and determinations [3.3]. There is, arguably, no other area of law that is as complex or as legislatively fertile as tax law.

Common law

Tax laws enacted by the Commonwealth, state and territory legislatures are interpreted by the courts in the many cases that come before them each year. Tax cases typically involve disputes between a particular taxpayer and either the Commissioner of Taxation (in matters involving Commonwealth taxes) or the relevant Commissioners of State or Territory Revenue (in matters involving state and territory taxes). These disputes usually concern the way in which specific provisions in the legislation apply to particular transactions, and arise because taxpayers and tax administrators have different interpretations of the law. Over time, a large body of case law concerning the interpretation of tax legislation has been developed by the courts. The amount of tax litigation is not surprising given that tax disputes often concern the operation of complex provisions and involve large sums of money. The common law is therefore, together with the tax legislation, an important source of law.

Doctrine of precedent

In reading any court decision, it is important to be aware of the doctrine of precedent (*stare decisis*). This doctrine requires courts to follow earlier decisions when making their rulings and was developed to promote consistency and certainty in the application of the law by the courts. According to the doctrine, the *ratio decidendi* of a higher court in a court hierarchy is 'binding' on a lower court in the same hierarchy. The *ratio decidendi* is the court's reasons for its decision in the particular case. It forms the legal principle derived from the judgment in the case which can then be applied to similar cases. While the *ratio decidendi* of a higher court must be followed by lower courts in the same court hierarchy, the *ratio decidendi* of a court in another court hierarchy (eg a foreign court) does not need to be followed, but may nevertheless have 'persuasive' authority. A court must make a ruling on a particular point of law for a *ratio decidendi* to arise and it is possible for one case to give rise to a number of separate *ratios*.

Ratio decidendi should be distinguished from *obiter dicta* which consist of comments made by judges in passing that are not essential or directly relevant to the decision in a case. *Obiter dicta* are not binding and only have persuasive authority. In practice, the weight that a court will give to *obiter dicta* will typically depend on the reputation of the judge who has made the comments and the jurisdiction and seniority of the court on which that judge sits. It is possible, and indeed common, for *obiter dicta* in one case to later form the basis of the *ratio decidendi* of another case (ie where it is applied by the court in arriving at its decision in the subsequent case).

It is important to understand, however, that the *ratio decidendi* of a case will not be binding on a lower court if the decision can be distinguished on some ground (eg due to material factual differences in the cases). Much time is therefore often spent in court arguing whether or not a particular decision is applicable. Even slight variations in factual situations may produce different legal outcomes. In some situations, there may be conflicting precedents that require a court to draw distinctions between cases to determine which decision is the most appropriate to follow.

Court hierarchy

In the Australian federal tax jurisdiction, the basic hierarchy of courts (from highest to lowest) is as follows:

- High Court (consisting of up to seven judges—the current members of the High Court are Gageler CJ, Beech-Jones, Gordon, Edelman, Steward, Gleeson and Jagot JJ)
- Full Court of the Federal Court (consisting of three judges), and
- Federal Court (consisting of one judge).

The Administrative Appeals Tribunal ('AAT'), which is strictly an administrative body as opposed to a judicial body, also hears tax cases. The *Taxation Administration Act 1953* (Cth) ('*TAA*') gives the AAT the power to review certain decisions (including reviewable objection decisions) made by the Commissioner of Taxation. Reviews are conducted in accordance with the rules set out in the *Administrative Appeals Tribunal Act 1975* (Cth) ('*AATA*') as modified by the *TAA*. Taxpayers may appeal tribunal decisions to the Federal Court on questions of law (s 44 *AATA*). The way in which the appeal process operates is examined at [38.5].

Reports

Decisions of the federal courts and tribunals can be accessed online [2.5] and are also reported in law reports, such as:

- *Australian Tax Cases* ('ATC'), which contain reports of AAT, Federal Court and High Court tax decisions handed down since 1969
- *Australian Tax Decisions* ('ATD'), which contain reports of tax decisions handed down between 1930 and 1969
- *Australian Tax Reports* ('ATR'), which contain reports of AAT, Federal Court and High Court tax decisions
- *Federal Court Reports* ('FCR'), which contain authorised reports of Federal Court decisions, and
- *Commonwealth Law Reports* ('CLR'), which contain authorised reports of High Court decisions.

[2.3] Taxation rulings and advice

The ATO publishes a broad range of advice and guidance documents outlining the Commissioner's views on the operation of the tax laws. The main form of formal advice comes in the form of 'rulings'. Since 1 July 1992, a 'binding ruling system' has operated in Australia [38.4]. Under this system, the Commissioner can issue 'public rulings' advising on the way a relevant provision in the tax law applies to entities generally or to a class of entities. The Commissioner can also issue 'private rulings' to taxpayers who request them about how the tax law applies to their existing or proposed schemes. Public and private rulings must be in writing and must state that they are public or private rulings.

The Commissioner is generally bound to apply the law as set out in a binding ruling unless he is satisfied that the ruling is incorrect and disadvantages the taxpayer, in which case he may apply the law in a way that is more favourable to the taxpayer (provided he is not prevented from doing so by any legal time limits). Taxpayers who rely on a binding ruling are protected from having to pay any tax shortfall (ie underpaid tax), penalties or interest in respect of the matters covered in the ruling if it turns out that the ruling is incorrect.

There are several different kinds of binding public rulings, which each have a distinct prefix, year and identification number. The rulings are sometimes updated by addenda, and may be withdrawn. The main kinds of binding public rulings are contained in the following series:

- **Taxation Rulings ('TRs').** These rulings are the principal series of binding public rulings. They cover many different topics, including income tax and FBT. An example of a taxation ruling is TR 2008/2, which provides guidance on income tax issues relating to activities in the horse industry.
- **GST Rulings ('GSTRs').** These rulings are used to provide guidance on GST. An example of a GST ruling is GSTR 2006/9, which deals with the meaning of the term 'supply' for GST purposes.
- **Product Rulings ('PRs').** These rulings are usually sought by promoters of investment products such as managed investment schemes ('MISs'). They are typically attached to the prospectus accompanying the schemes to provide certainty to potential investors about the ATO's views on the tax implications of the particular products being marketed. An example of a product ruling

is PR 2008/63, relating to the 2009 Timbercorp Forestry Project. Product rulings overcome the need for each investor in the scheme to individually apply for a private ruling. Provided the scheme is carried out as described in the product ruling, investors are able to rely on the ruling. The product rulings system is explained further in PR 2007/71.

- **Class Rulings ('CRs').** These rulings are sought by entities on the tax effect of particular arrangements on a class of taxpayers. Class rulings are often sought by companies to advise their shareholders of the ATO position on capital management and restructuring issues, such as share buy-backs, takeovers and demergers. An example of a class ruling is CR 2008/10, which deals with the tax consequences for Coca-Cola Amatil's shareholders of an off-market share buy-back undertaken by the company. As with product rulings, class rulings overcome the need for each shareholder to individually seek a private ruling about the arrangement. The class rulings system is explained further in CR 2001/1.
- **Law Companion Rulings ('LCRs').** These rulings set out the ATO's views on how recently enacted tax laws apply. They are usually developed at about the same time as a Bill is being drafted and are designed to provide certainty about the application of new laws. The law companion guidelines system is explained further in LCR 2015/1.

The ATO also issues determinations, which are typically shorter than most rulings and generally only address specific questions. The following determinations are binding on the Commissioner: Taxation Determinations ('TDs') and GST Determinations ('GSTDs').

Rulings and determinations issued before the binding ruling system was introduced (on 1 July 1992) are not binding on the Commissioner. This includes the old Income Tax Rulings ('ITs'). The ATO also publishes a range of non-binding superannuation rulings and determinations, such as Superannuation Guarantee Rulings ('SGRs'), Self-Managed Superannuation Fund Rulings ('SMSFRs'), Superannuation Guarantee Determinations ('SGDs'), Superannuation Contribution Determinations ('SCDs') and Self-Managed Superannuation Fund Determinations ('SMSFDs'). While taxpayers that rely on non-binding rulings are not protected from having to pay any tax shortfall, they are generally protected against having to pay certain penalties and, if they relied on the document reasonably and in good faith, they are also generally protected from having to pay interest.

The ATO also publishes Interpretative Decisions ('IDs'), which set out the way it has interpreted the law in particular instances, and Decision Impact Statements ('DISs'), which set out its views on the outcome of particular court and tribunal decisions. Furthermore, to provide guidance on ATO administrative practices and assist ATO staff in performing their duties, the ATO issues Practice Statements Law Administration ('PS LA'). More recently, the ATO has started to publish Practical Compliance Guidelines ('PCGs'), which provide broad guidance on significant administrative and compliance issues. IDs, DISs, PS LAs and PCGs are not binding on the Commissioner. They are, nevertheless, made publicly available for information and transparency purposes.

A large amount of general advice is also published on the ATO website. This includes bulletins, guidelines, taxpayer alerts, policy statements, media releases and consultative documents. Over the years, the ATO has also produced useful guidebooks and manuals detailing the practical operation of the tax laws (eg *Guide to the Debt and Equity Tests* and *Consolidation Reference Manual*). Practical information can also be obtained from ATO publications designed to assist taxpayers in compiling their tax returns (eg *Individual Tax Return Instructions*).

[2.4] Taxation reference material

In addition to legislation, cases and ATO rulings and advice, a vast array of secondary reference material can be used to research and resolve taxation issues. Some of the main kinds of publications that are frequently used by taxation practitioners, scholars and policymakers are discussed below.

Government publications

From time to time, the Government releases various papers, reports, research documents and exposure drafts in order to foster public awareness of an issue or as part of its consultative processes. For example, it is common for Treasury to issue an Exposure Draft Bill for public comment and submissions on important proposed alterations to the tax laws before a Bill is formally introduced into Parliament. The Exposure Draft Bill is usually accompanied by an Explanatory Memorandum. Likewise, the Bill that is eventually introduced into Parliament will also typically have its own Explanatory Memorandum. These documents are extremely useful as they explain how proposed laws are intended to operate and can assist with interpreting complex legislative provisions.

Many government publications also contain useful policy information and reform recommendations, which often form the basis of future tax laws. In the late 1990s, the Review of Business Taxation [5.4] published two important discussion papers (*A Strong Foundation* (1998) and *A Platform for Consultation* (1999)) as well as a major report recommending reforms to the Australian business tax system (*A Tax System Redesigned* (1999)). A number of significant papers and reports were also produced by the Henry Tax Review [5.5]. This included *Architecture of Australia's Tax and Transfer System* (2008) and *Australia's Future Tax System—Report to the Treasurer* (2009). More recently, the Abbott Government published its *Re:think* (2015) discussion paper [5.7].

Board of Taxation publications

The Board of Taxation, which is an advisory board that assists the Government in the development and implementation of the tax laws, has also published several interesting papers and reports over the years, including the following:

- *International Taxation—A Report to the Treasurer* (2003)
- *A Tax Transparency Code—A Report to the Treasurer* (2016)
- *Reforming Individual Tax Residency Rules—A Model for Modernisation* (2019), and
- *Review of GST on Low Value Imported Goods* (2021).

Professional publications

Professional bodies, such as those listed below, also produce a variety of tax publications:

- Taxation Institute of Australia
- Australian Tax Research Foundation
- Corporate Taxpayers' Association
- Chartered Accountants Australia and New Zealand
- Law societies in states and territories
- Law Council of Australia, and
- CPA Australia.

These bodies often make submissions or release consultative documents or research papers concerning various tax matters.

In addition, many law and accounting firms (particularly the larger firms) produce their own publications dealing with aspects of taxation law. These publications often have a useful practical focus.

Academic and professional journals and conference papers

Journal articles and conference papers are an excellent secondary research resource as they usually contain a focused and critical analysis of particular topics. The main specialist Australian tax journals are listed below.

Australian Tax Journals	
Australian Tax Forum	*Journal of the Australasian Tax Teachers Association*
Australian Tax Review	*Revenue Law Journal*
CCH Tax Week	*Taxation in Australia*
eJournal of Tax Research	*Tax Specialist*
Journal of Australian Taxation	*Weekly Tax Bulletin*

Tax articles can also be found in university law reviews (eg *Melbourne University Law Review*), law journals (eg *Australian Law Journal*) and accounting journals (eg *Charter*). Tax papers are also frequently presented at conferences conducted throughout the year by various professional bodies, including the Taxation Institute of Australia and CPA Australia. These papers often have a highly practical and current focus. Tax papers are also presented at academic conferences such as those conducted by the Australasian Tax Teachers Association and the Accounting Association of Australia and New Zealand. These papers are often more theoretical and policy-orientated in nature.

Journal and conference papers can be accessed via databases such as the Attorney-General's Information Service ('AGIS'), the Australian Public Affairs Information Service ('APAIS') and the Social Science Research Network ('SSRN').

Textbooks and casebooks

Textbooks are perhaps the most useful starting point in conducting tax research as they enable the reader to gain an overview and basic understanding of a particular issue. Textbooks usually provide a conceptual framework and introduction to the law and a structured discussion of the relevant legislation, cases and rulings in the area. There is also often a critical analysis and synthesis of the legal principles covered. The most widely used and comprehensive annually updated Australian taxation law textbooks designed for practitioners are Wolters Kluwer, *Australian Master Tax Guide*, and R Deutsch, M Friezer, I Fullerton, P Hanley and T Snape, *Australian Tax Handbook*. There are also several textbooks that focus on specialist areas, such as GST (eg P McCouat, *Australian Master GST Guide* and I Murray Jones, *Australian GST Handbook*) and superannuation (eg J Leow and S Murphy, *Australian Master Superannuation Guide* and S Jones, *Australian Superannuation Handbook*). The Australian Tax Research Foundation also publishes useful books containing in-depth research studies on particular taxation law topics.

Casebooks can also play a useful part in tax research. Casebooks generally provide the reader with the basic facts of a case as well as critical parts of the leading judgments (eg S Barkoczy, C Rider, J Baring and N Bellamy, *Australian Tax Casebook* (2021)). Some casebooks go beyond merely providing summaries and extracts of cases to also include commentary and questions (eg G Cooper, M Dirkis, M Stewart and R Vann, *Income Taxation Commentary and Materials* (2022)).

International resources

While the tax laws of each country vary dramatically, there are many common issues. For instance, many countries adopt similar concepts of income and deductions. They also usually base their jurisdictional rules on similar principles (eg residence and source) and have broadly similar kinds of international tax regimes (eg transfer pricing, accruals and withholding tax regimes). Likewise, many principles of tax theory are of universal concern—policy issues, such as what are the features of a good tax system and how should tax avoidance be tackled, are generally relevant to all jurisdictions. It is also interesting to look at alternative tax systems for comparative purposes. Foreign tax systems may provide useful benchmarking data and provide innovative ideas for tax reform. For these reasons, it is appropriate in many cases to extend one's research beyond Australia and investigate the

international literature. This includes using books published by international publishers like Wolters Kluwer, LexisNexis and Thomson Reuters as well as those published by international organisations such as the OECD and the International Bureau of Fiscal Documentation. It also involves using specialist international tax journals such as the following:

International Tax Journals	
American Journal of Tax Policy	*Florida Tax Review*
Asia-Pacific Tax Bulletin	*Houston Business and Tax Law Journal*
ATA Journal of Legal Tax Research	*Intertax*
British Tax Review	*International Tax Journal*
Bulletin for International Taxation	*International Tax Review*
Canadian Current Tax	*New Zealand Journal of Taxation Law and Policy*
Canadian Tax Journal	*Pittsburgh Tax Review*
Columbia Journal of Tax Law	*Tax Law Review*
EC Tax Journal	*Tax Lawyer*
EC Tax Review	*Tax Notes International*
European Taxation	*VAT Monitor*
Fiscal Studies	*Virginia Tax Review*

[2.5] Online and electronic resources

Useful tax and related legal information from Australia and around the world can be obtained via the internet. For instance, many of the articles in the overseas journals mentioned at [2.4] can be conveniently accessed electronically using databases such as *LexisNexis*, *Westlaw*, *Kluwer Law Online* and the *IBFD Tax Research Platform*.

Without doubt, one of the most useful practical research tools is Wolters Kluwer's *CCH IntelliConnect*, which is an electronic database that provides access to a number of products, including the *Master Tax Guide* and a range of more detailed encyclopaedic services. These services contain key source material (eg legislation, cases and rulings) and extensive commentary regarding the law. *CCH IntelliConnect* allows rapid searches across numerous products and is particularly user-friendly as references are linked by hypertext. Another useful electronic library service is *Checkpoint*, which provides access to an array of tax and related publications published by Thomson Reuters.

The following table lists some useful websites for conducting tax research.

Australian Government	
Australian Border Force	www.abf.gov.au
Australian Business Register	www.abr.business.gov.au
Australian Charities and Not-for-profits Commission	www.acnc.gov.au
Australian Parliament	www.aph.gov.au
Australian Prudential Regulation Authority	www.apra.gov.au
Australian Securities and Investment Commission	www.asic.gov.au
Australian Taxation Office	www.ato.gov.au
Australian Transaction Reports and Analysis Centre	www.austrac.gov.au

Board of Taxation	www.taxboard.gov.au
Industry Innovation and Science Australia	www.industry.gov.au
Inspector-General of Taxation	www.igt.gov.au
myGov	www.my.gov.au
Tax Practitioners Board	www.tpb.gov.au
Treasury	www.treasury.gov.au/review
Australian Federal Courts and Tribunals	
High Court	www.hcourt.gov.au
Federal Court	www.fedcourt.gov.au
Administrative Appeals Tribunal	www.aat.gov.au
State and Territory Revenue Agencies	
ACT Revenue Office	www.revenue.act.gov.au
Queensland Office of State Revenue	www.treasury.qld.gov.au
Revenue NSW	www.revenue.nsw.gov.au
RevenueSA	www.revenuesa.sa.gov.au
RevenueWA	www.finance.wa.gov.au
State Revenue Office of Tasmania	www.sro.tas.gov.au
State Revenue Office Victoria	www.sro.vic.gov.au
Territory Revenue Office	www.treasury.nt.gov.au
Foreign Revenue Agencies	
Canada Revenue Agency	www.cra-arc.gc.ca
Hong Kong Inland Revenue Department	www.ird.gov.hk
Inland Revenue Authority of Singapore	www.iras.gov.sg
New Zealand Inland Revenue	www.ird.govt.nz
United Kingdom HM Revenue and Customs	www.hmrc.gov.uk
United States Internal Revenue Service	www.irs.gov
Legal Research Sites	
Australasian Legal Information Institute	www.austlii.edu.au
Federal Register of Legislation	www.legislation.gov.au
World Legal Information Institute	www.worldlii.org
Australian Tax Law Publishers	
Cambridge University Press	www.cambridge.org
Thomson Reuters	www.thomsonreuters.com.au
Wolters Kluwer	www.wolterskluwer.com/en_au
Australian Professional Bodies	
Association of Superannuation Funds of Australia Ltd	www.superannuation.asn.au
CPA Australia	www.cpaaustralia.com.au
Chartered Accountants Australia and New Zealand	www.charteredaccountantsanz.com

Law Council of Australia	www.lawcouncil.asn.au
National Tax and Accountants' Association	www.ntaa.com.au
Tax Institute	www.taxinstitute.com.au
Australian Law Firms	
Allens	www.allens.com.au
Ashurst	www.ashurst.com
Clayton Utz	www.claytonutz.com
Corrs Chambers Westgarth	www.corrs.com.au
Herbert Smith Freehills	www.herbertsmithfreehills.com
King & Wood Mallesons	www.kwm.com
MinterEllison	www.minterellison.com
Australian Accounting and Tax Advisory Firms	
BDO	www.bdo.com.au
Deloitte	www.deloitte.com.au
Ernst and Young	www.ey.com/en_au
KPMG	www.kpmg.com.au
Pitcher Partners	www.pitcher.com.au
PricewaterhouseCoopers	www.pwc.com.au
International Organisations	
International Bureau of Fiscal Documentation	www.ibfd.org
International Monetary Fund	www.imf.org
Organisation for Economic Co-operation and Development	www.oecd.org
Tax Justice Network	www.taxjustice.net

[2.6] Statutory interpretation

As taxation law is a creature of statute, statutory interpretation (ie the process of ascertaining the meaning of words and phrases used in legislation) is a critical aspect of everyday tax practice. Unfortunately, language is not always a precise tool for conveying ideas and there are often different views on the meaning of words in a statute. This is particularly the case where a statute deals with difficult technical concepts, such as those relating to taxation.

Legislative intention

It is for the courts to rule on the interpretation of tax legislation and, in doing so, they are required to give effect to the intention of Parliament as expressed by the terms of the statute. In *Cooper Brookes (Wollongong) Pty Ltd v FC of T* 81 ATC 4292, Mason and Wilson JJ recognised (at 4305) that the object 'is to ascertain the legislative intention by reference to the language of the instrument viewed as a whole'. Their Honours went on to explain that 'in performing that task, the courts look to the operation of the statute according to its terms and to legitimate aids to construction'.

In *Project Blue Sky v Australian Broadcasting Authority* (1998) 194 CLR 355, the High Court explained (at 381) that 'the process of construction must always begin by examining the context of the provision that is being construed'. The High Court noted that statutes consist of verbal formulas, where the literal meaning of words is not always the same as their legal meaning. In elaborating on this point, McHugh, Gummow, Kirby and Hayne JJ said (at 384):

> Thus, the duty of a court is to give the words of a statutory provision the meaning that the legislature is taken to have intended them to have. Ordinarily, that meaning (the legal meaning) will correspond with the grammatical meaning of the provision. But not always. The context of the words, the consequences of a literal or grammatical construction, the purpose of the statute or the canons of construction may require the words of a legislative provision to be read in a way that does not correspond with the literal or grammatical meaning.

The importance of reading words in their proper context, rather than in isolation, was recognised long ago in *Metropolitan Gas Co v Federated Gas Employees' Industrial Union* (1924) 35 CLR 449, where Isaacs and Rich JJ emphasised (at 455) that a 'canon of interpretation' was that 'every passage in a document must be read, not as if it were entirely divorced from its context, but as part of the whole instrument'.

More recently, in *Construction, Forestry, Maritime, Mining and Energy Union v Australian Building and Construction Commissioner* [2020] FCAFC 192, Allsop CJ explained (at [4]):

> Meaning is to be ascribed to the text of the statute, read in its context. The context, general purpose and policy of the provision and its consistency and fairness are surer guides to meaning than the logic of the construction of the provision.

In *Zheng v Cai* (2009) 239 CLR 446, the High Court stated (at 455) that attributing legislative intention is 'something of a fiction' that does not involve the attribution of a 'collective mental state to legislators' but rather 'the application of rules of interpretation accepted by all arms of government in the system of representative democracy'.

Ultimately, a statute has the meaning that Parliament intended it to have. The High Court in *Lacey v Attorney-General* (Qld) (2011) 242 CLR 573 explained (at 592) that this meaning is ascertained by reference to 'the rules of construction, common law and statutory, which have been applied to reach the preferred results and which are known to parliamentary drafters and the courts'. The High Court went on to state:

> The application of the rules will properly involve the identification of a statutory purpose, which may appear from an express statement in the relevant statute, by inference from its terms and by appropriate reference to extrinsic materials. The purpose of a statute is not something which exists outside the statute. It resides in its text and structure, albeit it may be identified by reference to common law and statutory rules of construction.

The following discussion introduces some of the basic statutory and common law rules that have been developed over the years to assist with the interpretation of legislation. However, before examining these rules, it is worth noting the words of Pearce in *Statutory Interpretation in Australia* (2019) who states (at 136):

> Legislation is, at its heart, an instrument of communication. For this reason, many of the so-called rules or principles of interpretation are no more than common-sense and grammatical aids that are applicable to any document by which one person endeavours to convey a message to another. Any inquiry into the meaning of an Act should therefore start with the question: 'What message is the legislature trying to convey in this communication?'

Legislative rules of statutory interpretation

The *Acts Interpretation Act 1901* contains a number of rules and presumptions for interpreting Commonwealth legislation. Some of the more important provisions in the Act are outlined below:

- **Acts read subject to the *Constitution*.** Section 15A states that every Act 'shall be read and construed subject to the *Constitution*, and so as not to exceed the legislative power of the Commonwealth'. Where any enactment would otherwise be in excess of that power 'it shall nevertheless be a valid enactment to the extent to which it is not in excess of that power'.
- **Construction that promotes the purpose or object of the Act.** Section 15AA states that in interpreting a provision of an Act, 'a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object'.
- **Use of extrinsic material.** Section 15AB states that if any material not forming part of an Act is capable of assisting in ascertaining the meaning of a provision in the Act, consideration may be given to that material to:
  (a) confirm that the meaning of the provision is the ordinary meaning conveyed by the text taking into account its context and the purpose or object underlying the Act, or
  (b) determine the meaning of the provision when: (i) the provision is ambiguous or obscure; or (ii) the ordinary meaning conveyed by the text taking into account its context and the purpose or object underlying the Act leads to a result that is manifestly absurd or is unreasonable.

  Material that may be considered for the purposes of s 15AB includes:
  – documents attached to the Act
  – reports of a Royal Commission, Law Reform Commission or committee of inquiry or other similar body laid before Parliament before enactment
  – treaties or other international agreements referred to in the Act
  – explanatory memoranda relating to the Bill containing the provision, or any other relevant document, laid before Parliament by a Minister before enactment
  – Ministerial speeches made to Parliament moving the Bill, and
  – materials in the Journals of the Senate, Votes and Proceedings of the House of Representatives or in any official record of debates in Parliament.

  Only material existing at the time the relevant legislation was enacted should be considered under s 15AB. As Williams J of the Supreme Court of Queensland stated in *FC of T v Bill Wissler (Agencies) Pty Ltd* 85 ATC 4626 (at 4631):

  > I do not read s 15AB of the Acts Interpretation Act as permitting the Court to consider a statement made at a later point of time (say when the legislation was being amended) in order to discern the intention of the legislature when the original statute was passed. It is much easier to be wise after the legislation has been applied in practice and scrutinised by the courts. Such belated statements of legislative intent could hardly ever affect the proper construction of the language used in the statute.

- **Changes to style.** Section 15AC states that where an Act has expressed an idea in a particular form of words and a later Act appears to have expressed the same idea in a different form of words for the purpose of using a clearer style, the ideas shall not be taken to be different merely because different forms of words were used.
- **Relevance of examples.** Section 15AD states that where an Act includes an example of the operation of a provision, the example shall not be taken to be exhaustive and, if the example is inconsistent with the provision, the provision prevails.

Common law rules of statutory interpretation

Over the years, the courts have also devised a number of approaches to assist with the interpretation of legislation, including the following three basic rules:

1. **The literal rule.** The literal rule is the basic approach for interpreting legislation. According to this rule, the words of legislation are to be interpreted according to their natural and ordinary meaning. The essence of the literal rule was expressed by Higgins J in *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129 at (161) as follows:

   > The fundamental rule of interpretation, to which all others are subordinate, is that a statute is to be expounded according to the intent of the Parliament that made it; and that intention has to be found by an examination of the language used in the statute as a whole. The question is, what does the language mean; and when we find what the language means, in its ordinary and natural sense, it is our duty to obey that meaning, even if we think the result to be inconvenient or impolitic or improbable.

2. **The golden rule.** The golden rule is used where the literal rule produces an absurd, irrational, capricious or unjust outcome. It qualifies the literal rule and allows courts to interpret legislation in a common-sense way that avoids these results. The origins of the golden rule can be found in *Grey v Pearson* (1857) 10 ER 1216, where Lord Wensleydale stated (at 1234) that in construing statutes:

   > the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified, so as to avoid that absurdity and inconsistency, but no farther.

3. **The mischief rule.** The mischief rule requires a court to interpret legislation in a way that addresses the mischief, harm or defect that the legislature intended to remedy. This rule is another qualification to the literal rule and can be traced back more than five centuries to the Court of Exchequer's decision in *Heydon* (1584) 76 ER 637. It is considered by many to be the origins of the modern 'purposive approach' discussed further below.

Traditional approach to interpreting tax legislation

The traditional approach adopted by the Australian courts to interpreting tax legislation, particularly around the time that Sir Garfield Barwick was Chief Justice of the High Court (1964–1981), was to use a strict literal approach. This approach is evident from his Honour's remarks in *FC of T v Westraders Pty Limited* 80 ATC 4357 (at 4358–4359):

> It is for the Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. The function of the Court is to interpret and apply the language in which the Parliament has specified those circumstances. The Court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament which is discoverable from the language used by the Parliament. It is not for the Court to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve, though not expressed in the actual language employed . . . Parliament having prescribed the circumstances which will attract tax, or provide occasion for its reduction or elimination, the citizen has every right to mould the transaction into which he is about to enter into a form which satisfies the requirements of the statute. It is nothing to the point that he might have attained the

> same or a similar result as that achieved by the transaction into which he in fact entered by some other transaction, which, if he had entered into it, would or might have involved him in a liability to tax, or to more tax than that attracted by the transaction into which he in fact entered. Nor can it matter that his choice of transaction was influenced wholly or in part by its effect upon his obligation to pay tax. Of course, the transaction must not be a pretence obscuring or attempting to supplant some other transaction into which in fact the taxpayer had earlier entered. Again, the freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society.

Underpinning the strict literal approach is the basic principle that the intention to impose a tax must be shown by clear and unambiguous language and should not be inferred from ambiguous words. Gibbs CJ referred to this principle in *Western Australian Trustee Executor & Agency Co Ltd v C of ST (WA)* 80 ATC 4567 (at 4571):

> The established rule that no tax can be imposed on a subject by an Act of Parliament without words which clearly show an intention to lay the burden upon him does not mean that the court will strive to find loopholes where none are apparent; the words of the Act must be given a fair and reasonable construction, without leaning one way or the other. However, although, if the terms of the Act plainly impose the tax they should be given effect, equally if they do not reveal a clear intention to do so the liability should not be inferred from ambiguous words.

The courts have been prepared to depart from the literal meaning of a provision where doing so would give effect to the clear intention of Parliament. This occurred in *Cooper Brookes (Wollongong) Pty Ltd v FC of T* 81 ATC 4292, where a majority of the High Court construed a former poorly drafted anti-avoidance rule dealing with the carry forward of corporate losses according to its intent rather than its literal meaning so that its operation would not be 'capricious' or 'irrational'. Mason and Wilson JJ stated (at 4306):

> If the judge applies the literal rule it is because it gives emphasis to the factor which in the particular case he thinks is decisive . . . .
>
> On the other hand, when the judge labels the operation of the statute as 'absurd', 'extraordinary', 'capricious', 'irrational' or 'obscure' he assigns a ground for concluding that the Legislature could not have intended such an operation and that an alternative interpretation must be preferred. But the propriety of departing from the literal interpretation is not confined to situations described by these labels. It extends to any situation in which for good reason the operation of the statute on a literal reading does not conform to the legislative intent as ascertained from the provisions of the statute, including the policy which may be discerned from those provisions.

Modern approach to interpreting tax legislation

The modern approach to interpreting legislation is to adopt a construction that promotes the purpose or object of the statute. This 'purposive approach' is supported by s 15AA of the *Acts Interpretation Act* and requires the courts to have regard to the broader context of the legislation from the outset and not just when an ambiguity arises. In *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, Brennan CJ, Dawson, Toohey and Gummow JJ stated (at 408):

> the modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses 'context' in its widest sense to include such things as the existing state of the law and the mischief which . . . one may discern the statute was intended to remedy.

In *Fox v Commissioner for Superannuation (No 2)* (1999) 88 FCR 416, Black CJ referred to this passage and explained (at 419–420):

> It was once thought that a statutory provision was to be interpreted literally unless its terms disclosed an ambiguity of meaning, in which case regard could be had to its context in order to discern the intention behind the provision's enactment and thereby resolve the ambiguity. This, however, is contrary to the modern approach to statutory interpretation…
>
> It follows that context must be considered at the beginning of any inquiry into the meaning of a statute, regardless of the apparent clarity of the literal terms of the relevant provision itself…
>
> Where a conflict exists between the constructions of a provision revealed by two principles of interpretation—here, by a literal reading and a purposive reading—a court 'must proceed with its primary task of extracting the intention of the legislature from the fair meaning of words by which it has expressed that intention', remembering always the mischief that the provision was enacted to address…

More recently, the modern approach was summarised by the High Court in *Sztal v Minister for Immigration and Border Protection* (2017) 262 CLR 362, where Keifel CJ, Nettle and Gordon JJ stated (at 368):

> The starting point for the ascertainment of the meaning of a statutory provision is the text of the statute whilst, at the same time, regard is had to its context and purpose… Context should be regarded at this first stage and not at some later stage and it should be regarded in its widest sense… This is not to deny the importance of the natural and ordinary meaning of a word, namely how it is ordinarily understood in discourse, to the process of construction. Considerations of context and purpose simply recognise that, understood in its statutory, historical or other context, some other meaning of a word may be suggested, and so too, if its ordinary meaning is not consistent with the statutory purpose, that meaning must be rejected.

Legal maxims

To assist in working out the meaning of particular words or phrases in a statute that may be ambiguous or unclear, the courts have often relied on various guiding principles that have been expressed in Latin maxims. The principles reflect a logical and common-sense approach to interpreting the language of a statute and are founded on basic grammatical and syntactic rules. Some commonly encountered maxims are outlined below:

- ***Noscitur a sociis***. This maxim supports a contextual approach to interpretation. It stands for the principle that a word or phrase should take its meaning from associated or accompanying words or phrases. In his 1937 book, *Law & Other Things*, Lord Macmillan vividly expressed the maxim as 'words of a feather flock together'. An illustration of where the maxim was applied is found in *Montgomerie v CIR (NZ)* (1965) 14 ATD 102, where the Supreme Court of New Zealand had to consider whether income of a trust had been 'applied' for the purposes of a provision in a New Zealand tax statute that contained the words 'pays or applies'. Barrowclough CJ said (at 107): 'The word "applied" is used in conjunction with "paid" and whilst of course it must have a somewhat different connotation, nevertheless, *noscitur a sociis*, and in my opinion the income cannot be said to be "applied" unless there is some dealing with it that is akin to payment—some parting with the possession and control of it.'
- ***Ejusdem generis***. This maxim means 'of the same kind'. It stands for the principle that where there is a list of specific things followed by a more general thing, the meaning given to the general thing should be restricted to cover the same class of things that are included in the specific

list. In *R v Regos* (1947) 74 CLR 613, Latham CJ explained that under this rule, 'general words may be restricted to the same genus as the specific words that precede them'. For example, in *Canwan Coals Pty Ltd v FC of T* 74 ATC 4231, the Supreme Court of NSW considered the phrase 'a railway, road, pipe-line or other facility' in a former *ITAA36* provision. It relied on the *ejusdem generis* rule to construe the words 'other facility' as referring only to those facilities upon which, or through which, relevant goods might be moved or conveyed. A reserve storage facility was therefore not such a facility, as it was not used for transport.

- ***Expressio unius est exclusio alterius***. This maxim can be translated as 'the expression of one is at the exclusion of others'. It suggests that where one class of thing is mentioned in a statute, then other classes of the same thing that are not mentioned should be excluded. Although this maxim can be useful in certain cases, the courts have warned that it should be applied with caution (see eg *FC of T v Barnes Development Pty Ltd* 2009 ATC ¶20-121; *State of Tasmania v Cth* (1901) 1 CLR 329; *Houssein v Under Secretary of Industrial Relations and Technology* (1982) 148 CLR 88).
- ***Generalia specialibus non derogant***. This maxim means 'the general does not detract from the specific'. Based on this maxim, a specific provision in a statute should override a general provision in the statute where those provisions are in conflict. The maxim has been considered in a number of tax cases, including the High Court decision in *FC of T v Gulland* 85 ATC 4765. In *Barker v Edger* [1898] AC 748, the Privy Council explained (at 754) that the maxim operates as follows: 'whenever there is a particular enactment and a general enactment in the same statute, and the latter, taken in its most comprehensive sense, would overrule the former, the particular enactment must be operative, and the general enactment must be taken to affect only the parts of the statute to which it may properly apply'.

It is important not to view the above maxims as rigid and inflexible rules, but rather as simply aids to construction. As Higgins J said in *Bank Officials' Association (South Australian Branch) v Savings Bank of South Australia* (1923) 32 CLR 276 (at 299), the maxims 'merely afford presumptions' and 'merely aid us in taking our bearings in the movement of our reason'.

The difficulty in relying on the maxims was noted in *Chief Executive Officer of Customs v Biocontrol Ltd* [2006] FCA 107, where the Federal Court warned that the *ejusdem generis* rule is 'no more than a guide to interpretation' that should be 'used cautiously'. Young J said (at [46]):

> There will be occasions when it is not appropriate to apply the rule having regard to the context and purpose of the particular statutory provision. There will also be occasions where the descriptive terms that precede the general words are so varied that it is futile to search for a single genus or class that can be of assistance in giving meaning to the general words. Conversely, there will be occasions where it is both sensible and appropriate to give meaning to the general words by identifying the class or genus that is indicated by the preceding particular words. All in all, the surest approach is to give meaning to general words which follow particular words in a statutory provision by determining the meaning of those words in their context and by reference to the purpose of the provision, in the same way as meaning is given to other words in a statute.

Defined terms and common expressions

Where legislation defines a particular term, the term must obviously be interpreted in accordance with its technical statutory definition. It is, therefore, important when interpreting legislation to check whether it contains any express definitions. Most tax statutes have lengthy definition sections. Examples of such provisions in Australia's tax statutes include: s 6 *ITAA36*, s 995-1 *ITAA97*, s 195-1 *GSTA* and s 136 *FBTAA*. Terms that are not specifically defined in the legislation should ordinarily be given their natural meanings.

When reading statutes, it is also important to note the distinctions that are generally drawn between commonly used expressions, such as the following:

- **'May' and 'shall'.** The word 'may' usually confers a discretionary power (ie it indicates that something is permissible or optional). The word 'shall', on the other hand, usually imposes an obligation or duty (ie it indicates that something is mandatory or compulsory).
- **'Means' and 'includes'.** The word 'means' indicates that a term has an exhaustive and restricted definition and that no other meaning can be attributed to it (ie it confines the scope of a definition). The word 'includes', on the other hand, indicates that a term has meanings outside those things specifically mentioned (ie it enlarges the scope of a definition).
- **'And' and 'or'.** The word 'and' when used in a list of words or phrases indicates that the words or phrases are to be read conjunctively (ie as cumulative requirements). The word 'or' when used in a list of words or phrases indicates that the words or phrases are to be read disjunctively (ie as alternatives).

[2.7] QUESTIONS

1. What are the primary sources of tax law?
2. What kinds of rulings does the ATO issue? What is the difference between a binding and a non-binding ruling?
3. Discuss the main kinds of secondary resource materials available for undertaking tax research. What are some of the main Australian tax journals?
4. Visit the ATO website—what kinds of information does it contain? Visit the parliamentary website—what tax Bills are currently before Parliament?
5. In what circumstances does s 15AB of the *Acts Interpretation Act 1901* (Cth) permit material that does not form part of an Act to be used to assist in ascertaining the meaning of a provision in the Act?
6. Explain the different connotations of the words 'means' and 'includes' when used in a definition provision. Provide some examples from the *ITAA97*.

CONSTITUTIONAL FRAMEWORK OF THE AUSTRALIAN TAX SYSTEM 3

[3.1] Introduction

In order to properly appreciate the framework in which Australia's tax laws operate, it is necessary to understand Australia's system of government and the constitutional setting within which the tax system functions. This chapter discusses how Australia's federal system of government evolved and how sovereign power is shared between the Commonwealth and states [3.2]. It also examines the *Commonwealth Constitution* [3.3] and focuses on the following provisions:

- s 51(ii) (which deals with the Commonwealth Parliament's taxation power) [3.4]
- s 53 (which deals with the Senate's powers in relation to taxation laws) [3.5]
- s 55 (which deals with the nature of laws imposing taxation) [3.6]
- s 81 and s 83 (which deal with the Consolidated Revenue Fund and appropriations of money from Treasury) [3.7]
- s 90 (which deals with the power to impose customs and excise duties) [3.8]
- s 96 (which deals with grants of financial assistance to the states) [3.9], and
- s 114 (which deals with the imposition of taxes on property belonging to the states) [3.10].

[3.2] Australian system of government

Australia has been inhabited by First Nations people for over 50,000 years. In 1788, Australia was colonised by Britain when Governor Phillip arrived with the First Fleet in Botany Bay to establish New South Wales ('NSW') as a penal colony. NSW was subsequently divided into a number of additional independent colonies: namely, Tasmania, originally called Van Diemen's Land (in 1825), South Australia (in 1836), Victoria (in 1851) and Queensland (in 1859). Western Australia originated as a separate free colony (in 1829). As the colonies were 'British settlements', the existing laws of Britain were transplanted, insofar as they were applicable, to the colonies under the 'doctrine of received law'. The British colonisers treated Australia as *terra nullius* (ie a land belonging to nobody) and did not recognise the existence of any customary laws of the First Nations people.