Journal of Australian Taxation

(2025) Volume 27(3)

TABLE OF CONTENTS

EDITORIAL

The 2025 Volume 27(3) issue of the *Journal of Australian Taxation* contains five very interesting and yet diverse articles relating to taxation law in Australia, New Zealand, South Africa and Canada.

The first article by Lisa Marriott explores the OECD report outlining ten principles for fighting tax crime that was published in 2017 coupled with a second edition published in 2021 which provides a framework to assist countries in improving tax compliance. The OECD also published a Tax Crime Investigation Maturity Model to help tax authorities self-assess their capabilities to address tax crime. Adopting a descriptive approach and using official documents and information obtained under the Official Information Act 1982, this article uses the OECD framework and the OECD Tax Crime Investigation Maturity Model to evaluate New Zealand's approach to fighting tax crime. It also provides a critique of the OECD principles and offers suggestions to improve the operationalisation of the principles. The article recommends that future OECD reports include more precise measures of performance, as the principles currently indicate potential, rather than actual performance. Lisa Marriott contends that the principles would further benefit from greater acknowledgment of the potential for technology in addressing tax crime.

The second article written by Muneer Hassan contends that the existing South African VAT Act is intricate to instruct, implement and administer, and exhibits a need for profound improvements. His empirical study presents guidelines to improve the VAT Act, which entails following the lifecycle of a VAT vendor, organising sections into groups, incorporating headings and subheadings, providing clear signposting, and finding the most effective solution to address local challenges. His recommendation also included in the guidelines is that these guidelines should be used to construct a descriptive framework to the VAT Act. This study presents a descriptive framework to re-organising the VAT Act utilising the guidelines employing applied qualitative research as the research methodology. Recommendations provided by interviewees were integrated to improve the descriptive framework. The constructed descriptive framework to the VAT Act marks the first stage in the process of simplifying the South African VAT Act.

The third article is written by Peter McMahon and Aleks Zochowski and examines the precise geographical limits of Australia's primary indirect tax laws, the Goods and Services Tax (GST) and stamp duty which they contend is of critical importance to taxpayers operating in its coastal waters. In particular this article examines the myriad and diverse Federal, State and Territory laws that are primarily relevant to the identification of those geographical limits. Regarding GST, the article considers the precise meaning of the phrase 'indirect tax zone' in the GST legislation and determines that it is only those supplies that are connected with the first 3 nautical miles of Australia's 12 nautical mile 'territorial sea' that fall within the GST net. The authors consider that this position is at odds with clear Parliamentary intention which was to ensure GST applied to supplies connected with the full 12 nautical miles of the territorial sea. They recommend that amending legislation ought to be introduced to clarify the position, and to dispel any uncertainty for taxpayers as to the GST treatment of activities carried out in the country's full territorial sea. The article then goes on to consider the precise geographical scope of the stamp duty laws of the States and the Northern Territory, and whether stamp duties may be levied on transactions over property located on, in or under a jurisdiction's coastal waters sea bed. In that regard, the article considers the Duties legislation of each state and the Northern Territory separately.

The fourth article is written by Francois Vaillancourt. He presents evidence on the evolution of both the complexity of the personal income tax system and the compliance costs incurred by personal income tax filers (PIT) in Canada. The complexity is measured using three indicators: length of federal income tax code (1971-2018), number of federal PIT expenditures (1981-2014) and length of PIT forms (2000-2015). All three indicators show an increase in complexity. The compliance costs of the PIT are calculated using survey information gathered from individual Canadians on time expanded and amount spent the following year for the 1985, 2007, 2018 and 2022 tax filing /calendar years. His results show a decrease in the PIT compliance costs in hours, in total value and as share of GDP and revenues collected. This drop in compliance costs is most likely due to the increasing use of software by tax filers to prepare their tax returns; this allows them, amongst other things, to download information from the Revenue agencies. A tax pain index combining complexity and compliance costs is put forward; its small growth over time may well explain why increasing tax complexity of the PIT in Canada is apparently well tolerated. The article ends with a short review of similar Australian evidence.

The fifth article is written by Dale Boccabella and Norman Hanna. The authors undertake a very detailed analysis of the 'Charles Apartments' case which involved the deductibility of an 'amount' incurred by a group company in the context of a property development group heavily indebted to an outside lender, and that lender holding loan guarantees from all group companies. The group was not consolidated for income tax purposes. Upon the sale of its only asset, the group company paid the net-proceeds to the outside lender to reduce the group's overall debt, yet the group company had a loan on foot from another group company to fund development of its only asset. There were differing views between the AAT and the Federal Court of this underlying general law payment transaction, namely, the AAT holding that it was (in part) an interest payment to the intra-group lender and the Federal Court holding it was a payment under the guarantee to the outside lender. From those positions, the income tax deductibility outcome also differed. This article deals with this difference of approach between the AAT and the Federal Court, an issue of considerable significance to similarly placed groups. The article also identifies and discusses what appear to be anomalies and inconsistencies in the litigation to date.

John McLaren, John Minas and Sonali Walpola

Editors 2025

FIGHTING TAX CRIME: A CRITICAL ANALYSIS OF THE OECD TEN PRINCIPLES WITH APPLICATION TO AOTEAROA NEW ZEALAND

Lisa Marriott[≠]

Abstract

The OECD published a report outlining ten principles for fighting tax crime in 2017. This OECD report, along with a second edition in 2021, provided a framework to assist countries in improving tax compliance. The OECD also published a Tax Crime Investigation Maturity Model to help tax authorities self-assess their capabilities to address tax crime. Adopting a descriptive approach and using official documents and information obtained under the Official Information Act 1982, this article uses the OECD framework and the OECD Tax Crime Investigation Maturity Model to evaluate New Zealand's approach to fighting tax crime. It also provides a critique of the OECD principles and offers suggestions to improve the operationalisation of the principles.

Analysis of New Zealand's approach to fighting tax crime suggests that New Zealand performs well against seven of the ten principles. However, three appear less well complied with. Specifically, the analysis concludes that an effective and coherent strategy for addressing tax crime is absent; there is not a clear organisational structure with defined responsibilities for tax crime; and the tax investigation function is not adequately resourced.

The article recommends that future OECD reports include more precise measures of performance, as the principles currently indicate potential, rather than actual performance. The principles would further benefit from greater acknowledgment of the potential for technology in addressing tax crime.

The OECD guidelines are a welcome addition to assist with addressing tax crime. It is intended that the analysis and proposals in this study provide suggestions to the New Zealand tax authority to improve practice, and to the OECD for future iterations of both evaluations and development of the principles.

Keywords: tax crime; OECD principles; New Zealand; tax resourcing; tax strategy

I INTRODUCTION

This article examines New Zealand's approach to fighting tax crime.There are multiple reasons why a country should address tax crime. The presence of illegal tax conduct distorts the competitive landscape for businesses. There are potential reputation impacts for a country that is perceived to not take tax crime seriously. Perhaps the most self-evident is that tax crime reduces tax revenue collected, with a concomitant impact on society.

[≠] Professor, Victoria University of Wellington, NZ, and University of Pretoria, South Africa.

Addressing tax crimes is increasingly important as the crimes become more sophisticated, harder to identify, and more significant by way of monetary value lost to society.[1] While it is not possible to quantify a precise measure of harm from tax crime, estimates typically agree that at least a trillion US tax dollars are lost globally due to tax fraud.[2] Despite the significant harm attributable to this crime, it has only been in more recent times that global solutions have been sought, and provided, for the issue.[3] One of these global solutions is used for evaluation purposes in this article, specifically the proposals outlined in the OECD publication *Fighting Tax Crime.*[4] This publication, which is discussed in more detail later in the article, is used to evaluate New Zealand's approach to fighting tax crime, as it was created to help countries identify areas where changes could be made to help with addressing tax crime. In addition, the OECD *Tax Crime Investigation Maturity Model*, a model to assist tax authorities self-assess their capabilities, is used to assess New Zealand's progress on the spectrums outlined in the model.[5]

The *Fighting Tax Crime* report introduced a framework to assist tax administrations in improving tax compliance. Specifically, it proposed ten principles to increase transparency, inter-agency cooperation, and international collaboration, to address global threats to tax compliance. A second edition was published in 2021.[6] This second report includes strategies for tackling situations where professionals enable tax and other white-collar crimes, as well as the inclusion of best practices in international cooperation in tackling tax crimes. This second edition also includes country reports for 33 jurisdictions, including New Zealand. The New Zealand country report provides an assessment of actions New Zealand has taken against the ten principles.

The OECD principles are chosen for this study as they are the most comprehensive set of global principles created to date that focus on tax crime. Other guidelines are outlined in the next section of the article, but many of these incorporate a broader perspective, such as corruption, and tax is a sub-set of the broader focus. New Zealand is used for illustrative purposes in this study as there is already some analysis on its performance (in the country report) but with a high degree of transparency in the country, it is also possible to obtain additional data to support analysis. Notwithstanding the choice of New Zealand in this study, most OECD countries would be appropriate for future research and such analysis would add considerable depth to knowledge on global approaches to fighting tax crime, beyond that reported in the OECD country reports.

Tax crime covers a wide range of activities, ranging from low-level tax evasion by an individual to complex global tax fraud. For this article the OECD definition of tax crime is adopted: "intentional conduct that violates a tax law".[7] This includes breaches of income tax and indirect tax laws but excludes financial crimes such as money laundering.

---

[1] OECD, *Fighting Tax Crime: The Ten Global Principles* (OECD Publishing, 2017); U Turksen, *Countering Tax Crime in the European Union: Benchmarking the OECD's Ten Global Principles* (Bloomsbury Publishing, 2021); L Winter and D Vozza, 'Corruption, Tax Evasion, and the Distortion of Justice: Global challenges and international responses' (2022) 85(4) *Law and Contemporary Problems*, 75.

[2] Rita de la Feria writes that European Union estimates reach up to one trillion Euros in revenue loss in 2019, which converts to just over one trillion US dollars. Rita de la Feria, 'Tax Fraud and Selective Law Enforcement' (2020) 47(2) *Journal of Law and Society* 240. See also Winter and Vozza (n 1).

[3] M Levi, Financial Action Task Force (FATF). In *Elgar Concise Encyclopedia of Corruption Law*, pp. 224-227. (Edward Elgar Publishing, 2023).

[4] OECD (n 1).

[5] OECD, *Tax Crime Investigation Maturity Model* (OECD Publishing, 2020).

[6] OECD, *Fighting Tax Crime – The Ten Global Principles, Second Edition* (OECD Publishing, 2021).

[7] OECD (n 1) 11.

The article makes two primary contributions. The OECD New Zealand country report describes New Zealand's approach to fighting tax crime, but does not critique the approach. A critique is needed to identify gaps in New Zealand's approach and thereby assist with improving practice. This article provides this critique and highlights three areas where New Zealand would benefit from strengthening its approach to fighting tax crime. The OECD's *Tax Crime Investigation Maturity Model* (the Maturity Model) is used to frame this discussion. While the Maturity Model was created for tax authorities to self-assess their capabilities, it is also possible for others to use the model as an analytical framework to assess progress. As New Zealand's approach to addressing tax crime has been criticised in scholarly research,[8] this article builds on these studies, providing further insight into Inland Revenue's progress in fighting tax crime.

The second contribution from this article is a critique of the OECD principles and proposed changes intended to assist with operationalisation of the principles. While the principles are intended to be globally relevant, this article recommends some changes to allow for greater comparison between countries and potentially increase their utility.

While the article is largely descriptive, original data from Official Information Act 1982 requests is provided to support arguments made and assist with analysis. Additional data sources include Inland Revenue annual reports and other Inland Revenue publications.

The article commences in section two with a synopsis of the literature on tax crime, to provide a contextual backdrop for the remainder of the article. This section also outlines some of the global approaches to fighting tax crime. Section three follows, which provides a brief outline of the ten OECD principles alongside New Zealand's actions that relate to each of the principles. Section four evaluates New Zealand's approaches to fighting tax crime, assessed against the OECD ten principles, using the Maturity Model as a framework. This section provides the first contribution from the article, identifying where New Zealand's current practices are strong, as well as highlighting weaknesses. It also discusses three identified gaps in New Zealand's practices and the proposed principles. Section five critiques the OECD principles, providing the second primary contribution from this article. Conclusions are drawn in section six.

II APPROACHES TO FIGHTING TAX CRIME

The focus of this study is to evaluate how the OECD principles apply in New Zealand. However, the OECD principles are not the only initiatives to help address tax crime. This section commences with a discussion on other global initiatives to tackle tax crime, typically within a broader focus on financial crime. This is for the purpose of showing some of the work that may include tax crime, while not solely focusing on this activity. This is followed with a synopsis of the academic literature on fighting tax crime, to illustrate the broader body of work that has investigated this issue. The section finishes with a brief discussion of some of the scholarly work that has examined tax evasion in New Zealand to provide some context for the discussion later in the article.

[8] Lisa Marriott, 'Pursuit of White-Collar Crime in New Zealand' (2018) 20(2) *Journal of Australian Taxation* 1; Lisa Marriott, 'White-Collar Crime: The privileging of serious financial fraud in New Zealand' (2020) 29(4) *Social and Legal Studies* 486; D Weaver and Mark Keating, 'Prosecution of tax evasion raises significant problems for Inland Revenue' (2022) 5 *CCH iKnowConnect News and Articles* 1.

A *Global initiatives that encompass tax crime*

In 2020 the OECD generated a Tax Crime Investigation Maturity Model to "help jurisdictions understand where they stand in the implementation of the OECD's Council Recommendation on the Ten Global Principles for Fighting Tax Crime".[9] Through an "evolutionary path" approach, countries can self-assess their capability at levels of emerging, progressing, established, and aspirational.[10] The Maturity Model comprises the ten OECD principles that are discussed below, with descriptions of different levels of "maturity" that facilitate the self-assessment. As part of the analysis in this article, the Maturity Model is used later in this article to assess New Zealand's progress on the spectrums provided in the model.

Another initiative relevant to New Zealand is the introduction of the Asia-Pacific Academy for Tax and Financial Crime Investigation, which was launched in 2019, to provide training to address the needs of countries in the Asia-Pacific region to address financial crime.[11] This includes courses on conducting and managing financial crime investigations, tackling money laundering, and tax fraud. Other initiatives include the United Nations Convention against Corruption[12] and the Council of Europe's Group of States against Corruption.[13] However, these two latter initiatives focus on corruption more generally, rather than tax specifically.

Similarly, the Financial Action Task Force leads global action to tackle "money laundering, terrorist and proliferation financing" and monitors how criminals use and move funds.[14] However, Levi observes that anti-corruption "has never been a central feature of the leading global policy-making and sanctioning body" of the Financial Action Task Force.[15] This body was created as a temporary organisation of 16 countries in 1989, which increased to 39 countries and regional bodies by 2022, by which point the temporary status had become "open-ended".[16]

A further initiative is a joint report by the World Bank and the OECD in 2018 that identifies obstacles to effective global cooperation, based on survey responses from 67 countries including New Zealand.[17] While also focussing on corruption, rather than tax, tax crime is incorporated within the report.

B *What we know about fighting tax crime*

[9] OECD (n 5) 5.
[10] OECD (n 5) 4.
[11] OECD, OECD Asia-Pacific Academy for Tax and Financial Crime Investigation, Retrieved from https://www.oecd.org/corruption/crime/oecd-asia-pacific-academy-for-tax-and-financial-crime-investigation.htm, 22 February 2024
[12] The only reference to tax in the United Nations Convention against Corruption is disallowing the tax deductibility of bribes (Article 12). United Nations Office on Drugs and Crime, *United Nations Convention against Corruption* (United Nations, 2004).
[13] Council of Europe, The Fight against Corruption: A priority for the Council of Europe. Retrieved from https://www.coe.int/en/web/greco/about-greco/priority-for-the-coe, 20 February 2024.
[14] Financial Action Task Force, The FATF is leading global action to fight back, Retrieved from https://www.fatf-gafi.org/en/the-fatf/what-we-do.html, 20 February 2024
[15] Levi (n 3) 224.
[16] Ibid.
[17] World Bank and OECD, *Improving Co-operation between Tax Authorities and Anti-Corruption Authorities in Combating Tax Crime and Corruption* (World Bank, 2018).

This sub-section provides a brief outline of some of the scholarly literature focused on tax crime. Of particular relevance to this study is the benchmarking against the OECD framework undertaken by scholars in a range of jurisdictions. For example, Turksen[18] and Turksen and Abukari[19] undertake a critical analysis of a range of European Union countries to assess the extent to which the countries are integrating the minimum standards into their respective legal frameworks, and which tools can effectively and sustainably counter tax crimes. Turksen and Abukari find that European Union countries have made considerable progress towards meeting the OECD ten global principles while also identifying the different legal and institutional approaches to fighting tax crimes.[20] Similarly, Hoosen uses selected aspects of the OECD framework to evaluate the investigative powers of the South African revenue services and makes a case that the tax authority's powers need to be enhanced.[21]

Other studies have examined the implications of adopting specific principles. For example, Rossel, Unger, Batchelor & van Koningsveld[22] and Rossel, Unger & Ferwerda[23] examine the principle of making tax crimes a predicate crime for money laundering in the European Union (EU) (principle seven of the OECD principles). Rossel et al. describe the adoption of this principle in the EU as "a shock that put money laundering regulation inside the tax ecosystem".[24] The researchers build a dataset incorporating the legislation of all EU countries on tax crime and money laundering. They raise the need for harmonisation of tax and money laundering laws so that criminals are not tempted to select the EU jurisdiction that is best for them to engage in tax crimes.

Research by Brun et al proposes specific steps that could be included in policy to promote a whole-of-government approach to tax crime.[25] These are similar to those proposed by the OECD and include enhanced cooperation and information sharing among agencies; appropriate legal frameworks free from unreasonable legal barriers to the exchange of information; and technical and structural arrangements to ensure information sharing can be operationalised in a timely, cost-efficient way.[26]

In 2021 the OECD published a report on those who enable tax and other white-collar crime.[27] The report identifies the role of professional enablers in tax and other financial crimes, as well as providing guidance on deterring, investigating, and sanctioning them. The report acknowledges that tax and financial crimes "are often facilitated by lawyers, accountants,

---

[18] Turksen (n 1).
[19] U Turksen and A Abukari, 'OECD's global principles and EU's tax crime measures' (2021) 29(2) *Journal of Financial Crime* 406.
[20] Ibid.
[21] M Hoosen, *An in-depth critical analysis of the South African Revenue Service's investigative powers and whether such powers need to be enhanced*. [Unpublished Master's Dissertation]. Johannesburg: University of Johannesburg, 2022.
[22] L Rossel, B Unger, J Batchelor and J van Koningsveld, The Implications of Making Tax Crimes a Predicate Crime for Money Laundering in the EU: Building a legal dataset of tax crimes and money laundering in the European Union. In B. Unger, L. Rossel and J. Ferwerda (Eds.), *Combatting Fiscal Fraud and Empowering Regulators: Bringing tax money back into the COFFERS* (pp.236-271) (Oxford University Press, 2021)
[23] L Rossel, B Unger and J Ferwerda, 'Shedding light inside the black box of implementation: Tax crimes as a predicate crime for money laundering' (2022) 16(3) *Regulation & Governance* 781.
[24] Rossel et al (n 22) 237.
[25] J-P Brun, A Gomez, R Julien, J Ndubai, J Owens, S Rao and Y Soto, *Taxing Crime: A whole-of-government approach to fighting corruption, money laundering, and tax crimes* (World Bank Publications, 2022).
[26] Ibid.
[27] OCED, *Ending the Shell Game: Cracking down on the professionals who enable tax and white collar crime* (OECD Publishing, 2021).

financial institutions and other professionals who help engineer the legal and financial structures seen in complex tax evasion and financial crime", while also recognising that it is a small proportion of professionals who engage in these behaviours.[28] The types of activity include offering non-transparent structures that conceal the identity of those involved in illegal activity. Similar recommendations are included in the OECD reports on fighting tax crime, e.g. ensuring tax crime investigators are sufficiently resourced to identify and understand the activities involved, including sufficient authority to prosecute and sanction offenders; having a coherent and multi-disciplinary strategy to prevent and disrupt professional enablers; and ensuring pro-active interagency and cross-country sharing of intelligence.[29]

There is relatively little research on the use of technology or artificial intelligence in the fight against tax crime. For example, the predictive capabilities of machine learning have been highlighted by researchers in Sao Paulo.[30] Specifically, they find that machine learning can help predict tax crime in fiscal audits, which has the potential to assist with taxpayer compliance.

This brief synopsis of the literature supports the approach adopted in this study of using the OECD ten principles for evaluative purposes, providing examples of the potential insights that this approach facilitates. Other examples are returned to later in this study to further support the analaysis.

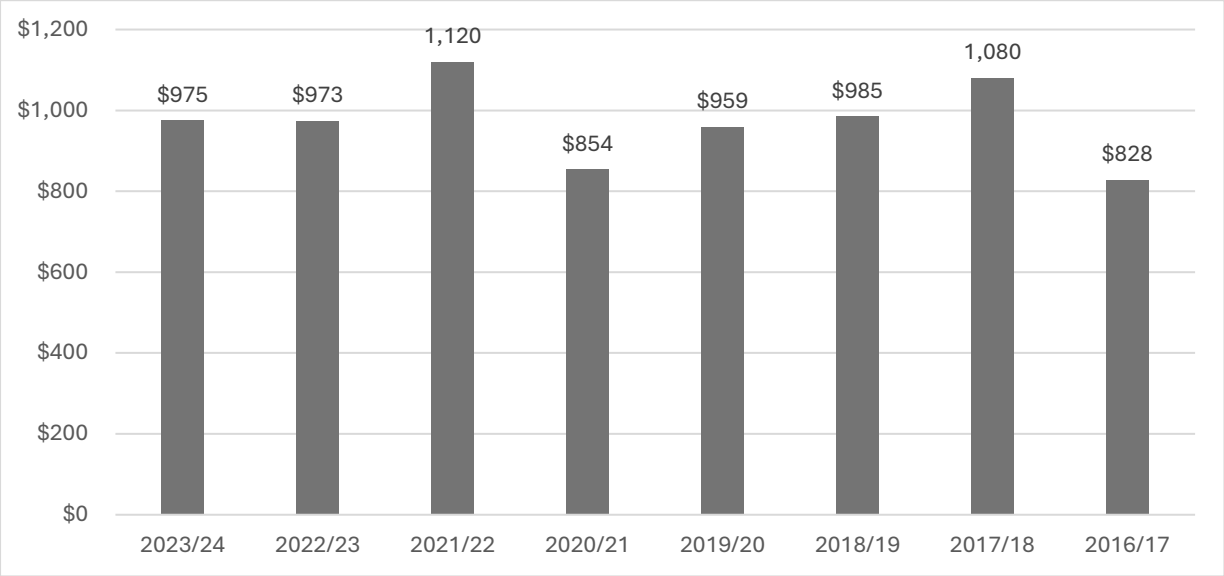
C *Tax crime in New Zealand*

This section provides a brief background on tax crime in New Zealand to provide some context of the offence before evaluating the activity against the OECD principles. The two primary forms of tax crime reporting in New Zealand come from the Inland Revenue, the New Zealand tax authority, which reports some information on tax crime in its annual report, as well as reporting prosecuted cases through media releases.

In its annual report, Inland Revenue no longer reports "tax evasion". Instead "additional revenue collected", "tax discrepancies" or "tax position differences" are used to describe deliberate non-compliance. Arguably, this is more accurately described as tax crime, however, the language used tends to suggest that the non-payment of tax is accidental or perhaps due to misinterpretation, obfuscating what, in at least some cases,is deliberate non-compliance. Figure 1 shows additional tax collected from these activities from 2016/17 to 2023/24. While there is some fluctuation in the value, typically it is not far from NZ$1 billion in each year. The title refers to the three descriptions attached to non-compliant tax behaviour over the period shown, but are essentially describing the same activity.

[28] Ibid 7.
[29] OECD (n 1); OECD (n 6).
[30] A Ippolito and A Lozano, 'Tax Crime Prediction with Machine Learning: A Case Study in the Municipality of São Paulo' (2020) 1 *ICEIS* 452.

Figure 1: Tax discrepancies, tax position differences and additional revenue 2016/17 to 2023/24 (NZ$ million)[31]



While around $1 billion in tax fraud is detected annually by Inland Revenue, perhaps the more interesting value is the tax crime that is not detected. There have been varying attempts to quantify this, ranging from a high of 4-4.5% of GDP, [32] which calculated to around NZ$10 billion at the time, through to the more recent Tax Justice Network estimate of NZ$600 million in 2024.[33]

A further example of tax evasion in New Zealand can be seen in novel research using tax return data that finds income disclosed by the self-employed is around 20% underreported on average.[34] This proportion is the same as that estimated by Inland Revenue.[35] Further illustration of at least the presence of tax evasion is the bunching that is visible around the tax threshold changes. Alinaghi, Creedy and Gemmell report "substantial bunching around both tax kinks" and suggest that this includes large responses to tax rates by the self-employed.[36]

The 20% estimate of tax evasion has been consistent over time, with research from 25 years earlier reporting similar results. In 1994, Hasseldine, Kaplan and Fuller reported on survey

[31] Inland Revenue, *Annual Report* (Inland Revenue, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024).

[32] D Giles and P Caragata 'The Learning Path of the Hidden Economy: The tax burden and tax evasion in New Zealand' (2001) 33(14) *Applied Economics* 1857.

[33] Tax Justice Network, Country Profiles – New Zealand (2024), Retrieved from https://taxjustice.net/country-profiles/new-zealand/, 22 January 2025

[34] A Cabral, N Gemmell and N Alinaghi, 'Are Survey-Based Self-Employment Income Underreporting Estimates Biased? New evidence from matched register and survey data' (2021) 28(2) *International Tax and Public Finance* 284.

[35] Inland Revenue, Tax Policy Report: Estimating the underreporting of income in the self-employed sector (Inland Revenue, 2018).

[36] N Alinaghi, J Creedy and N Gemmell, 'Elasticities of Taxable Income and Adjustment Costs: Bunching evidence from New Zealand' (2021) 73(3) *Oxford Economic Papers* 1244, 1244.

findings showing 23% of respondents admitted underreporting income, while 12% reported overstating deductions.[37]

III THE TEN OECD PRINCIPLES AND THEIR APPLICATION IN NEW ZEALAND

The OECD created its ten principles to assist jurisdictions in identifying areas where changes in law or operational practices are needed, "such as increasing the type of investigative or enforcement powers, expanding access to other government-held data, devising or updating the strategy for addressing tax offenses, and taking greater efforts to measure the impact of the work they do".[38] This section briefly outlines the key concepts of each principle, along with an outline of the actions taken by Inland Revenue that are relevant for each principle. As the OECD New Zealand country report provides data on New Zealand actions, these are not repeated in depth in this section. However, new information such as data collected from Official Information Act 1982 requests is reported where relevant.[39]

A *Principle 1: Ensure tax offences are criminalised*

The first principle relates to the presence of legal frameworks that criminalise tax offences, as well as having "effective sanctions [that] apply in practice".[40] Criminalisation is intended to act as both a deterrent, as well as facilitating appropriate penalties for non-compliance. It also signals to compliant taxpayers that fitting consequences will follow for those who do not comply.

There are two discrete components to this principle. The first is the criminalisation of tax crime and the second is the application of sanctions. Several tax offences are criminalised in New Zealand.[41] These include not keeping documents as required by law;[42] knowledge offences, such as not providing information when required to do so by tax law;[43] tax evasion;[44] and manufacturing, supplying, acquiring, or possessing electronic sales suppression tools.[45] Penalties for these offences range from monetary sanctions, such as $4,000 for the first time a person is convicted for not keeping documents as required by law,[46] through to a term of imprisonment for a maximum of five years.[47] These examples are similar to those outlined in

[37] D Hasseldine, S Kaplan and L Fuller, 'Characteristics of New Zealand Tax Evaders: A note' (1994) 34(2) *Accounting and Finance* 79.
[38] OECD (n 1) 9.
[39] In 2025, the OECD published a document embodying the ten principles into an OECD Recommendation to "strengthen the OECD's role in global standard-setting and capacity building in the area of tax crimes and illicit financial flows". OECD, *Recommendation of the Council on the Ten Global Principles for Fighting Tax Crime* (OECD Publishing, 2025) 3.
[40] OECD (n 1) 13.
[41] Tax Administration Act 1994 (TAA), s143-148.
[42] TAA, s 143.
[43] TAA, s 143A.
[44] TAA, s 143B.
[45] TAA, ss 143BB-143BC.
[46] TAA, s 143(3)(a).
[47] TAA, s 143A(8)(d).

the OECD report.[48] The 2017 OECD report also recommends the criminalisation of aiding, abetting, facilitating, or enabling the commission of a tax offence. This is also present in New Zealand, with a person convicted of this offence liable for a sanction that is the same that applies to the person who commits the principal offence.[49]

The second part of this principle is the application of criminal sanctions. The 2017 OECD report outlines the maximum prison sentence for tax offences across 31 countries. Note that while the maximum prison sentence in the Tax Administration Act 1994 is five years, crimes prosecuted under the Crimes Act 1961 have a higher threshold of either seven or ten years, depending on the charge. However, few tax crimes are prosecuted under the Crimes Act 1961. As shown in Table 1, the majority of tax offences are prosecuted under the Tax Administration Act 1994, with only 16% prosecuted under the Crimes Act 1961 in the three years from 2018 to 2020. The majority of offences are evasion or similar offences (33%) or knowledge offences (27%).[50]

Table 1: Charging Legislation for Inland Revenue offences (2018-2020)[51]

	Crimes Act 1961	Tax Administration Act 1994	Total
Inland Revenue (number and per cent of total cases)	31 (16%)	164 (84%)	195

Note also that relatively small numbers of prosecutions are taken for tax crime in New Zealand. These numbers are outlined in Table 2 for the four years from 2019 to 2022. Before this time, tax crime prosecutions were also few, typically 60-80 per annum.[52]

Table 2: Inland Revenue Completed Prosecutions (2019-2022)[53]

	2019	**2020**	**2021**	**2022**
Inland Revenue	68	58	50	38

Among the 31 countries included in the 2017 OECD report, the average prison sentence is 8.3 years. However, there are outliers with high maximum prison sentences, such as South Africa (25 years) and Greece (20 years). Sanctions imposed in New Zealand over the tax years ending 2015 through to 2019 are outlined in Table 3. Note that offenders may receive multiple sanctions. Total prosecutions over the five years shown in Table 3 are 441. Table 3 shows that the most common sanction is home detention (used in 39% of prosecuted cases), followed by

[48] OECD (n 1) 15.
[49] TAA, s 148.
[50] Obtained under an Official Information Act 1982 request to the Ministry of Justice, received 18 October 2021.
[51] Obtained under an Official Information Act 1982 request to the Ministry of Justice, received 18 October 2021. The year is based on the charge outcome date.
[52] Lisa Marriott, 'Tax Compliance in New Zealand' (2024) *New Zealand Tax Planning Report,* December, 1-13.
[53] Inland Revenue 2020, 2021, 2022, 2023 (n 31).

community work or service (36%). The financial penalties of fines and reparation are used in 9% and 34% of cases, respectively.

Table 3: Sanctions imposed for tax crime in tax years ending 2015-2019[54]

Sanction	Number of times sanction is imposed	Proportional use of sanction (in 441 cases prosecuted)
Imprisonment	58	13%
Home detention	173	39%
Community detention	84	19%
Community work or service	158	36%
Fine	39	9%
Reparation	148	34%
Other, e.g. supervision	44	10%

An Official Information Act 1982 request was made to Inland Revenue in January 2024, asking for information on the collection rate of fines, that is, whether these were eventually paid or whether bankruptcies or liquidations processes resulted in unpaid financial penalties. Inland Revenue advised that they could not comment on specific cases. A subsequent OIA was made on 22 February 2024, asking for an indication of the value paid from the largest 20 fines. Inland Revenue provided information on the aggregate totals awarded and amounts paid for the current top 20 reparation orders recorded since October 2021.[55] The total reparation awarded for the highest 20 orders was $1,788,284, of which $512,319 had been collected, i.e. a relatively low proportion at 28.6%. Actual collection rates may differ significantly from this calculation, however, it provides some indication of the low collection rate on at least some financial penalties.

The 2017 OECD report notes that it may be appropriate for alternative criminal sanctions to apply, such as community service, "naming and shaming" offenders or enablers, disqualification from holding certain offices, suspension of licences or other privileges, forfeiting assets or a combination of these.[56] As noted in Table 3, community service is used in just over one-third of prosecuted cases. While publicising the names of tax debtors or suspending licences are used by many OECD countries, these are not used in New Zealand.[57] While Inland Revenue can place a lien over a taxpayer's assets, this is not an action frequently taken. The OECD country report shows that $90 million of assets related to tax crime were seized over the five years from 2015 to 2019, an average of $18 million per annum.[58]

Data from the OECD New Zealand country report provides evidence of the infrequency of criminal prosecutions. Over the 2015 and 2016 income years, 12,172 investigations occurred

[54] OECD, *Fighting Tax Crime – The Ten Global Principles, Second Edition, Country Chapters* (OECD Publishing, 2021) 294. As multiple sanctions may be applied, percentages do not total 100%.
[55] Obtained under an Official Information Act 1982 request to Inland Revenue, received 21 March 2024.
[56] OECD (n 1) 19.
[57] OECD, *Working Smarter in Tax Debt Management* (OECD Publishing, 2014); OECD (n 54).
[58] OECD (n 54) 298.

(civil and criminal) of which a criminal investigation was pursued in 1,369 cases.[59] In 1,155 (84%) of these cases a civil shortfall penalty was applied, that is, no criminal prosecution was taken. The other 214 (16%) cases were referred for criminal prosecution, although this referral does not necessarily result in a prosecution.[60]

B *Principle 2: Devise an effective strategy for addressing tax crimes*

Principle two requires that the tax authority have a strategy to address tax crimes that is regularly reviewed and monitored. This is likely to be part of a tax authority's overall compliance strategy. In 2024, the OECD published a report titled *Designing a National Strategy against Tax Crime: Core elements and consideration,* intended to support principle two.[61] The report details recommendations for core elements of a strategy for countries to consider, as well as providing several country examples.

Inland Revenue publishes its overall strategy, including the organisational objectives. However, this incorporates high-level strategies and intended outcomes, with only brief and general reference to compliance, e.g. "maintaining the integrity of the tax and social policy systems".[62] Due to the brevity of the document, it is not possible to assess the extent to which the strategy aligns with the expectations outlined in the OECD report.

A recent briefing to the incoming minister advises that historically "public perception of our compliance activities focused on audits, investigations, litigation and prosecution".[63] However, the current approach is to treat compliance more holistically, with a focus on helping taxpayers to be compliant. The recent completion of the Business Transformation process has greater digitalisation of filing and payment of tax. This change, combined with more advanced analytic tools, has facilitated focus "on those operating outside the tax system" and a greater understanding of compliance.[64] Thus, Inland Revenue can develop more efficient interventions and respond faster to non-compliance. However, the benefits of the Business Transformation are not fully visible at this time. In addition, during the COVID-19 period, resources were redirected to assist with a range of new support payments. This resulted in reduced activity in pursuing tax debt. Therefore, it is difficult to assess the efficacy of the overall strategy due to the timing of these two key issues.

C *Principle 3: Have adequate investigative powers*

Principle three requires that jurisdictions have appropriate investigative powers to successfully investigate tax crimes. The initial OECD report in 2017 provides a range of general organisational models for investigating tax crimes. New Zealand adopts the first of these

[59] OECD (n 54) 293.
[60] OECD (n 54) 294.
[61] OECD, *Designing a National Strategy against Tax Crime: Core elements and considerations,* (OECD Publishing, 2024).
[62] Inland Revenue, Our Strategy, Retrieved from https://www.ird.govt.nz/-/media/project/ir/home/documents/about-us/publications/annual-and-corporate-reports/our-corporate-strategy/our-strategy.pdf?modified=20231116012514&modified=20231116012514, 12 Feb 2024.
[63] Inland Revenue, Briefing to the Incoming Minister, November 2023 (Inland Revenue, 2023) 9.
[64] Ibid.

models, which is where the tax administration directs and conducts investigations. The OECD report notes that a tax administration using this model may not have the necessary powers to conduct criminal tax investigations. However, Inland Revenue has comprehensive powers to assist with conducting effective investigations. These powers are outlined in Part 3 of the Tax Administration Act 1994. Specifically, the Commissioner "may access any property or documents for the purpose of inspecting a document, property, process, or matter that the Commissioner considers is necessary or relevant for the purposes and principles set out in sections 16 and 16B (the purposes of collecting revenue information); and is likely to provide information that would otherwise be required for the purposes of the Inland Revenue Acts and any function lawfully conferred on the Commissioner".[65] However, the Commissioner must have a warrant issued under section 17D to enter a private dwelling to access property or documents.[66] The occupier of a place that the Commissioner proposes to enter must provide the Commissioner with all reasonable facilities and assistance, and answer all questions relating to the effective exercise of the powers.[67]

A specific factor outlined in the initial OECD report is the power to intercept mail and telecommunications, this includes digital communications, social media, internet routing, and other forms of interceptions. In New Zealand, this power is not available, although Inland Revenue can obtain existing telecommunications data from third-party service providers.[68] Inland Revenue can also search and seize computer hardware, software, cell phones and other digital media.[69]

The initial OECD report also observes that New Zealand has powers such as the ability to conduct undercover operations and to conduct covert surveillance. While there is no legislative authority for this, there is also no legislative prohibition.[70] The New Zealand country report notes that they do not operate undercover officers or conduct undercover operations.[71]

An unusual feature of Inland Revenue's compliance toolkit is it does not undertake random audits.[72] While this is likely to be for efficiency grounds, it does require that non-compliant taxpayers must be identified by certain risk factors, and if their non-compliant behaviour does not generate any flags then it will not be detected.

D *Principle 4: Have effective powers to freeze, seize and confiscate assets*

Principle four supports the ability of a tax authority to temporarily suspend rights over assets, including bank accounts, while investigations are underway. This is to "prevent the movement of assets pending the outcome of a case".[73] Confiscation of assets is when a taxpayer is permanently deprived of that asset, typically after a case is concluded.

[65] TAA, s 17(1).
[66] TAA, s 17(2).
[67] TAA, s 17(3).
[68] OECD (n 6) 32.
[69] OECD (n 6) 33.
[70] OECD (n 54).
[71] Ibid.
[72] Confirmed in an Official Information Act 1982 request to Inland Revenue, received 9 June 2023.
[73] OECD (n 1) 40.

There are no provisions that explicitly permit the Commissioner of Inland Revenue to seize assets to assist with debt recovery.[74] However, under the Criminal Proceeds (Recovery) Act 2009, assets may be seized when they are derived from "significant criminal activity".[75] Under this Act, restraint and forfeiture of property derived from significant criminal activity may occur without the need for conviction.[76] As a general creditor who has obtained judgment in the District Court, the Commissioner is entitled to apply for a warrant to seize assets under section 167 of the District Court Act 2016, however, this option is not generally used as the Commissioner has other, more cost effective, options available.[77]

Inland Revenue may also apply for freezing orders, reported as occurring approximately 1-5 times per annum.[78] As noted above, Inland Revenue seized an average of $18 million in assets per annum that were connected with tax crime.[79]

E *Principle 5: Put in place an organisational structure with defined responsibilities*

Principle five recommends an organisational structure that has defined responsibilities for fighting tax crime. The OECD provides several models, as outlined in Table 4:

Table 4: Organisational models for investigating tax crimes[80]

Model 1	Model 2	Model 3	Model 4
The tax administration has responsibility for directing and conducting investigations, often through a specialist criminal investigations division. The public prosecutor's office does not have a direct role in investigations, though a prosecutor may provide advice to investigators with respect to matters such as legal process and the laws of evidence.	The tax administration has responsibility for conducting investigations, under the direction of the public prosecutor or, exceptionally, examining judges.	A specialist tax agency, under the supervision of the Ministry of Finance but outside the tax administration, has responsibility for conducting investigations, which may involve public prosecutors.	The police or public prosecutor has responsibility for conducting investigations.

The OECD emphasise the importance of the tax authority having clearly defined responsibilities, as well as clear governance arrangements and adequate resources (discussed below). The Inland Revenue model is closest to model 1, where the tax authority is responsible for detecting, investigating, and prosecuting (with the Crown Solicitor) tax evasion and other

[74] Provisions exist under s 183 of the *Child Support Act.* However, this is outside the scope of the current discussion, which relates to core tax payments.
[75] Criminal Proceeds (Recovery) Act 2009, s 3(1)(a).
[76] Criminal Proceeds (Recovery) Act 2009, s 4(1)(1).
[77] Official Information Act 1982 request to Inland Revenue, received 12 July 2016.
[78] OECD (n 54).
[79] Ibid.
[80] OECD (n 1).

tax fraud.[81] However, this is not actioned through a specialist criminal investigations division. While cases may be referred to the Serious Fraud Office, this infrequently occurs. A Financial Intelligence Unit is situated with the New Zealand Police, although it is available across the government.[82]

The Inland Revenue structure has separate Customer and Compliance Services for businesses, and for individuals, to assist with compliance. There are clear processes relating to the customer compliance team that investigates taxpayers. However, there is not a discrete area responsible for addressing tax crime. Once a crime is identified, the legal services group undertake the prosecution, with complex cases referred to the Crown solicitor.

Audit and investigation activity is determined based on intelligence and risk-based analytics.[83] Interventions in recent years have been moderated for the COVID-19 environment, with Inland Revenue acknowledging "we did not want to put more pressure on customers during a difficult year".[84] However, the department intends to return to some of the activities that were ceased over past years. This incorporates work on the hidden economy and fraud activity.

F *Principle 6: Provide adequate resources for tax crime investigation*

Principle six requires that sufficient resources are allocated to investigate and enforce action relating to tax crimes. The OECD 2017 report acknowledges that the level and type of resources will vary with budgetary constraints and different economies will require different resourcing for this activity. Resourcing includes financial resources, human resources, sufficient training, infrastructure and organisational resources, as well as data and technology resources.

The OECD report presents several jurisdictions' estimates of the return on investment from the tax crime investigation function.[85] These ranged from over 150% in Georgia in 2015, through to over 1,000% in Spain. New Zealand is reported as having a return of 750% for general tax evasion and 400% for fraud. This appears to be for the 2015/16 year. Table 5 shows the return on general tax evasion investigation activity for subsequent years, through 2021/22. These range from a return of $7.17 (in 2020/21) to $9.88 (in 2021/22) for each dollar spent on investigation activity. These represent a high return on investment and suggest there is potential for greater expenditure on this function, as it is likely to be revenue-positive.

Inland Revenue's full-time equivalent staffing has reduced by 29% from 2016 to 2023, as shown in Table 5.[86] Table 5 also shows funding allocated to Inland Revenue for undertaking investigation, audit and litigation activities. The appropriation for investigations is $107.6 million in 2023, a decrease from $113 million in 2022, and a significant decrease of 61% from the $173 million allocated to the function in 2017.[87]

An Official Information Act 1982 request was made to Inland Revenue in February 2024 asking for the number of staff undertaking work relating to tax crimes over the periods shown in Table

[81] OECD, *Effective Inter-Agency Co-Operation in Fighting Tax Crimes and Other Financial Crimes: Third Edition* (OECD Publishing, 2017).
[82] Ibid.
[83] Inland Revenue 2023 (n 31) 98.
[84] Ibid.
[85] OECD (n 1).
[86] OECD (n 63).
[87] Inland Revenue 2017, 2023 (n 31).

5. A request was made for this data as the OECD original report in 2017 report identified the number of staff at 189. In response, Inland Revenue provided some context related to their "get it right from the start" approach, which has resulted in refocusing resourcing and investing in helping people comply. This change in operating model has developed since 2018, which has resulted in "the people previously working in investigations or prosecution roles in the Service Delivery group [moving] to broad-based capability roles" in the Customer and Compliance Services business groups. As the number of people working on investigations cannot be quantified, instead, Inland Revenue provided a "best approximation" of time spent on investigations by providing the audit hours. This is shown in Table 5. The general downward trend is attributed to "Inland Revenue implementing the 'get it right from the start' compliance approach and short-term shift in priorities", the latter referring to Inland Revenue staff working on COVID-19 arrangements.[88] The audit hours in the most recent year (2022/23) total approximately 65 full-time equivalent employees: slightly less than two per cent of staff and significantly fewer than the 189 reported by the OECD several years prior.[89]

Table 5: Inland Revenue resourcing 2017-2023[90]

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Full-time equivalent staff	5,401	5134	4,888	4,724	4,106	3,819	4,023
Budget ($M)	$173	$152.7	$142.2	$123.1	$124.1	$113.2	$107.6
ROI for investigation activity	$8.31:$1	$7.86:$1	$7.54:$1	$8.75:$1	$7.17:$1	$9.88:$1	$8.92:$1
Audit hours[91]	543,870	586,571	401,869	231,427	201,924	67,095	112,795

Table 5 shows the declining trend in both staff and budget. Staff numbers have decreased by 25.5% while financial resources have reduced by 37.8%. Staff numbers are for all of Inland Revenue, rather than only staff who work on investigations or tax crime, as these are not available, as noted above. Staff reductions can, at least in part, be attributed to the Business Transformation process that has resulted in increased use of technology and a concomitant reduced need for staff interventions. However, the budget numbers are the appropriations for the investigations, audit and litigation funding and this shows a significant decline in funding for this function. While the Business Transformation process will have increased automation, the audit and investigation function requires human intervention for many activities once non-compliance has been identified. Note that there have not been significant changes in the values of unpaid tax over this period, with most years disclosing either slightly more or slightly less than $1 billion in unpaid tax across a range of different categories, e.g. from the hidden economy, aggressive tax planning, or property compliance.

[88] Obtained under an Official Information Act 1982 request to Inland Revenue, received 21 March 2024.
[89] OECD (n 1).
[90] Inland Revenue 2017, 2018, 2019, 2020, 2021, 2022, 2023 (n 31).
[91] Obtained under an Official Information Act 1982 request to Inland Revenue, received 21 March 2024.

By way of access to other resources, New Zealand also has access to all databases proposed by the OECD, either through direct access or by request. Those with direct access include company formation and ownership registries, the land registry and tax databases. Those on request include customs, police, and judicial databases.

G *Principle 7: Make tax crimes a predicate offence for money laundering*

Principle seven proposes that jurisdictions should designate tax crimes as one of the predicate offences for money laundering. The concept of predicate offences originates in American law.[92] Predicate offences are 'specified types of criminal activity that give rise to funds or assets' that may then be 'laundered' to obscure the illegal source.[93] Thus the predicate offence is the underlying criminal activity that generates the proceeds. Research suggests that 'money laundering and tax evasion are important issues, which often go hand in hand'.[94] By making tax crimes a predicate offence for money laundering, the taxpayer can be charged with money laundering, as well as the tax crime. This may allow the imposition of harsher penalties and may increase the chance of conviction.[95]

In New Zealand, tax evasion and tax fraud are predicate offences for money laundering under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.[96] Inland Revenue provides examples on a fact sheet that include activity 'such as wire transfers to 'low tax' or 'no tax' jurisdictions; the involvement of cash in large deposits or withdrawals; or where transactions are conducted outside of a customer expected behaviour or financial profile'.[97] Note that money laundering, as well as some other financial fraud, may be investigated by the New Zealand Police or the Serious Fraud Office.[98]

H *Principle 8: Have an effective framework for domestic inter-agency cooperation*

Principle eight requires that jurisdictions have an effective legal and administrative framework to allow for cooperation among other government agencies. This is to facilitate effective investigations and enforcement. The OECD has a separate, nearly 500-page, document on effective inter-agency cooperation in fighting tax crimes, as well as other financial crimes.[99] This document outlines a range of organisational models for agencies to effectively share information, including joint investigation teams, inter-agency centres of intelligence, secondments between agencies, and training programmes.[100] New Zealand is one of the 51 countries included in the report.

---

[92] Rossel et al (n 22).
[93] OECD (n 1) 58
[94] B Unger, *Offshore activities and money laundering: recent findings and challenges* (European Parliament Directorate-General for Internal Policies, Economic and Scientific Policy, 2017) 1.
[95] OECD (n 1) 58.
[96] Inland Revenue, Tax Evasion, tax fraud and money laundering – IR 1061 (Inland Revenue, 2019).
[97] Inland Revenue (n 96) 1.
[98] The Commerce Commission and the Financial Markets Authority also have some responsibility with certain financial offending.
[99] OECD (n 81).
[100] Ibid.

Inland Revenue has many tools to assist with national agency cooperation. There are several approved information-sharing arrangements (AISAs) involving government agencies. The Privacy Act 2020 regulates information matching in the public sector with AISAs listed in Schedule 2 of the Act. Agencies must publish a copy of the agreement online and report on the activity as specified by the Privacy Commissioner.[101]

Table 6 shows information shared between 1 July 2021 and 30 June 2023 with key agencies to assist with preventing, detecting and investigating serious crime. As well as the agencies outlined in Table 6, Inland Revenue has agreements with the Department of Internal Affairs and the Ministry of Social Development.

Table 6: Information sharing between Inland Revenue and the Police, the Customs Service, and the Serious Fraud Office[102]

	Serious Fraud Office		Customs Service		Police	
	2021-22	2022-23	2021-22	2022-23	2021-22	2022-23
Number of requests made by the agency	3	75	4	14	346	463
Number of responses by Inland Revenue	8	75	4	11	322	471

I *Principle 9: Ensure international cooperation mechanisms are available*

Principle nine exists as tax crimes commonly have international connections. Examples provided by the OECD include where foreign jurisdictions are used to hide assets or income, or where proceeds from illicit transactions are kept abroad and not declared to tax authorities.[103] Therefore, tax authorities must have the ability to investigate international arrangements, which would typically require the cooperation of tax authorities in other countries. As noted by McGillivray '[t]he increasingly global nature of tax evasion means that sovereign tax regulators find themselves somewhat hamstrung in their efforts to protect tax revenues and catch tax evaders if they act in isolation. Just as criminals nowadays are wont to take a "global view" when organising their nefarious activities, so too must the organisations who seek to stop them'.[104]

[101] Privacy Commissioner, Approved Information Sharing Agreements (2013) Retrieved from https://privacy.org.nz/privacy-act-2020/information-sharing/approved-information-sharing-agreements/, 23 February 2024
[102] Inland Revenue 2023 (n 31) 192.
[103] OECD (1).
[104] A McGillivray, 'Tackling financial crime and protecting tax revenues through global collaboration' (2019) 22(3) *Tax Specialist* 122, 123.

The OECD report notes that this cooperation may take several forms, including information sharing, serving documents, obtaining evidence, taking witness testimony, executing freezing and seizing orders, or joint investigations.[105] These forms of cooperation require legal contractual agreements across a wide network of countries.

Inland Revenue participates in the automatic exchange of financial account information in tax matters, whereby financial institutions pass information on non-resident financial accounts on to Inland Revenue.[106] Inland Revenue currently exchanges financial account information with more than 70 countries.[107] These are operationalised through Double Tax Agreements and Tax Information Exchange Agreements. In addition, the Mutual Assistance in Criminal Matters Act 1992 allows for cooperation with jurisdictions where a Double Tax Agreement or Tax Information Exchange Agreement is not in place.[108] Specifically, a request for assistance may be made to any foreign country.[109]

J *Principle 10: Protect suspects' rights*

The final principle confirms the importance of ensuring that taxpayers are afforded procedural and fundamental rights when suspected of committing a tax crime. The OECD 2017 report outlines the United Nations' Universal Declaration of Human Rights fundamental human rights as indicative of the rights that a taxpayer should be able to rely on.[110] These include access to legal advice; access to documents; the right to a speedy trial; and a presumption of innocence.

In New Zealand, these are outlined in the Bill of Rights Act 1990. Regarding search, arrest and detention, there are protections against unreasonable search or seizure,[111] the right not to be arbitrarily arrested or detained,[112] the right to consult a lawyer, and the right to be informed of the reason for the arrest at the time it occurs.[113] A taxpayer's right to silence has been confirmed in Commissioner's Statment CS 20/04, along with other rights, such as the right to a fair trial, adequate time to prepare a defence, and a presumption of innocence.[114] Under the Tax Administration Act 1994, secrecy is imposed on the tax administration in most situations, including investigating tax crimes.[115]

K *Summary*

The ten OECD principles as outlined above are designed to provide a framework for countries to examine their approaches to fighting tax crime. As noted, the OECD has reported on the

[105] OECD (n 1).
[106] Inland Revenue 2023 (n 31).
[107] Inland Revenue (n 86).
[108] OECD (n 54).
[109] Mutual Assistance in Criminal Matters Act 1992, s 7.
[110] OECD (n 1); United Nations, *Universal Declaration of Human Rights* (United Nations, 2015).
[111] Bill of Rights Act 1990 (BORA), s 21.
[112] BORA, s 22.
[113] BORA, s 23.
[114] Inland Revenue, The Disputes Resolution Process and Fair Trial Rights Commissioners Statement 20/04 (Inland Revenue, 2020); Weaver and Keating (n 8).
[115] OECD (n 81).

performance of 33 countries against these principles. The data for this OECD report is provided by the relevant tax authorities and therefore does not adopt a critical lens on performance. Indeed, in some places the data provided is only tangentially related to the principle and, perhaps unsurprisingly, the data reported generally reflects positively on the tax authority. The following section engages in a more critical analysis of New Zealand's performance against the ten OECD principles, as well as the principles themselves in order to provide a different perspective on New Zealand's approach to fighting tax crime.

IV THE GAPS IN NEW ZEALAND'S APPROACH TO FIGHTING TAX CRIME

This section starts with an evaluation of how well New Zealand's Inland Revenue's current policies and practices align with the proposals of the OECD. The OECD's Maturity Model is used to frame this discussion. The Maturity Model sets out four levels of "maturity": emerging, progressing, established and aspirational. Three gaps (where New Zealand is considered to be emerging or progressing) are identified through this exercise. Note that the OECD expects most developed jurisdictions to be classified as established.[116] The four levels are outlined below:

- Emerging, where processes have been used to develop some capability to address tax crime, but these are ad hoc and need significant improvement.
- Progressing, where process-improvements have been started, but are not fully implemented and institutionalised.
- Established, which represents robust processes that result in a high degree of capability to address tax crime.
- Aspirational, where innovative tools and technology are used in efforts to combat tax crime.[117]

Some of the assessment criterion in the Maturity Model overlap, for example, information sharing or access to resources. Where this occurs, the assessment criterion is discussed only once, at the most relevant principle. Each of the principles is assessed by the researcher according to the four levels outlined above. The subjectivity present in this assessment is acknowledged, although explanations for each assessment are provided for transparency.

A *Principle 1: Offences are criminalised*

This appears to fit the category of "established". Inland Revenue can address emerging forms of tax crime. Criminal sanctions are adequate and available, and maximum sanctions of up to ten years imprisonment are likely to dissuade at least some offending, although the maximum sentences are infrequently applied and criminal prosecutions are few. The law provides for graded sanctions for aggravating circumstances and professional enablers are subject to enhanced sanctions.

[116] OECD (n 5) 6.
[117] Ibid.

B *Principle 2: An effective tax crime strategy exists*

As there is little activity to support this principle it appears to be best categorised as "progressing". There are no specific performance indicators on goals relating to prevention, detection, enforcement and recovery of assets. Targets exist for certain forms of debt, on-time payments and filing, and accuracy, for example, but these are absent for crime.[118] However, in 2024, Inland Revenue ran targeted campaigns to improve compliance in sectors identified as high risk of incorrect tax reporting.[119]

The Maturity Model recommends a strategy developed through a formal consultative approach that is extended to other agencies.[120] A good strategy "provides a clear roadmap, consisting of a set of guiding principles or rules, that defines the actions people in the business should take (and not take) and the things they should prioritize (and not prioritize) to achieve desired goals".[121] This is not apparent in the New Zealand context. There are documents on overall compliance and New Zealand participates in several multi-agency forums on financial crime, but this is different from having a strategy to manage tax crime. The country chapter on New Zealand for Principle 2 discusses a range of tools that Inland Revenue uses in its tax crime programme. These include threat assessment and their communications strategy, but again these are not a strategy to address tax crime.

The Maturity Model recommends a robust risk assessment is in place that identifies current and emerging risks. In November 2024, Inland Revenue presented their Compliance Update.[122] This presentation outlined an overall approach to compliance, including the intended focus for financial year 2024/25. It identified compliance interventions in three high-risk sectors, and the need to reduce systemic risks related to other activity such as cryptocurrency, electronic sales suppression tools, organised crime, offshore income and corporate restructures.[123] Thus, the prioritisation of risks appears systematic and a plan to mitigate risks exists. However, while the presentation reported on various areas of focus, there was no comment on how tax crime would be addressed. That is, the focus was on encouraging people to get it right, rather than detailing consequences when taxpayers deliberately get it wrong.

The Maturity Model also proposes a clear communication strategy to inform the public of the risks and trends on an ongoing basis. There is some communication by Inland Revenue, for example the use of media releases when successful tax crime prosecutions are completed. However, there is capacity for more communication on the overall approach adopted by Inland Revenue to address tax crime. By way of example, the Compliance Update referred to above was only made available online for three weeks after the formal presentation and does not appear to be replicated or available elsewhere.

C *Principle 3: Inland Revenue has adequate investigative powers*

[118] Inland Revenue 2024 (n 31).
[119] Ibid.
[120] OECD (n 5).
[121] M Watkins, 'Demystifying Strategy: The what, who, how and why' *Harvard Business Review*, September 10 2007, 1.
[122] Inland Revenue 'Compliance Focus'. Webinar presentation, 6 November 2024.
[123] Ibid.

Inland Revenue has adequate powers granted with extensive procedural safeguards, as outlined in the previous sub-section, therefore this principle would appear to be "aspirational". These include powers to access property and seize documents, interview suspects and witnesses, and intercept communications. These powers are affirmed in law and it is clear when and how the power can be used in practice. Inland Revenue has the ability to engage in advanced analytics, through access to the Integrated Data Infrastructure that holds government data, as well as powers to access data from other agencies.

D *Principle 4: There are effective powers to confiscate assets*

This principle appears to be best categorised as "established". Powers exist to freeze assets that are suspected to be connected to tax fraud. However, these powers are infrequently used, as outlined in the previous section. The powers meet the Maturity Model requirement for legal barriers to be minimised and able to adapt to changing operational environments. The Maturity Model also recommends that tax authorities freeze assets in all appropriate cases of suspected tax crime, which does not occur in New Zealand.

E *Principle 5: The organisational structure has defined responsibilities for tax crime*

This principle appears to be "progressing". There are legal mandates to access diverse sources for exchange of information, inter-agency coordination, clearly allocated resources, and detection and prevention of tax crimes is part of the overall risk management strategy. However, there does not appear to be an early warning system for detection and prevention of tax crime, along with adequate resources (discussed further below). This is particularly relevant at the present time, when Inland Revenue acknowledge that there has been a period of lower than usual enforcement activity.[124]

Historically, New Zealand has been accused of not treating tax crime, and white-collar crime more generally, seriously.[125] Adoption of an organisational structure that has a department with allocated responsibility for tax crime is likely to be beneficial in multiple ways. It will signal that non-compliant behaviour is more likely to be discovered and appropriately sanctioned. As noted by the OECD, it also allows for efficient allocation of responsibilities, which can reduce duplication of efforts and help identify gaps in enforcement.[126] Importantly, it allows for "greater transparency and accountability for the use of resources and deployment of strategies".[127] Note that the other two principles identified as problematic in this article relate to resources and strategy: the organisational structure impacts the design of the compliance strategy and the allocation of resources to that function.

---

[124] Ibid.
[125] Marriott (n 8); Lisa Marriott and Dalice Sim, 'Social Inequity, Taxes and Welfare in Australasia' (2019) 32(7) *Journal of Accounting, Auditing and Accountability* 2004.
[126] OECD (n 1).
[127] Ibid 46.

It may be argued that there is an organisational structure with defined responsibilities, as Inland Revenue is responsible for all functions relating to the detection, investigation, and prosecution of tax crime, and there is a clear process for investigations and prosecutions. However, this is not the same as having a dedicated resource for addressing tax crime, for example, the Maturity Model proposes specialised courts and prosecutors for the prosecution of tax crime.

F *Principle 6: Tax crime investigation is adequately resourced*

Similarly to principle 5, this principle also appears to be best classified as "progressing". While there are separate budget allocations for Inland Revenue, and a small level of additional resource ($29 million) has been allocated to the Inland Revenue to assist with compliance in the 2024 budget, budgets have been reducing for several years.[128] The ability to respond to emerging issues, as recommended in the Maturity Model, is dependent on these budget allocations.

Staff secondments exist to share knowledge and experience among government agencies, as also recommended in the Maturity Model. In addition, Inland Revenue offer, and mandate, training opportunities for staff with dedicated budget.[129]

The potential for New Zealand's Inland Revenue to be insufficiently resourced to prosecute tax crime has been raised by researchers for some years.[130] Recent commentary notes that "those familiar with Inland Revenue's operations know its investigation function is almost entirely targeted towards the (re)assessment and collection of tax and not upon the detection and prosecution of criminal offences".[131] The discussion on principle 6 in the previous section showed that both human and financial resources have declined significantly in recent years. While technology can be argued to compensate for at least some of the human and financial resources, the investigative function remains reliant on human input. Table 2 shows a downward trajectory of prosecutions, reducing from 68 in 2019 to 38 in 2022. While this is likely to be at least in part attributable to the COVID-19 response, which redirected resources from the tax authority to the social welfare authority, tax crime prosecutions have been low for many years.[132]

A high return on investment is shown in Table 5. This calculates to an approximate return of $8.25 for each dollar of investigation activity over the seven years from 2017 to 2023, indicating the value that can be attributed to this activity. The return on investment is also a strong argument for greater funding of this activity, as it is revenue-positive and likely to remain so with further investment.

Greater investment in the tax crime function may also act as a deterrent to the activity. While sanctions are the primary deterrent, a general deterrent is likely to result from signalling greater enforcement of tax crime.[133] This can only be achieved with greater resourcing. The previous

[128] New Zealand Government, *Budget 2024: Summary of Initiatives* (New Zealand Government, 2024).
[129] Inland Revenue, 2024 (n 31).
[130] Marriott 2020 (n 8); Weaver and Keating (n 8).
[131] Weaver and Keating (n 8) 1.
[132] Marriott (n 52).
[133] H Kleven, M Knudsen, C Kreiner, S Pedersen, and E Saez, 'Unwilling or unable to cheat? Evidence from a tax audit experiment in Denmark' (2010) 79(3) *Econometrica*, 651.

section reported on the relatively low proportion of financial penalties collected. The deterrent effect is further diluted when payment of financial penalties can be avoided.

Inland Revenue's refocus of their activity towards compliance is visible in the lower numbers of people attached to an investment or audit activity. However, tax compliance does not appear to have improved since the new approach was implemented. As noted above, the approximate $1 billion in tax discrepancies identified has not reduced with this new approach.

G *Principle 7: Tax crime is a predicate offence for money laundering*

This principle can be assessed as "established". A range of tax crimes are included in law as a predicate offence for money laundering, as required under the Maturity Model. Data matching has been introduced and is fully functional. The importance of adopting this principle has been identified by several researchers, as noted in section two.

H *Principle 8: Domestic information sharing exists*

This principle can also be considered as "established". Other government agencies are involved in fighting tax crime, although this principle does not reach the aspirational level due to the absence of a whole-of-government approach with enhanced collaborative arrangements for investigative capability. As noted in section two, Brun et al. identify specific steps that can be adopted to facilitate a whole-of-government approach to tax crime.[134]

I *Principle 9: International cooperation frameworks are in place*

Like principles 7 and 8, principle 9 can also be considered as "established". There is an extensive range of legal instruments and a network of treaty partners covering relevant jurisdictions that have strategic importance for New Zealand. In addition, there is access to instruments including the multilateral Convention on Mutual Administrative Assistance in Tax Matters, which has been in force for New Zealand since 2014 and is explicitly included in the Maturity Model.

J *Principle 10: Suspects' rights are protected*

This principle is considered to be "aspirational". Fundamental and procedural rights are clearly affirmed in law, and these rights are enforced. There are several layers of review of tax decisions, where taxpayers can request reviews and reassessments. These start with documented dispute resolution processes in the Tax Administration Act 1994, and progress

[134] Brun (n 25).

through the Taxation Review Authority and formal court system. Additional rights exist in the Bill of Rights Act.

K *Summary*

As outlined above, the majority of the principles are assessed by the researcher as established or aspirational, with only three exceptions. The first is the absence of a coherent tax crime strategy (principle 2). The second is the absence of an organisational structure with defined responsibilities (principle 5). With this principle, the primary concern is that no dedicated department is responsible for tax crime. The final principle is principle 6, which relates to adequate resourcing for tax crime investigations. This evaluation builds on the country report referred to above. As noted, the country report details information provided by Inland Revenue which, while correct, does not identify deficiencies in how the principles are met. Information is reported uncritically and, in some places, does not directly address the core components as outlined in the principles. The evaluation in this article is intended to identify gaps and areas for potential improvement.

The next section moves from a focus on New Zealand's adherence to the principles, to a critique of the principles themselves. This results from the evaluation exercise where gaps in the principles were identified.

V A CRITIQUE OF THE OECD PRINCIPLES

The OECD principles as discussed above are intended to be a 'global reference guide'.[135] The initial 2017 report was updated in 2021, with expanded content on performance in 33 countries, measured against the principles. As noted above, these country chapters allow tax authorities to provide context on their performance against the principles. This reporting is not independent and does not allow for the identification of gaps where the principles are not met, as the country reports detail what countries are doing, rather than what they are not doing. The country reports would benefit from the development of structured questions that would allow for comparison across jurisdictions and provide greater clarity into the gaps in performance.

In its current form, the OECD provides the guidelines and the tax authorities provide some indication of performance. In many cases, it would be insightful to have more precise data. For example, principle three queries whether adequate investigate powers exist. These powers may exist within a tax authority, but if they are not used this diminishes the actual fighting of tax crime, as compared to the potential for fighting tax crime. An example in New Zealand relates to principle 1. Tax offences are criminalised, but there are few criminal prosecutions. Rather than reflecting an absence of serious tax crime, this is likely to relate more to principle 6 (resourcing). However, this nuance is not evident in the country report on New Zealand.

The OECD principles are focused on government activity. There is no reference to any role of the private sector in helping address tax crimes, such as banks or other financial institutions. While the principles focus strongly on inter-agency cooperation, there is little inclusion of the

[135] OECD (n 1) 5.

private sector. There would appear to be some benefit in including cooperation with agencies outside the public sector in the principles.

There is an absence of reference to technology, artificial intelligence, or cryptocurrencies in the OECD reports. However, the Maturity Model acknowledges the gains to be made from using technology. Technology and artificial intelligence can help address tax crime, while digital currencies are known to facilitate the concealment of criminal flows of money. While research by Leighton-Daly suggests that tax authorities, and specifically the Australian Tax Office, 'can counter even the more sophisticated attempts to defraud the revenue and third parties based on taxpayer information',[136] it is well-established that technology can assist with data mining and advanced analysis 'vastly improving their ability to detect and investigate tax evasion'.[137]

A further factor that is not specifically raised in the OECD principles, although it may perhaps be implied, is effective legislation and operational support activity. By way of example, Weaver and Keating recently highlighted the difficulty for the New Zealand Inland Revenue to 'complete both a successful criminal prosecution and a substantive dispute within the tight statutory timeframes'.[138] Weaver and Keating observed that delays in either the civil or criminal proceedings could 'run the clock down' and suggested that there may be an incentive for taxpayers to take advantage of delays to avoid a criminal prosecution. Weaver and Keating suggest that the Commissioner of Inland Revenue will have to decide at an early stage of the investigative process whether to take a criminal prosecution, as it may not be possible to do so at a later stage.[139] While perhaps an unusual example, this highlights the need to not only have criminalisation of tax offences (as per principle 1) but also to have legislative and administrative support to allow effective operationalisation.

A *Limitations*

There are several limitations to this research. The assessment of New Zealand's approach to fighting tax crime uses primarily publicly available information supported by information provided under the Official Information Act. It does not have insights from internal Inland Revenue practice that would lend greater depth to the analysis. In addition, the analysis is limited to the ten OECD principles and there are likely to be other factors that are relevant to addressing tax crime.

VI CONCLUSION

The OECD principles for addressing tax crime are welcome. This has facilitated the examination of New Zealand's approach to fighting tax crime. As noted, New Zealand performs reasonably well against seven of the ten principles. The three that are weaker highlight the need for additional resourcing for addressing tax crime, not only for its effective operation but also

[136] M Leighton-Daly, 'Identity Theft and Tax Crime: Has Technology Made It Easier to Defraud the Revenue' (2018) 16 *eJournal of Tax Research* 578, 578.
[137] V Ramgulam and S Bourton, 'Technology and tax evasion in the world of finance' (2021) 1 *FinTech, Artificial Intelligence and the Law: Regulation and Crime Prevention* 96, 98.
[138] Weaver and Keating (n 8) 9.
[139] Ibid.

for structural factors such as implementing an effective strategy to address tax crime and having an effective organisational structure to assist in fighting tax crime.

It is important to have guidelines from which to assess performance. However, it is also important for these to be independently assessed. While the OECD has country reports, these report on data provided by the tax authority and are not an independent critical analysis of performance. Future country reports would benefit from the provision of specific country data, such as how frequently criminal prosecutions are actioned or how frequently powers to freeze assets are used. Furthermore, the OECD principles would benefit from recognition of the importance of technology in the fight against tax crime as recent advances in data mining, data cross-referencing, and data sharing have significantly changed the landscape for tax compliance.

A PROPOSED DESCRIPTIVE FRAMEWORK TO THE SOUTH AFRICAN VALUE-ADDED TAX (VAT) ACT

MUNEER E. HASSAN*

Abstract

The existing VAT Act is intricate to instruct, implement and administer, exhibiting a need for profound improvements. An empirical study presents guidelines to improve the VAT Act, which entails following the lifecycle of a VAT vendor, organising sections into groups, incorporating headings and subheadings, providing clear signposting, and finding the most effective solution to address local challenges. A recommendation also included in the guidelines is that these guidelines should be used to construct a descriptive framework to the VAT Act. This study presents a descriptive framework to re-organising the VAT Act utilising these guidelines employing applied qualitative research as the research methodology. Recommendations provided by interviewees were integrated to improve the descriptive framework. The constructed descriptive framework to the VAT Act marks the first stage in the process of simplifying the South African VAT Act. The proposed descriptive framework to the VAT Act is a new addition to the body of knowledge.

Keywords: guidelines, descriptive framework, logical, simplified, structure, value-added tax

I INTRODUCTION

The concept of value added is not clearcut or easily defined [...] On the whole, the value-added tax is not nearly as simple a levy as is sometimes argued[1].

The South African VAT Act was found to be complex due to its incoherent structure which contributes to legal complexity[2]. The VAT implications of importing "electronic services" are presented to display the problem of dispersed sections, which make the VAT Act incoherent. Before analysing the VAT consequences of importing "electronic services", "imported services" must be considered.

The sections that must be considered for "imported services" are as follows:

- Section 1 definitions: "supply"; "imported services"; "open market value"

* Deputy HOD, Senior Lecturer: Taxation, Department of Accountancy, College of Business and Economics, University of Johannesburg, Johannesburg, South Africa.

[1] Williams *Tax law design and drafting* (1996) 164.

[2] Hassan, Bornman & Sawyer "Guidelines for a simplified Value-Added Tax Act" *South African Journal of Accounting Research* 1 (2024) 18.

- Section 3: determination of "open market value"
- Section 7(1)(c): imposition of VAT on imported services by any person
- Section 14: collection of VAT on imported services, determination of value and exemptions; read with section 10(2) and (3): general value of supply rule; and section 3: determination of open market value.

The following sections must be considered when importing "electronic services":

- Section 1 definitions: "electronic services"; "enterprise" – paragraph (b)(vi); "export country"; "services"; "supply"
- Section 7(1)(a): imposition of VAT on the sale of goods or services
- Section 7(1)(c): imposition of VAT on imported services by any person; read with section 14(5)(a): exceptions to imposition of VAT on imported services by any person
- Section 23(1A): registration requirements suppliers of electronic services
- Section 16(2)(b), read with section 20(7): input tax and documentary requirements
- Government Notice No. 429 published in Government Gazette No. 4231: regulations in respect of electronic services.

In addition to the sections of the VAT Act, vendors must also consult the following documents issued by the South African Revenue Service (SARS) to fully comprehend the VAT obligations imposed on the supply of electronic services in South Africa:

- SARS Frequently Asked Questions: Supplies of Electronic Services[3]
- SARS External Guide: Foreign Suppliers of Electronic Service[4]
- Binding General Ruling No. 28: Electronic Services[5].

The example illustrates the number of sections that must be evaluated when importing services and electronic services, which are scattered throughout the VAT Act.

The lack of coherence in the structure makes it necessary to assess numerous sections dispersed throughout the VAT Act in relation to a single event. Occasionally, it is also necessary to refer to external documents, such as Government Gazette notices, SARS guides, rulings and interpretation notes. The issue with taxpayers relying on external documents other than Gazette notices which form part of the Act is that these interpretations have limited or no significance when disputes arise and their interpretation is contested in court[6]. This reaffirms the necessity for a simplified VAT Act. The VAT Act lacks logical design, as it fails to adhere to the chronological sequence of a VAT vendor's lifecycle, as VAT registration is first encountered in section 23 of the VAT Act, while the basis of registration is contained in section 15. It seems

[3] South African Revenue Service (SARS) *Legal Council: Value-added tax. Frequently Asked Questions: Supplies of electronic services* (2019).
[4] SARS Service *External guide: Foreign suppliers of electronic service* (2022).
[5] SARS *Binding General Ruling (VAT): No. 28 (Issue 2), Electronic service*s (2016).
[6] *Marshall NO and Others v Commissioner for SARS* CCT 208/17 ZACC 11 (2018).

that several sections have been hastily assembled. The lack of coherence in the structure renders the VAT Act complex to comprehend and apply.

The incoherent structure of the VAT Act increases its complexity and poses challenges in terms of instruction, practical implementation and administration[7]. Clear and concise legislation is necessary to ensure that taxpayers can understand and adhere to it accurately and efficiently[8]. The complexity of the VAT Act undermines the objective of the VAT system[9].

The Value-Added Tax (VAT) Act was implemented by South Africa on 30 September 1991[10]. VAT plays a substantial role in achieving the annual revenue collection goal of the South African Revenue Service (SARS). VAT accounted for 25.7% of SARS's annual revenue target for the fiscal year 2023/24, making it the second-largest contributor after personal income tax, which accounted for 37.4%[11].

There is a difference between reorganising, revising and rewriting a law. They are different concepts. The first allows a legal text to be grouped differently while the second implies modifying, adding, or repealing texts in a law. The third represents a rewrite project which results in a new Act. The research problem focusses on reorganising the VAT Act.

Guidelines for a simplified VAT Act have been put forward as a remedy to improve the incoherent structure in the current VAT Act[12]. To teach the VAT Act, educators find it useful to follow the lifecycle of a VAT vendor while explaining what is required at each stage. A similar approach is followed by the author of this article while applying the guidelines. Furthermore, the guidelines mandate the incorporation of headings and subheadings, the organisation of intricate sections and the prevention of incongruity. This means that each section must be presented in alignment with its appropriate section headings and include clear signposting, i.e. forward and backward cross-referencing of sections. Furthermore, it is essential to incorporate international best practices. The guidelines propose that the first stage of the VAT Act reorganising project should involve the creation of a descriptive framework (i.e., which can be included as an appendix to the VAT Act).

The purpose of this article is to propose such a descriptive framework by implementing the guidelines at each stage of a vendor's lifecycle, thereby offering direction in the re-organising of the VAT Act in South Africa. As a preliminary measure for this VAT Act re-organisation project, the development of a VAT Act descriptive framework serves as a practical implementation of the VAT guidelines. At present, there is little to no published information regarding the legal complexity of the VAT Act in South Africa. This article aims to fill this gap and hence provide a theoretical contribution by providing a descriptive framework for a simplified VAT Act.

II LITERATURE REVIEW

[7] n 2 above.

[8] American Institute of Certified Public Accountants. *Tax policy concept: Guiding principles of good tax policy: A framework for evaluating tax proposals* (2001).

[9] n 2 above.

[10] Value-Added Tax Act (Act No. 89 of 1991).

[11] National Treasury & South African Revenue Service. *2024 tax statistics – highlights* (2024).

[12] n 2 above.

The literature review is presented in this section in the following manner: legal complexity and tax complexity are explained, then an overview of the literature on guidelines on logical structure in legal drafting is presented, followed by a discussion of international and local literature on simplification reforms.

A *Tax complexity and legal complexity*

Tax legislation, similar to several other legislations, is often ambiguous in numerous instances[13]. There exist three categories of potential ambiguities in tax law: the exact interpretation of legislative text, the implementation of the law in a particular factual scenario, and the kind of evidence required to demonstrate essential facts. Tax complexity refers to intricate substantive tax regulations with intricate interrelationships, all of which are articulated in intricate statutory terminology and structure[14]. An increase in the sophistication of tax legislation leads to tax complexity[15]. According to Tran-Nam[16] the degree of complexity of a tax law is determined by both the language used to express the law (e.g., plain English, grammar, sentence length, active voice and logical structure) and the content of the law (e.g., ambiguity; exemptions, rebates and concessions; and annual amendments).

When described in this manner, this study focuses on logical structure, which is an element of legal complexity in tax complexity. Legal complexity refers to the difficulty with which a given tax statute may be read, comprehended, interpreted, and applied in various practical scenarios. In this definition, legal simplicity is evidently of fundamental interest to academic and practising tax attorneys, tax advisors, tax policymakers and the judiciary. Although several academics highlight the impact of tax law complexity associated with compliance, it is clear that tax law complexity also has an impact on the level of legal certainty[17]. The presence of legal complexity inherently generates ambiguity. Legal difficulties also arise due to the accuracy of administrative regulations, resulting from either administrative lack of precision or excessive regulatory inflexibility[18].

Legal simplicity is the inverse to legal complexity. In 1997, Epstein proposed six fundamental principles to attain legal simplicity[19]. These principles consist of four rules that govern human interactions in everyday social life: autonomy of the individual, property, contract, and tort. Additionally, there are two rules that allow for forced exchanges on payment of fair compensation when private or public necessity so dictates. Roberts *et al*., advised that all stakeholders involved in tax formulation should prioritise the avoidance of complexity and ambiguity[20].

---

[13] Givati "Resolving legal uncertainty: the fulfilled promise of advance tax rulings" *Va. Tax Rev 29* (2009) 137.

[14] Surrey "Complexity and the internal revenue code: the problem of the management of tax detail" *Law and Contemporary Problems* 34(4) (1969) 673-710.

[15] Richardson & Sawyer "Complexity in the expression of New Zealand's tax laws: An empirical analysis" *Australian Tax Forum* 14(3) (1998) 325–360.

[16] Tran-Nam "Tax reform and tax simplification: Some conceptual issues and a preliminary assessment" *The Sydney Law Review* 21(3) (1999) 500–522.

[17] n 10 above.

[18] Diver "The optimal precision of administrative rules" *Yale LJ 93* (1983) 65.

[19] Epstein *Simple rules for a complex world* (1997).

[20] Roberts, Friedman, Ginsburg, & Louthan "A report on complexity and the income tax" *Tax L. Rev. 27* (1971) 325.

Katz presents an organised framework for measuring the complex nature of legal systems[21]. Based on "knowledge acquisition," a methodology at the convergence of psychology and computer science, this paradigm considers the structure, language, and interdependence of law. It is important to distinguish between legal language and simple language. A tax law such as the VAT Act is a legal text and must comply with the standards of a legal framework. Grouping concepts more simply can support understanding, but the concepts of structure, language, and interdependence must be evaluated[22].

B *Guidelines on Logical Structure*

The logical arrangement of a statute enhances understanding[23]. A well-organised statute facilitates the identification of the relevant sections to consult for a specific question and enables the reader to disregard irrelevant sections. Provisions pertaining to the same topic should be consolidated for the purpose of organisation. Moreover, it is essential that every division of the statute, including individual sections, be composed in a coherent sequence. In general, this involves initially stating the overarching principle and subsequently outlining any exceptions and specific regulations for particular instances. Kimble conducted a literature review on the utilisation of plain English and proposes several principles for legal writing, including the organisation of related concepts and the arrangement of components in a coherent sequence[24].

An instance of inadequate organisation occurs when a substantial statute lacks division into sections, thereby necessitating the reader to search the entire statute for the pertinent provisions[25]. A well-written tax statute often contains numerous cross-references, both explicit and implicit i.e. the use of a term that is defined elsewhere in the statute.

Petelin suggests starting clear writing by profiling the target and potential audience[26]. To organise information coherently, the text must be structured from the reader's perspective, not the authors. Therefore, readers must be able to easily navigate the text, find what they need and understand it[27]. Due to the incoherent structure of the VAT Act, one needs to be a VAT specialist to understand the obligations on a VAT vendor[28].

The Davis Tax Committee (DTC) provides the following statement regarding the simplification of the corporate tax system in South Africa:

> One radical suggestion has been that the Act should be re-written and re-structured in its entirety. *Such a rewrite would undoubtedly result in a rearrangement of the provisions of the Act into a more coherent logical sequence. This may enhance the efficiency of the compliance environment of taxpayers*[29]. [emphasis added]

---

21 Katz *Measuring the Complexity of the Law: The United States Code* (2010).

22 Katz & Bommarito "Measuring the complexity of the law: the United States Code" *Artificial intelligence and law 22* (2014) 337-374.

23 Thuronyi *Tax law design and drafting: Volume 1* (1996).

24 Kimble "Writing for dollars, writing to please" *Scribes Journal of Legal Writing*, *6.* (1996).

25 n 19 above.

26 Petelin "Considering plain language: Issues and initiatives" *Corporate Communications 15*(2) (2010) 205–216.

27 Cutts *Oxford guide to plain English* (2013).

28 No 2 above.

29 DTC *Report on the efficiency of South Africa's corporate tax system* (2018) 91.

Clear and concise tax laws are necessary to ensure that taxpayers can understand and adhere to the regulations accurately and efficiently[30].

C *International and Local Simplification Reforms*

The guidelines for a simplified VAT Act included international benchmarking of best practices. In this regard, the guidance provided by the Organisation for Economic Co-operation and Development (OECD) should be taken into account; however, it is also important to consider a hybrid solution that addresses the specific local issues in South Africa.

Several countries have already implemented tax re-organisation simplification measures. This literature highlights best practices for achieving legal simplicity, drawing on global experiences of countries that have successfully simplified their VAT and/or Income Tax Acts. In addition, South Africa has initiated the process of streamlining its tax system.

I *Guidance Provided by the OECD*

South Africa is a member of, and active participant in the OECD, which grants South African policymakers the opportunity to access the OECD's extensive knowledge and exemplary policy practices[31]. Simplicity refers to the quality of tax rules being easily comprehensible, allowing taxpayers to predict the tax implications of a transaction in advance, including the timing, location and method of tax accounting[32]. While originally designed to pertain to income tax, these overarching principles are widely acknowledged to be applicable to consumption taxes too.

II *The Office of Tax Simplification in the United Kingdom*

The Office of Tax Simplification (OTS) served as the United Kingdom (UK) government's unbiased consultant regarding the simplification of the tax system[33]. The objective of the OTS was to enhance the overall tax-related experience for all individuals involved. The OTS endeavoured to streamline and enhance the administrative procedure. These factors are of equal importance to both taxpayers and His Majesty's Revenue and Customs (HMRC). While certain suggestions put forth by OTS to streamline the VAT system in the UK have been put into effect, none of them pertain to the organisation, layout and structure of the VAT Act. The OTS has been dissolved and ceased to contribute to the process of tax simplification in the UK[34]. The government chose to integrate tax simplification into the existing governmental institutions instead of having an independent supervise simplification[35]. Sawyer asserts that the decision was misinformed and poses a risk of undoing the extensive effort of the OTS, based on the

[30] n 7 above.
[31] OECD *South Africa and the OECD* (2021).
[32] OECD *International VAT/GST guidelines* (2017).
[33] OTS *Office of Tax Simplification Complexity Index paper 2017* (2017).
[34] OTS *Update on the closure of the Office of Tax Simplification* (2022).
[35] HM Treasury *The Growth Plan 2022* (2022).

available evidence[36]. The UK has demonstrated the necessity for the OTS to possess autonomy from both the government and the corporate sector[37]. Establishing such a body in South Africa would pose a significant challenge to maintaining independence. Considering that South Africa's government has remained unchanged since gaining independence, being plagued with allegations of corruption and nepotism, it is challenging to envision such an entity functioning without political influence.

III The Experience of New Zealand

New Zealand has taken the lead globally in modernising and restructuring its income tax laws in order to decrease complexity. Richardson & Sawyer showed that the New Zealand government, in 1992, demonstrated its dedication to restructuring and ultimately updating its income tax legislation[38]. This study delivered promising results for the New Zealand government's objectives regarding sentence length. A comparison of the research conducted by Tan & Tower[39] and Saw & Sawyer[40] reveals that New Zealand's effort to revise its tax regulations achieved success in terms of improving readability[41]. The New Zealand Income Tax Act underwent a series of revisions, starting with the restructuring of the Income Tax Act of 1976 and the Inland Revenue Department Act of 1974. This process resulted in the creation of the Income Tax Act of 1994, the Tax Administration Act of 1994 and the Taxation Review Authorities Act of 1994. The rewrite project in New Zealand teaches us a valuable lesson: reorganising can enhance the clarity of a text.

The tax law rewrite project did not include other important tax laws, such as the Tax Administration Act (TAA) of 1994 and the Goods and Service (GST) Act of 1985. However, the TAA was a result of the first phase of the project, which involved reorganising existing legislation. Although a member of the Supreme Court made a request to revise the GST Act, no subsequent efforts to rewrite the tax legislation have taken place. Blanchard stated as follows regarding the rewrite project:

> [I]t is to be hoped that once the redrafting exercise on the Income Tax Act is completed the team will move on to the [GST Act 1985], *which is not, and never has been, a user-friendly statute*" [emphasis added][42].

The VAT legislation in South Africa draws heavily from the GST legislation in New Zealand[43]. The issue with the VAT Act in South Africa is reinforced by the suggestion from the New Zealand judiciary to revise the GST Act.

---

[36] *Sawyer* "Vale the Office of Tax Simplification: Is its abolition an ill-informed decision?" *British Tax Review* 1 (2023) 1–8.

[37] Jain "Redrafting process of the income tax legislation in South Africa and India and lessons from New Zealand, the United Kingdom and Australia" *New Zealand Journal of Taxation Law and Policy 27*(3) (2021) 195–221.

[38] n 14 above.

[39] Tan & Tower "The readability of tax laws: An empirical study in New Zealand" *Australian Tax Forum 9*(3) (1992) 355–372.

[40] Saw & Sawyer "Complexity of New Zealand's income tax legislation: The final instalment" *Australian Tax Forum 25*(2) (2010) 213–245.

[41] n 33 above.

[42] Blanchard *GST in retrospect and prospect* (2017) 91 92.

[43] National Treasury *Value added tax South Africa 1991–2011: Presentation to standing committee on finance* (2011); SARS *Overview of value-added tax presentation to standing committee on finance 2016* (2016).

When assessing the New Zealand experience, it appears that New Zealand has come closest to implementing the most effective methods for rewriting income tax legislation, compared to Australia and the UK[44]. The subsequent points were significant examples of commendable methodology used by New Zealand:

- the coordinated process of reorganising existing material first (in addition to taking a staged process);
- setting up the Rewrite Advisory Panel to deal with (potential) unintended policy changes;
- employing a fully consultative process; and
- completing the project (at least with respect to the income tax legislation)[45].

The potential enhancements that could have been implemented in New Zealand include the following, as indicated by Sawyer et al.:

- Setting a realistic timeframe and budget
- Dealing with related major policy issues concurrently
- Focusing on areas of unnecessary complexity
- Undertaking rewriting of other major statutes, including the Tax Administration Act of 1994 and the Goods and Services Tax Act of 1985[46].

Despite Australia's involvement in a rewrite project, this was not thoroughly examined due to the findings of the review, which indicated that the project did not meet the desired standards of simplification[47].

IV *South Africa's Progress towards Simplifying its Tax Legislation*

Tax simplification in South Africa has been a protracted journey marked by multiple interruptions. In 1996, the Katz Commission recommended the rewriting of the Income Tax Act[48].

The Minister of Finance, in his 1997 Budget Review, announced that there would be revisions made to the Income Tax Act. The announcement did not include any reference to the government's intention to substitute the Income Tax Act[49]. The Income Tax Act underwent a process of reorganisation, reordering and restructuring from 1997 to 2000. In 2000, it was announced that significant tax reforms, including the gradual implementation of residence-based tax and the introduction of capital gains tax, would necessitate a review of the drafting process for the Income Tax Act. This was because the new principles would influence how the

---

[44] Richardson & Smith "The readability of Australia's goods and services tax legislation: Empirical investigation" *Federal Law Review 30*(3) (2002) 475–506.

[45] Sawyer, Bornman, & Smith "Simplification: Lessons from New Zealand" *Tax simplification: An African perspective* (2019) 144.

[46] n 43 above.

[47] Smith & Richardson "The readability of Australia's taxation laws and supplementary materials: An empirical investigation" *Fiscal Studies 20*(3) (1999) 321–349.

[48] Katz *Katz Commission report into taxatio*n (1996).

[49] n 34 above.

Act was rewritten[50]. Consequently, the project was suspended until the new principles were incorporated into the Income Tax Act.

Subsequently, in 2005, a venture was launched with the aim of formulating tax administration legislation. The Minister of Finance explained that the objective of the Tax Administration Bill (TAB) was to consolidate various common administrative provisions, which were repeated in the different tax Acts[51]. In March 2009, the initial conceptual version of the TAB was disclosed confidentially[52]. SARS engaged in consultations with important stakeholders and conducted multiple workshops to enhance the quality of the draft TAB. The TAB, which aimed to simplify South Africa's income tax legislation, was implemented on 1 October 2011[53].

The TAB (now known as the Tax Administration Act (TAA)) in South Africa had a profound impact on the tax administration sector[54]. The TAA shares a similar overall structure with the TAA (No. 166 of 1994) of New Zealand[55]. The TAA introduces a systematic approach that aligns the key sequence of tax administration with the administrative lifecycle of taxpayers. This is exemplified by the chapter headings, which play a significant role in the intentional interpretation of legislation[56]. Moosa asserts that the primary objective of the TAA is undeniably centred on improving public interest[57].

In 2003, the customs division of SARS revised the South African customs law to implement the Revised Kyoto Convention and other international agreements[58]. The purpose was to create a well-structured and coherent legislative framework that complements other laws dependent on customs control. The process of revising the 1964 Customs and Excise Act spanned several years. Consequently, the customs and excise were divided, and the project was carried out in stages. Initially, a Customs Control Bill and a Customs Duty Bill were formulated. Subsequently, the Excise Duty Bill was formulated. The Government Gazettes released the Customs Control Act, the Customs Duty Act and the Customs and Excise Amendment Act in July 2014. The commencement of these Acts in 2025 is still pending the decision of the president of South Africa. An important takeaway from this approach is that whilst these Acts are yet to be enacted, which is a criticism, implementing a step-by-step process with multiple stages in the rewriting project, along with extensive input from the public, results in a high-quality solution.

There has been no disclosure from the South African government regarding any additional measures taken in the process of rewriting the Income Tax Act since 2012[59]. The DTC proposed the simplification of South Africa's tax structure, specifically the income tax[60]. The DTC's 2018 closing report states the following:

---

[50] National Treasury *Budget review in Chapter 4: Revenue trends and tax proposals* (2000).

[51] National Treasury *Budget review in Chapter 4: Revenue trends and tax proposals* (2005).

[52] Croome & Olivier *Tax administration* (2nd ed.) (2015).

[53] Tax Administration Act (Act No. 28 of 2011)

[54] Moosa "Tax Administration Act: Fulfilling human rights through efficient and effective tax administration" *De jure* 51(1) (2018) 1–16.

[55] n 52 above.

[56] Botha *Statutory interpretation: An introduction for students* (4th ed.) (2005).

[57] n 52 above.

[58] SARS *New customs legislation update* (2021).

[59] n 26 above.

[60] n 26 above.

> *Tax legislation has become far too onerous and complicated*, and the associated tax compliance and reporting requirements are becoming too burdensome and expensive to comply with – *there is a need for simplicity and certainty* to encourage local and foreign direct investment. [own emphasis][61]

Nevertheless, the government and SARS have suffered a substantial blow to their reputation due to allegations of corruption[62]. Given SARS's efforts to restore its reputation, it is not unfounded to expect a delay in the implementation of the reform project[63].

As mentioned previously, VAT in South Africa is the consistent second-largest contributor to the SARS annual collections target after personal income tax[64]. It is therefore surprising that the rewrite of the VAT Act has received no attention or mention. It is submitted by the researcher that, if a logical approach is adopted, the rewrite of the VAT Act must be considered after employment income since it is the second-largest contributor to SARS' revenue and before corporate income tax. This is based on the principle that VAT affects gross income and costs for allowance and deduction purposes when calculating corporate income tax obligation. It is also for this reason that tax scholars generally teach VAT before corporate taxes in order to achieve horizontal integration.

After examining the simplification reforms and best practices, it is evident that in cases where simplification reforms have been implemented, such as in New Zealand, where the restructuring of the Income Tax Act resulted in a notable enhancement to the Act's readability. This is further validated by South Africa's TAA, which is praised for its meticulous organisation and well-defined structure[65]. Hence, it is crucial to take into consideration the simplification reforms that are considered the best internationally, but it is equally important to consider the specific conditions and circumstances in South Africa. Creating an independent office to oversee the simplification project, such as the OTS in the UK, would be ideal. However, considering the limitations of resources and capacity, a gradual approach as with the TAA and not creating a separate legal body to oversee tax simplification are also reasonable. It is essential to consult international best practices on tax simplifications, while also considering the local operating environment. Hence, the researcher considered this while implementing the guidelines to construct the descriptive framework.

III RESEARCH METHOD

This article is based on literature and the guidelines in Figure 1 derived from the findings of a qualitative study completed in 2023[66]. A literature review and semi-structured interviews constituted the two phases of the research. Due to the complex nature of the legal issue under investigation, the researchers adopted Babbie and Mouton's recommendation of using interviews as the most suitable method of data collection[67]. In accordance with the sequential

---

[61] DTC *Closing report on the work done by the Davis Tax Committee* (2018) 15.

[62] Dicey The impact of corruption on tax administration *Tax Professional* (34) (2018) 6–8.

[63] Jain "How serious are South Africa and India about rewriting their income tax legislation?" *New Zealand Journal of Taxation Law and Policy 27*(2) (2021) 173–184.

[64] n 11 above.

[65] No 57 above.

[66] No 2 above.

[67] Babbie & Mouton *The practice of social research* (2001).

design, the literature review in Phase 1 partly informed and influenced the interview structure in Phase 2. The semi-structured interview questions were designed to address the legal complexity and its components, with an emphasis on logical structure (see Appendix 2: Sample interview questions). Imported services were provided as an example to the interviewees to contextualise the research problem. The research problem that is highlighted is the number of sections throughout the VAT Act together with external document references that must be evaluated to fully comprehend the VAT implications for the importer, which adds to the complexity. Potential enhancements to the VAT Act's incoherent structure, which contributed to its complexity, were sought through the interviews with individuals affected by the issue.

There were only 10 core questions included in the 2023 study. Some questions were categorised as subsets of main questions. Ethical clearance and approval were obtained from the University of Johannesburg's School of Accounting Research Ethics Committee (Ethical clearance code: SAREC20220414/03). Participants provided written consent to participate in the study.

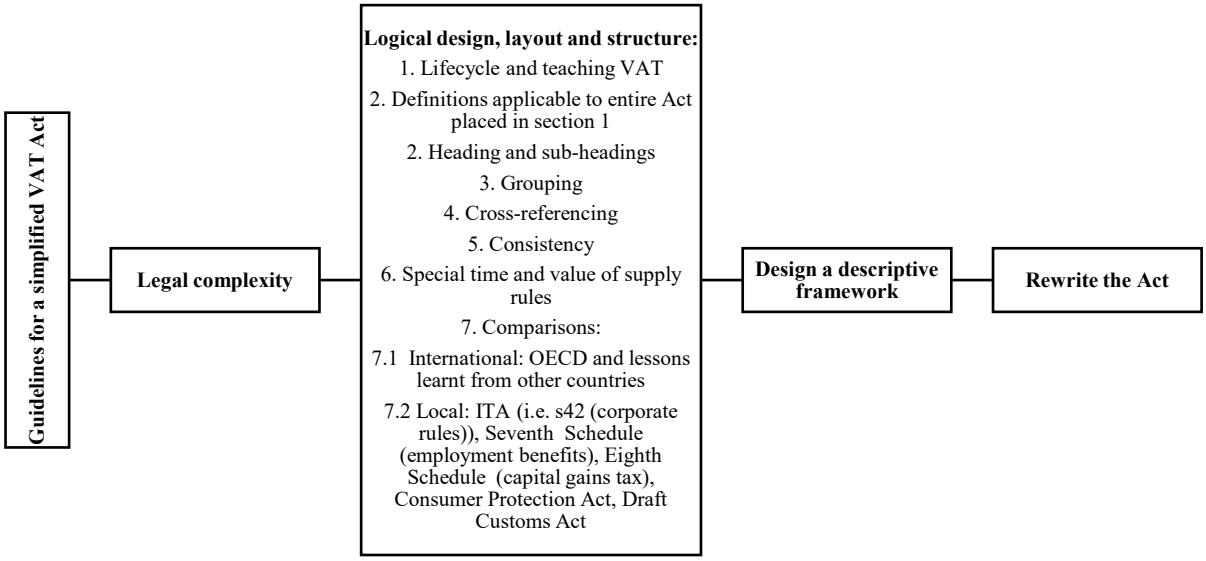


Figure 1: Guidelines for logical design, layout and structure of the VAT Act

Source: Hassan, Bornman & Sawyer "Guidelines for a simplified Value-Added Tax Act" South African Journal of Accounting Research 1 (2024) *18.*

This research employed expert sampling, a form of purposive sampling that relies on individuals possessing specialised knowledge, to gather data[68]. The sample consisted of VAT specialists from academia, industry and government who were directly involved with the VAT Act. The researchers exercised discretion in their selection process, drawing upon their experience and expertise.

[68] Rai & Thapa "A study on purposive sampling method in research" *Kathmandu: Kathmandu School of Law 5* (2005).

The sample frame was set as four significant stakeholder groups: seven tax lecturers who provided instruction on VAT (academics), five tax practitioners specialising in VAT (advisors), two SARS personnel employed in the VAT department (administrators), and one National Treasury employee engaged in the formulation of the VAT Act (drafters). As reconfirmation of the research problem, before approving the request to interview SARS personnel, the SARS Research Committee chairman requested that the researcher make a formal presentation to the SARS Research Committee. The following response was received via the Committee's secretariat from the SARS Research Committee:

> The SARS Research Committee is highly recommending this research for its relevance not only to SARS but National Treasury (NT) too…Therefore, the committee is requesting a follow up engagement for a discussion on your proposal before the next phase of data collection[69].

Based on the presence of VAT specialists within each stakeholder group who worked and interacted daily with the VAT Act, all four stakeholder groups were utilised. As opposed to focusing on the interpretation of the VAT Act, judges in South Africa do not work with and interact with the legislation frequently enough to fully comprehend its overall structural concerns. As a result, the judiciary was excluded from the stakeholder groups. Table I below displays the absolute frequency of quotations in relation to the key themes across the 15 interviewees.

[69] Twala *Request to interview SARS personnel involved in administering the VAT Act* (2022 PhD research).

Table I: Absolute values (quotations)

	AC-I-1 GR=89 #1	AC-I-2 GR=71 #2	AC-I-3 GR=60 #3	AC-I-4 GR=68 #4	AC-I-5 GR=19 #5	AC-I-6 GR=50 #6	AC-I-7 GR=71 #7	AD-I-1 GR=56 #8	AD-I-2 GR=54 #9	AD-I-3 GR=29 #10	AD-I-4 GR=36 #11	AD-I-5 GR=49 #12	SARS-I-1 GR=34 #13	SARS-I-2 GR=57 #14	NT-I-1 GR=45 #15	TOTALS
AMBIGUITY GR=119; GS=23	8	1	8	23	1	6	9	10	5	1	21	8	7	4	7	119
AMENDMENTS GR=50; GS=10	4	1	0	4	1	3	9	1	5	1	2	2	1	3	13	50
BEST PRACTICE GR=70; GS=13	7	7	14	3	2	7	3	1	6	2	3	7	3	2	3	70
CONCESSIONS GR=29; GS=7	3	1	3	1	2	2	4	2	1	1	2	2	2	2	1	29
ECONOMIC POLICY GR=54; GS=10	5	1	2	3	2	8	6	3	11	0	3	2	2	0	6	54
ENGLISH GR=111; GS=13	10	12	8	11	3	7	8	3	5	6	10	6	5	10	7	111
LENGTH OF SENTENCES GR=71; GS=13	6	7	6	6	3	6	6	11	2	1	5	2	4	4	2	71

RESEARCH PROBLEM GR=314; GS=40	39	28	20	24	7	20	24	26	23	9	7	23	10	30	24	314
SOLUTIONS GR=232; GS=17	22	28	24	12	4	11	21	13	13	12	5	23	14	15	15	232
VOICES GR=16; GS=6	3	1	0	1	1	1	3	0	0	2	0	0	0	2	2	16
TOTALS	107	87	85	88	26	71	93	70	71	35	58	75	48	72	80	1066

Author's own contribution (2024)

Abbreviations

Gr	Groundedness of codes (number of quotations coded by a code) or documents (quotations created in a document)
GS	Number of documents in a document group or number of codes in a code group
AC-I	Academic interviewee
AD-I	Advisor interviewee
SARS-I	SARS interviewee
NT-I	National Treasury interviewee

The researcher was able to reach a point of saturation with the 15 semi-structured interviews that were conducted. Studies employing qualitative methods and empirical data have achieved saturation within a limited number of interviews (9–17) or focus group discussions (4–8), especially in cases when the study populations are somewhat similar and the objectives are precise[1]. The results obtained from the sample are neither intended to represent the entire population of South Africa, nor is it the purpose of this study to represent the opinions of a large social group.

A descriptive framework was designed based on the findings from the interviews. A logical organising frame was the lifecycle of a vendor's business, and the other guidelines were used to organise the structure of the Act into the different stages of the lifecycle.

The organisation of the VAT chapters in these textbooks facilitated the development of the descriptive framework. The literature review and findings from the semi-structured interviews support the guidelines for the logical design, layout and structure of the VAT Act. The literature review in combination with the researcher's expertise was then applied to these guidelines to produce the descriptive framework to the VAT Act. Thus, this study employed applied qualitative research as the research methodology. It involves using insights from empirical studies to develop a descriptive framework that addresses a real-world, practical research problem[2].

Bryman & Bell recommend "submitting research findings to the people who were studied to confirm that the investigator has correctly understood their social world" to establish credibility[3]. To obtain additional qualitative data, such as interviewees' opinions and suggestions for improvements, the researcher emailed the descriptive framework he created based on the guidelines for a simplified VAT Act to them.

Interviewees were only asked to respond to the researcher's email if they had additional suggestions or comments, nine of fifteen responded. The nine participants included five academics, three advisory professionals and one National Treasury employee. Five of the nine participants said they had reviewed the documents and had no comments. Four of the nine interviewees suggested improvements. The two advisors who responded provided recommendations or observations.

The suggestions by the participants were incorporated to refine the descriptive framework.

IV FINDINGS

The following comments on the initial simplified structure of the VAT Act were incorporated in the descriptive framework:

> Interviewee 7 made additional comments in relation to the readability of the VAT Act and circular referencing, which were incorporated and are reflected in the guidelines for a simplified VAT Act.

---

[1] Hennink & Kaiser "Sample sizes for saturation in qualitative research: A systematic review of empirical tests" *Social science & medicine 292* (2022) 114523.

[2] Brodsky, Welsh, Hoffman, Deffenbacher & Nye Applied research in *The SAGE encyclopedia of qualitative research methods* SAGE Publications, Inc (2008).

[3] Bryman & Bell *Research methodology: Business and management contexts*. (2014) 80.

Interviewee 8 provided the following suggestions and/or improvements in relation to the descriptive framework:

In relation to Part I – Administration:

> **Definitions:** s1, s2 & s3
>
> Definitions used in the VAT Act are generally contained in s1(1). It is noted that s2 is included in the proposed "Part I – Administration" notwithstanding that the s2 definitions relate only to s2 matters (i.e. the definitions apply only for purposes of subsection (1) of s2). If the proposal is to group all definitions contained elsewhere in the VAT Act together in this part, then it should be noted that there are also definitions contained in s16(3)(j), s17(2)(a)(ii), s18D, s41B(2), s54(4), s73(2), s78(1) and s78A(1). Similar to the definitions contained in s2, these definitions relate only to the sections in which they are contained.
>
> **Administration: s4 & s5**
>
> Either the proposed title of Part 1, or the proposed grouping of definitions together with s4 and s5, may not be entirely accurate. The concept of "administration" in a tax context refers to the statutory duties and powers in terms whereof SARS is responsible for the *administration* of tax Acts (such as the VAT Act) pursuant to the SARS Act.

Section 2 has been eliminated from the definitions and consolidated with section 12(a) of the VAT Act, which pertains to the exemption for financial services, in accordance with the feedback received. Furthermore, the descriptive framework was structured in a way that distinguished administration from definitions.

Interviewee 8 commented as follows in relation to Part II – Value-Added Tax:

> **Value of supply**
>
> s16(4)(a) and (b) and s16(3)(a)(iiA) are more closely related to a special accounting basis (i.e. payment basis) for fixed property rather than value of supply rules.

The descriptive framework was updated to reflect accordingly.

Interviewee 8 commented as follows in relation to Part III – Registration:

> S19 Pre-incorporation is closer related to an adjustment, as it is an entry provision into the VAT Act. It functions similar to s18(4), except that s18(4) applies after incorporation whereas s19 applies only to pre-incorporation expenses in certain instances.
>
> In terms of sequence, "accounting basis" should come directly after "category of registration" as both aspects are assigned to a vendor upon registration and are reflected in the vendor's notice of registration / VAT registration certificate.
>
> Liability not affected by persons ceasing to be a vendor" is closer related to "Liabilities" under PART VI PAYMENT, RECOVERY AND REFUND OF TAX. Given that it deals with liabilities, one might not think to look for it under registration (as the VAT act does not specifically deal with (compulsory) *deregistration*, only with the notion that a vendor is no longer liable *to be registered* in certain instances, e.g. see s24).

Although the researcher acknowledges that pre-incorporation is indeed a section for adjustments, section 19, which is specifically related to pre-incorporation, was included in the registration process to synchronise with the lifecycle of a VAT vendor. The secondary suggestions have been accepted due to their enhancement of the logical framework, resulting in corresponding modifications to the descriptive framework.

Interviewee 8 commented as follows in relation to Part IV – Returns, Payment and Assessments and Part IX – Representative Vendor:

> PART IV - RETURNS, PAYMENT AND ASSESSMENTS
>
> Returns, payments and assessments
>
> S31 and s61 relate more closely to objections and appeals (i.e. dispute resolution).
>
> PART IX - REPRESENTATIVE VENDOR
>
> Representative vendors, agents and auctioneers
>
> S46 goes along with registration (e.g. see s23(2)(a)). A "representative vendor" is an office holder such as a public officer and not an agent in law as envisaged in s54. Not sure whether the grouping of s46 and s54 is accurate.

These suggestions improve the logical structure, hence were accepted, and the descriptive framework was modified accordingly.

Interviewee 11 made the following comment in relation to VAT registration requirements:

> With regard to VAT registration, there are special rules or issues to consider for the following entities when they register for VAT, and also VAT guides in relation to some of them. I am not sure if you want to include these as well:
>
> - Suppliers of commercial accommodation
> - Welfare organisations
> - Public authorities
> - Share block companies, homeowners' associations, etc. (refer s12(f))
> - Lloyds of London
> - Non-resident enterprises and their branches
> - Diesel refund applicants.

The researcher responded to this comment by ensuring, where applicable, that the relevant SARS VAT guides were incorporated and included in the descriptive framework.

Interviewee 12 raised concern about the VAT Act not keeping up with the latest developments. The analysis of the data revealed that opinions differ as to whether the VAT Act has been kept current and reflects the most recent developments.

V GUIDELINES APPLIED TO CREATE THE DESCRIPTIVE FRAMEWORK

It is necessary to take into account international best practices, such as the guidance provided by the OECD. However, interviewees also emphasised the importance of considering a hybrid solution that addresses the specific local issues in South Africa. When creating a solution, it is necessary to conduct further comparisons with other statutes, such as the Income Tax Act, as well as with textbooks.

Hence, the following international documents were used:

- International VAT/GST Guidelines[4]
- Singapore's GST Act of 1993, as amended[5]
- Canada's Excise Tax Act (No. 15 of 1985), as amended and the Harmonized Sales Tax incorporated into the Excise Tax Act of 1985[6]
- United Arab Emirates' Value Added Tax Law (No. 8 of 2017)[7]
- Bahrain's Value Added Tax Law (No. 48 of 2018), as amended[8].

The researcher focused on Singapore and Canada, along with Middle Eastern countries where VAT was implemented more recently. Despite the fact that the VAT Act of South Africa is based on the GST Act of New Zealand, New Zealand itself was not taken into consideration. This is because it has not undergone VAT simplification, despite the judiciary's calls for it[9].

In order to incorporate South African-specific concerns, the following local documents were consulted:

- The Income Tax Act[10]
- The TAA[11]
- The Consumer Protection Act (No. 68 of 2008)[12]
- The Customs Duty Act (No. 30 of 2014)[13]
- The Customs Control Act (No. 31 of 2014)[14]
- The Customs and Excise Amendment Act (No. 31 of 2014)[15]
- Textbooks:
  - *Silke: South African income tax*[16]
  - *Notes on South African income tax*[17]
  - *Value-Added tax in South Africa (commentary)*[18]
  - *Juta's value-added tax*[19]

---

[4] n 35 above.
[5] *Goods and Services Tax Act, 1993.*
[6] Excise Tax Act, 15 of 1985.
[7] Value Added Tax Law, 8 of 2017.
[8] Value Added Tax Law, 48 of 2018.
[9] n 39 above; Sawyer *The complexity of tax simplification* (2016) 110–132.
[10] Income Tax Act 1962, 58 of 1962.
[11] n 50 above.
[12] Consumer Protection Act, No. 68 of 2008.
[13] Customs Duty Act 30 of 2014.
[14] Customs Control Act 31 of 2014.
[15] Customs and Excise Amendment Act, No. 31 of 2014.
[16] n 66 above.
[17] n 67 above.
[18] n 68 above.
[19] n 69 above.

The research specifically examined certain areas of the Income Tax Act that were identified by interviewees as effective illustrations of grouping through the use of headings and subheadings.

Part III of the Income Tax Act deals with corporate reorganisations, specifically section 42, which involves asset-for-share transactions. This section is a complex area that has implications for both the transferor and the transferee.

The Income Tax Act includes two schedules that cover specific areas of taxation. The Seventh Schedule pertains to employment benefits, while the Eighth Schedule deals with capital gains tax. The elements of the aforementioned examples are now presented.

42. Asset-for-share transactions

(2) Subject to subsections (4) and (8), where a *person disposes of an asset to a company in terms of an asset-for-share transaction* –

(a) that *person* must be deemed to have –

(i) *disposed of that asset* –

(aa) in the case of an asset-for-share transaction contemplated in paragraph (a) of the definition of 'asset-for-share transaction', for an amount *equal* to the amount contemplated in *item (aa) or (bb) of subparagraph (i)* of that paragraph, as the case may be; and

(ii) *acquired the equity shares* in that company on the date that such person acquired that asset (other than for purposes of determining whether that asset had been held for at least three years for purposes of section 9C (2) where that asset is not an equity share) and for a *cost equal* to –

(aa) where that asset is so disposed of as *a capital asset*, any expenditure in respect of that asset incurred by that person that is allowable in terms of *paragraph 20* of the Eighth Schedule and to have incurred such cost at the date of incurral by that person of such expenditure; *or*

(bb) where that asset is so disposed of as *trading stock*, The amount taken into account in respect of that asset in terms of *section 11(a) or 22*(1) or (2),

Which cost must, where those equity shares are acquired as –

(A) capital assets, be treated as an expenditure actually incurred and paid by that person in respect of those equity shares for the purposes of paragraph 20 of the Eighth Schedule; and

(B) trading stock, be treated as the amount to be taken into account by that person in respect of those equity shares for the purposes of section 11(a) or 22(1) or (2).

[emphasis added]

This example demonstrates that the tax consequences for both the seller of the asset (transferor) and the purchaser of the asset (transferee) are presented and discussed in the same section.

Referring to paragraph 12 of the Seventh Schedule to the Income Tax Act:

> 12. Subsidies in respect of debt
>
> The *cash equivalent* of the *value* of the taxable benefit consisting of any *subsidy* in respect of the amounts of interest or capital repayments referred to in paragraph 2(g) or any subsidy contemplated in paragraph 2(gA) *shall be the amount of such subsidy*.
>
> [emphasis added]

In terms of sections 3 to 10 of the Eighth Schedule to the Income Tax Act:

> **PART II**
>
> **TAXABLE CAPITAL GAINS AND ASSESSED CAPITAL LOSSES**
>
> **3. Capital gain**
>
> A person's capital gain for a year of assessment, in respect of the disposal of an asset […]
>
> **4. Capital loss**
>
> A person's capital loss for a year of assessment in respect of the disposal of an asset
>
> **5. Annual exclusion**
>
> (1) Subject to subparagraph (2), the annual exclusion …
>
> **6. Aggregate capital gain**
>
> A person's aggregate capital gain for a year of assessment is …
>
> **7. Aggregate capital loss**
>
> A person's aggregate capital loss for a year of assessment is …
>
> **8. Net capital gain**
>
> A person's net capital gain for the year of assessment is the sum of …
>
> **9. Assessed capital loss**
>
> A person's assessed capital loss for a year of assessment, where that person has …
>
> **10. Taxable capital gain**
>
> (1) A person's taxable capital gain for the year of assessment is …

The utilisation of headings and subheadings in the aforementioned paragraphs improves the legibility, organisation and arrangement. The researcher incorporated the practice of grouping to exemplify the concept of grouping in relation to the following transactions:

- Imported services (specifically electronic services)
- Fixed property
- Leasehold improvements (i.e. adjustments).

This was done to demonstrate the extent and consequences of grouping for all parties involved in the transactions or events. The interviewees also identified these examples as the most concrete illustrations of the scattered provisions of the VAT Act[20].

Figure 2 provides a comprehensive summary of the structure of the current VAT Act.

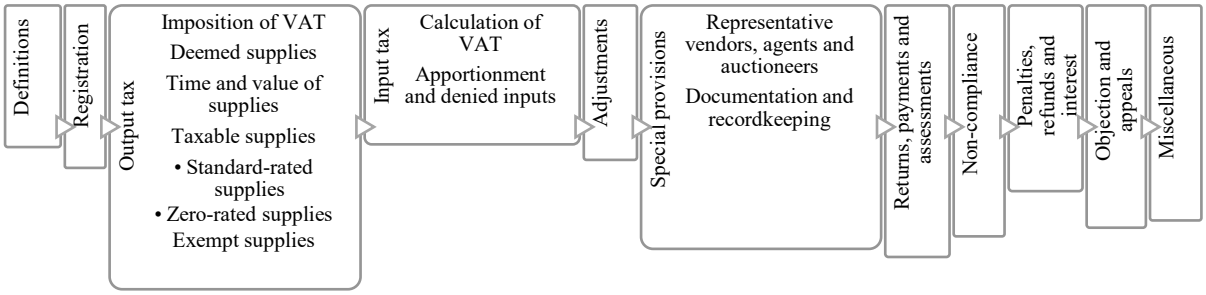


Figure 2: Overview of the current VAT Act

Source: Author's own contribution (2024)

Figure 3 (found in Appendix 1 of this article) displays the descriptive framework to the VAT Act, which includes the original sections of the Act. Sections that have been moved to align with the VAT vendor's lifecycle, resulting in an improved logical design and layout, are indicated by a plus sign (+) and those that should be left out by a strikethrough.

The descriptive framework supplements sections of the VAT Act that currently lack subheadings. Furthermore, all relevant sections are cross-referenced, and when appropriate, references to external documents are also incorporated. The descriptive framework encompasses both the concept of grouping and the practical illustrations of its implementation.

Table II below provides a matrix analysis of the benefits provided by the VAT law modification. The matrix incorporates estimates on the impact on collection or what gains there are in terms of structure, layout, and interdependence of the law, with the premise that greater simplicity does not necessarily ensure greater collection[21].

[20] n 9 above.

[21] Díaz, Boskin & McLure "Tax reform issues in Mexico" *World Tax Reform* (1990).

Table II: Benefits of the VAT modification: structure, lay-out, and interdependence of the Law

Current VAT Act	The descriptive framework to the VAT Act	Benefits of the VAT modification
Definitions	Definitions applicable to the full Act are all placed in section 1 and definitions that are only specific to a section are contained within the section.	Ease of navigation. Cross-referencing.
Registration	Consolidates all sections throughout the Act that relate to the pre and registration process under main heading. In relation to electronic services supplied by non-residents due to the complexity, the sections that must be evaluated for registration by the importer are group together under specific headings i.e. definitions, scope, time, value rules.	Provides grouping of sections that must be evaluated for all parties in relation to specific areas of complexity in the VAT Act. Follows the life cycle of a VAT vendor. External documents reference that must be consulted are also incorporated.
Output tax	Grouping sections together, with the introduction of heading and sub-headings. In relation to the leasehold improvements and fixed property transactions due to the complexity the sections that must be evaluated for both partes are provided.	Ease of navigation to find the specific sections that must be evaluated in relation to output tax. Cross referencing. Special time and value rules. Overcomes the problem of inconsistency applied in the VAT Act. Follows the life cycle of a VAT vendor. External documents reference that must be consulted are also incorporated.
Input tax	Grouping sections together, with the introduction of heading and sub-headings.	Ease of navigation to find the specific sections that must be evaluated. Follows the life cycle of a VAT vendor. External documents reference that must be consulted are also incorporated.
Adjustments	Introduction of heading and sub-headings. Re-allocated sections that are better placed under different heading.	
Special provisions	Introduction of heading and sub-headings where necessary. Reallocated sections that are better placed under different heading.	
Returns, payments and assessments	Reallocated sections that are better placed under different heading.	
Non-compliance	Allocated and reallocated sections that are better placed under this or different heading.	
Penalties, refunds and interest	Reallocated sections that are better placed under different heading.	
Objections and appeals	Allocated sections that are better placed under this heading.	
Miscellaneous	Allocated and reallocated sections that are better placed under this or different heading.	

Source: Author's own contribution (2024)

VI CONCLUSION

The guidelines for a simplified VAT Act include consolidating sections, implementing headings and subheadings, following the lifecycle of a VAT vendor, referencing international benchmarks and finding the most suitable solution for addressing local challenges.

Internationally, the OECD guidelines and New Zealand's simplification experience were taken into account. An important insight gained from New Zealand's experience is that the arrangement, organisation and formatting of the Income Tax Act resulted in a notable enhancement in its comprehensibility. The UK's simplification efforts, specifically the establishment of the OTS, can serve as a useful model. However, it is important to note that the simplifications made to the VAT Act in the UK, based on the OTS recommendations, did not address organisational, layout, structural and design aspects. Although Australia also engaged in a rewriting initiative, it was not further examined, as literature uncovered benchmarks that fell below acceptable standards, suggesting that the goal of simplification was not accomplished. The countries included in the review were Canada, Singapore, the United Arab Emirates and Bahrain. An analysis was conducted on the VAT statutes of these countries, as interviewees specifically mentioned and referenced them as countries that should be included in the international benchmarking.

Local lessons were also considered, specifically regarding the arrangement, organisation and format of other Acts, such as the Income Tax Act (with specific sections mentioned), the TAB, the Consumer Protection Act and Customs Acts, among others. The arrangement of chapters in local tax textbooks was also examined.

To provide a practical illustration, the researcher utilised the guidelines for a simplified VAT Act to create a descriptive framework to the VAT Act. The researcher presented the descriptive framework to the interviewees for their input and potential enhancements. The researcher then assessed the recommendations and refined the descriptive framework.

The most prominent suggestion is to completely rewrite the VAT Act by comparison to the other guidelines. However, considering the significant scale of the task, the researcher proposes that, as an initial measure in this rewriting project, the existing descriptive framework be improved, expanded and re-integrated into the VAT Act. Alternatively, it could be included in the SARS VAT 404 guide for vendors or be published as an industry guide.

The place of supply rules, specifically in relation to services, is raised as an area requiring future research.

APPENDIX 1: ARRANGEMENT OF SECTIONS IN THE VAT ACT

[VATG404]

Definitions: s1 & s3

PART I ADMINISTRATION

Administration: s4 & s5

PART III REGISTRATION

Registration	**Section**	**Sections and other references**
+ Pre-incorporation	s19	
Registration	s23	[BGR41, R.112, R.221, R.446, R.447, N.2570, VATG403, VATG414], Electronic services supplied by non-residents: s23(1A) [BGR28, N.429]
+ Representative vendor	s46	
+ Separate enterprises, branches and divisions	s50	[BGR17]
+ Separate persons carrying on same enterprise under certain circumstances deemed to be single person	s50A	
+ Bodies of persons, corporate or un-incorporate	s51	
+ Pooling arrangements	s52	
Category of registration	s27	[BGR19, IN52]
+ Accounting basis	s15	
Vendor to notify of change in status	s25	
+ Death or insolvency of vendor	s53	[VATG413]
Cancellation of registration	s24	
~~Liability not affected by persons ceasing to be a vendor~~	~~s26~~	

PART II VALUE-ADDED TAX

Imposition of VAT	**Section**	**Sections and other references**
Goods or services (vendor)	s7(1)(a)	
Imported goods (any person)	s7(1)(b), s13	[BGR26, BGR33, BGR35, BGR38]
Time of supply	s13(1)	
Value of supply	(2)	
Exemptions	(3)	
Deleted	(4)	
Importation by post	(5)	
VAT collected by Customs	(6)	
Imported services (any person)	s7(1)(c), s14	

Deemed supplies	**Section**	**Time**	**Value**	**Other section references**
Sales in execution	s8(1)	-	-	s6(3)(j), s29, s31(2)
Ceasing to be a vendor	s8(2) – 2(G)	s9(5)	s10(5)	s22(3)(b)
Credit agreements	s8(3)	s9(2)(b)	-	
Lay-by agreements	s8(4)	s9(2)(c)	s10(11)	67A(5)
Subsidies from public authorities and municipalities	s8(5)	-	s10(14)	s11(2)(n) [IN39]
Grants and subsidies	s8(5A)	-	-	s11(2)(t)[IN39]
Foreign donor-funded projects	s8(5B)	-	-	s11(2)(q)
Municipality	s8(6)	-	-	[VATG414,BGR4]
Disposal of going concern	s8(7)	s9(1)	-	s11(1)(e)
Indemnity payments	s8(8)	-	-	s16(3)(c)
Branch or main business in foreign country	s8(9)	s9(2)(e)	s10(5)	s11(1)(i), s11(2)(o)
Repossessions and surrender	s8(10)	s9(8)	s10(16)	s22(1)
Right of use of goods	s8(11)	s9(3)(a)	-	s11(1)(c)

Repealed	s8(12)	-	-	
Betting services	s8(13)	s9(3)(e)	s10(17)	s16(3)(d), s16(3)(e), s11(2)(x) [BGR59, IN41,IN84]
Prizes, winnings	s8(13A)	s(9)(f)	s10(17A)	[IN41]
Deemed non-supplies	s8(14)	s9(10)	s10(24)	s17(2), s18(9)
Game-viewing vehicles and hearses	s8(14A)	s9(10	s10(24)	
Single consideration for two types of supply	s8(15)	-	-	
Goods or services partly used for making taxable supplies	s8(16)	-	-	
Share block transactions	s8(17)	-	s10(4A)	[VATG412]
Share block transactions	s8(18)	-	-	[VATG412]
Share block transactions	s8(19)	-	s10(27)	[VATG412]
Importation of goods by agents	s8(20)	s(9)(9)	s10(22B)	
Compensation and damages	s8(21)	-	-	
Merger of higher education institutions	s8(22)	-	-	
Low-cost housing	s8(23)	-	-	s11(2)(s)
Customs controlled area (SEZ)	s8(24)	s9(11)	s10(25)	[IN40]
Corporate 'rollover relief'	s8(25)	-	-	s11(1)(e)
Warranties	s8(26)	-	-	
Excess consideration	s8(27)	-	s10(26)	s16(3)(m)
Structural changes to municipalities	s8(28)	-	-	[BGR39]
Leasehold improvements	s8(29)	s9(12)	s10(28)	S18C
Shariah-compliant financing arrangements	s8A	-	-	
Fringe benefits	s18(3)	s9(7)	s10(13)	

Time of supply	**Section**	**Sections and other references**
General time of supply	s9(1)	
Connected persons	s9(2)(a)	
Credit agreements	(b)	
Lay-by agreements	(c)	
Coins and tokens and vending machines	(d)	
Transfer of goods to branch or main business outside Republic	(e)	
Rental	s9(3)(a)	
Periodic or progressive supplies	(b)	
Instalment credit agreements	(c)	
Fixed property	(d)	[VATG409]
Betting	(e) – (f)	
Special, undetermined consideration	s9(4)	
Person ceasing to be a vendor	s9(5)	
Output tax adjustment in s18(1)	s9(6)	
Fringe benefits	s9(7)	
Repossessed goods	s9(8)	
Importation by an agent on behalf of a foreign principal	s9(9)	
Deemed non-supplies	s9(10)	
Game-viewing vehicles and hearses	s9(10)	
Customs controlled area (SEZ)	s9(11)	
Leasehold improvements	s9(12)	
Temporary letting of residential property	s9(13)	

Value of supply	**Section**	**Sections and other references**
General value of supply	s10(2)	
Consideration	s10(3)	
Connected persons	s10(4)	
Ceasing to be a vendor; transfer of goods or provision of services to branch or main business located outside Republic	s10(5)	

Instalment credit agreements	s10(6)	
Self-supply	s10(7)	
Adjustment under s18(1)	s10(8)	
Adjustment under s18(2)	s10(9)	
Commercial accommodation	s10(10)	[VATG411]
Cancellation of a lay-by sale	s10(11)	
Exported second-hand goods	s10(12)	
Fringe benefits	s10(13)	[N.2835]
Supplies deemed to be made to public authorities or municipalities	s10(14)	
Repealed	-	
Repossessed goods	s10(16)	
Betting transactions	s10(17)	
Tokens, vouchers or stamps	s10(18) – (20)	[IN118]
Entertainment	s10(21)	
Supply of medical or dental services by a superannuation scheme	s10(21A)	
Part supply	s10(22)	
Repealed	s10(22A)	
Importation by an agent on behalf of a foreign principal	s10(22B)	
Supply for no consideration	s10(23)	[IN70]
Deemed supply of game-viewing vehicle or hearse	s10(24)	
Goods temporarily removed from customs-controlled area	s10(25)	
Receipt of excess consideration	s10(26)	
Share block transactions	s10(27)	
Leasehold improvements	s10(28)	
Temporary letting of fixed property developed for sale	s10(29)	

Zero-rated supplies	**Section**	**Sections and other references** s11 [BGR37, IN31, IN57, IN103, N.2761, R.316] Schedule 2 [BGR45]
Zero-rated goods		
Exports	s11(1)(a)	[IN30]
Goods used for foreign-going ships/ aircraft	(b)	
Rentals: exclusive foreign use or in CCA	(c)	
Rentals: use by foreign concern	(d)	
Going concerns	(e)	
Gold: unmanufactured	(f)	
Agricultural products	(g)	
Fuel levy goods	(h)	
Petroleum oils	(hA)	
Deleted	(hB)	
Foreign branches	(i)	
Foodstuffs	(j)	
Gold coins	(k)	
Illuminating paraffin	(l)	
Goods to CCA vendor	(m)	
Fixed property in CCA	(mA)	
Mining rights	(n)	
Deleted	(o)	
Going concerns (same entity)	(p)	
Triangular supplies	(q)	
Destroyed animals	(r)	
Land reform sales	(s) and (t)	
C&E storage warehouses	(u)	
Duty- and tax-free shops	(v)	
Sanitary towels	(w)	
To (a), (b), (c), (d), (i)	s11(1), Proviso	
Zero-rated services		
International transport	s11(2)(a)	
International carriage by aircraft	(b)	
Local leg of international transport of goods	(c)	
Arranging/insurance of transport of (a), (b), (c)	(d)	
Local transport of goods/ancillary transport services	(e)	
Land in export country	(f)	
International services	(g)	
Handling/management services	(h)	

Arranging international services	(i)	
Repair of railway train	(j)	
Physically rendered outside SA	(k)	
Non-residents outside SA	(l)	[IN42, IN81, IN85]
Intellectual property rights	(m)	
Grants to welfare organisations	(n)	
Foreign branches	(o)	
Arranging international services	(i)	
Deleted	(p)	
International donor funds	(q)	
Vocational training	(r)	
Housing subsidies	(s)	
Grants	(t)	
SETA grants	(u)	
Warranty services	(v)	
Municipal rates	(w)	
Racehorse winnings	(x)	
International roaming services	(y)	

Exempt supplies	**Section**	**Sections and other references**
Financial services	s2	
Goods and services	s12	
Financial services	(a)	[BGR62]
Donated goods or services	(b)	
Accommodation in a dwelling	(c)	
Leasehold land	(d)	
Land outside SA	(e)	
Body corporate, share block scheme and housing development scheme levies	(f)	
Transport of passengers by road or rail	(g)	[PN7/1992]
Educational services	(h)	
Employee organisation membership fees	(i)	
Crèche or after-school care	(j)	
Customs & Excise storage warehouses	(k)	
Bargaining councils	(l)	
Political parties	(m)	
~~Accounting basis~~	~~s15~~	

Calculation of VAT	**Sections**	**Other references**
	s16	
VAT payable	s16(4) output tax less s16(3) deductions	[BGR12, BGR14, BGR32, BGR43, IN82]
Calculate VAT for each tax period	s16(1)	[BGR13, R.169]
Documentary requirements for deductions	s16(2)	
Invoice basis	s16(3)(a)	[BGR57]
Payments basis	(b)	[BGR57]
Previously denied under s16(2)	(g)	
Insurance indemnity payments	(c)	
Prizes for betting transactions	(d)	
Payment to Lottery Distribution Trust Fund	(dA)	
Provincial betting tax	(e)	
Change in use adjustments	(f)	
Mixed-use assets	(h)	
Redemption of discount voucher	(i)	
Properties in possession	(j)	
Excess refunded	(m)	
Customs controlled areas	(n)	
Temporary letting of dwelling	(o)	
Small-scale farmers: flat rate scheme	(k)	
Diesel refunds: flat rate scheme	(l)	
Prescription period: 5 years	(i)	
Practice generally prevailing: 6 months	(ii)	
If payment required: apportionment		
Invoice basis	s16(4)(a)	
Payments basis	(b)	
If s16(3) deductions exceed s16(4) output tax	s16(5)	

Apportionment and denied inputs	**Section**	**Sections and other references**
Input tax apportionment percentage	s17(1)	[BGR16]
95% de minimis rule	Provisos(i)	
Successive supplies	(ii)	
Change of apportionment method	(iii)	
Denial of input tax	s17(2)	[IN82]
Entertainment	(a)	[VATG411, 420]
Subscriptions to sport, social & recreational clubs	(b)	
Motor cars	(c)	
Medical services by medical scheme	(d)	
Denial not applicable to foreign donor funded projects (if 0%)	s17(2A)	
Repossession of motor car	s17(3)	
Denial of double deduction	s17(4)	

Adjustments	**Section**	**Sections and other references** s18 [BGR48, BGR55]
Wholly non-taxable use	s18(1)	
Decreased taxable use	(2)	
Fringe benefits	(3)	
Wholly/partly taxable use	(4	
Increased taxable use	(5)	
Time when decrease/increase takes place	(6)	
Calculation of decrease/increase	(7)	
Cancellation of non-taxable second-hand goods sale	(8)	
Motor cars converted to game-viewing vehicles or hearse	(9)	
Custom controlled areas: entertainment and motor cars	(10)	
Acquisition of a going concern adjustment	s18A	
Leasehold improvements adjustment	S18C	
Temporary letting of residential property	s18D	
Pre-incorporation	~~s19~~	
Irrecoverable debts	s22	

PART IX

REPRESENTATIVE VENDOR

PART VII

SPECIAL PROVISIONS

Representative vendors, agents and auctioneers	**Section**	**Sections and other references**
~~Representative vendor~~	~~s46~~	
~~Separate enterprises, branches and divisions~~	~~s50~~	
~~Separate persons carrying on same enterprise under certain circumstances deemed to be single person~~	~~s50A~~	
~~Bodies of persons, corporate or un-incorporate~~	~~s51~~	
~~Pooling arrangements~~	~~s52~~	
~~Death or insolvency of vendor~~	~~s53~~	
Agents and auctioneers	s54	

Documentation and record keeping	**Section**	**Sections and other references**
Documents	s16(2)	[BGR36, IN92]
Tax invoices	s20	[BGR5,BGR6,BGR11, BGR15, BGR21, BGR27, BGR28, IN56, IN83, N.1594]
Credit and debit notes	s21	[BGR5,BGR6,BGR11, BGR15, BGR21, BGR27, BGR28, IN56, IN83]
+ Special records	s29	[VATG215, VATG216]
+ Records	s55	

PART IV

RETURNS, PAYMENT AND ASSESSMENTS

Returns, payments and assessments	**Section**	**Sections and other references**
Tax periods	s27	[IN52]
VAT returns and due dates for payments	s28	[R.312, N.290, 291]
~~Special records~~	~~s29~~	
~~VAT payments~~	~~s38~~	
~~Assessments~~	~~31~~	

PART IX

COMPLIANCE

Non-compliance	**Section**	**Sections and other references**
~~Records~~	~~s55~~	
Offences	s58	
~~Recovery from recipient~~	~~s61~~	
+Schemes	s73	

PART VI

PAYMENT, RECOVERY AND REFUND OF TAX

Penalties, refunds and interest	**Section**	**Sections and other references**
~~VAT payments~~	~~s38~~	
Penalties over and above TAA	s39	[IN61]
Refunds	s44, s16(5)	
Interest on delayed refunds	s45	
Calculation of interest	s45A	

Liabilities	**Section**	**Sections and other references**
+ Liability not affected by persons ceasing to be a vendor	s26	
Bargaining council or political parties	s40C	
National Housing Programmes	s40D	
Past supplies or importations	s41	[BGR1, BGR2]
VAT rulings	s41B	

PART V

OBJECTION AND APPEALS

Objection & appeals	**Section**	**Sections and other references**
+ Assessments	31	
Objection to decisions	s32	
Pay now argue later	s36	
+ Recovery from recipient	s61	

PART X

MISCELLANEOUS

VAT rulings and other arrangements	**Section**	**Sections and other references**
+ VAT rulings	s41B	[Ref. Guide]
Difficulties, anomalies or incongruities	s72	[BGR56, N.300, Ref. Guide]
~~Schemes~~	~~s73~~	
Schedules and regulations	s74	
Pricing	**Section**	**Sections and other references**
Prices deemed to include VAT	s64	
Advertised prices or quoted prices	s65	

Rounding-off	s66	
Contract prices	s67	
Change in VAT rate	s67A	

Appendix 2: Sample interview questions

QUESTIONS

PART A

Name (you can choose not to provide your name and indicate anonymous):

_____

PART B

The researcher will explain the purpose and scope of the research, namely that it focuses on the current South African Value-Added Tax (VAT) Act, which lacks a coherent structure and is therefore difficult to teach, apply in practice and administer. In addition, there is no correct or incorrect answer.

1. What are your thoughts on the research that investigates the current South African VAT Act, which lacks a coherent structure, making it challenging to teach, apply in practice and administer? To illustrate the issue, consider the following example:

The following sections of the VAT Act must be considered when evaluating "imported services":

- Section 1 definitions: "supply"; "imported services"; "open market value"
- Section 7(1)(c)
- Section 14, read with section 10(3).

In this instance, section 7(1)(c) does not contain a cross-reference to section 14. However, the backward cross-reference to section 7(1)(c) is located in section 14.

The following sections must be taken into account when importing "electronic services":

- Section 1 definitions: "electronic services"; "enterprise" – paragraph (b)(vi); "export country"; "services"; "supply"
- Section 7(1)(a)
- Section 7(1)(c) read with section 14(5)(a)

- Section 23(1A)
- Section 16(2)(b) read with section 20(7)
- Binding General Ruling: BGR 28, dated 23 February 2016
- GG 42316, Notice 429.

Tax complexity can be distinguished between legal (formal) and tax complexity that is economic (effective). Legal complexity includes:

- the use of language; and
- the content of the law.

2. Regarding the use of language:
   a) Does the current VAT Act use plain English?
   b) What are some examples of lengthy sections of the VAT Act?
   c) Does the VAT Act make use of active voice?[22]
   d) What examples can you think of that demonstrate the prevalence of scattered provisions in the VAT Act?
3. How can the VAT Act be simplified in relation to the use of language (see Question 2 above)?
4. Regarding the content of the law:
   a) What are the primary areas of ambiguity (interpretation issues) in the VAT Act?
   b) Does the quantity of exemptions, rebates and concessions in the VAT Act contribute to complication?
   c) Has the complexity of the VAT Act been increased by the number of annual amendments?
5. How can the VAT Act be simplified in relation to the content of the law (see Question 4 above)?
6. What other areas of improvement can be made to the economic tax complexity of the VAT Act in terms of policy considerations?
7. Do you believe that the South African simplification project and international lessons learned will be valuable considerations in the design of a suggested framework for a simplified South African VAT Act?
8. What additional guiding principles, in your opinion, should be adopted when designing a suggested framework for a simpler South African VAT Act in order to reduce the legal complexity of the VAT Act?
9. Do you have any specific recommendations for improvements or enhancements regarding the framework for a simplified South African VAT Act?

[22] (a)–(c) is collectively referred to as readability of the law.

10. Do you have any additional comments, considerations or suggestions?

THE OPERATION OF GST AND TRANSFER DUTY LAWS IN AUSTRALIA'S COASTAL SEAS

PETER J MCMAHON AND ALEKS ZOCHOWSKI[1]

Abstract

Identifying the precise geographical limits of Australia's primary indirect tax laws, the Goods and Services Tax (GST) and stamp duty is of critical importance to taxpayers operating in its coastal waters and to their advisors. This article examines the myriad and diverse Federal, State and Territory laws that are primarily relevant to the identification of those geographical limits. Regarding GST, the article considers the precise meaning of the phrase 'indirect tax zone' in the GST legislation and determines that it is only those supplies that are connected with the first 3 nautical miles of Australia's 12 nautical mile 'territorial sea' that fall within the GST net. The authors consider that this position is at odds with clear Parliamentary intention which was to ensure GST applied to supplies connected with the full 12 nautical miles of the territorial sea. They recommend that amending legislation ought to be introduced to clarify the position, and to dispel any uncertainty for taxpayers as to the GST treatment of activities carried out in the country's full territorial sea. The article then goes on to consider the precise geographical scope of the stamp duty laws of the States and the Northern Territory, and whether stamp duties may be levied on transactions over property located on, in or under a jurisdiction's coastal waters sea bed. In that regard, the article considers the Duties legislation of each state and the Northern Territory separately.

I INTRODUCTION

Knowledge of the precise geographical limits of Australia's primary indirect tax laws being GST and transfer duties is of critical importance to the many taxpayers who carry on activities in the country's coastal seas. Market participants in the telecommunications, resources and energy, import-export, tourism, shipping and fishing sectors, for example, need to know if their activities in particular waters between the coastlines of the Australian States and the Northern Territory and the outer limit of our continental shelf are subject to indirect taxes.

GST is payable on a supply of something only if, among other things, it is 'connected' with Australia's 'indirect tax zone' (see s 9-5(c) of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('GST Act')). Similarly, input tax credits can only be claimed with respect to taxable supplies which are, among other things, connected to the 'indirect tax zone'. Further,

[1] Peter McMahon B Com LLB (UNSW) and LLM (USYD). Aleks Zochowski, Senior Associate at Corrs Chambers Westgarth, BA (Hons) LLB (Hons) (USYD) and LLM (USYD).

GST is payable on many goods imported into the indirect tax zone and to determine whether goods are in fact imported, it is necessary to establish the physical boundaries of Australia. And under the test in s 9-27 of the GST Act entities need to consider whether they make supplies through an enterprise carried on in the 'indirect tax zone' so that it is connected with that zone and, consequently, whether they need to register for GST.

Transfer duties imposed by the States and the Northern Territory generally only apply to transfers and certain other dealings involving land and other dutiable property that is physically located in those jurisdictions. Thus, it is critical to determine the precise boundaries of these jurisdictions for the purposes of duties legislation.

Consider, for example, a sale to investors of an interest in the assets of a Queensland submarine cables enterprise, including physical infrastructure consisting of fibre optic cable, landing station, beach manholes and associated infrastructure. Some of that plant will be located on land, while other components will be installed in waters off the Queensland coast. The potential liability of the transaction to GST and Queensland stamp duty will turn on whether the sale assets are connected with the indirect tax zone and/or physically located on "land" in Queensland.

Identifying the precise geographical limits of Australia's GST and duties laws can be a daunting task, as it requires analysis of a complex web of diverse laws that have been introduced successively by Federal and State legislatures over many decades. These laws include:

- the GST Act
- *Income Tax Assessment Act 1997* (Cth) ('ITAA 1997')
- the *Customs Act 1901* (Cth)
- *Seas and Submerged Lands Act 1973* (Cth) ('SSL Act')
- *Acts Interpretation Act 1901* (Cth) ('Interpretation Act (Cth)')
- *Treasury Legislation Amendment (Repeal Day) Act 2015* (Cth) ('Repeal Day Act')
- *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (Cth) ('OPGGS Act');
- *Coastal Waters (State Powers) Act 1980* (Cth);
- *Coastal Waters (State Title) Act 1980* (Cth); and
- relevant State and Territories duties and acts interpretation legislation.

The task is not helped by the absence of clear public statements and rulings from the Australian Taxation Office ('ATO ') and State and Territory Revenue Offices as to the correct legal position. Therefore, it is only from a close analysis of the relevant legislation itself that the true position as to the scope of our primary indirect tax laws becomes clear.

Section 2 of this paper summarises the amendments to the GST Act which replaced the term 'Australia' with the definition of 'indirect tax zone'.

Section 3 of this paper outlines how the changed terminology limits the application of Australia's GST reach to transactions affecting property located in or supplies otherwise connected to Australia's coastal waters and considers whether this definition may be interpreted in such a way so as to cure the seemingly unintended limits to Australia's GST net.

Section 4 of this paper considers the scope of all Australian states' and the Northern Territory's transfer duty laws in respect of transactions affecting dutiable property located in Australia's coastal waters.

Section 5 concludes this paper by summarising the key findings and - suggesting that Parliament might introduce amending legislation to reverse the unintended limitations to Australia's GST net which occurred when the term 'Australia' was replaced with 'indirect tax zone' in the GST Act.

II GOODS AND SERVICES TAX (GST)

A *Introduction*

Generally, a supply of something is taxable only if, among other things, the supply is connected with the 'indirect tax zone' in one of the ways specified in s 9-25 of the GST Act. In this way, the concept of the 'indirect tax zone' (defined in s 195-1 of the GST Act) imposes strict geographical limits on the operation and application of the GST.

The 'indirect tax zone' is generally assumed to cover Australia's territorial land mass as well as the coastal waters that make up Australia's 12 nautical mile territorial sea. It would appear, however, on a close examination of the definition of 'indirect tax zone' and the underpinning statutes that this assumption as to the territorial reach of our GST system is incorrect.

B *What coastal waters fall within the 'indirect tax zone'?*

Precisely, then, what is the limit of the 'indirect tax zone'? Which coastal waters surrounding the Australian land territory does the term include? Despite its importance, a discussion of the precise meaning and scope of the "indirect tax zone" is yet to be found in judgments of the Federal courts. Also, the only public statements by the ATO on the operation of GST in our coastal seas are to be found in rulings that do not address the legal consequences of the exclusion from the 'indirect tax zone' of an 'offshore area' for the purposes of the OPGGS Act, discussed below. [2]

It is also noteworthy that The International VAT/GST Guidelines published by the Organisation for Economic Co-operation and Development (OECD) which records the internationally agreed principles for OECD member countries implementing their respective value added taxes

[2] See, for example, public ruling GSTR 2002/6 at [103]. See also LCR 2016/1 at [26], the footnote to which states that the paragraph "describes the practical outcome of the definition of 'indirect tax zone' under s 195-1 of the GST Act". The ATO's other public rulings which concern when supplies are connected to the indirect tax zone do not address the geographical parameters of the "indirect tax zone" – see for example GSTR 2018/1 Goods and services tax: supplies of real property connected with the indirect tax zone (Australia), GSTR 2018/2 Goods and services tax: supplies of goods connected with the indirect tax zone (Australia) and GSTR 2019/1 Goods and services tax: supply of anything other than goods or real property connected with the indirect tax zone (Australia).

does not provide guidance on the application of such taxes to a jurisdiction's surrounding waters. Given the absence of guidance by the ATO and the OECD, the answer to the above questions therefore requires a consideration of the relevant legislation, being the GST Act, the ITAA 1997, the SSL Act, the Interpretation Act (Cth), the Repeal Day Act, and the OPGGS Act.

1*Position prior to 1 July 2015 – 'Australia'*

Prior to 1 July 2015, the GST Act used the term 'Australia' as the delineator of the geographical reach of the GST. The term was defined in s 195-1 as follows:

> Australia does not include any external Territory. However, it includes an installation (within the meaning of the Customs Act 1901) that is deemed by section 5C of the Customs Act 1901 to be part of Australia.

Being a non-exhaustive definition, 'Australia' here meant the "Commonwealth of Australia" (excluding certain external Territories).[3] This refers to the Commonwealth of Australia as established in 1901 under the Commonwealth of Australia Constitution Act. By operation of s 15B(2) of the *Interpretation Act* (Cth), "Australia" included "the coastal sea" of Australia, defined to be:

- the 'territorial sea' of Australia,
- the sea on the landward side of the territorial sea of Australia and not within the limits of a State or internal Territory, and
- the airspace above, and the sea-bed and subsoil beneath, any such sea.[4]

The 'territorial sea' of Australia takes its meaning from the SSL Act (being the foundational Australian legislation that establishes sovereignty over its territorial sea). It is essentially the 12 nautical mile zone extending seaward from the low-water line of the Australian coast, and the airspace above it and its bed and subsoil. International laws stipulate that the supreme power or authority of a coastal nation extends to its territorial sea (and the airspace above it and its bed and subsoil), and nations can claim a territorial sea of up to 12 nautical miles measured seaward from the "baseline".[5] Section 6 of the SSL Act declares that sovereignty vests in and is exercisable by the Crown in right of the Commonwealth in respect of the "territorial sea" (and the airspace over it, and its bed and subsoil). Section 7 of the SSL Act permits the Governor-General to declare by proclamation the limits of the territorial sea. By the 1990 Proclamation under the SSL Act, the Governor-General declared that the outer limit of Australia's territorial sea, except for specified areas, was extended from 3 nautical miles to 12 nautical miles, effective from November 20, 1990, and aligning with the rights to establish such a limit under international law. Under the Proclamation, the baseline was the low-water line, except where a straight baseline could be drawn according to the principles set out in the United Nations Convention on the Law of the Sea, to which Australia is a party.

'Australia' for GST Act purposes also included certain installations deemed to be part of Australia under s 5C of the *Customs Act 1901* (Cth). These are certain "resources installations" attached to the Australian sea-bed, "sea installations" installed in an adjacent or coastal area,

[3] Interpretation Act (Cth), s 2B.
[4] Interpretation Act (Cth), s 15B(4).
[5]For a detailed discussion on relevant international laws see the Australian Government Solicitor's Legal Briefing No 116 "Ruling the waves - regulating Australia's offshore waters", 1 December 2020.

and "offshore electricity installations". Typically, these installations are oil drilling rigs and similar mining exploration installations attached to the Australian sea-bed.

In summary, prior to 1 July 2015, the GST Act applied to relevant activities connected with Australia's land territory, the specified offshore 'installations', and Australia's 12 nautical mile territorial sea including the airspace above it and its bed and subsoil. It did not extend to the external Territories.

2 *Position from 1 July 2015 – 'Indirect tax zone'*

With effect from 1 July 2015, the term 'Australia', as the delineator of the geographical scope of the GST, was replaced (in most instances) with the term 'indirect tax zone'.[6] This terminological switch altered the extent to which the GST applied in Australia's coastal waters.

The substituted term, 'indirect tax zone', is defined in s 195-1 of the GST Act to mean:

> Australia (within the meaning of the ITAA 1997), **but does not include** any of the following:
>
> (a) the external Territories;
>
> (b) **an offshore area** for the purpose of the Offshore Petroleum and Greenhouse Gas Storage Act 2006 ;
>
> other than an installation (within the meaning of the Customs Act 1901) that is deemed by section 5C of the Customs Act 1901 to be part of Australia and that is located in an offshore area".[emphasis added]

'Australia' in the above definition is itself defined in s 960.505 of the ITAA 1997 as follows:

> (1) Australia , when used in a geographical sense, includes each of the following:
>
> (a) Norfolk Island;
>
> (b) the Coral Sea Islands Territory;
>
> (c) the Territory of Ashmore and Cartier Islands;
>
> (d) the Territory of Christmas Island;
>
> (e) the Territory of Cocos (Keeling) Islands;
>
> (f) the Territory of Heard Island and the McDonald Islands.
>
> (2) Australia , when used in a geographical sense, **includes an offshore area** for the purposes of the Offshore Petroleum and Greenhouse Gas Storage Act 2006 .[emphasis added]

Being a non-exhaustive definition, 'Australia' in the ITAA 1997 definition also includes its 12 nautical mile territorial sea and the sea on the landward side of the territorial sea and not within the limits of a State or internal Territory (including the airspace above, and the bed and subsoil beneath, such seas) by operation of s 15B of the *Interpretation Act* (Cth) as discussed above. When used in a geographical sense, it also expressly includes the 'offshore areas' under OPGGS Act detailed below. However, importantly, the substituted 'indirect tax zone' definition in the GST Act expressly excludes those same "offshore areas".

[6] Repeal Day Act, Sch 4 s 27, commencing 25 February 2015; by operation of Sch 4 s 79(1), the amendments made by the Schedule to the GST Act applied to a tax period that commenced on or after 1 July 2015.

In making this change in terminology, it appears not to have been the intention of the Federal Parliament to alter in any way the legal reach of the GST:

> Unlike income tax, the GST does not operate in Australia's external territories and in certain offshore areas. As opposed to referring to the GST as operating in 'Australia' when the GST does not apply to certain parts of Australia, a new label, the indirect tax zone, is applied to make clear the difference in application of the indirect taxes. **The scope of the indirect tax zone is no different to the current scope of 'Australia' for indirect tax purposes. That is, there is no policy change in regard to the application of the GST**. This change in terminology allows the policy outcome to be preserved while still having a consistent definition of Australia across the taxation laws.[7] [emphasis added]

Subsequent statements made by the ATO in public rulings confirmed that the Parliament enacted the change to ensure consistency of terminology across tax legislation, "with no change in policy or legal effect", including no change in the geographical scope of the GST.[8] In a non-binding private ruling (authorisation No 1051338642533, dated 16 February 2018), the ATO quite clearly indicated that the "indirect tax zone" included Australia's 12 nautical mile territorial sea:

> **Australia includes the entire land territory of Australia, coastal areas and seabed**, but not any external Territories, such as Norfolk Island, Christmas Island or the Australian Antarctic Territory. Australia also includes sea installations and resources installations (such as oil or gas rigs) that are attached to the seabed within the territorial boundaries of Australia, or to an adjacent or coastal area as defined in that Act.
>
> **The territorial limit of the coastal seas surrounding Australia is 12 nautical miles from the territorial sea baseline of Australian land masses.** This was established in November 199X, by proclamation under section 7 of the *Seas and Submerged Lands Act 1973.* [emphasis added]

However, despite these statements as to Parliament's intention and the ATO's interpretation of the law, the new definition did in fact change the geographical reach of the GST, and in a material way. The change was brought about by the express exclusion of 'offshore areas' (as defined in the OPGGS Act) from the 'indirect tax zone' definition.[9]

3 *'Offshore areas' excluded from indirect tax zone*

The OPGGS Act provides a regulatory framework for petroleum exploration and recovery, and the injection and storage of greenhouse gas substances in 'offshore areas' prescribed for each of the Australian states and certain Territories[10]. For example, the 'New South Wales offshore area' is defined to mean:

> So much of the scheduled area for that State as comprises waters of the sea that are: (a) beyond the outer limits of the coastal waters of that State; and (b) within the outer limits of the continental shelf.[11]

The 'coastal waters' of New South Wales in paragraph (a) above means so much of the scheduled area for the State as consists of:

---

[7] Explanatory Memorandum to the Treasury Legislation Amendment (Repeal Day) Bill 2014 (**EM**), at [4.86].
[8] See, for example, the preliminary note to ATO Interpretative Decision 2013/20.
[9] See para (b) of the definition of "indirect tax zone" in s 195-1 of the GST Act.
[10] OPGGS Act, s 3.
[11] OPGGS Act, s 8(1) table.

- the territorial sea (N.B. for this purpose, assumed to be 3 nautical miles); and
- any waters that are on the landward side of the territorial sea, and not within the limits of the State.[12]

In simpler terms, the 'coastal waters' of a State or Territory for the purposes of the 'offshore area' definition is the 3 nautical mile zone adjacent to that jurisdiction's coastline.

It follows from the foregoing that the 'offshore area' of a State (or the Northern Territory) that is excluded from the GST "indirect tax zone" is an area that:

- starts 3 nautical miles from the jurisdiction's low-water line baseline from which the breadth of the territorial sea is measured (i.e. generally, the low-water line);
- extends seaward to the outer limits of the continental shelf;
- includes all things located in that area, including all installations and structures such as oil and gas rigs;
- extends to the airspace over, and the sea-bed and subsoil beneath, that area; and
- includes the exclusive economic zone and the continental shelf of Australia.[13]

4 *Summary of position regarding offshore areas*

With effect from 1 July 2015, the reach of the GST to activities in Australia's coastal waters was narrowed to those activities connected with the States' and the Northern Territory's 3 nautical mile zones adjacent to their respective coastlines (as well as certain installations deemed to be part of Australia under s 5C of the *Customs Act 1901* (Cth) and located in offshore areas).

From that date, the GST no longer extended to relevant activities occurring in the 9 nautical mile balance of Australia's territorial sea. In other words, such activities were outside of Australia's GST net. Even though 'Australia' in the definition of 'indirect tax zone' includes the full 12 nautical mile territorial sea (by virtue of s 15B of the Interpretation Act (Cth)), it is abundantly clear from a plain reading of the exclusions in the latter definition that the GST is not to be imposed on supplies connected with 'offshore areas', other than the stated installations located in those areas.[14]

C *Application of the relevant provisions*

Based on the foregoing analysis, the 'indirect tax zone' in the GST Act includes the land territory of Australia, the coastal waters that make up the States' and the Northern Territory's 3 nautical mile coastal zones, and certain offshore installations. It excludes the remaining 9 nautical mile zones that form Australia's territorial sea.

---

[12] OPGGS Act, s 7.

[13] See the OPGGS Act, ss 3, 4 and 8, and the notes to the definition of "Australia" in the ITAA 1997, s 960-505. Simplified maps illustrating the "offshore areas" can be found in s 6 of the OPGGS Act.

[14] Note that s 2(2) of the Interpretation Act (Cth) provides that the application of a provision of the Act to another Commonwealth Act (or a provision of another Commonwealth Act) is subject to a contrary intention.

If this is correct, as it seems to be, then supplies connected with the States' and the Northern Territory's 3 nautical mile zones fall within the 'indirect tax zone' and are potentially subject to GST, while supplies connected with waters beyond the 3 nautical mile zones, including within parts of Australia 12 nautical mile territorial sea, are potentially not subject to GST as they fall outside the 'indirect tax zone'.

This is a strange result, but one that is reached upon a plain reading of the definition of 'indirect tax zone' and analysis of the underpinning statutes. As previously noted, the Explanatory Memorandum to the Bill for the Repeal Day Act makes it very clear that Parliament did not intend to narrow the geographical reach of the GST Act in adopting the term 'indirect tax zone' in place of 'Australia'. It would seem, therefore, that the exclusion of the entirety of "offshore areas" from the indirect tax zone was a drafting error on the part of the drafter and the Parliament by inadvertence, and the consequences of the error were clearly unintended. If the issue were to be the subject of future litigation a party might argue for the definition of 'indirect tax zone' to be construed in a purposive manner so as to include, not exclude, the outermost 9 nautical mile zone forming part of Australia's territorial sea. Such a construction might be said to promote a purpose or object of the GST Act, namely, to extend the GST to supplies connected with Australia's territorial sea, as was the position prior to 1 July 2015.[15] However, this is not a case of 'irrational', 'absurd' or 'obscure' language in legislation; nor is it a case where two constructions of language are available, being the bases upon which Courts have construed legislation so as to do away with such irrationality or conflict.[16] Section 15AB of the Interpretation Act (Cth)[17] was legislated soon after *Cooper Brookes*. This section provides that an interpretation of a provision may have recourse to secondary materials (such as explanatory memoranda) to 'confirm' the 'ordinary meaning' of the provision taking into account its context in the Act and the purpose of the underlying Act, or to assist to determine the meaning where the provision is 'ambiguous' or 'obscure' or where 'the ordinary meaning conveyed by the text of the provision taking into account its context in the Act and the purpose or object underlying the Act leads to a result that is manifestly absurd or is unreasonable.' Again, section 15AB poses no assistance here given the clear, unambiguous language of the 'indirect tax zone' definition. That is, the only interpretation of the "indirect tax zone" definition which can be arrived at from a plain literal reading, is that it excludes from the zone all offshore areas as defined and, hence, the furthermost 9 nautical mile zones of Australia's territorial sea. No other meaning can be inferred from the words 'but does not include' as they appear in the definition.

It is noteworthy that Section 15AA of the Interpretation Act (Cth), requires that the interpretation of an Act that is to be preferred is the one which would "best achieve the purpose or object of the Act (whether or not that that purpose or object is expressly stated in the Act). As seen in the EM extracted at paragraph 2.2.2 above, Parliament did not intend to limit the GST net to activities occurring in Australia's coastal waters.[18]

However, there are limits to applying the purposive approach espoused by section 15AA. In this regard, in *Mills v Meeking*[19] the High Court considered legislation in almost identical terms to section 15AA.[20] Dawson J in his judgment outlined a significant limitation to the purposive

[15] See the Interpretation Act (Cth), s15AA.
[16] See *Cooper Brookes (Woolongong) Pty Ltd v Commissioner of Taxation* (1981) 147 CLR 297 (*Cooper Brookes*).
[17] Section 15AB of the *Interpretation Act* (Cth) was introduced by *Acts Interpretation Amendment Act 1984* No. 27 of 1984.
[18] See EM at paragraph [4.86].
[19] 169 CLR 214.
[20] Being section 35(a) of the *Interpretation of Legislation Act 1984* (Vic).

approach – namely that an interpretation must be consistent with the text of the statute and must not 'rewrite it':

> The approach required by s.35 needs no ambiguity or inconsistency; it allows a court to consider the purposes of an Act in determining whether there is more than one possible construction. Reference to the purposes may reveal that the draftsman has inadvertently overlooked something which he would have dealt with had his attention been drawn to it and if it is possible as a matter of construction to repair the defect, then this must be done. However, if the literal meaning of a provision is to be modified by reference to the purposes of the Act, the modification must be precisely identifiable as that which is necessary to effectuate those purposes and it must be consistent with the wording otherwise adopted by the draftsman. Section 35 requires a court to construe an Act, not to rewrite it, in the light of its purposes.[21]

In a similar judgment, in *Taylor v The Owners – Strata Plan 11564*[22] the High Court recognised that in some circumstances a purposive construction of legislation may permit a reading of a provision as if it contained or omitted words with the effect of expanding or narrowing its operation. However, any modification of meaning must be consistent with the text of the statute – the language in fact used by the legislature. In *Taylor*, the court said as follows:

> The constructional task remains throughout to expound the meaning of the statutory text, not to divine unexpressed legislative intention or to remedy perceived legislative inattention. Construction is not speculation, and it is not repair. [23] (citations omitted)

In these circumstances, it is considered that amending legislation, made retrospective to 1 July 2015, ought to be introduced as soon as possible to rectify the position, and to dispel any uncertainty as to the proper GST treatment of activities carried out in Australia's coastal seas. Otherwise, the GST may be at risk of missing its intended mark – that of taxing supplies made in Australia, and within the full breath of its surrounding 12 nautical mile territorial sea.

III STAMP DUTY

A *Legislative power of States and Territories*

The Commonwealth does not have exclusive law-making powers in respect of taxation. The States have residual law-making powers not explicitly granted to the Commonwealth under s 51 of the Constitution. State Parliaments are thus empowered with the authority to make laws for the peace, order and good government of a State,[24] being the corollary of the Commonwealth's power to make laws for the peace, order and good government of the Commonwealth.[25] This power extends to making laws that are intended to operate extraterritorially. It follows that each Australian State has the general legislative power to impose transfer duty on transactions, such a tax being for the peace, welfare and good

[21] *Mills v Meeking* (1990)169 CLR 214 at [19].
[22] [2014] HCA 9.
[23] Per Gageler and Keane JJ at [65]. See also *Chief Executive Officer, Department of Water and Environmental Regulation v Waroona Resources Pty Ltd* [2023] WASCA 73.
[24] See e,g, s5 of the C*onstitution Act 1902* (NSW) and comparable State constitutions.
[25] S 51 of the Commonwealth Constitution.

government of the State. For constitutional validity of a State's taxing legislation, it must also have a relevant and not too remote connection with the 'State', as it is not within the competence of a State legislature to legislate for a matter occurring outside of or not otherwise connected to a State in some relevant way. A relevant territorial connection generally exists if the law operates in respect of 'any fact, circumstance, occurrence or thing in or connected with the territory'.[26]

The question then whether a State or the Northern Territory has constitutional power to impose transfer duty on a particular transaction occurring in its coastal waters calls for consideration of two distinct matters. The first issue discussed below is the delineation of the jurisdiction's legal boundaries, that is, precisely what waters extending beyond the shore of a State are legally within or taken to form part of the 'State'. It is only by knowing the geographical limits of a State that one can say whether a transaction or thing is located 'in' or 'connected' to that State and may therefore be subjected to its transfer duty laws. The second matter discussed below is whether, in respect of a particular transaction occurring in or connected to a State or Territory's coastal waters, the duties legislation of that jurisdiction expressly or impliedly applies to impose tax on the particular transaction.

B *Geographical limits of a State or Territory*

As regards the physical boundaries of a State, the position before June 1979 was that the legislative territory of a State was limited to the land mass of the State as existed at the time of Federation in 1901, ending at the low water mark being the point along the coast that is reached by the sea at low tide, together with inland waters lying within State boundaries.[27] Sovereignty in respect of the seas washing the shorelines of the States, and the seabed and the airspace over those seas, was vested in and exercisable by the Commonwealth from the time of Federation.[28] This position still permitted a State to make laws that related to activities undertaken in the coastal waters adjacent to the State, provided the law had a relevant connection with the State and, importantly, was not inconsistent with a Commonwealth law.[29]

In 1979, the States[30] and the Commonwealth entered into an agreement extending the powers of the States to make laws affecting the sea, seabed and airspace beyond the low water mark. That agreement resulted in the passing by the Commonwealth of the *Coastal Waters (State Powers) Act 1980* (Cth) ('CW Cth Act') which codified each State's law-making powers in relation to its 'coastal waters' (see below).[31] By this Act, the State legislatures were given power to make laws, generally, in respect of the coastal waters surrounding the State including the seabed and subsoil beneath and airspace above, and also for laws concerning specified

---

[26] *Broken Hill South Ltd (Public Officer)* v *Commissioner of Taxation (NSW)* (1937) 4 ATD 163 at 183; (1937) 56 CLR 337 at 375. For further discussion on the States' legislative powers, see Justice DG Hill, Constitutional Power and Extraterritorial Enforcement (1996) 19(1) *University of New South. Wales Law Journal* 45.

[27] *New South Wales v The Commonwealth* (1975) 135 CLR 337.

[28] High Court majority in *New South Wales* v *The Commonwealth* [1975] HCA 58; (1975) 135 CLR 337.

[29] *Pearce* v *Florenca* [1976] HCA 26; (1976) 135 CLR 507.

[30] See e.g. *Constitutional Powers (Coastal Waters) Act 1979* (NSW), *Constitutional Powers (Coastal Waters) Act 1980* (Qld), *Constitutional Powers (Coastal Waters) Act 1980* (Vic); *Constitutional Powers (Coastal Waters) Act 1979* (WA).

[31] In the same year, the Commonwealth Parliament also passed the *Coastal Waters (State Title) Act 1980* (Cth) which vested in each State the same right and title to the property in the sea-bed beneath the coastal waters of a State, and the same rights in respect of space (including space occupied by water) above the sea-bed as if that sea-bed were the sea-bed beneath waters of the sea within the limits of the State.

subject matters including subterranean mining, shipping facilities and fisheries in respect of areas beyond the coastal waters including the seabed and subsoil beneath, and airspace above. The operative provision is contained in s 5, which is relevantly in these terms:

> 5 The legislative powers exercisable from time to time under the constitution of each State extend to the making of:
>
> (a) all such laws of the State as could be made by virtue of those powers **if the coastal waters of the State, as extending from time to time, were within the limits of the State**, including laws applying in or in relation to the sea-bed and subsoil beneath, and the airspace above, the coastal waters of the State;
>
> (b) laws of the State having effect in or in relation to waters within the adjacent area in respect of the State but beyond the outer limits of the coastal waters of the State, including laws applying in or in relation to the sea-bed and subsoil beneath, and the airspace above, the first-mentioned waters, being laws with respect to:
>
> (i) subterranean mining from land within the limits of the State; or
>
> ii) ports, harbours and other shipping facilities, including installations, and dredging and other works, relating thereto, and other coastal works". [emphasis added]

As regards the limits of the coastal waters (and, necessarily, the limits of a State's law-making powers), s 3(1) of the CW Cth Act defined "coastal waters of the State"[32] to mean:

> (a) the part or parts of the territorial sea of Australia that is or are within the adjacent area[33] in respect of the State, **other than any part referred to in subsection 4(2)**; and
>
> (b) any sea that is on the landward side of any part of the territorial sea of Australia and is within the adjacent area in respect of the State but is not within the limits of the State or of a Territory. [emphasis added]

S 4(2) of the Act provided that the coastal waters would not extend beyond the initial 3 nautical miles of a State's coastal waters:

> (2) If at any time the breadth of the territorial sea of Australia is determined or declared to be greater than 3 nautical miles, references in this Act to the coastal waters of the State do not include, in relation to any State, any part of the territorial sea of Australia that would not be within the limits of that territorial sea if the breadth of that territorial sea had continued to be 3 nautical miles.

The 'territorial sea of Australia' in the above definition is essentially the sea within the limits of the territorial sea of Australia as subsisting from time to time under agreements between 'Australia and another country', at present being 12 nautical miles from the low water mark.[34] However, the 'coastal waters' of each State is limited to that part or parts of the territorial sea within the adjacent area for the State other than any part referred to in s 4(2) of the CW Cth Act. That subsection, as noted above refers to parts of the territorial sea of Australia that at any time are determined to exceed a breadth of 3 nautical miles. This operates to limit the extent of the coastal waters of a State to 3 nautical miles from the low water mark, together with any sea described in para (b) of the definition of 'coastal waters of the State', as shown above.

---

[32] This definition is replicated in s 58 of the *Interpretation Act 1987* (NSW).

[33] The "adjacent area in respect of the State" is defined in the same section to mean the area the boundary of which was described under the heading referring to the State in Schedule 2 to the repealed Petroleum (Submerged Lands) Act 1967 of the Commonwealth, as in force immediately before the commencement of the CW Cth Act.

[34] Section 4(1) of the CW Cth Act.

The CW Cth Act and the equivalent State enactments on the same terms[35] thereby provided the relevant framework by which States became empowered to legislate in respect of their coastal waters, as 'if' the coastal waters were within the State.

In pursuance of the powers so bestowed on them by the CW Cth Act, each of the States passed equivalent legislation to the *Application of Laws (Coastal Sea) Act 1980* (NSW)[36] to expressly apply their laws to their respective coastal waters, s 4 of which reads as follows:

> 4. The provisions of the laws in force in the State, whether written or unwritten, and whether substantive or procedural, and as in force from time to time, other than criminal laws and laws of the Commonwealth, apply to and in relation to the coastal sea, and so apply **as if the coastal sea were part of the State**. [emphasis added]

The above provision is echoed in s 59 of the *Interpretation Act 1987* (NSW) which applies the laws of the State to its coastal waters and the seabed and subsoil beneath, and the airspace above, those waters. S 59 provides as follows:

> 59. The laws of the State apply in and in relation to--
>
> (a) the coastal waters of the State, and
>
> (b) the sea-bed and subsoil beneath, and the airspace above, the coastal waters of the State,
>
> **as if the coastal waters of the State, as extending from time to time, were within the limits of the State**. [emphasis added]

As regards the Northern Territory, the Territory was given power to legislate in respect of its coastal seas by the *Coastal Waters (Northern Territory Powers) Act 1980 (Cth)* which, like its State counterpart the CW Cth Act, gave legislative power to the Northern Territory Legislative Assembly over the surrounding coastal waters, seabed, subsoil, and airspace above, as if those areas were part of the Territory.[37] As per the State counterpart legislation, the coastal waters of the Northern Territory were defined to be limited to 3 nautical miles.[38] The Commonwealth legislation was given effect by the *Off-shore Waters (Application of Territory Laws) Act 1985* (NT).

C *Has the jurisdiction chosen to tax the transaction?*

Because of the interlocking Federal and State laws discussed above, the parliaments of the States and the Northern Territory have non-exclusive constitutional power to make tax laws that apply to or in relation to their respective coastal waters, and any such laws will apply 'as if the coastal seas were part of the State'. That is, a State or the Northern Territory legislature can legislate to impose transfer duty in respect of a matter or thing located or done in its coastal waters 'as if' the matter or thing was located or done in the jurisdiction.

---

[35] Ibid fn 25.

[36] See s 3 of the *Off-shore (Application of Laws) Act 1982* (WA); s 3 of the *Coastal and Other Waters (Application of State Laws Act)* 1982 (Tas); s 3 of the *Off-shore Waters (Application of Laws) Act 1976* (SA), s 47a of the *Acts Interpretation Act 1954* (Qld) and s 57(1) of the *Interpretation of Legislation Act 1984* (Vic).

[37] Section 5 of the *Coastal Waters (Northern Territory Powers) Act 1980 (Cth)*.

[38] Ibid s 4.

Importantly, however, these Federal and State laws did not change the actual legal limits of the States as they were created at Federation. The actual limits of a State can only be altered in the manner provided for by s 123 of the *Commonwealth of Australia Constitution Act 1900* (Cth) which states as follows:

> The Parliament of the Commonwealth may, with the consent of the Parliament of a State, and the approval of the majority of the electors of the State voting upon the question, increase, diminish, or otherwise alter the limits of the State, upon such terms and conditions as may be agreed on, and may, with the like consent, make provision respecting the effect and operation of any increase or diminution or alteration of territory in relation to any State affected.

This intended outcome was clearly acknowledged in the saving provision in s 7 of the CW Cth Act:

> **Nothing in this Act shall be taken to**:
>
> (a) **extend the limits of any State**;
>
> (b) derogate from any power existing, apart from this Act, to make laws of a State having extra-territorial effect; or
>
> (c) give any force or effect to a provision of a law of a State to the extent of any inconsistency with a law of the Commonwealth or with the Constitution of the Commonwealth of Australia or the Commonwealth of Australia Constitution Act". [emphasis added]

An important question then is whether, in a particular case, a State has elected to have its duties law apply extra-territorially to matters occurring in or connected to its coastal waters. Take the case of a charging provision of a State's duties legislation that imposes duty on a transfer or other specified dealing in 'dutiable property' located in the State. In this case, does the provision apply not only to property located on or under the State's territorial land, but also to property located in or under the coastal waters of the State? Arguably it does not, in the absence of clear language to the contrary.

For example, under s 8(1) of the *Duties Act 1997* (NSW) ('NSW Duties Act'), duty is imposed on various transactions, including a transfer of, and agreement to transfer, 'dutiable property'. S 11(1)(a) of the NSW Duties Act defines dutiable property to include 'land in New South Wales'. The stipulation for duty to apply on a transfer of land is that the land be physically located 'in New South Wales'. The term 'New South Wales' in s 11(1)(a) is not itself defined in the Act and so arguably takes its ordinary meaning, being the State of New South Wales having the geographical limits existing at the time of Federation. In other words, although s 5 of the CW Cth Act and s 59 of the *Interpretation Act 1987* (NSW) empowers the New South Wales legislature to make laws 'as if' the coastal waters were part of the State, the NSW Duties Act does not go so far as to say that a reference in the Act to a thing 'in New South Wales' is to be read as including such a thing located in the coastal waters of New South Wales. Note also that s 12(1)(b) of the *Interpretation Act 1987* (NSW) requires references to a locality, jurisdiction or other matters or thing in New South Wales statutes to be read as references to such a locality, jurisdiction or other matter or thing 'in and of New South Wales'.

D *Application*

What follows from the above discussion is that a State or territory, as regards the Northern Territory, legislature must expressly stipulate that its transfer duty laws apply to specified matters, for example a transfer of land located in or otherwise connected to the coastal waters of that jurisdiction for the tax to operate extra-territorially. In that regard, as at the date of publication, no State or Territory appears to have legislated so that duty applies to transfers and other specified dealings in property such as land, fixtures or chattels located in or under its respective coastal waters, except Queensland. The *Duties Act 2001* (Qld) ('Qld Duties Act') has brought its coastal waters into the duty net by defining the term 'land' to include the 'coastal waters of the State'.[39] A summary of the transfer duty position of each state and the Northern Territory is summarised in the table below.

Jurisdiction	Does the jurisdiction charge duty on a dutiable transaction affecting dutiable property located in its coastal waters?	Legislative basis
Queensland	Yes	Definition of 'land' in Schedule 6 to the Qld Duties Act explicitly includes 'coastal waters of the State'.
New South Wales	No	Definition of 'land' in Dictionary to the NSW Duties Act does not include 'coastal waters of the State'.
Victoria	No	Land is not defined in the *Duties Act 2000* (Vic) and so the State should arguably be given its ordinary meaning i.e. boundaries as at Federation.
South Australia	No	Section 2(7) of the *Stamp Duties Act 1923* (SA) which expands the concept of 'land' does not refer to the State's coastal waters.
Western Australia	No	Definition of 'land' in Section 3A of the *Duties Act 2008* (WA) does not include 'coastal waters of the State'.
Tasmania	No	Definition of 'land' in section 3 of the *Duties Act 2001* (Tas)

[39] Definition of 'land' in Schedule 6 to the Qld Duties Act.

		does not include 'coastal waters of the State'.
Northern Territory	No	Definition of 'land' in section 4 of the *Stamp Duty Act 1978* (NT) does not include 'coastal waters of the Territory'.

Having regard to the position in each jurisdiction summarised above, a transfer or an agreement for the transfer of infrastructure located in Queensland's 3 nautical mile coastal zone, to the extent it constitutes 'land', for example a fixture to land, or a good transferred with other dutiable property will be liable to duty as a 'dutiable transaction' under the Qld Duties Act. In the case of the other jurisdictions, however, land and other dutiable property located in or under their respective coastal waters are not subject to duty on transfer, as those waters are beyond the low water mark and thus are not 'in' the jurisdiction.

While the legislative position regarding the powers of the States and the Norther Territory to impose transfer duty on transactions connected with their coastal waters is complex, as demonstrated above, it can also be said with certainty that transactions concerning waters beyond the 3 nautical mile coastal zones are at present not subject to the transfer duty laws of any Australian State or the Northern Territory.

IV CONCLUSION

Taxpayers operating in Australia's coastal waters need to take particular care to ascertain whether Australia's primary indirect tax laws, being GST and transfer duties, apply to those operations.

Having regard to the GST Act's current iteration following the replacement of the term 'Australia' with 'indirect tax zone' – supplies connected to Australia's 'indirect tax zone' which include its coastal seas extending to 3 nautical miles from the low water mark, will be subject to GST where all other criteria required to give rise to a taxable supply in section 9-5 of the GST Act are satisfied. Supplies which are solely connected with the seas located beyond the coastal waters should not be taxable. Prior to the replacement of the terminology, GST applied to supplies connected with the surrounding 12 nautical mile territorial sea. Amending legislation, made retrospective to 1 July 2015, ought to be introduced as soon as possible to rectify the position, and to dispel any uncertainty as to the proper GST treatment of activities carried out in Australia's coastal seas.

In relation to transfer duty, while each state and the Northern Territory is empowered to impose duty on transactions occurring in their coastal waters, only the state of Queensland has legislated to provide that dutiable transactions affecting property in Queensland's coastal seas will give rise to duty unless an exemption applies. All other states and the Northern Territory have not legislated to allow for duty to apply to transactions affecting property in the respective coastal waters. It remains to be seen whether other states' Parliaments will amend their respective duty legislations to follow the position in Queensland.

While this article does not address these topics, future academic research and writing in this area may include discussion of the interaction of international laws and a jurisdiction's ability to tax transactions occurring or connected to the jurisdiction's surrounding seas, and also the application of direct taxes in Australia's surrounding waters.

TAX COMPLEXITY AND INDIVIDUAL TAX COMPLIANCE COSTS OF THE PERSONAL INCOME TAX IN CANADA, 1985-2022: A SYNTHESIS*

FRANCOIS VAILLANCOURT**

Abstract

This article presents evidence on the evolution of both the complexity of the personal income tax system and the compliance costs incurred by personal income tax filers (PIT) in Canada. The complexity is measured using three indicators: length of federal income tax code (1971-2018), number of federal PIT expenditures (1981-2014) and length of provincial PIT forms (2000-2015). All three indicators show an increase in complexity. The compliance costs of the PIT are calculated using survey information gathered from individual Canadians on time expanded and amount spent the following year for the 1985, 2007, 2018 and 2022 tax filing /calendar years. Our results show a decrease in the PIT compliance costs in hours, in total value and as share of GDP and revenues collected. This drop in compliance costs is most likely due to the increasing use of software by tax filers to prepare their tax returns; this allows them, amongst other things, to download information from the Revenue agencies. A tax pain index combining complexity and compliance costs is put forward; its small growth over time may well explain why increasing tax complexity of the PIT in Canada is apparently well tolerated. The article ends with a short review of similar Australian evidence.

*A first version of this paper was presented at the Canadian Law and Economics Association conference, Toronto, October ,2024 and the *Aspects of Tax Administration and Economic Development* conference, Bali, November 2024.We thank participants for their comments. We also thank an anonymous reviewer of this Journal and Chris Evans for their help with finalizing this paper for publication.

** Emeritus Professor, Economics, Université de Montréal and Fellow, CIRANO

I INTRODUCTION

The purpose of this paper is to synthesize and combine the information available in 2025 on both the compliance costs incurred by Canadian personal income tax (PIT) filers and the complexity of the Canadian PIT. The paper covers the 1985, 2007, 2018, and 2022 taxation (calendar) years and thus the compliance costs incurred the year after. The paper is divided in five sections. The first presents briefly the Canadian personal income tax system and the data used in our analysis. The second examines the evolution over time of tax preparation choices and of compliance costs (time, expenditures, total resources) for all tax filers and groups of particular interest, such as self-employed filers. The third brings together evidence on indicators of complexity over time (number of standardized pages in the tax code, number of tax expenditures). The fourth links the indicators of complexity and compliance costs to ascertain what relationship exists. The fifth relates those results to the relevant Australian literature.

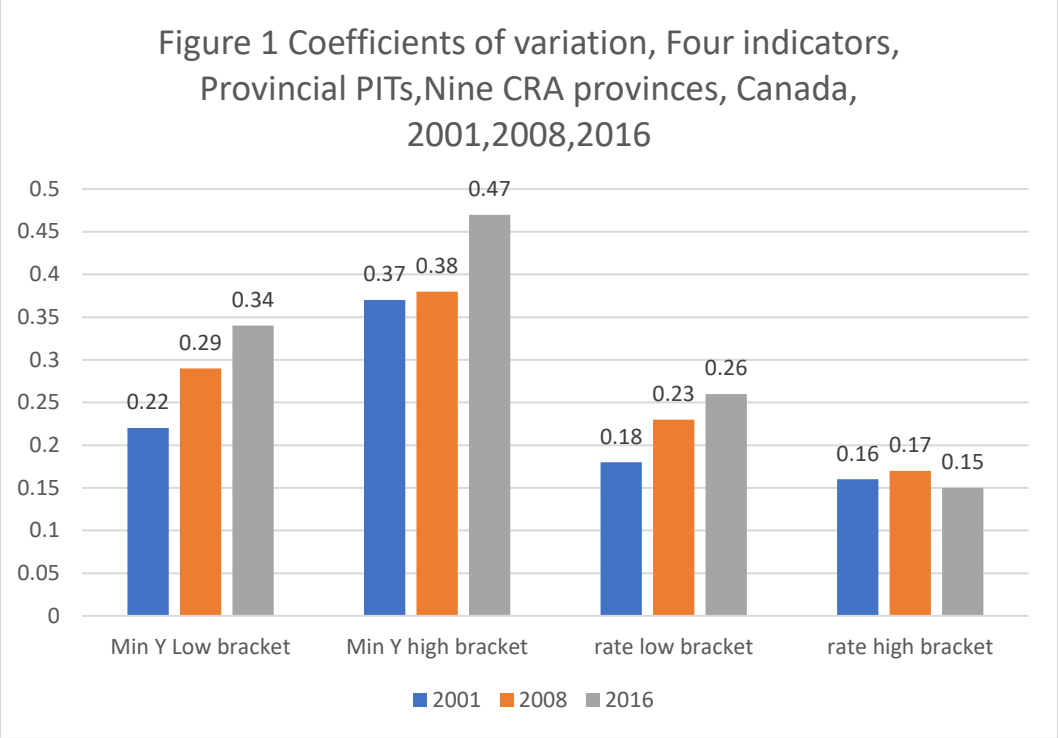
II THE PERSONAL INCOME TAX (PIT) SYSTEM IN CANADA: DESCRIPTION AND SURVEY EVIDENCE ON COMPLIANCE COSTS

The personal income tax system in Canada comprises 14 rate-setting bodies and two tax administrations. The rate-setting bodies are the federal government, the ten provinces, and the three[1] northern territories. The two tax administrations are the federal Canada Revenue Agency (CRA)[2] and the provincial Revenu Québec (RQ) [3]agencies. The federal government and the provinces have a constitutional right to levy taxes on personal income, while the territories have the legal right to do so, granted by the federal government. The CRA collects the federal, provincial and territorial PIT in all provinces and territories, except in Québec, where it only collects the federal PIT; the Québec PIT is collected by RQ. Thus, a non-Québec tax filer files one PIT return with a provincial/territorial annex, while a Québec tax filer files two PIT returns. Since 2018, Québec politicians have been asking for a single PIT return to be administered by RQ; the federal government has said no. Vaillancourt (2023) summarizes this debate.

The CRA collects provincial/territorial PITs free of charge if provinces use the same definition of income as the federal government. Until 2000, the provinces had to use a Tax-on-Tax approach. They thus set their PIT as a percent of the federal PIT; they could use specific tax credits. This changed that year to a Tax-on-Income system allowing provinces to set their own tax brackets, whose number and boundaries may differ from the federal ones, and their own tax rates. This allowed them to make their own choices in terms of the progressivity of their share of the PIT. Québec uses its own definition of taxable personal income, credits, deductions and so on, yielding numerous small differences between the federal and Québec PIT codes, as shown by Godbout and Michael-Angers.[4]

[1] There were two before 1999.
[2] Before 1999 the Department of National Revenue.
[3] Before 2011, the Quebec Department of Revenue.
[4] One simple difference is the use of the Québec Consumer Price Index (CPI) to adjust amounts over time for inflation while the federal government uses the Canada-wide CPI. See Godbout, Luc and Michaël Robert-Angers 'How Does Quebec Exercise Its Fiscal Autonomy?' (2023) 71:3 *Canadian Tax Journal* 779.

One consequence of the 2000 reform is the possibility of increased diversity in provincial PITs. Ruiz-Almendral and Vaillancourt (2016) [5] examined this diversity for 2008, while Vaillancourt et al (2016) update this information for 2016.[6] Diversity is measured using coefficients of variations for four aspects of the provincial PITs for all provinces except Québec. The diversity for the minimum income for the lowest tax bracket, the minimum income for the highest tax bracket, and the statutory rate for the lowest bracket have all increased from 2001 to 2016, as shown in Figure 1. Interestingly, the indicator for the statutory rate for the highest tax bracket shows little change, perhaps due to tax competition concerns.



Source: author using information in Appendix tables 1 and 2, Vaillancourt et al, 2016

The main methodological characteristics of the compliance costs studies used in this paper are summarized in Table 1. It shows that the sample sizes are in the 1500-2700 range. These sample sizes are sufficient to obtain good Canada-wide estimates from a random sample. Such a sample is used in the earlier two studies, but the last two studies use Internet panels that rely on members of the panel answering the survey and weights being used to make the results representative of the target population. Data collection has moved from a face-to-face survey to Internet surveys. The wording of the question on tax filing mode has evolved over time to reflect the availability of various types of software. The time/money questioning has moved from four to one/two questions. The 2018 question is the shortest with no content prompt, while the 2022 question wraps into one question the information gathered by three questions for 1985 and 2007 on time use.

---

[5] Violeta Ruiz-Almendral and François Vaillancourt, 'Subnational Personal Income Tax Autonomy in Selected OECD Countries: A comparative perspective' (2016) *Forum of Federations* occasional paper 11.
[6]Francois Vaillancourt, Charles Lammam, Feixue Ren and Marylène Roy *Measuring Personal Income Tax Complexity in Canada* (Fraser Institute, 2016).

Table 1 Key Methodological Dimensions, Personal Income Tax Compliance Cost Studies, Canada, 1985,2007 2018 2022

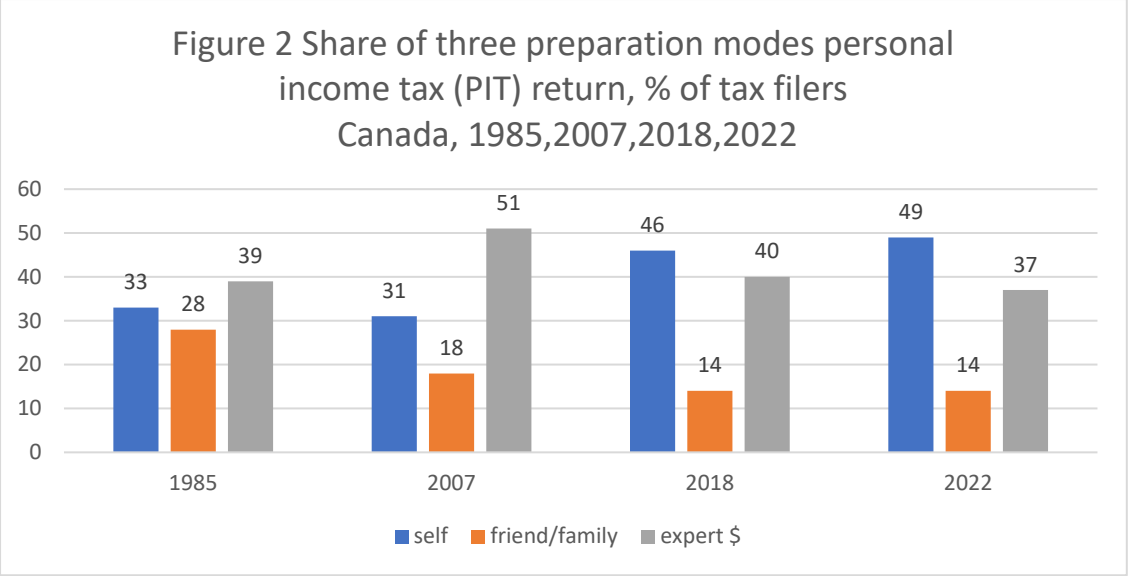
Study author (year of publication)	Vaillancourt (1989)	Vaillancourt, Roy-Cesar and Barros (2013)	Grine and Vaillancourt (2023)	Vaillancourt and Li (2024)
Tax year studied	1985	2007	2018	2022
Data collection method for adults,10 provinces	In-person interviews, May -June 1986	Phone survey, April-May 2008	Internet panel, May-June 2019	Internet panel, May 2023
Questionnaire prepared by	Vaillancourt	Vaillancourt	Chaire en Fiscalité et Finances Publiques	Vaillancourt
N analysed	1682	2000	2 669	1 523
Tax return completion mode choices	1)Yourself; 2)Friend or family without payment 3)Individual or firm against payment	1) Yourself using: a) paper form; b) purchased PC software; c) internet software 2) Friend family or NGO 3) Paid tax preparer	1) Yourself using: a) paper form; b) software 2) Friend or family 3) professional tax preparer	1) Yourself using: a) paper form; software purchased (b) or free (c) 2) Friend family NGO 3) Tax preparer
Compliance costs question(s)	Three questions on time Time sorting & preparing documents Time gathering information Time filling the tax return(s) One question on amount paid	Three questions on time Time sorting & preparing documents Time gathering information Time filling the tax return(s) One question on amount paid	One question How much money and time were required for this task? with space for responses of time and money	Two questions How much time did you need to spend to prepare and file your 2022 personal income tax return(s) How much did you spend (software, tax preparer services)

III PERSONAL INCOME TAX RETURNS: COMPLETION MODE AND COMPLIANCE COSTS

To understand the evolution of the cost of filing a personal income tax return in Canada, it is necessary to first examine how they are prepared. We do this in Figures 2 and 3. That done, we examine the average cost of filing a return for all tax filers in Figures 4, 5, and 6. We then turn to some specific types of tax filers in Figures 7 and 8. Finally, we assess the compliance costs with respect to indicators of overall economic activity in Table 2.

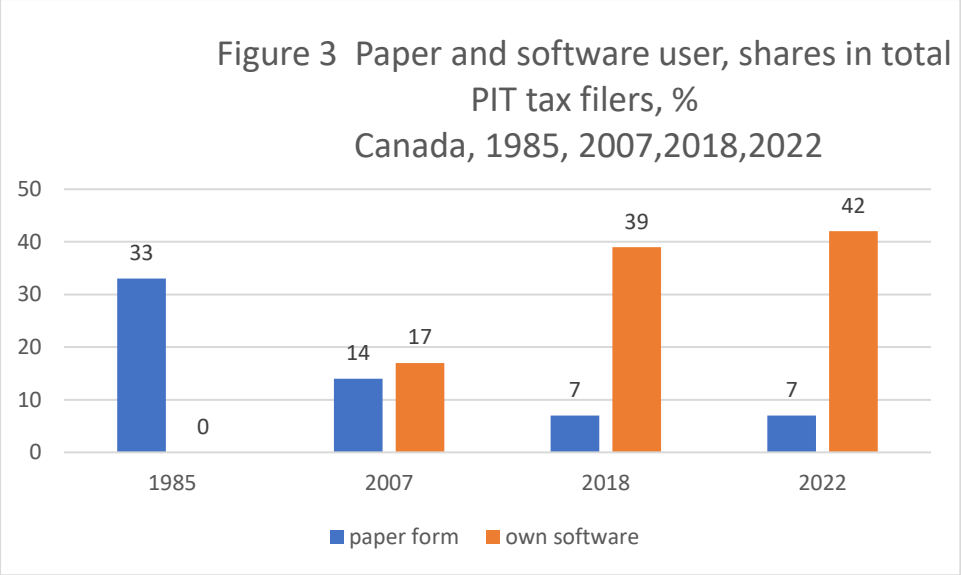
A *Personal Income Tax Filing Choices*

Figure 2 shows an increase between 1985 and 2007 in the use of paid tax preparers, then a drop in the use of tax preparers such that, for the 2022 tax year, they are used slightly less than for the 1985 tax year. Indeed, for 2022, roughly half the returns are self-prepared. This can be explained by the increasing use of software shown in Figure 3. The numbers in Figure 3 do not account for the use by friends and family members of software; consequently, the total share of returns filed using personal software is most likely around 60% in 2022. One should note that for 2022, 43% of self-preparer software users used free software (Vaillancourt and Li, 2024, table 1[7])



Sources: 1985 : Vaillancourt (1989) table B-1, p 103 ; 2007 Vaillancourt et al. (2013), table 2, p. 8 ; 2018 Grine and Vaillancourt table 3 ; 2022 Vaillancourt and Li, table 1

[7]Francois Vaillancourt and Nathaniel Li, *Personal Income Tax Compliance for Canadians How and at What Cost?* (Fraser Institute, 2024).



Sources: 1985 : Vaillancourt (1989) table B-1 ; 2007 Vaillancourt et al. (2013), table 2; 2018 Grine and Vaillancourt table 3; 2022 Vaillancourt and Li, table 1

B *Personal income tax filing compliance costs of individual filers*

Figures 4, 5, and 6 present information on the compliance costs incurred by personal income tax filers in Canada. These costs do not include the costs incurred by employers or financial institutions in preparing the various income statements (T3, T4, and T5, for example).

Figure 4 shows a sharp drop in the time cost of filing a PIT return in Canada between 2007 and 2018 and a small drop between 2018 and 2022. These drops can be explained, in our opinion, by four factors:

i. a generalised increase in the use of software to prepare PIT returns since software users spend less time on PIT compliance activities.
ii. more knowledge acquired /retained over time by software users that facilitates filing the PIT tax return.
iii. increased use of online (banking sites) payment of tax liabilities.
iv. an increased use of information downloaded from the CRA and RQ websites to fill the software-prepared tax returns.

Let us examine the evidence supporting the relevance of each factor. Support for i) is found in Figure 3 and in the results of Vaillancourt and Li[8] (2024 table A-5). Figure 3 shows the increase in the use of software. Vaillancourt and Li[9] (2024, Table A-5) report that the time spent to prepare and file a PIT return is 3 hours for paper form users, 2 hours for users of paid software and 1 hour for users of free software. We can use this information to simulate what would happen if software was not available to self-filers. Assuming that all software users revert to a

[8] Ibid.
[9] Ibid.

paper form and that they are otherwise similar to paper form users, we calculate an increase in time spent on preparing and filing a PIT return by 43% for 2022 [10].

For ii), Vaillancourt et al. 2013[11] (tables 5c and 8) report a drop in the time required by self-preparers when their level of experience with the tax system is higher than four years; presumably, this holds also in the case of software users. As to iii), this is a trend found for all types of spending[12].

Finally, for iv), Vaillancourt and Li[13] (2024) report that downloading data (Auto-fill my return) from the CRA was first offered for the 2015 PIT return. In the case of RQ, downloading, while first offered for 2013, was made easier to access (TDF: téléchargement des données fiscales) in 2015. Data provided[14] by the e-Services Program-HQ from the CRA allow us to ascertain that:

- there was an 87.5% increase in the number of individual users of this service from 2018 to 2022 (2 890 691 in 2018 and 5 420 008 in 2022);
- the percentage of eligible self-filers that use Auto-fill[15] increases from 42.5% to 53.3% over the 2019-2022 period [16].

We do not have chronological data for RQ tax filers. In 2021, 40.5% of Québec self- filers using software indicate having used Auto-fill while 37.1% indicate having used TDF.[17] Downloading should reduce the time required to prepare a tax return for a given level of complexity. We cannot measure this precisely.

This drop in PIT compliance time costs of about 65% over a period of 37 years for Canada in the time needed to file a PIT return is similar to what one can calculate for the United States for a period of 39 years. For 1984, Slemrod and Sorum (1984)[18] report an average of 21.7 hours spent on PIT compliance. For 2023, Benzarti and Wallossek (2023)[19] report an average of 4-5 hours spent on PIT compliance. Putting these two sets of numbers together, one finds a drop of about 75% in the time needed to file a PIT return in the USA.

---

[10]We calculate this using data from Table 1 and Table A-5 in Vaillancourt and Li (2024). We multiply each mode share (table1) by the mean number of hours associated with this mode (table A-5) to obtain the base case hours. The no-software case is obtained by assuming three hours rather than one or two for software users and redoing the calculations. The mean total hours go from 1,38 to 1,98 and thus 1,98/1,38= 1,43

[11] Francois Vaillancourt, Édison Roy-César and Maria Silvia Barros, *The Compliance and Administrative Costs of Taxation in Canada* (Fraser Institute, 2013).

[12] In 2022, 52% of tax payments are made using online banking. See Figure A10 https://www.payments.ca/sites/default/files/PaymentsCanada_Canadian_Payment_Methods_and_Trends_Report_2023_En.pdf

[13] (n 7) 6-7.

[14] Personal communication 18 July 2024.

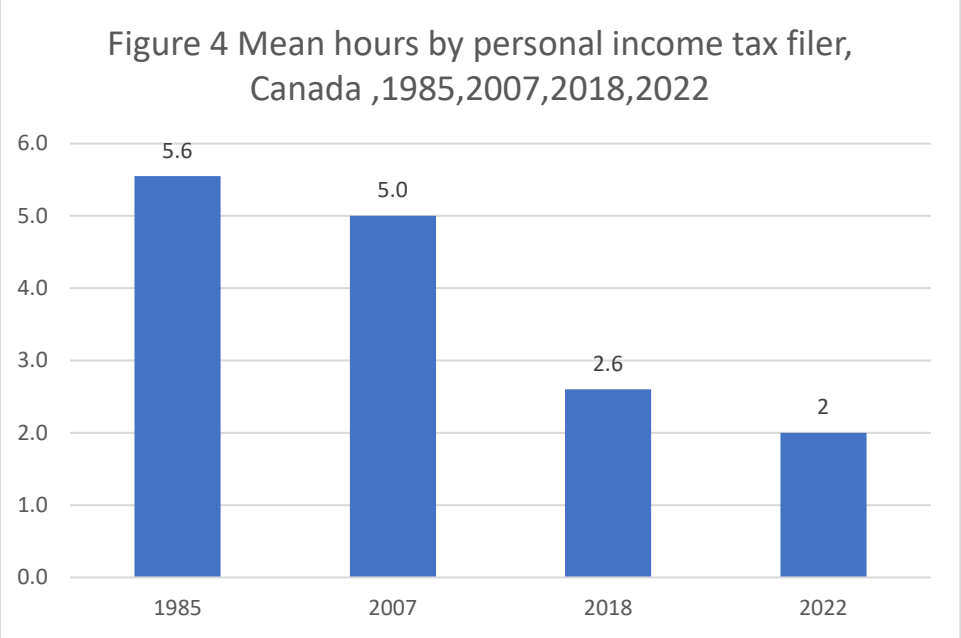
[15] That is self-filers who file electronically and do not use a paper form

[16] We compute this by dividing the data on Auto- fill users for 2019 by the number of Individual e-filershttps://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/individual-income-tax-return-statistics.html consulted 16/09/2024.There is no data on the number of e-filers for 2019.

[17] Tables 6 and 7 SONDAGE SUR LE TÉLÉCHARGEMENT DES DONNÉES FISCALES : PARTICULIERS https://www.revenuquebec.ca/documents/fr/docs_adm/sondage-telechargement-donnees-fiscales-particuliers-2022.pdf

[18] Joel Slemrod and Nikki Sorum, 'The Compliance Cost of the U.S. Individual Income Tax System' (1984) NBER paper 1401.

[19] Youssef Benzarti and Luisa Wallossek, *Rising Income Tax Complexity* (2023).

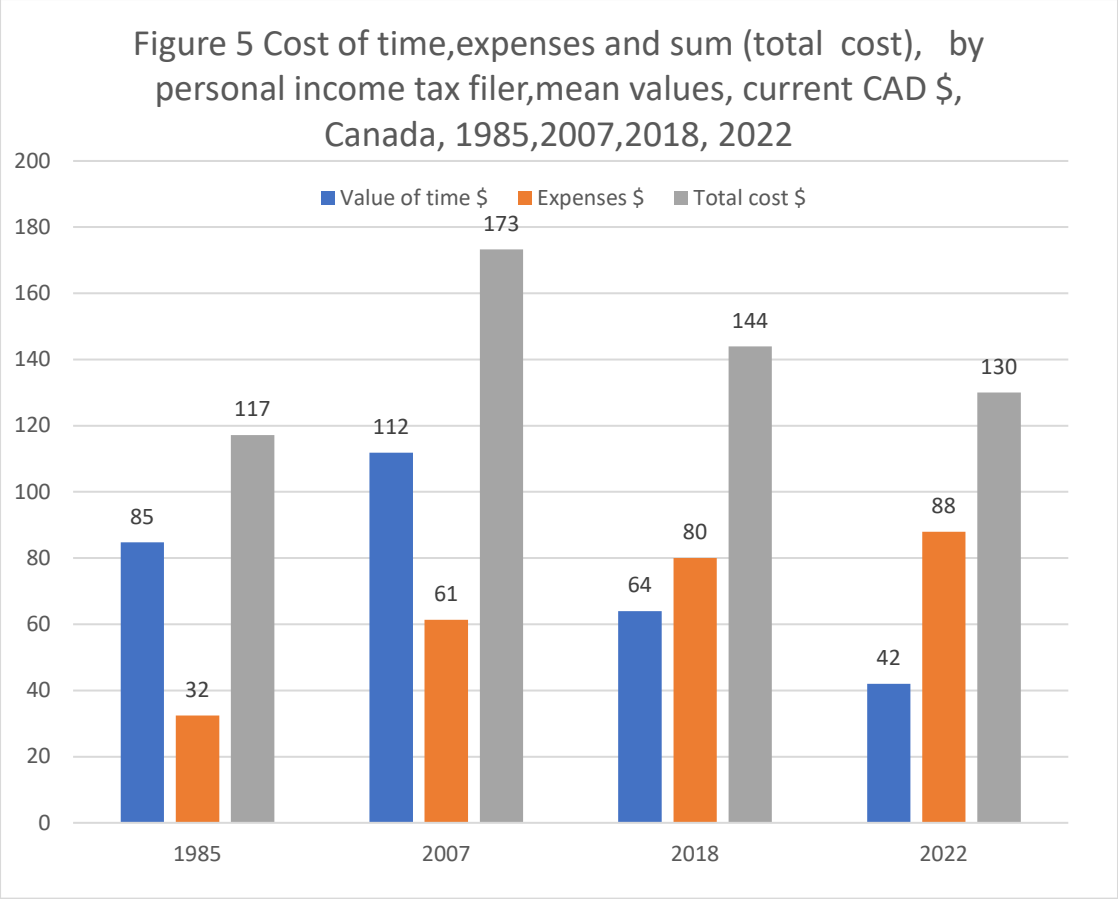


Sources: 1985 : Vaillancourt (1989) table 2.1, ; 2007 Vaillancourt et al (2013), table 4a ; 2018 Grine and Vaillancourt table 3 ; 2022 Vaillancourt and Li, table 2

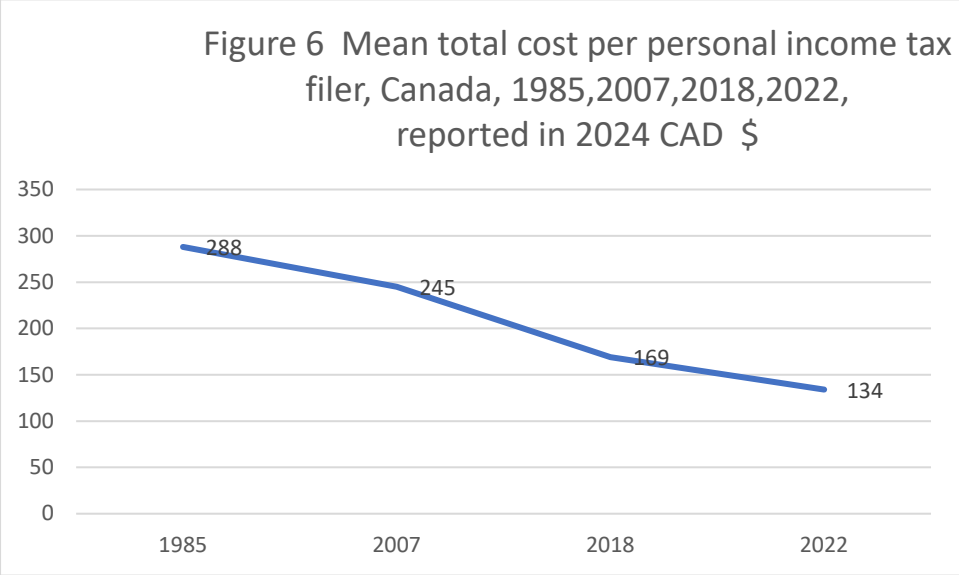
Transforming time into money using gross wages, we can present the value of time and expenses and, adding them up, total PIT compliance costs in Figure 5. Total nominal costs peak for the 2007 tax year and then drop. Transforming these nominal costs into 2024 Canadian dollars accentuates this drop in costs, as shown in Figure 6.

Are these intertemporal comparisons valid? The discussion of Table 1 highlighted the differences in methodology between each survey; this makes them less comparable than desirable. The literature on the impact of mode change in surveys does not indicate that major issues in the measurement of compliance costs would result from this[20]. That said, changes in provincial PITs in the early 2000s should increase compliance costs, something we observe between 1985 and 2007, before the use of tax software was generalised. And we noted four factors that should lead to a drop in the time costs of preparing PIT returns in Canada over the last 20 years or so. One should also note that the ageing of the population will mechanically reduce the estimation of PIT compliance costs, since the four studies impute a low value of time to retirees.

[20] Differences in survey administration mode appear to affect mainly attitudinal answers, with more extreme answers given in in-person or phone surveys than in web surveys; this does not seem to apply to our type of questions. See https://www.pewresearch.org/short-reads/2019/02/07/phone-vs-online-surveys-why-do-respondents-answers-sometimes-differ-by-mode/
https://www.pewresearch.org/short-reads/2015/05/14/where-web-surveys-produce-different-results-than-phone-interviews/
https://news.gallup.com/opinion/methodology/233291/why-phone-web-survey-results-aren.aspx
https://www.surveysensum.com/blog/cati-vs-online-surveys

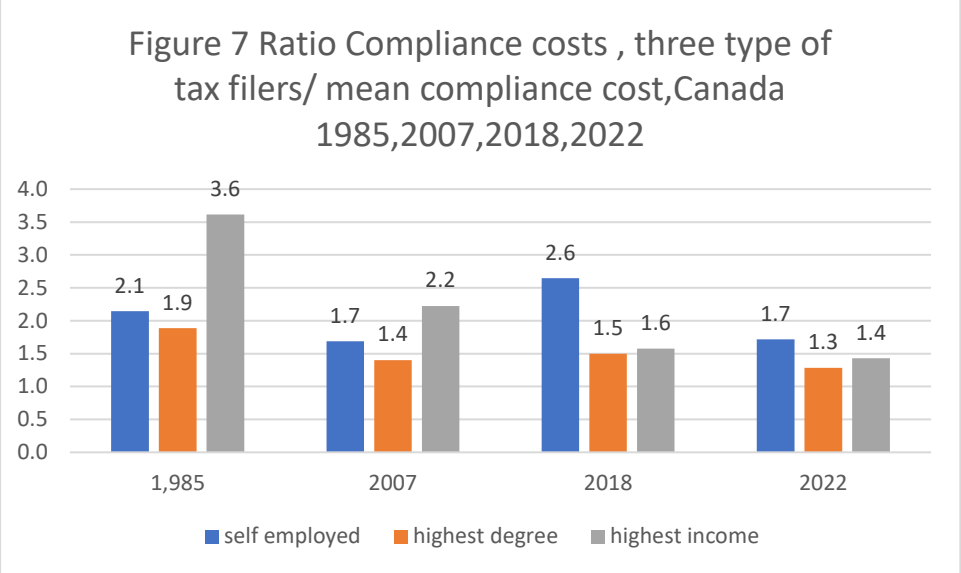


Sources: 1985 : Vaillancourt (1989) table 2.4, ; 2007 Vaillancourt et al (2013), table 4a ; 2018 Grine and Vaillancourt table 5 ; 2022 Vaillancourt and Li, table 2



Source: figure 5, this paper total costs transformed into 2024 dollars using the Bank of Canada inflation calculator.[21]

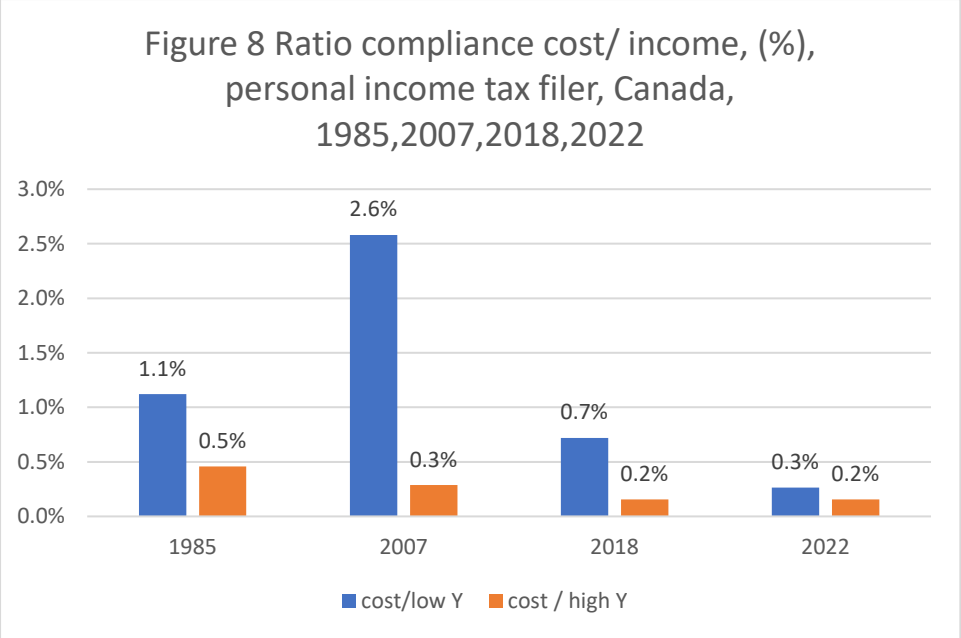
Figure 7 examines the evolution over time of the compliance costs of PIT filers that belong to three specific groups: self-employed, highest education, and highest income. For each year, we compute the mean time cost of each group. We then calculate the ratio of the costs for each of these groups relative to the mean time cost of all tax filers, yielding the relative cost reported in Figure 7. The relative costs of the self-employed have not changed much over time[22]. The relative costs of tax filers with the highest education and highest income have dropped. The finding for high income individuals is particularly striking; it is probably the result of a combination of more sophisticated software and downloading of financial information slips.



Sources: 1985 : Vaillancourt (1989) table 2.4, ; 2007 Vaillancourt et al (2013), tables 4a and 4b ; 2018 Grine and Vaillancourt table 7 ; 2022 Vaillancourt and Li, table 2

Figure 8 shows that the classic (Eichfelder and Vaillancourt, 2014) downward-sloping compliance costs/size indicator ratio is found in all four years but that the drop in mean cost is reducing somewhat the steepness of the slope.

[21] Bank of Canada <https://www.bankofcanada.ca/rates/related/inflation-calculator/>
[22]The self-employed account for 10% of tax filers in the 2022 tax year (Vaillancourt and Li, 2024 (n 7) Table A-1).



Sources: 1985 : Vaillancourt (1989) table 2.4, ; 2007 Vaillancourt et al. (2013), table 4b; 2018 Grine and Vaillancourt table 5; 2022 Vaillancourt and Li, table 2

Note These compliance cost/income ratios are calculated using the median point of known income levels, thus excluding the highest income since in all surveys it is an open interval.

Table 2 shows that, overall, the compliance costs incurred by PIT tax-fillers in Canada have dropped by more than half between 2007 and 2022, when measured as a share of GDP or of revenue collected by the federal government.

Table2 **Total compliance costs, personal income tax filers, CAD $ and % GDP, Canada, 1985, 2007, 2018, 2022**

	1985	**2007**	**2018**	**2022**
Million $ current (1)	1 951	4 318	4 024	4171
% GDP (2)	0.39 %	0.33 %	0.18 %	0.15%
% PIT revenue (3)	3.60%	1.68%	1.08%	0. 87%

Source: lines 1 and 2: author from Table 9 Grine and Vaillancourt; Table 3, Vaillancourt and Li. Line 3: calculation by author numerator: line 1; denominator 1985 Statistics Canada. Table 36-10-0161-01 ; 2007-2018-2012 : Table 33 Fiscal Reference table.[23]

[23] Government of Canada <https://www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables/2023.html>.

IV PERSONAL INCOME TAX: COMPLEXITY INDICATORS

Vaillancourt et al. (2015, 2016)[24], Lugo and Vaillancourt (2015)[25], Bird and Vaillancourt (2016)[26] and Poschmann et al. (2019)[27] have examined various dimensions of tax complexity in Canada. The definition of complexity, let alone its measurement and evolution over time, is not something upon which there is a strong consensus in the literature. In Canada both individuals and organisations argue that the tax system is complex.[28] Poschmann et al[29] (2019, p-6) report that there are three measures commonly used to measure tax complexity: the number of words in the tax code, the number of lines in tax forms, and the number of tax expenditures. They do not subscribe to the view that compliance costs are an indicator of complexity as such, as other factors could be at play in setting the level of compliance costs. Figure 9 shows that the three measures noted above can be linked to various steps in the tax setting/collecting process that leads to compliance activities and thus costs.

Figure 9 Analytical relationship between tax complexity and compliance costs

Tax activity:	Policy	Legal framework	Administrative document	Compliance activity

Government → **Taxpayer**

Measureable tax activity :	Tax expenditures	Length of legal texts	Length of documents	Compliance costs

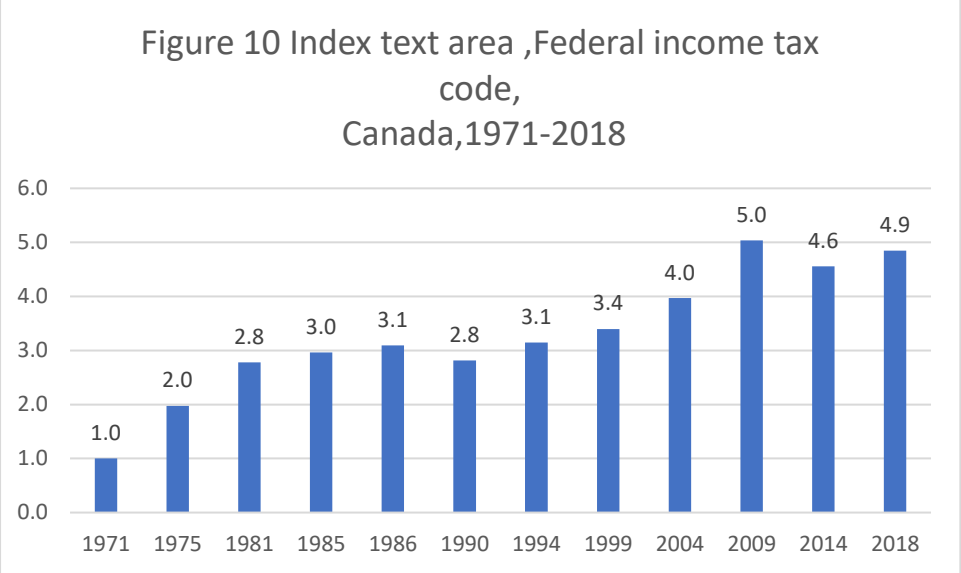
Source Bird and Vaillancourt, 2016

We focus here on PIT complexity, presenting two indicators of federal-level complexity and one indicator of provincial-level complexity.

[24] Francois Vaillancourt, Charles Lammam and Marylène Roy (2015) *Measuring Tax Complexity in Canada* (Fraser Institute, 2015); Francois Vaillancourt, Charles Lammam, Feixue Ren and Marylène Roy, *Measuring Personal Income Tax Complexity in Canada,* Fraser Institute, 2016).
[25] Marco Lugo and François Vaillancourt, 'Measuring Tax Complexity: Analytical Framework and Evidence for Individual Income Tax Preferences for Canada' in *Tax Simplification* (C Evans, R Krever, and P Mellor eds.). (Alphen aan den Rijn: Kluwer Law International, 2015) 141-166.
[26] Richard Bird and François Vaillancourt (2016) 'Tax Simplification in Canada: A Journey not yet mapped' in S James, A Sawyer and T Budak (eds), *The Complexity of Tax Simplification* (Palgrave Macmillan, 2016) 70-94.
[27] Finn Poschmann, François Vaillancourt and Jake Fuss *Tax Complexity in 2019: Can It Be Tamed?* (2019).
[28] For example, see https://www.cpacanada.ca/public-interest/public-policy-government-relations/policy-advocacy/cpa-canada-tax-review-initiative or https://epe.bac-lac.gc.ca/100/200/301/pwgsc-tpsgc/por-ef/canada_revenue_agency/2023/147-22-e/summary/summary.html
[29] (n 27)

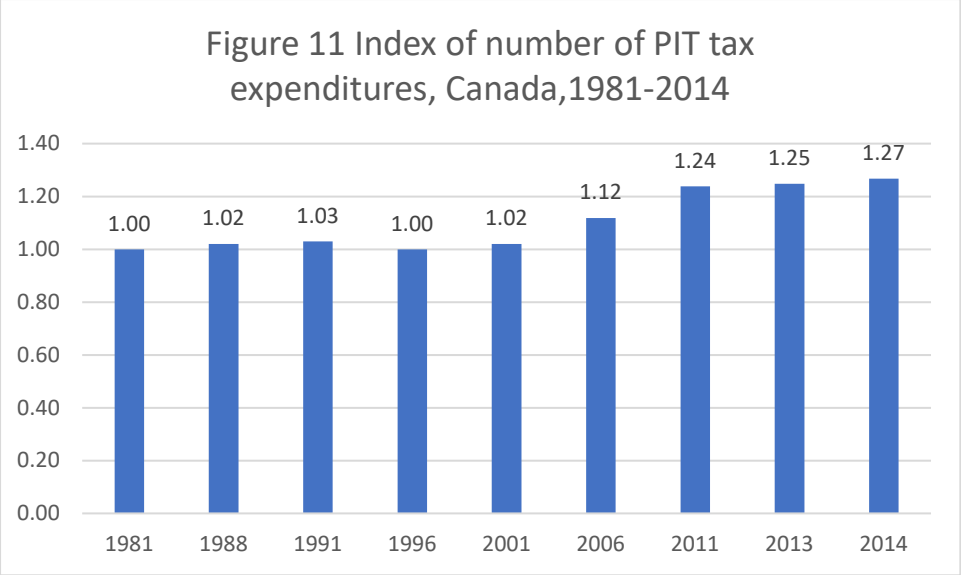
Figure 10 presents the growth over the 1971-2018 period of the size of the federal income tax code as measured by the physical size of the text. This is obtained by a combination of the number of pages and their size (cm^2). This income tax code is used by all provinces and territories except Québec. We can compare our results with that of Benzarti and Wallossek (2023).[30] They report in graphical form on the number of words (PDF count) in the Canadian federal income tax code. This number goes from about[31] 850 000 in 2004 to about 1, 250 000 in 2022; from 2018 to 2022, the increase is about 100 000. Thus, the growth from 2004 to 2022 is 47%, and from 2004 to 2018, 35%. Using data from Figure 10, we calculate a growth of 22% for 2002-2018 for our text area indicator. Thus, the two trends are similar.

Figure 11 reports, for a shorter period due to data availability, the growth in the number of tax expenditures at the federal level. It also shows increasing complexity, a correlation between tax complexity indicators noted by Vaillancourt et al (2015).[32] Figure 12, using the number of pages of the provincial PIT forms, shows a sharp rise in tax complexity at the provincial level between 2000 and 2005, then a levelling off. This increase is the result of the reforms in the provincial PITs outside Québec that were implemented in 2000.

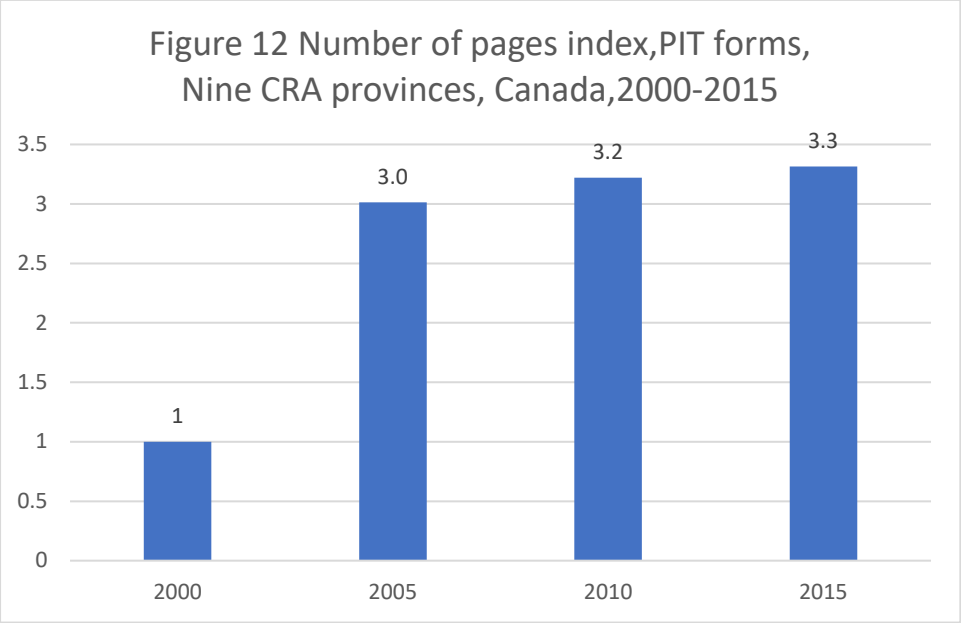


Source: calculations by author drawing on data from Table 2 (1971-2014) in Vaillancourt et al (2016) and Table 1 in Poschmann et al (2019)

[30] (n 19)
[31] Values are read off their Figure 8 (a) thus slightly approximate.
[32] (n 24) 8



Source: calculations by author drawing on data from Figure 2 (1991-2014) in Vaillancourt et al (2016)



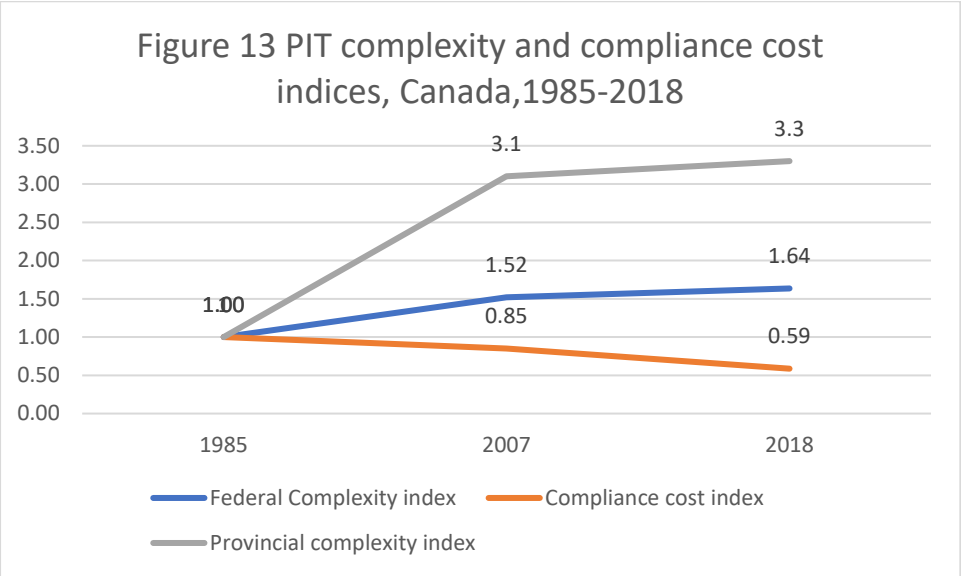
Source: Figure 7a Vaillancourt et al. (2016)

The increase in income tax complexity discussed above is also observed in the United States. Using figure 8 from Benzarti and Wallossek (2023)[33], one can calculate a 40-45% (numbers read off graph) increase in tax complexity from 1995 to 2022 for that country.

[33] (n 19).

V LINKING PIT COMPLIANCE COSTS AND INCOME TAX COMPLEXITY FOR CANADA

Combining the information presented in the two preceding parts of the paper and presenting it in index form yields Figure 13. It shows an increase in complexity and a decrease in total compliance costs in Canada over the 1985-2018 period.



Source: calculations by author using data from figures 5 (total costs), 10 and 12 above.

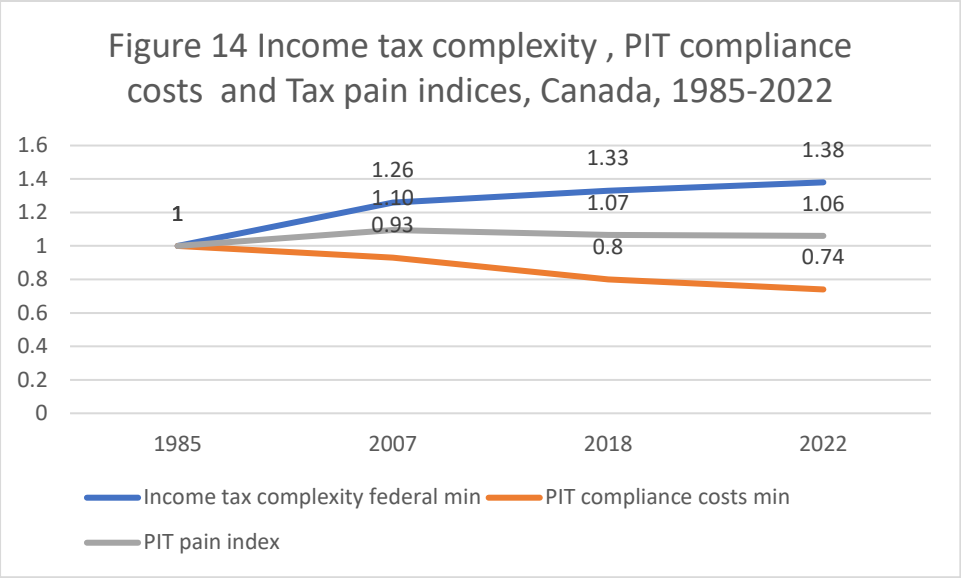
The divergence between the paths of complexity and compliance costs in Canada over the last 40 years can be explained in two ways.

One way is to assume that all indicators are correctly measured and that the divergence results from changes in the tax environment. Complexity measured by size of text went up between 1985 and 2007 in part because of the introduction of the new provincial PIT system; this has now stabilized. At the same time, the generalisation of the use of software to prepare PIT returns allows for a drop in the time of self-preparers and in the costs of tax preparers.

The second way is to argue that there are measurement issues at play. On the complexity side, the increased federal complexity may mainly affect firms and not individuals, and thus its growth is overestimated for the PIT. On the compliance cost side, changes in survey methods lead to an underestimation of compliance cost. Figure 14 presents the federal complexity index and the compliance cost index, both with a 50% reduction in the changes in values between years.[34] This is, in our opinion, a minimal quantification of the paradox of diverging trends. We combine these two indices in a new tax pain index, defined as the average of the compliance costs and complexity indices. This 50-50 weighting is an arbitrary one; it is plausible that weights could vary by types of taxpayers. Those with more standard sources of income may be

[34] We add the 2018-2022 period by applying the 12% growth for that period in the Benzarti and Wallossek (2023) index to our index and by including all data points from figure 5.

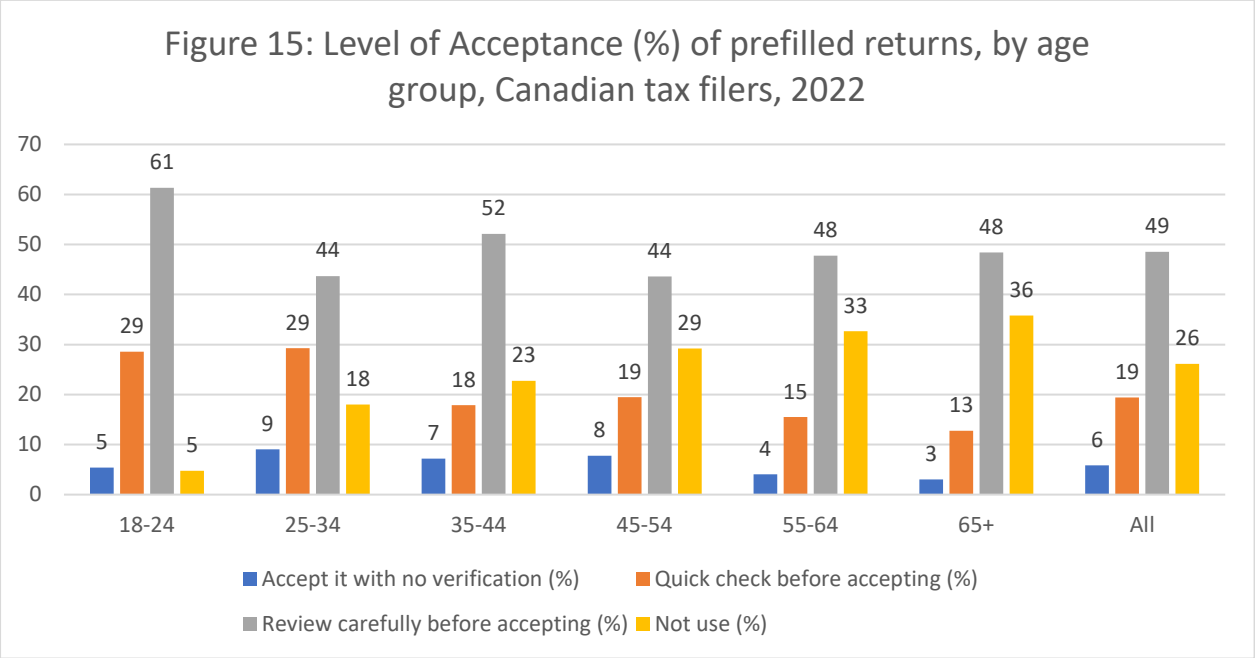
more impacted by compliance costs, while those using rarer sources of income may feel the impact of complexity more. We see that this tax pain index has not increased much over the 1985-2022 period for the Canadian PIT.



Source Figure 13 with changes in indices for 1985-2018; 2022 complexity index imputed from Benzarti and Wallossek (2023) and compliance index computed from figure 6.

With respect to PIT compliance costs, let us note that Canada does not have a general prefilled returns program.[35] One could presumably reduce compliance costs even more if prefilled returns were produced and used. Figure 15 presents information collected in 2023 about the acceptance by age group of such returns, should they be sent to tax filers. Compliance costs of the PIT are simulated to be reduced by one-third if such returns are put in place (Vaillancourt and Li, 2024, table 4).[36]

[35] Francois Vaillancourt, 'Prefilled Personal Income Tax Returns: An examination of five cases' in F Vaillancourt (ed) *Prefilled Personal Income Tax Returns: A comparative analysis of Australia, Belgium, California, Québec and Spain* (Fraser Institute, 2011) p.ii-xii; Kevin Brookes, 'Should the Government Pre-fill your tax return?' Montreal (Economic Institute, 2018).
[36] (n 7).



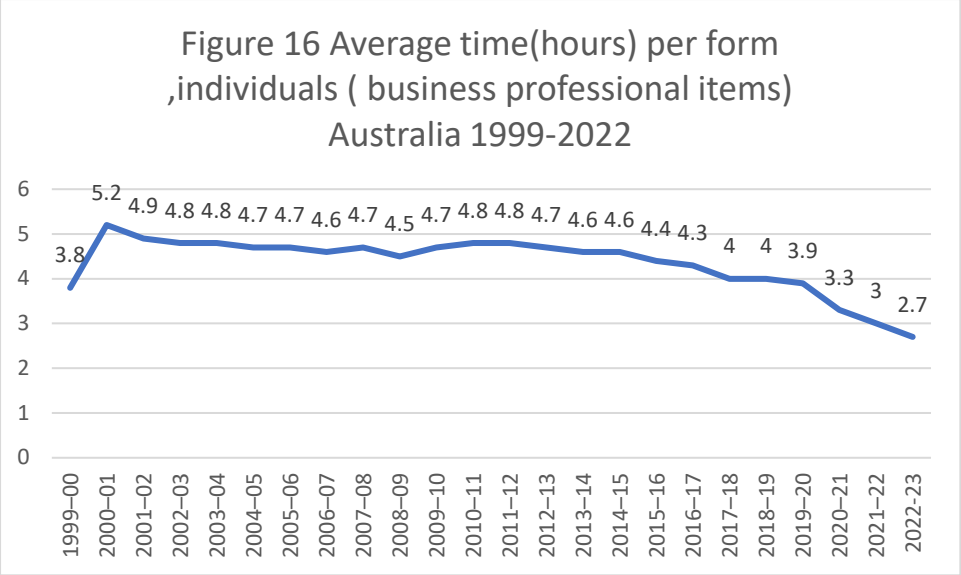
Source: figure 7 Vaillancourt and Li,2024

VI LINK TO THE AUSTRALIAN LITERATURE

Given the audience for this journal and the importance of the work by Australian tax scholars on tax compliance costs, it is appropriate to end this paper by attempting to link our work for Canada to the Australian literature. Pope et al. (1990) produced the first estimates for 1986-1987 of the personal income tax compliance costs for Australia. Evans et al. (1997, 2014) provide more recent results for respectively, 1994-1995, and 2011-2012. Pairing the results of these last two studies, the authors of the latter one report that the social PIT tax compliance costs as a percentage of GDP were 0.44% in 1994-95 and 0.57% in 2011-12 (Evans et al. 2014, p30). This is higher than the Canadian estimates of 0,33% for 2007 and 0,18% in 2018 and shows compliance costs increasing over time compared to a decrease over time for Canada.

Evans et al. (2014, p 31) also report that: the average real (compliance) costs rose from A$462 (A$349) to A$797 (A$605), representing a growth rate of about 73 per cent for both measures, over the comparison period. This is similar to the increase of 74% that the ATO reports for the 1998-1999 to 2011-2012 period in the average real cost of managing tax affairs for individual Australian tax filers based on the deduction claimed by a subset of taxpayers for managing tax affairs (ATO, 2015).

Contrary to the case of Canada, there are no studies of the compliance costs of the personal income tax for Australia after 2015.The ATO data used to generate the 74% mentioned above extends to 2022. Figure 16 presents annual values for that data set; it shows a relative stability in the amount of time between 2000-2001 between 4,9 and 4,8 hours then a slow decline from 2000-2001 to 2018-2019 and a sharp drop from 2019-2020 to 2022-2023.



Source: graphed using data from Australian Tax Office, *Cost of tax compliance, detailed tables*[37]

Turning to tax complexity, one finds that the number of pages of the Income Tax legislation was about (since we read numbers of a graph) 500 in 1970, reached a peak in 2005 of 9000, then, following the removal of inoperative clauses, dropped to about 6000 in 2006.[38] A slide desk shows a page count of (about) 11 000 in 2006 and 14 000 in 2015 for all Australian tax legislation[39] (Australian Treasury,2015 a, slide 2). McKerchar (2007) [40] presents numbers similar to those we read off graphs. There is no publicly available measurement of tax complexity in Australia since 2015, but it seems plausible that it has continued increasing. The 6% increase in the total number of tax concessions from 289 in 2016 (Australian Treasury,2017, p7) [41] to 307 in 2024 (Australian Treasury, 2024 p53) [42] supports this view.

VII CONCLUSION

The main results of this paper are that there is, for Canada from 1985 to 2022, a positive trend in income tax complexity and a negative trend in personal income tax compliance costs. The widespread use of self-preparation software in 2022, along with the possibility of downloading into such software information held by tax authorities, made it easier to prepare one's PIT return in 2022 than in 1985, when paper forms and tax slips were the tools used. The associated drop in the compliance burden may well explain why the complaint that the Canadian tax system is getting more complex over time has not led to action by governments, particularly as

[37] Australian Taxation Office, *Tax Statistics 2022-2023* <https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/taxation-statistics/taxation-statistics-2022-23/statistics/cost-of-tax-compliance-statistics>
[38] Parliament of Australia, 'Complex Legislation' (2008) 52 Figure 3.1.
[39] Australian Treasury (2015a) 'Complexity: a sketch in five slides' <https://treasury.gov.au/review/tax-white-paper/in-five-slides>. See Slide 2.
[40] Margaret McKerchar, (2007) Tax Complexity and its Impact on Tax Compliance and Tax Administration in Australia IRS Research Bulletin (2007) 185-204.
[41] Australian Treasury (2017) *Tax Expenditures Statement 2016* 7.
[42] Australian Treasury (2024) *2024-2025 Tax Expenditures and Insights Statement* 53.

the administrative costs of the CRA have dropped as a % of revenue collected from 2.1% of all taxes collected in 2007 to 1.7% in 2018 and 1.4% of all taxes collected in 2022[43].

Information for the United States reported above also shows a drop in compliance costs and an increase in tax complexity over a similar time frame to that of Canada. Information for Australia does not allow us to draw a conclusion on this point. The inverse relationship in the evolution between the compliance costs incurred by individuals and the complexity of the tax system in North America may explain why tax simplification has not gained much traction in these two countries. The planned introduction in Canada in 2026 for the 2025 tax year of prefilled returns for tax filers with low incomes and simple returns[44] should reduce compliance costs somewhat, reinforcing the divergent trends discussed above. Thus, increasing tax complexity, measured imperfectly by word or page or size counts, may be more sustainable than one would expect when tax filers that endure it are rewarded with lower compliance costs resulting from both private and public sector innovations in tax compliance tools.

BIBLIOGRAPHY

Australian Tax Office ATO (2015) *Tax White Paper* Chart 10.1 data https://treasury.gov.au/review/tax-white-paper/chart-data/10-complexity-and-administration

Australian Treasury (2015a) ''Complexity: a sketch in five slides'' https://treasury.gov.au/review/tax-white-paper/in-five-slides

Australian Treasury (2017) *Tax Expenditures Statement 2016* https://treasury.gov.au/sites/default/files/2019-03/Tax-Expenditure-Statement-2016.pdf

Australian Treasury (2024) *2024-2025 Tax Expenditures and Insights Statement* https://treasury.gov.au/publication/p2025-607085

Benzarti, Youssef and Luisa Wallossek (2023) Rising Income tax Complexity https://www.nber.org/papers/w31944

Bird, Richard and François Vaillancourt (2016) 'Tax Simplification in Canada: A Journey not yet mapped' in *The Complexity of Tax Simplification* (S James, A Sawyer and T Budak eds) New York: Palgrave Macmillan, 2016 p 70-94

Brookes, Kevin (2018) 'Should the Government Pre-fill your tax return?' Montreal Economic Institute https://www.iedm.org/sites/default/files/web/pub_files/note0518_en.pdf

[43] There is no published data on the collection costs of the PIT by the CRA. We use data from the Public Accounts of Canada to calculate these amounts as follows 2007-2008: pages 4-4 to 4-7; 2018-2019: pages 421 and 425; and 2022-2023: pages 383 and 387. Documents are accessible at https://epe.lac-bac.gc.ca/100/201/301/public_accounts_can/pdf/index.html The overall budget of CRA has increased substantially in recent years as it acts as a conduct for the Canada Carbon Rebate https://www.canada.ca/en/revenue-agency/services/child-family-benefits/cai-payment.html

[44] https://irpp.org/research-studies/automatic-tax-filing/#:~:text=With%20pre%2Dfilled%20tax%20returns,not%20use%20them%20at%20all.

Eichfelder Sebastian and François Vaillancourt ’Tax Compliance Costs: A Review of Cost Burdens and Cost Structures’’ and François Vaillancourt *Hacienda Pública Española / Review of Public Economics,* 210-(3/2014): 111-148

Evans, C., Ritchie, K., Tran-Nam, B. and Walpole, M. (1997), A Report into Taxpayer Costs of Compliance, Australian Government Publishing Service, Canberra.

Evans Chris; Tran-Nam Binh; Lignier Phil, 2014, 'Personal taxpayer compliance costs: Recent evidence from Australia', *Australian Tax Forum: a journal of taxation policy, law and reform*, 29, pp. 137 - 171,

Godbout, Luc and Michaël Robert-Angers (2023) ‘’How Does Quebec Exercise Its Fiscal Autonomy?’’ *Canadian Tax Journal* (2023) 71:3, 779 - 94 https://www.ctf.ca/common/Uploaded%20files/Documents/CTJ%202023/Issue%203/Public/779_Public-2023CTJ3-PF-4-Godbout-EN.pdf

Grine, Feriel and François Vaillancourt (2023). *Modes de préparation et coûts de produire une déclaration de revenus des particuliers au Canada : résultats pour 2018 et comparaisons intertemporelles.* Cahier de recherche 2023/18, Chaire de recherche en fiscalité et en finances publiques, 28 p. https://cffp.recherche.usherbrooke.ca/modes-de-preparation-et-couts-de-produire-une-declaration-de-revenus-des-particuliers-au-canada-resultats-pour-2018-et-comparaisons-intertemporelles/

Lugo, Marco and François Vaillancourt ‘‘Measuring Tax Complexity: Analytical Framework and Evidence for Individual Income Tax Preferences for Canada’’ in *Tax Simplification* (Evans, C. Krever, R. and P Mellor eds.). Alphen aan den Rijn: Kluwer Law International, 2015, p141-166

McKerchar, Margaret (2007) Tax Complexity and its Impact on Tax Compliance and Tax Administration in Australia IRS Research Bulletin p185-204 https://www.irs.gov/pub/irs-soi/07resconfmckerchar.pdf

Parliament of Australia, Complex Legislation https://www.aph.gov.au/~/media/wopapub/house/committee/jcpaa/taxation06/report/chap3_pdf.ashx

Pope, J., R. Fayle and M. Duncanson (1990) *The Compliance Costs of Personal Income Taxation in Australia*, 1986/87 Sydney; Australian Tax Research Foundation.

Poschmann, Finn, François Vaillancourt and Jake Fuss *Tax Complexity in 2019: Can It Be Tamed?* (2019) https://www.fraserinstitute.org/sites/default/files/tax-complexity-in-canada-2019.pdf

Ruiz-Almendral ,Violeta and François Vaillancourt (2016) *Subnational Personal Income Tax Autonomy in Selected OECD Countries: A comparative perspective* Forum of Federations occasional paper 11 https://www.forumfed.org/wp-content/uploads/2016/02/op11.pdf

Slemrod, Joel and Nikki Sorum (1984) The Compliance Cost of the U.S. Individual Income Tax System NBER paper 1401 https://www.nber.org/papers/w1401

Vaillancourt, François (1989). *The Administrative and Compliance Costs of Personal Income Taxes and Payroll Taxes, Canada 1986*, Canadian Tax Foundation.

Vaillancourt, François (2011) ’Prefilled Personal Income Tax Returns: An examination of five cases’ in *Prefilled Personal Income Tax Returns: A comparative analysis of Australia,*

Belgium, California, Québec and Spain (F Vaillancourt ,Ed)*V*ancouver: Fraser Institute,2011pii-xii http://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/prefilled-personal-income-tax-returns.pdf

Vaillancourt, François, Édison Roy-César, Maria Silvia Barros (2013). *The Compliance and Administrative Costs of Taxation in Canada*, Fraser Institute. https://www.fraserinstitute.org/sites/default/files/compliance-and-administrative-costs-of-taxation-in-canada-2013.pdf.

Vaillancourt, François Charles Lammam and Marylène Roy (2015) *Measuring Tax Complexity in Canada* Fraser Institute 2015 https://www.fraserinstitute.org/sites/default/files/measuring-tax-complexity-in-canada.pdf

Vaillancourt, François, Charles Lammam, Feixue Ren, et Marylène Roy (2016). *Measuring Personal Income Tax Complexity in Canada,* Fraser Institute. https://www.fraserinstitute.org/sites/default/files/measuring-personal-income-tax-complexity-in-canada.pdf

Vaillancourt ,François (2023) ‘’The Quest for a Quebec Single Income Tax Report—History and Estimated Savings’’ Canadian Tax Journal (2023) 71:3, 763 – 78 https://www.ctf.ca/common/Uploaded%20files/Documents/CTJ%202023/Issue%203/Public/763_Public-2023CTJ3-PF-3-Vaillancourt.pdf

Vaillancourt, François and Nathaniel Li (2024) *Personal Income Tax Compliance for Canadians How and at What Cost?* Fraser Institute https://www.fraserinstitute.org/sites/default/files/personal-income-tax-compliance-for-canadians.pdf

DID *CHARLES APARTMENTS CASE* INVOLVING GROUP COMPANY'S INTEREST DEDUCTIBILITY TAKE [A] WRONG TURN(S)?

DALE BOCCABELLA* AND NORMAN HANNA#

Abstract

The Charles Apartments case mostly involved the deductibility of an 'amount' incurred by a group company in the context of a property development group heavily indebted to an outside lender, that lender holding loan guarantees from all group companies. The group was not consolidated for income tax purposes. Upon sale of its only asset, the group company paid the net-proceeds to the outside lender to reduce the group's overall debt, yet the group company had a loan on foot from another group company to fund development of its only asset. There were differing views between the AAT and the Federal Court of this underlying general law payment transaction, namely, the AAT holding that it was (in part) an interest payment to the intra-group lender and the Federal Court holding it was a payment under the guarantee to the outside lender. From those positions, the income tax deductibility outcome also differed. This article deals with this difference of approach, an issue of considerable significance to similarly placed groups. The article also identifies and discusses what appear to be anomalies and inconsistencies in the litigation to date.

I INTRODUCTION

The *Charles Apartments case*[1] raises numerous tax issues but the one that generated a difference of opinion between the Administrative Appeals Tribunal (AAT) and the Federal Court involved the proper characterisation to give to a payment made by the taxpayer.[2] The AAT said it was a payment to a lender (intra-group company lender) whereas the Federal Court said it was a guarantee payment (as a guarantor) to an external lender to 'the group'. The AAT held the payment to be deductible, but the Federal Court denied deductibility because it was

* Associate Professor of Taxation Law, School of Accounting, Auditing & Taxation, The University of New South Wales.
# Barrister-at-law.

[1] *WCVB v FCT* [2024] AATA 1259; *Charles Apartments Pty Ltd v FCT* [2025] FCA 461.

[2] This article will not cover all the tax issues that arose in the litigation. Instead, only issues that go to the deductibility of the "interest expense" or liability of the taxpayer-company to the external financier will be dealt with.

capital. The decision is likely to have significant implications for similarly placed taxpayers. The decision is on appeal to the Full Federal Court.[3]

This article is structured as follows. Part 2 sets out the facts of the case and the decisions reached at each level and notes areas where the AAT (and the Federal Court) failed to make findings of fact that may be of some consequence in ultimately determining deductibility. Part 3 contains the analysis in the sense of testing the application of the tax law to the identified transaction(s) involved and the reasoning of the AAT and the Federal Court. Part 3 also considers the strategies of those involved in the case including why the taxpayer structured the loan as suggested,[4] and why (and whether it was open) for the taxpayer did not put forward an argument that it owed two liabilities to separate entities (loan and guarantee).

The reasoning and conclusions reached in both the AAT and the Federal Court are at times very difficult to follow. This may be partly due to a failure to make adequate findings of fact. This article canvasses whether the taxpayer may have made a strategic error in its claim of what the liability was under its loan from the intra-group company and whether there was in fact "two-liabilities". In the end, it is submitted that it is likely the Full Federal Court will allow the taxpayer's appeal and remit the matter back to the AAT (now Administrative Review Tribunal) along with directions for fuller (and relevant) findings of fact to allow the application of the tax law to be resolved.

II FACTS AND DECISIONS IN THE *CHARLES APARTMENTS CASE*

A *Facts as found in the Administrative Appeals Tribunal (AAT), and recorded in the Federal Court of Australia*

Most of the findings of material fact are set out in the AAT case (Mr McCabe, Deputy President) and they were generally accepted by the Federal Court (Wheatley J). However, in recording the facts as found by the AAT, Wheatley J arguably does not capture all the AAT's material findings in the area that is important to the key deductibility issue in the case. The following facts are the most relevant findings of fact:

1. The taxpayer (Charles Apartments Pty Ltd) was established in 2001 as a special purpose company to purchase, develop and sell a property (Parramatta property).[5] The development involved mixed-use multi-storey building(s) with some retail space and residential apartments. The taxpayer had no other sources of income.[6] The taxpayer was part of the Demian group of companies that comprised a maze of companies and trusts that were

[3] Given the taxpayer has funding under the ATO's Test Case Litigation Program, it is likely the issues in the case will have implications beyond just the taxpayer's circumstances: *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 127 and 153.

[4] We will see below that the structure of the taxpayer's loan seems to have had the undesirable effect of shifting the focus of the interest deduction question to a later point in time that coincided with the liability to make the guarantee payment.

[5] In fact, three contiguous properties were involved in the development but for convenience, this article refers to them as a single property. The intent was always to combine the three properties and to sell the development as one. As it turns out, the three properties were sold separately under [separate] contracts to the same purchaser, but this was not material to the tax analysis.

[6] Once the taxpayer purchased the relevant property, there was a small amount of parking fee receipts, but these can be disregarded.

involved in property development.[7] The group was controlled by Mr Demian. Although not stated, the group was not consolidated for income tax purposes at any relevant time.

2. In early 2002, the taxpayer borrowed $3m from St George to purchase the Parramatta property.[8] St George took a mortgage over the property. In the middle of 2003, St George advised the taxpayer the loan was about to expire. It appears St George was also concerned about other loan facilities to the group. Around this time, Mr Demian decided to seek out a more global solution to the group's financing needs.

3. Whilst not expressly pointed out by the AAT, it can be inferred that the purchase, holding and sale of the Parramatta property was treated as a revenue asset that was trading stock of the taxpayer.[9]

4. In the latter part of 2003, the Demian group's borrowing company (West Apartments Pty Ltd) entered a loan facility of $27m with Suncorp.

5. In December 2003, West Apartments Pty Ltd paid $3m of the funds advanced by Suncorp to St George and this discharged the taxpayer's loan liability to St George.[10] However, and contrary to the submissions from the ATO, the AAT accepted that West Apartments Pty Ltd lent $3m to the Demian group treasury company (Treasury Company) and that Treasury Company loaned $3m to the taxpayer to enable it to discharge the St George loan.[11] There was no evidence that Suncorp provided a loan of $3m or any amount [direct] to the taxpayer.

6. The interest rate that "accrued" on the $3m loan made to the taxpayer by the Treasury Company was the same as the interest rate charged to West Apartments Pty Ltd by Suncorp. An important finding was that the amount of interest the taxpayer was liable to pay on the loan to Treasury Company was limited to the amount of profit made by the taxpayer on the sale of the Parramatta property (amount above $3m), and not the amount of interest that would have arisen had the interest liability been determined by reference to the period of the loan. This would have turned out to be around $3.4m.[12]

7. The taxpayer's property was mortgaged to Suncorp as part of the establishment of the $27m Suncorp facility. Any sale of the taxpayer's property required Suncorp's permission. Other companies in the group also provided security for the Suncorp facility. Mr Demian also signed a Deed of Guarantee and Indemnity as between the taxpayer and Suncorp (amongst others).

8. Around the time of the Global Financial Crisis (2008-2009), Suncorp became concerned because of the failure (default) of West Apartments Pty Ltd to meet payment obligations under the Suncorp facility. To forestall Suncorp withdrawing the facility or taking enforcement action, in June 2009, Mr Demian signed a Deed of Forbearance with Suncorp in his capacity as a director of the taxpayer, other Demian group companies and in his

---

[7] *WCVB v FCT* [2024] AATA 1259 at para 28.

[8] The purchase cost of the property was in fact $3.125m and the property was co-purchased with Demian Holdings Pty Ltd with this company owning a 1/20th interest. The Administrative Appeals Tribunal (AAT) and the Federal Court largely ignored this 1/20th ownership interest. This article does the same.

[9] In short, the tax accounting applicable to the application of the trading stock regime was applied to the sale of the Parramatta property (sale proceeds of the property was income). Profit and loss accounting was not applied to the sale of the property.

[10] *WCVB v FCT* [2024] AATA 1259 at para 112.

[11] *WCVB v FCT* [2024] AATA 1259 at paras 122-132.

[12] *WCVB v FCT* [2024] AATA 1259 at para 121 An interesting question arises as to why the key witness for the taxpayer (Mr Demian) insisted that the loan was contingent and that it capped the interest payable.

personal capacity. The deed was said to amount to an action plan that required additional security, guarantees and asset sales from companies in the group.[13] Clause 9 of the deed provided:

> Notwithstanding any other terms of this Deed [Deed of Forbearance], the Obligers acknowledge and agree that all amounts due and owing to Suncorp by the Obligers pursuant to the Facilities and the Securities shall be repaid to Suncorp in full no later than 30 April 2010.[14]

Immediately after extracting clause 9, Mr McCabe wrote:

> The intent of the [deed of Forbearance] was clear: whereas [the taxpayer's Parramatta] properties were originally mortgaged to secure the debt owing under the facility established in December 2003, [the taxpayer] was acknowledging that it and the other obligers would be responsible for *all* the debts under *all* the facilities.[15] (emphasis in original)

There was no mention whether the taxpayer's obligations under the Deed of Forbearance extinguished the taxpayer's liability to Treasury Company.

9. After obtaining permission from Suncorp for the sale of the undeveloped Parramatta property to proceed,[16] the taxpayer sold the property (settlement on 12 August 2010) for $4.87m and therefore realised an economic profit of $1.87m.[17] For the sale to proceed, Suncorp required the proceeds of sale to be paid to Suncorp to reduce the Demian group's liability to it.[18] The cheque for payment by the purchaser was drawn, in favour of Suncorp, and on 13 August 2010 was deposited into the loan account held by West Apartments Pty Ltd with Suncorp.[19]

10. There was no evidence in the financial records (or elsewhere) of the taxpayer, the Treasury Company or West Apartments Pty Ltd of discharge of loan principal or interest or the receipt of repayment of a loan or interest in relation to the purchaser's $4.87m payment made directly to Suncorp. There was no evidence as to the character of the amount of $4.87m that Suncorp received in its records (e.g. repayment of principal and interest, payment by a guarantor, payment by a [primary] debtor). There was however the following statement by the AAT:

> When the [Parramatta] properties were sold, the entirety of the proceeds of the sale…were ultimately paid to Suncorp *via [the Treasury Company] and [West Apartments]*. $3 million of the amount paid to Suncorp was repayment of principal (ie the amount advanced to [taxpayer] to pay out the St George facility in 2003). The balance - an amount of [$1.87m] - was presumably referable to interest on the Suncorp facility.[20] (emphasis added)

The Federal Court largely adopted the findings of fact of the AAT.[21] However, there may be at least one important omission. The statement of the AAT (extracted immediately above) that the proceeds of the sale were ultimately paid to Suncorp via [the Treasury Company] and [West

---

[13] *WCVB v FCT* [2024] AATA 1259 at para 117.
[14] *WCVB v FCT* [2024] AATA 1259 at para 117.
[15] *WCVB v FCT* [2024] AATA 1259 at para 118.
[16] There was some evidence that some work had been done including demolition and removal of some existing structures and excavation of contaminated soil and securing approval of a development application (DA) over the property: *WCVB v FCT* [2024] AATA 1259 at paras 143 and 149.
[17] Although the taxpayer had obtained a DA for the property, little in the way of work towards implementing the development had taken place by the time of the sale of the property.
[18] *WCVB v FCT* [2024] AATA 1259 at para 37.
[19] *WCVB v FCT* [2024] AATA 1259 at para 41.
[20] *WCVB v FCT* [2024] AATA 1259 at para 119.
[21] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 144-145.

Apartments Pty Ltd] was not expressly noted or adopted by the Federal Court. This was the case even though reference was made by the Federal Court to the paragraph in the AAT reasons from which the statement referred to above was made.[22]

1 *Further contract, and further receipt and interest expense*

On 7 June 2010 - this is also the day the contract for the sale of the Parramatta property was entered (exchange) - another company in the Demian group (Advanced Communications Pty Ltd [Advanced]) entered a contract to sell documents that related to the development (e.g. council development approval documents) of properties held by various Demian group companies for $3.85m. The role of Advanced within the group was to carry out planning processes from conception to approval stages of the Development Application. The purchaser of the documents was the same entity that purchased the Parramatta property from the taxpayer.

Amongst the documents sold by Advanced was the development approval for the proposed development of the taxpayer's Parramatta property. The contract of sale of the documents owned by Advanced did not assign a value to each separate document sold, but the Commissioner assigned $946,000 (of the $3.85m) to the documents relating to the Parramatta property. The Commissioner asserted that this $946,000 was assessable income of the taxpayer because of an implied direction from the taxpayer to the purchaser of the documents to pay Advanced the portion of the $3.85m sale proceeds relating to the Parramatta property. We will see below that in the Federal Court, the taxpayer raised an argument, for the first time, that it should now also be allowed an additional deduction of $946,000.

B *Deduction decision, etc, of AAT and Federal Court*

I *Administrative Appeals Tribunal (AAT)*

(a) Deduction issue concerning $1.87m surplus on sale of Parramatta property

The parties agreed that the $4.87m (net sale proceeds) which was paid into the West Apartments Pty Ltd loan account with Suncorp was included in the taxpayer's assessable income in the 2010-11 income year in respect of the sale of the Parramatta property.

Mr McCabe, Deputy President, first held that the "interest" was only incurred when the sale of the property occurred (sale proceeds received), and that only $1.87m of interest was the taxable event (expense).[23] In other words, the transaction between the taxpayer and the Treasury Company was not the "[everyday] ordinary loan agreement" where interest accrues as a liability on a day-per-day basis while the borrower has use of the lender's money. Instead, the agreement only provided a liability to arise on sale of the taxpayer's property, and then the amount of the liability was capped to the surplus received on sale ($1.87m). This was far less than the amount (about $3.4m) had the liability for interest accrued without capping.[24]

[22] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 144(h) and its reference to para 119 in *WCVB v FCT* [2024] AATA 1259.
[23] *WCVB v FCT* [2024] AATA 1259 at paras 131-133.
[24] *WCVB v FCT* [2024] AATA 1259 at paras 121 and 131-133.

From there, Mr McCabe turned to the nexus test(s) or relevance test(s) in the positive limbs (it seems the focus was on the first positive limb) of the general deduction provision. Mr McCabe started by saying that the complication in this case is that the group borrowed $27m through West Apartments Pty Ltd and those monies were advanced to various groups companies to fund their projects.[25] Mr McCabe also noted that the taxpayer had become an obliger under the Deed of Forbearance with Suncorp and this increased its exposure to the debts of the wider group.[26]

Mr McCabe also acknowledged that there was some uncertainty over whether other entities in the group benefited from the taxpayer's payment to Suncorp. Mr McCabe concluded that the taxpayer would not have derived any of the assessable income without agreeing to pay the proceeds of sale to Suncorp in reduction of the debt due under the Suncorp facility. Mr McCabe stated that it seems obvious that the outgoing was incurred in producing assessable income.[27] There was no analysis of the capital exclusion in s 8-1(2) of the ITAA97.

(b) Further contract, and further assessable income and deduction

As noted earlier, Advanced, another Demian group company, sold documents relating to the Parramatta property (amongst other documents) to the same entity that purchased the Parramatta property. Advanced received $3.85m for the sale of all the documents, and the ATO attributed $946,000 of this to the documents relating to the Parramatta property.

It was accepted by Mr McCabe that the taxpayer did not receive the $946,000.[28] However, after weighing up extensive evidence and arguments on the matter, Mr McCabe held that the $946,000 was assessable income of the taxpayer because it can readily be inferred that there was an implied direction from the taxpayer to the purchaser of the documents to pay Advanced the portion of the $3.85m sale proceeds that related to the Parramatta property.[29] The key reasons given were that the taxpayer was still the registered proprietor of the Parramatta property when the sale of documents contract was signed, there was a commercial relationship between the sale of the property and sale of documents contract and the subject matter of the sale of documents contract is inextricably linked to the subject matter of the sale of property contract.[30] Mr McCabe did not conclude that the $946,000 was part of the sale proceeds for the Parramatta property.

II *Federal Court of Australia*

(a) Deduction issue concerning $1.87m surplus on sale of Parramatta property

In the Federal Court, Wheatley J concluded that the $4.87m payment by the taxpayer to Suncorp was made pursuant to the taxpayer's obligations as a guarantor and the payment was therefore viewed as a guarantee payment (and not an interest payment).[31] In support of this, her Honour noted that the taxpayer was not a borrower from Suncorp.[32] Her Honour applied

[25] *WCVB v FCT* [2024] AATA 1259 at para 136.
[26] *WCVB v FCT* [2024] AATA 1259 at para 137.
[27] *WCVB v FCT* [2024] AATA 1259 at para 139.
[28] *WCVB v FCT* [2024] AATA 1259 at paras 101-102.
[29] *WCVB v FCT* [2024] AATA 1259 at para 100.
[30] *WCVB v FCT* [2024] AATA 1259 at para 100.
[31] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 149-150.
[32] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 150.

the tax cases on the deductibility of guarantee payments (liabilities) to reach the conclusion that the payment to Suncorp was capital.[33] There was no express consideration of the application of the positive limbs of s 8-1 to the payment.[34] Wheatley J made no reference to the AAT's point that the $4.87m payment to Suncorp went via the Treasury Company and West Apartments Pty Ltd to Suncorp.

(b) Further contract, and further assessable income and deduction

In the Federal Court, the taxpayer abandoned its claim that the $946,000 was not to be included in its assessable income.[35] However, consequent on this $946,000 assessable income inclusion, the taxpayer wanted to raise an argument in the Federal Court (not raised in the AAT) for a further deduction. This was due to the further proceeds of sale or a further surplus[36] "available" following the sale of the Parramatta property (an extra $946,000). It was said by the taxpayer that a further amount of interest was incurred to the Treasury Company, and therefore a further deduction in this amount was available.

Wheatley J granted the taxpayer leave to raise the $946,000 deduction issue.[37] Ultimately, her Honour dismissed the deduction claim. The key substantive tax reason was that the taxpayer did not receive the $946,000 under the further contract and therefore could not have paid by way of cash any interest from such an amount (only liable to pay what it could).[38] This is despite derivation of the $946,000 by the taxpayer for income tax purposes (s 6-5).[39]

III ANALYSIS OF ISSUE(S)

A *Accrual and timing of taxpayer's interest expense*

It will be recalled the AAT found that the taxpayer's obligation to repay its lender (Treasury Company) principal and interest was deferred until the taxpayer sold the property and obtained sufficient sale proceeds. The amount of interest was capped by reference to the excess of available sale proceeds above the $3m of principal owed. Given the sale proceeds, the interest amount was $1.87m. This is compared to interest of about $3.4m over the period the taxpayer had use of the principal sum. It is noted that initially (2021), the taxpayer's claim for the interest

[33] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 152. The cases referred to were *Bell & Moir Corporation Pty Ltd v FCT* 99 ATC 4738 and *FCT v Email Ltd* 99 ATC 4868.
[34] Wheatley J did observe that the voluntary act of giving the guarantee had some benefit to the taxpayer, namely, the Suncorp facility provided to the Demian group: *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 149. If the nexus test in s 8-1 is similar to the nexus test in s 40-880(2), the substantive possibility of the taxpayer obtaining a deduction under s 40-880 may arise.
[35] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 10.
[36] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 49(e).
[37] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 65.
[38] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 70.
[39] Wheatley J also pointed out that the $946,000 was not the proceeds of sale of the Parramatta property, but rather were from the sale of the right, title and interest in the D.A. Documents: *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 71. For completeness, Wheatley J also found that the taxpayer did narrow its case for deductibility of interest to the amount of $1.87m so that there was no error on the part of the AAT to not consider deductibility of an amount greater than $1.87m: *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 82-83.

deduction was a larger amount than $1.87m.[40] This however does not necessarily mean that the taxpayer's position was a deduction claim for around $3.4m. Indeed, the better view is that it was not because the deduction amount claimed by the taxpayer in 2021 in its statement of facts, issues and contentions was around $2.8m, which is the sum of the $1.87m and $946,000 additional deduction flowing from further contract.[41]

Absent a special arrangement in the loan contract, interest is a cost or expense that accrues day-by-day. The accrual of interest day-by-day satisfies the notion of incurred in the general deduction section.[42]

It is clear the Parramatta property was trading stock and not a revenue asset that was not trading stock of the taxpayer for income tax purposes. One sound indicator of this is the sale proceeds (not profit) was treated as assessable income (income).[43] Interest on a loan to purchase or maintain ownership of trading stock satisfies s 8-1. Therefore, interest of about $3.4m would have been deductible to the taxpayer across the years 2003-04 to 2010-11 and would have become the taxpayer's tax losses of prior years. Around $1.87m of the $3.4m would have been deductible in 2010-11 as the application of a prior year tax loss to extinguish the assessable income amount of $1.87m. The other $3m of assessable income from the sale would have been extinguished by excess of opening stock over closing stock for 2010-11.

Even if the interest for each year had to be embedded into the cost of the Parramatta property under the trading stock regime, all it would do is cancel out the interest deduction in each of the seven-years. However, the effective deduction of $3.4m would have been available to extinguish the commercial profit on the sale of the property above $3m (i.e. $1.87m).

Acceptance that the interest expense was only incurred at the time of the sale of the property meant that the deductibility question was "shifted" to the time of the sale of that property and the surrounding circumstances (i.e. group in financial distress to an external lender), and away from the otherwise day-by-day as the principal sum was being used. It is submitted that in both the AAT and the Federal Court, this shift of focus has proved to be the biggest difficulty and has put the deduction in jeopardy.[44]

It is worth noting the analysis of Wheatley J concerning whether the AAT had fallen into error when applying the nexus test in the positive limbs of s 8-1 to the $1.87m liability and in particular, the AAT's alleged application of a "but for" test. Wheatley J first sets out the normal usage test (use of the principal sum) for satisfying the positive limbs of s 8-1 and that this usage test also applied to a refinancing situation (what occurred in the taxpayer's situation).[45] Wheatley J then progresses to criticise, amongst other things, the AAT's failure to apply the usage test to the deductibility of the expenditure,[46] and therefore found the AAT had erred in applying the nexus test.

---

[40] *WCVB v FCT* [2024] AATA 1259 at para 128.
[41] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 38, 77 and 81. The precise amounts were $2,816,223 ($1,870,233 plus $946,000).
[42] *Alliance Holdings Limited v FCT* 81 ATC 4637; *FC of T v. Australian Guarantee Corporation Limited* 84 ATC 4642.
[43] The sale proceeds were $5m, and this amount should have been included in assessable income, and not $4.87m. The difference of $130,000 involved lawyers' costs associated with the sale. Strictly, these should have been deductible and not subtracted from the sale proceeds: *WCVB v FCT* [2024] AATA 1259 at para 41.
[44] It might be that Mr Demian had good reason to assert the loan arrangement between the taxpayer and the Treasury Company was not the common type of loan.

[45] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 90-91.
[46] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 103 and 116.

In light of her Honour's criticism of the AAT's failure to consider the usage test, it is submitted that had Wheatley J identified the $1.87m as interest under the limited recourse loan as found by the AAT (and not a guarantee payment), it would have been open for her Honour to conclude that the amount of $1.87m was deductible. Notably, her Honour observed that despite the presence of the Deed of Forbearance, the use of the borrowed funds did not change.[47]

B *Was approach of AAT and Federal Court based on an incorrect singular liability (payment) analysis?*

One cannot help but consider whether or not the taxpayer, at the time of receipt of the sale proceeds for the Parramatta property, had two liabilities, one to Treasury Company (under intra-group loan) and the other to Suncorp (under Deed of Forbearance and/or the guarantee obligations thereunder). On the AAT's analysis, the taxpayer was discharging the liability to Treasury Company. On the Federal Court's analysis, the taxpayer was discharging the liability owed to Suncorp. Little if any appears in the AAT or Federal Court that the taxpayer may have owed liabilities to two parties, but only one was discharged.

The two-liabilities analysis raises the spectre that the taxpayer may still have "incurred" a liability to Treasury Company even if the correct analysis is the taxpayer incurred (and paid) a liability to Suncorp (under the Deed of Forbearance (guarantee)). Part of the two-liability analysis is the requirement that the taxpayer's entry into the Deed of Forbearance (about a year before the sale of the Parramatta property) did not extinguish its liability (at the time, contingent but 'accruing') under the loan it had with Treasury Company. There is nothing in the facts referred to in the AAT or Federal Court that directly assists with this question, but extinguishment seems unlikely because one can readily infer the key focus of the Deed of Forbearance was for Suncorp to secure priority for repayment from the Demian group on its outstanding facility amount.

If the two-liability analysis is correct, further analysis may be needed beyond that which was undertaken in the AAT and the Federal Court. In this regard and strictly speaking, the focus should be on 'incurred' and not 'paid'. Incurred is easily satisfied for the taxpayer's guarantee liability to Suncorp. In addition, the taxpayer did receive the $4.87m from the purchaser, albeit constructively, and therefore would seem to have incurred the $1.87m of interest to Treasury Company. However, there may be some doubt on meeting the incurred threshold to the Treasury Company because the taxpayer did not have any funds available and objectively did not seem to have any future sources of funds coming in to discharge the liability to Treasury Company.[48]

C *AAT's 'but for' analysis was an error of law: Federal Court*

The ATO's cross appeal from the AAT's decision to allow the taxpayer a deduction for the $1.87m included the claim that the AAT had misconstrued s 8-1. The ATO claimed the AAT had applied a 'but for' test as the nexus test in the positive limbs of s 8-1. The Federal Court

[47] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 103.
[48] The issue may require an analysis of the cases on the incurred concept.

held that the AAT had made an error of law,[49] despite the fact the AAT did not expressly use the words of the but for test. Wheatley J's reasoning was that the taxpayer would not have derived any assessable income without agreeing to pay the entire sale proceeds of the Parramatta property to Suncorp.[50] Her Honour appears to be saying, but for the expenditure ($1.87m of the $4.87m) payable to Suncorp, the taxpayer would not have derived the $4.87m amount.

While Wheatley J did not refer to any authorities concerning the but for test,[51] her Honour's analysis of the AAT's approach can be seen as the application of the but for test. Accepting this, we submit that her Honour's analysis is only correct under two conditions. First, the analysis is constrained to the but for test and secondly, the relevant transaction is narrowly identified around the sale of the property. The but for test is a method of reasoning that has been rejected as a relevance test (relevance between expenditure and an assessable income activity) in the positive limbs of s 8-1.[52] In resolving a substantive nexus question, this does not exclude the identification and application of a correct relevance test(s) to a given fact pattern.

Two well-established nexus tests in s 8-1 are the incidental and relevant test and the occasion of the outgoing test. Although not referred to as much in the authorities, we would also add the cost of the trade test.[53] It is submitted that even if the relevant transaction is identified narrowly around the sale transaction and that the relevant liability is interest (not a guarantee obligation), we submit that the $1.87m satisfies all three tests of relevance put forward above. The key reason is that the $1.87m cost is closely connected (intertwined) and flows naturally from the sale of the property, this being the same event that brought in the taxpayer's assessable income of $4.87m. The decision and reasoning in *The Herald & Weekly Times Ltd case* provides a close analogy (i.e. publication of the alleged defamatory item was both the source of taxpayer's income and its liability, that was held deductible).[54]

Two other key factors supported the Federal Court finding a relevant error of law in the AAT's application of the nexus test. First, also noted earlier, the AAT did not focus its analysis sufficiently on the use of the borrowed funds.[55] Secondly, the AAT did not consider the effect of the guarantee and entry into the Deed of Forbearance.[56]

D *Character of the taxpayer's expenditure and deductibility issue*

As a starting point, the tax law applies to the general law effect of transactions often called the taxable facts,[57] subject to the tax law specifying a departure from this. Taxable facts generally require recognition of the general law effect of transactions along with due recognition of the nature of the actors involved. The separate legal personality of a company also needs due recognition. This approach to taxable facts applies to deductibility of an expense under the general deduction provision.

---

[49] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 118.
[50] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 117.
[51] For example, *Trustee of the Estate Mortgage Fighting Fund Trust v FCT* 2000 ATC 4525 at 4535-4536.
[52] *Trustee of the Estate Mortgage Fighting Fund Trust v FCT* 2000 ATC 4525 at 4535.
[53] *John Fairfax & Sons Pty Ltd v FCT* (1959) 11 ATD 510 at 519.
[54] *The Herald & Weekly Times Ltd v FCT* (1932) 2 ATD 169 at 171 and 173.
[55] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 116.
[56] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 103 and 113.
[57] *FCT v Thomas & Ors* 2018 ATC 20-663 at paras 84-93.

As things stand, the competing characterisations of the taxable facts are relatively clear; the AAT says the $1.87m is interest (incurred by a borrower to a lender) and the Federal Court says it is a payment of a guarantee amount. It is submitted that the expenditure, from the taxpayer's perspective, cannot be both an interest payment and a guarantee payment if only for the reason it would be double counting.

Before getting to the characterisation and deductibility questions, two preliminary points are worth making. First, it is submitted that as between the taxpayer and Treasury Company, the $1.87m is properly described as interest because this amount does represent a cost of hiring or having the use of a principal sum. The fact the $1.87m turned out not to be the full cost of hiring funds for the period of use by the taxpayer does not undermine this.

Secondly, it is submitted that the distinction between the event of liability arising (incurred) and the event of a "payment" (discharge of a liability) in respect to the $1.87m should not be pursued. The AAT and the Federal Court did not make the distinction. The reason is that on the facts of the $1.87m transaction, the payment event occurs very close to the event of the liability arising (whether interest or a guarantee obligation) that to distinguish between the two would not assist the characterisation analysis.

I *Character of expenditure*

One part, but not all, of the characterisation question comes down to the identity of the payee of the $4.87m. If the Treasury Company was the payee, the interest conclusion seems the stronger conclusion. If the payee is Suncorp, the guarantee conclusion (or something similar) seems the stronger conclusion. Despite Mr McCabe's observations around the Deed of Forbearance and its effect of making the taxpayer liable for all debts owing under the Suncorp facility, Mr McCabe was able to conclude the $4.87m payment went to Suncorp via the Treasury Company and West Apartments Pty Ltd. There is no reasoning supporting this conclusion that the taxpayer's payee was Treasury Company. There was no reasoning rejecting the guarantee characterisation, but this is not altogether surprising given that the guarantee characterisation does not seem to have been put to the AAT by the ATO. However, the taxpayer did at one point describe itself as a guarantor in the AAT (see below).

On the other hand, Wheatley J held that the taxpayer's payee was Suncorp and that the payment was a guarantee payment. Her Honour pointed to the taxpayer's closing submission in the AAT that the taxpayer's 'legal obligation was as guarantor'. That taxpayer submission was immediately followed by the statement that "there was nevertheless a borrowing by the taxpayer, through the intercompany loan mechanism".[58] The taxpayer argued it was not a "true guarantor" but rather it was a 'true borrower'.[59] With respect, Wheatley J never really engaged with these submissions before reaching the guarantee conclusion. With respect, her Honour's later comments that the taxpayer was not a borrower with Suncorp and that it was not a party to the Credit Facility loan deed (back in 2003) are not really to the point.[60] The taxpayer never claimed to be either of these two things.

It is also arguable that Wheatley J gave too much weight to Suncorp's power to withhold or provide consent as mortgagee for the sale of the Parramatta property to proceed, and that any sale proceeds were to be paid (and were paid) to Suncorp. It is possible that the presence of

[58] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 146 and 150.
[59] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 147.
[60] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 150.

these two circumstances gave unjustified support to the finding that the only payee was Suncorp, and that the sale proceeds were, in legal terms, solely paid to Suncorp (see constructive receipt, etc, discussion below).

The 2009 Deed of Forbearance had a major influence on Wheatley J's analysis of the character of the taxpayer's $4.87m payment. Her Honour was highly critical of the AAT's failure to consider the effect of the 2009 Deed of Forbearance.[61] Under this deed, Wheatley J said the nature of the taxpayer's security had changed and that the nature of the taxpayer's obligations to Suncorp changed.[62] Under the Deed of Forbearance, the taxpayer became an obliger, a party liable to all the debts under all the facilities with Suncorp. In many situations, there may be little practical difference between a guarantor and an obliger in that both owe money to a creditor.[63] A guarantor does however obtain an indemnity against the principal debtor for the amount paid to the creditor of the principal debtor, whereas an obliger per se may not have an avenue of recourse like that of a guarantor. In the end, Wheatley J held that the proper characterisation was one under the guarantee, which likely means as a guarantor.[64]

(a) Constructive receipt and constructive payment analysis not pursued by Federal Court

The analysis in both the AAT and the Federal Court does not engage with the notions of a constructive receipt followed by a constructive payment, as opposed to actual receipts and actual payments. On the face of the reasons, the taxpayer does not seem to have made submissions to the Federal Court on the constructive payment, etc, issue. There was no useful evidence given by Mr. Demian on this in the AAT. As noted earlier, the AAT did state the conclusion that the proceeds of sale of the Parramatta property were paid to Suncorp by the taxpayer via the Treasury Company and West Apartments Pty Ltd. Wheatley J in the Federal Court, did not mention or address this constructive payment, etc, comment in the AAT.

Given the AAT's conclusion and the circumstances of the taxpayer and the Demian group, the failure of Wheatley J to address the constructive receipts, etc, could be seen as surprising. Those circumstances include: (i) the discharge of the taxpayer's loan to St George back in 2003 was made through a constructive payment situation, and that constructive payment, etc, situation also involved two on-loans within the Demian group from funds obtained from the external lender and (ii) the employment of the constructive derivation idea in respect of the proceeds of sale of development documents under the further contract issue. One could also add that the transaction of the sale of the Parramatta property by the taxpayer itself involved a constructive receipt situation, namely, the taxpayer being treated as receiving $4.87m when in fact the money was paid by the purchaser direct to Suncorp. Indeed, whenever there is a financially distressed borrower, one might expect constructive payments and receipts to be quite common (often at the insistence of the lender-creditor).

It is clear Wheatley J was aware of the presence of a constructive receipt, etc, concerning the $4.87m payment in terms of receipt of sale proceeds (assessable income to) by the taxpayer. What was missing was an analysis of the possibility that the taxpayer constructively paid Treasury Company and Treasury Company paid West Apartments Pty Ltd and West Apartments Pty Ltd paid into Suncorp; this is Mr McCabe's bald conclusion in the AAT. It may also be the

[61] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 102-103, 105, 112-113 and 115.
[62] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at paras 102-103, 105 and 113.
[63] In *Bellas v Powers* [2023] NSWSC 1198, the definition of Obligors in the facility agreement meant the Borrower and the Guarantor.
[64] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 152.

case that Suncorp may not have had any concerns as to which entity within the Demian group became the strict legal payer of the realised value represented by the Parramatta property and that a payment by West Apartments Pty Ltd to Suncorp was likely still in compliance with Suncorp's rights (and the Demian group companies' obligations, including the taxpayer).

It is submitted that a finding (or conclusion to the same effect) that there were no constructive payments, etc, involved, aside from the one involving the purchaser of the property, the possibility arises that the taxpayer still owed money to Treasury Company and that Treasury Company still owed money to West Apartments Pty Ltd. From a commercial perspective (and perhaps a legal perspective), it may be hard to see how this was intended. Focusing just on the taxpayer, the taxpayer is said to 'sign up' to a situation where it has sold its only asset and it has not had the debt related to the purchase and holding of that asset extinguished by the sale. The authors have not seen the Deed of Forbearance but from what has been extracted of that document in the AAT and the Federal Court, there is no hint that deed addressed intra-group liabilities, and arguably, one would not expect it to, given its focus on Suncorp obtaining repayment of its facility. Given Mr Demian's poor track record in documenting and recording intra-group transactions, nothing useful can be gleaned from the lack of a recording of the $4.87m paid to Suncorp in the financial records of either the taxpayer, Treasury Company or West Apartments Pty Ltd. For completeness, the fact the $4.87m was paid into the loan facility account held by West Apartments Pty Ltd with Suncorp does not provide any support for the constructive payment, etc, analysis.

(b) Cross-examination regarding taxpayer's portion of Suncorp facility

The Commissioner's counsel in the AAT had the following exchange with Mr Demian:

> Counsel: I suggest to you that you have no way of knowing what amount within the $14.1 million balance as at 1 August 2010 was referable to interest in relation to the [Parramatta property]?
>
> [Mr Demian]: As I said, it was based on a pro rata of the initial lent money to each of those five properties and it would have continued on that basis.[65]

Recall that the $4.87m sale proceeds from the Paramatta property was paid into the loan facility that West Apartments Pty Ltd had with Suncorp on 13 August 2010.

The question asked by the Commissioner's counsel seems to be challenging Mr Demian to identify the amount of interest referable to (and perhaps outstanding on) the Parramatta property, within the $14.1m outstanding facility amount. In the AAT, there was no discussion that the $4.87m payment was a guarantee payment. The Commissioner's main submission in the AAT was that there was no loan [at all] from Treasury Company to the taxpayer. However, this was rejected. If there was no loan from Treasury Company, it may be that the question was based on the idea that the taxpayer had a $3m loan from Suncorp. As we know, this was rejected by the Federal Court and is inconsistent with the AAT's position.

It is hard to know what to make of the above, but on one view, there may have been some willingness by the Commissioner to concede a deduction if an appropriate amount of interest could be identified or quantified.

[65] *WCVB v FCT* [2024] 1259 at para 138.

II *Deductibility question*

If the $1.87m is ultimately found to be a payment of interest to Treasury Company, the positive limbs of s 8-1 will be satisfied because the amount secured the use of funds deployed in the taxpayer's business or to maintain ownership of trading stock. The amount will not be caught by the negative capital limb. Importantly, this outcome holds (cost is the use of funds) even if the question of "incurred" is shifted to the point in time of the sale of the Parramatta property because of the contingencies surrounding the liability to Treasury Company. In other words, just because the incurred question is shifted to a later time than when use was made of the principal sum, the character question should still take account of the reality of the benefit obtained by the taxpayer from the expenditure. That benefit to the taxpayer was the use of the principal sum over the years of that usage.

If the ultimate finding is that the $4.87m is a guarantee payment by the taxpayer, Wheatley J's non-deductible conclusion under s 8-1 will be correct. It should be noted that Wheatley J's analysis does not really engage the positive limbs of s 8-1 but rather relies on the negative capital limb applying.[66] Further, her Honour provided no analysis of the revenue-capital analysis to the facts of the guarantee payment by the taxpayer. Despite this, we submit her Honour's conclusion will be correct.

Somewhat strangely, the taxpayer does not appear to have made a submission on deductibility outside s 8-1 (e.g. a capital allowance provision) and consistent with usual practice, Wheatley J was not required to consider an alternative route to deductibility.[67]

E *Federal Court's analysis of additional deduction may reveal inconsistent characterisation approach in Federal Court*

It was noted earlier that Wheatley J in the Federal Court pointed to the AAT's failure to apply the usage test when testing for deductibility of the interest as a factor in reaching the conclusion that the AAT fell into error in its application of the nexus test in s 8-1. It is submitted that this is not an indication that Wheatley J was accepting that the taxpayer's liability (payment) of $1.87m was interest and not a guarantee payment. What her Honour was merely doing was responding to an ATO submission from the facts in the AAT.

A similar explanation is not as obvious in respect to the additional interest ($946,000) argument (under the further contract: sale of documents) that was raised for the first time in the Federal Court. Wheatley J gave leave to raise the argument and then proceeded to analyse the deductibility issue on the basis there was an intra-group loan to the taxpayer. Her Honour concluded that the additional interest was not deductible because the liability for it never arose (i.e. taxpayer never received the money under the sale of documents contract).

Wheatley J's analysis of the additional interest deduction appears to be based on the presence of the intra-group loan as the taxable event and the payment of $1.87m of interest to Treasury Company (to which the $946,000 was argued to be added to). This seems inconsistent with her Honour's conclusion that the $4.87m liability and payment was a guarantee payment. On the

[66] There is a hint though in Wheatley J's comments that the guarantee liability may have satisfied the positive limbs of s 8-1 because the giving of the guarantee was of some benefit to the taxpayer: *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 149.
[67] Section 40-880 may be satisfied.

other hand, at least one aspect of her Honour's analysis of the taxpayer's "additional interest deduction" claim can be accommodated to the guarantee conclusion. This was her Honour's analysis that the $946,000 was not the proceeds of sale of the Parramatta property (but rather for sale of the development documents).[68] From here, the analysis is that this amount would not be required to be paid over to Suncorp under the guarantee. Further support that her Honour had not adopted an inconsistent position was her conclusion that the sale of documents contract was not within the terms of the intra-group loan from Treasury Company.[69]

F *Broader implications analysis*

One can envisage situations where judicial reasoning on an issue may be influenced by the implications flowing from a particular conclusion that could or would arise to those external to the transaction in issue that needs resolution.[70] Further, one may also envisage a situation where such influence may not be expressly stated in judicial reasoning. The concern that is briefly raised here concerning the *Charles Apartments case* is that should the approach and decision of the Federal Court be [ultimately] upheld on appeal, is there a chance that a taxpayer or a group of taxpayers will not effectively get any recognition for interest costs (cost of money) incurred to an external lender where those costs are securing funds deployed for making assessable income.

As noted earlier, there is no information in front of the AAT and the Federal Court as to the financial accounting treatment and the income tax treatment of the $4.87m (and hence the $1.87m) liability or payment (or receipt) made to Suncorp in the records of Treasury Company or West Apartments Pty Ltd. The same point can be made in respect to Suncorp. Indeed, we do not know if the loan arrangement from West Apartments Pty Ltd to Treasury Company reflected the 'unusual' features of the on-lending arrangement between Treasury Company and the taxpayer (e.g. taxpayer's interest liability capped to surplus on sale of Parramatta property).

If the intra-group loans concerning interest largely offset each other for income tax, namely, the assessable income for one group entity and the deduction for the other entity, then provided the group borrowing company (i.e. lead borrower from external lender) is obtaining a deduction for interest incurred to the external lender, a just tax outcome seems to be achieved. Relevant offsetting can also be achieved even if there is capping of the interest deduction or zero interest arises for tax purposes on the loans between intra-group entities. However, if one of the premises above breaks down, there is potential for departure from a just outcome, either to the disadvantage of the Commissioner or the taxpayer.

In short, we do not know if one of the premises above breaks down in the *Charles Apartments case* on either the AAT's analysis (deduction to taxpayer) or that of the Federal Court (no deduction to taxpayer). Even on the Federal Court's analysis that appears to make the relevant taxable event solely a payment from the taxpayer to the external lender (Suncorp), there is a chance that a just tax outcome is achieved. A just outcome should still be achieved provided that the intra-group transactions are offsetting and West Apartments Pty Ltd obtained a deduction for the interest it incurred to the external lender.

---

[68] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 71.
[69] *Charles Apartments Pty Ltd v FCT* [2025] FCA 461 at para 72.
[70] Of course, in terms of the application of the general deduction provision and the application of the income concept (s 6-5), it is the perspective of the taxpayer involved in the transaction that matters.

IV CONCLUSION

The *Charles Apartments case* is one that can truly be described as 'a hard case'. Remitting the matter back to the AAT to make additional findings of fact, with directions from the Full Federal Court, is a possibility. The biggest difficulty was the differing views between the AAT and the Federal Court of the underlying general law transaction involving the taxpayer. This in part may have been due to a failure of the AAT to make full findings of fact. The article also raised the possibility that the taxpayer had two liabilities to meet at the time of sale of the Parramatta property, so that even if the view of the character of the transaction of the Federal Court is upheld, a deduction for $1.87m may still be available. The article also points out some anomalies and inconsistencies that appear to have featured in the litigation to date.

V POSTSCRIPT

The Full Federal Court handed down its decision on 11 December 2025 ([2025] FCAFC 180) in the appeal from the decision of Wheatley J in the *Charles Apartments case*. This article was written after Wheatley J handed down her decision but before the Full Federal Court handed down its decision. The Full Federal Court dismissed the ATO's appeal from Wheatley J's judgment.