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ABOUT THE JOURNAL

The Journal of Tax Administration (JOTA) is a peer-reviewed, open access journal concerned with all aspects of tax administration. Initiated in 2014, it is a joint venture between the University of Exeter and the Chartered Institute of Taxation (CIOT).

JOTA provides an interdisciplinary forum for research on all aspects of tax administration. Research in this area is currently widely dispersed across a range of outlets, making it difficult to keep abreast of. Tax administration can also be approached from a variety of perspectives including, but not limited to, accounting, economics, psychology, sociology and law. JOTA seeks to bring together these disparate perspectives within a single source to engender more nuanced debate about this significant aspect of socio-economic relations. Submissions are welcome from both researchers and practitioners on tax compliance, tax authority organisation and functioning, comparative tax administration and global developments.

The editorial team welcomes a wide variety of methodological approaches, including analytical modelling, archival, experimental, survey, qualitative and descriptive approaches. Submitted papers are subjected to a rigorous blind peer review process.

SUBMISSION OF PAPERS

In preparing papers for submission to the journal, authors are requested to bear in mind the diverse readership, which includes academics from a wide range of disciplinary backgrounds, tax policy makers and administrators, and tax practitioners. Technical and methodological discussion should be tailored accordingly and lengthy mathematical derivations, if any, should be located in appendices.

MESSAGE FROM THE CHARTERED INSITUTE OF TAXATION

The Chartered Institute of Taxation is an education charity with a remit to advance public education in, and the promotion of, the study of the administration and practice of taxation. Although we are best known for the professional examinations for our members, we have also supported the academic study of taxation for many years and are pleased to widen that support with our involvement with this journal.

WEBSITE

The Journal of Tax Administration website can be found here: www.jota.website

SOCIAL MEDIA

We also have a Twitter account: https://twitter.com/jotajournal

EDITORIAL NOTE

This first issue of the Journal of Tax Administration for 2017 contains a rich variety of papers, demonstrating the breadth and importance of tax administration. We are grateful to all contributors to this issue, both authors and reviewers.

In the first paper, "A Thrice Told Tale: A Collaboration Between the Swedish Tax Agency and Academia", Lotta Björklund Larsen and her colleagues, Karin Thoresson and Ulf Johannesson, describe a collaborative project in which the authors, all from quite different backgrounds, designed and delivered a course on qualitative research methods to a group of analysts from the Swedish tax agency. Their description of the event serves as a reminder that knowledge can be acquired in many varied ways and that, for tax agency analysts, expanding the suite of tools used to better understand taxpayer practices may lead to new insights and ultimately improved compliance.

The second paper, "Tax Competition, Tax Co-Operation and BEPS", by Richard Collier, explores developments in international tax administration, which are inextricably linked to questions of tax competition together with the drive to tackle tax avoidance in the international arena. The UK is highlighted as a case study of a country for which BEPS is having an impact on policy design and hence administration.

The third paper takes us to Africa, in which Deogratius Mahangila provides insights into the relationship between tax compliance costs and tax compliance behaviour though an empirical study conducted among small and medium-sized businesses in Tanzania. The importance of compliance costs is often overlooked and this study demonstrates that, in this setting, high levels of compliance costs for taxpayers has a significant negative impact on tax compliance behaviour.

Tax Exceptionalism

In July 2016, JOTA and the Centre for Tax Law, University of Cambridge, hosted an event in London on “Trends in Tax Exceptionalism and Tax Litigation”. An audience of some 40 from academia, practice and administration met in London to hear the latest from Professor Kristin Hickman from the University of Minnesota, Don Korb, Of Council and Stephen Daly from Oxford University. Kristin Hickman’s article in this issue of JOTA was developed from her presentation at that event, as was Daly’s response from a UK perspective.

Kristin Hickman notes that since 2011, there has been growing recognition in the US that tax administration falls under the Administrative Procedure Act that governs procedural aspects of federal government agencies; i.e. that the Internal Revenue Service (IRS) should not be treated differently unless specific departures are authorised by the tax code. In this paper, she adds to the growing body of tax jurisprudence that explores the extent of, and limits to, tax administrative exceptionalism. Three cases in particular are examined, and their implications in terms of transparency and accountability of the IRS are explored. Set against a backdrop of an overloaded IRS suffering from mission creep, increased scrutiny may be important for perceptions of legitimacy.

In response, Stephen Daly provides a UK perspective on tax exceptionalism where it takes a subtler form, taking account of Her Majesty’s Revenue and Customs’ ‘special context’.

Finally, this issue contains three reviews. The first, by Nigar Hashimzade, is of the 2016 Institute for Fiscal Studies residential conference. The second, by Dale Pinto, is a review of Chris Evans, Richard Krever and Peter Mellor's book, "Tax Simplification" (2015). The third is a review of recent literature which summarises a range of scholarly work on aspects of tax administration published in late 2016 and early 2017.

Lynne Oats
(on behalf of the Managing Editors)

A THRICE-TOLD TALE[1]: A COLLABORATION BETWEEN THE SWEDISH TAX AGENCY AND ACADEMIA

Lotta Björklund Larsen[2], Karin Thoresson[3], Ulf Johannesson[4]

Abstract

This is the story of a collaborative project involving the creation, development and teaching of a course on qualitative research, which was designed for all Swedish Tax Agency analysts. The collaboration took place between the Swedish Tax Agency and Linköping University, and this story is told from the perspective of three researchers: Lotta, Karin and Ulf. It was a successful course. However, this is not just a story about collaboration between academia and tax authority, but also one about how interdisciplinary approaches can create new knowledge. We argue that, due to our different backgrounds, and diverse interests and resources, the collaboration also gave us new insights into our daily research and analytic work. Our experience can perhaps inspire other collaborations between academia and tax administration.

INTRODUCTION

Lotta - the anthropologist - was attending yet another meeting with the five analysts who carried out a risk assessment project at the headquarters of the Swedish Tax Agency (referred to from now on as the 'Agency'). In her study of how the Agency makes Swedish taxpayers comply with tax laws and pay their dues, she was interested to find out what knowledge they apply (Björklund Larsen, 2017). The Agency's Analysis Department provides decision-making support for Agency management and, aiming to understand what the Agency does in practice to understand tax compliance issues, she followed this project ethnographically (cf. Boll, 2014b). This included undertaking participant observation by attending all meetings in which the project was discussed.

"How do you solve this type of problem in the research world/academia?" The question came suddenly and unexpectedly from Ulf, the most recent analyst to join the team.

Although Lotta was studying this project through participant observation, she never actively interacted in these meetings. She tried to make herself even smaller behind her computer screen, where she sat taking notes of the discussion. She kept quiet and hoped for the moment to pass. It did not. Ulf was adamant.

"Can't one pose a question?"

The other analysts shifted uncomfortably and Lotta finally mumbled something noncommittal about various ways of performing research. After a long silence, the meeting continued. This somewhat awkward event was the start of an interesting collaboration between a tax administration and academia.

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[1] Inspired by Margery Wolf's book: *A Thrice-Told Tale: Feminism, Postmodernism & Ethnographic Responsibility.*
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[3] Researcher, Swedish National Road and Transport Research Institute.
[4] Analyst, Swedish Tax Agency.

In this article, three researchers - Lotta, Karin and Ulf - each tell our story of the collaborative project embarked upon by the Agency and Linköping University. Lotta is an economic anthropologist, specializing in cultural aspects of taxation; Karin is a sociologist with experience of teaching introductory courses on social science to university students; and Ulf has worked as an analyst at the Agency for a long time. With our different backgrounds, and diverse interests and resources, we describe how we worked together to develop and teach a course on qualitative research for more than 40 Agency analysts nationwide. This story is not just about our collaboration but, we argue, also about how carrying out this quest gave each of us new insights into our daily research and analytic work. The collaboration about the course inspired, changed and shaped our understanding of how to study tax compliance in academia and at the Agency.

Employees of the Agency who have the job title "analyst" are responsible for performing in-depth analyses of various topics in order to provide the decision-making support needed for management. The most common analyses made are risk analysis, trend forecasting and analyzing the effects of the Tax Agency's work. As the analysts at the Agency create knowledge and decision-making support for the management and leaders at the Agency, new knowledge relating to researching tax compliance has the potential to make an impact on how the entire Agency regards tax compliance in Swedish society.

Our aim in this article is to present the insights we gained from our collaboration and in discussions with the analysts developing, performing, and evaluating the course from start to finish. Ethnographic methods were the stepping stones to this course; both when discussing how to understand taxation issues in a different light at the Agency and also in content when we developed this course. We therefore tell our story from the perspective of collaborative anthropology using ethnography as a method (Lassiter, 2005; Holmes & Marcus, 2008; Konrad, 2012).

The article is organized as follows: we will each explain the background relevant to this collaboration; we will then describe how the course came about, followed by what we identify as four instances in which the new knowledge came to the fore in collaboration; and we will conclude with the insights this experience has given us. But first, we would like to situate our contribution within the literature about the anthropology of collaborations and discuss what this theoretical approach can teach us.

COLLABORATIVE ETHNOGRAPHY AND ANTHROPOLOGY

Ethnography means to enter someone else's world for a time; it is a systematic study of issues from the point of view of the subject of the study. An ethnographic approach is holistic and aims to provide an understanding of what happens in practice, often addressing social and cultural aspects. It is the preferred method of anthropologists and Lotta was, in the above study, interested in the knowledge created and applied by the Agency in making taxpayers more compliant. The chosen object was a risk assessment project. She followed it from start to finish, a process which included carrying out participant observation at many places in and outside the Agency where knowledge was collected, analysed and discussed pertaining to this project. Taxation ethnographies are rare apart from a few noteworthy contributions (cf. Boll, 2014b; Oats, 2012; Rawlings & Braithwaite, 2003; Tuck, 2010); these types of studies provide other insights about taxation issues that an analysis of the legal framework or economic forecasting cannot. An ethnography of a tax authority highlights different aspects of what its employees do when they implement rules and regulations in practice; when they "tax" (cf. Boll, 2014a).

Yet ethnographic fieldwork always means engaging with the very people that are being researched – the informants. An ethnographer can never be just an observer; a "fly on the wall", as it were. Ulf's initial question to Lotta, the anthropologist at work, started a discussion about future collaboration. There are many inlets to study cooperation, collaboration, partnership, teamwork etc., but we have chosen "collaborative anthropology" in this article. There are several reasons for this choice. Firstly, participant observation, one ethnographic method, was used in an anthropological research project which prompted Ulf's question in the first place. Secondly, the course that we created and performed was very much inspired by ethnographic methods. In this article, we therefore borrow from collaborative ethnography and anthropology studies. As Eric Lassiter writes; "Ethnographic fieldwork is, by definition, collaborative, collaborative ethnography extends fieldwork collaboration more systematically" (Lassiter, 2005, p. 84).

We have identified three broad strands of collaborative anthropology:

The first strand argues that the insights about the studied society are only reached while collaborating with the so-called informants. The history of anthropology is full of such examples. Such informants are, at best, described in forewords as interpreters or assistants to the anthropologist's efforts to understand a phenomena (Lassiter, 2005, p. 85). However, more commonly, frustration with non-cooperative informants is mentioned; for example, what Evans-Pritchard described as his "Nuerosis" (Evans-Pritchard, 1940, p. 13) when studying the group of people named Nuer in Southern Sudan in the 1920s. Contemporary anthropological studies are more conscious about the value of such cooperations and collaborations. The vital importance of the informants has been exemplified in many ethnographic studies of contemporary phenomenon, such as: the sports world (Downey, 2008); global poker tournaments (Farnsworth & Austrin, 2010); corporations (Cefkin, 2010) and bureaucracies, such as the WTO (Deeb & Marcus, 2011), the Swedish Pension Fund (Nyqvist, 2008); and in fieldwork experiences at the Danish Tax and Custom Administration (2014a, 2014b) and its Swedish equivalent (Björklund Larsen, 2013). Daring to recognize collaboration with informants created a shift in the definition of ethnography itself, from the attempt to describe and analyze informants' realities to really getting to know what they know; how they think and what they do (cf. Holmes & Marcus, 2008, p. 82).

The second strand is directed to the blending of knowledge(s) between the informants and the anthropologist. This view on collaboration has developed since the mid-1980s with the seminal anthology *Writing Culture* (Clifford & Marcus, 1986). A further expansion of this second strand, was the concept of "para-ethnography" which has emerged during the last decade (Holmes & Marcus, 2005, 2006). Para-ethnography offers a perspective to ethnographically study experts operating in complex societies - not in their entirety as social beings, but in their professional roles (Boyer, 2008) and especially when engaging with them while they carry out their jobs (cf. Björklund Larsen, 2013). Such experts have a deep knowledge of, and interest in, both theory and practice. In this capacity, they engage with society in an almost ethnographic way, which often includes the ethnographers that come to study them. They take on a "pre-existing ethnographic consciousness or curiosity" (Holmes & Marcus, 2008, p. 82).

The third strand in the literature is the recognition of collaborations within action anthropology. The aim of these collaborations is to propose changes to social policy and/or to implement such policies (Fluehr-Lobban, 2008; Knorr-Cetina, 1999). The intention is to serve humankind more directly (Lassiter, 2005), rather than to implement academic ideas into social practice, which

is often a long-term dissemination. Yet this is changing. An impressive anthology (Konrad, 2012) provides us with many and diverse examples on how collaborators collaborate (here we almost cite its enticing title) from anthropological perspectives in everyday life. Her book details a number of situations in which anthropologists have been part of research endeavors with participants from a wide variety of disciplines and professions; mainly in health and medicine, drawing simultaneously on local knowledge and on scientific expertise. The interesting conclusion is that such collaborations create new insights and ideas. We agree with that "the matter of enduring interest, though, is whether alternative social imaginaries can be generated collaboratively for the long-term sustainability of new ideas and new expertises" (Konrad, 2012, p. 33).

The collaboration we describe takes inspiration from the above strands, yet also differs slightly. More specifically, we want to propose some rough ideas about how new knowledge is formed as part of such collaborative efforts in the taxation field. This means that we will engage with issues in our everyday, contemporary, complex work (cf. Konrad, 2012). We are less interested in understanding "the native points of view" or co-authoring articles depicting issues at the Agency than on focusing on the new insights each of us made, in order to illustrate what interdisciplinary cooperation in the tax field can create.

In a broader sense, our collaboration is also one between diverse organizations in society - our employers. By law, Swedish universities have three objectives: to teach, to perform research, and to collaborate with institutions in society (such as organizations, corporations, schools and so forth). The course we developed is an example of the latter objective and is colloquially referred to as academia's third task. In this third task, the emphasis is on *samverkan*, collaboration, with a "flow of competencies, people, and results in both directions" (SOU, 1996, p. 181[authors' translation]). In everyday conversation, the third task is often spoken about as a transfer of knowledge from "wise" academia to a recipient society. Although we anthropologists (as social scientists) study society from many theoretical perspectives, dispersing knowledge this way takes on a realist's view. We share "our" knowledge with "others"; we give it to them. Yet, as Konrad writes about her work elsewhere, "the shift from traditional models of extracting research to those based on collaboration and participation change how we learn" (Konrad, 2012). We argue that in making and performing this course we developed new insights; insights only made possible by recognizing collaboration with analysts at the Agency.

It is noteworthy to mention that this was also a business cooperation, as the Agency paid Linköping University and the Swedish National Road and Transport Research Institute (VTI) for the course. It could be argued to only be a reciprocal relationship in the economic sense (money for a course) (cf. Hinson, 1999), yet we argue it was more; the rewards were more than monetary because of the collaborative aspects between three researchers from diverse contexts (cf. Konrad, 2012, p. 19).

THE COLLABORATIVE PROCESS: THREE BACKGROUND STORIES

The course that we developed became more than just academic knowledge about qualitative methodologies presented to a group of analysts. Before we elaborate on the mutual insights that we gained from this collaboration, we will each present our account of the process. Let us go back to the meeting room at the Agency. What was the reason for Ulf's initial question?

Ulf's story:

I work as an analyst at the Agency. Much of my work involves analyzing external risks about compliance at a tactical level. The tactical level means that a risk analysis encompasses a large group of taxpayers or a significant phenomenon, such as an established approach to tax evasion. A risk analysis therefore aims to identify, describe and analyze a group of people or a phenomenon, evaluate the risks attached to it, and make suggestions as to how those risks can be reduced. For me, a good risk analysis means understanding what is studied in depth, including the social and psychological causes.

Thirty years ago, when I started at the Agency, it worked almost entirely reactively. The vision was *rätt skatt på rätt sätt* (correct taxes properly collected). It was a working view from within the Agency. Inspections, sanctions and, sometimes, penalties were seen as enough for general deterrence and any risk assessment endeavor was the responsibility of individual inspectors.

At the time, the causes of deviant behavior among taxpayers were considered either as strictly rational or due to plain ignorance. The strictly rational approach was based on models where the taxpayer always made cognitive assessments: on the one hand, that profit could be made by cheating on taxes and, on the other hand, the perceived probability of detection and that consequences could follow from detection. This was, to some extent, inspired by Allingham and Sandmo's theories from 1972. To recap, a taxpayer is always calculating profit and will therefore attempt to maximize their economic outcome by paying enough tax without being caught by a control and thus having to pay penalties.

A reactive approach requires vast knowledge of tax law, accounting, and the legislation governing the Agency's ways of working (procedural law). In other words, the Agency needed employees with legal and/or economic knowledge. New employees were given comprehensive internal training; thus knowledge was transferred from the more experienced employees to the newcomers. It created a culture in which it was considered important to master fiscal and procedural law so compliance could be achieved by sanctions.

A lot has changed since then. About 25 years ago, a slow change began at the Agency, when we started pondering how the taxpayers were thinking about their own and others' behavior. The Agency vision was eventually changed to '*Vår vision är ett samhälle där alla vill göra rätt för sig*' ('A society where everyone wants to do their fair share') and the organization was moving from a reactionary mode to instituting risk management. The big challenge now for the Agency is to preserve the willingness of people who want to comply and to influence those who do not want to do so.

Initially, the Agency built both risk management and measurement of effects into statistical analyses. These were based, for example, on how many people had erred in their yearly statements and what categories they belonged to. Another source used was attitudinal surveys, where the members of the public were asked about their views on taxation and the Agency's work. It took some time before the Agency began to seriously realize that the reasons for compliance and non-compliance were not focused on strictly rational considerations (e.g. Allingham & Sandmo, 1972) but on an elusive mix of soft factors (cf. Skatteverket, 2005). It could be moral considerations which, in turn, were based on values and attitudes, and so on. This change of views on taxation led to an important change in attitude that was slowly implemented: we at the Agency had to understand more about the underlying reasons for compliance and non-compliance, and learn how to influence people to be compliant. It was no longer about just being able to explain but also about being able to understand.

The Agency thus had to add other types of knowledge to the legal and procedural knowledge. In other words, what the Agency really needed, as part of the preventive work, was a way in which to proceed in order to describe the underlying causes of desired and undesired behavior of certain groups of taxpayers. Initially, such knowledge could only be generated using qualitative methods. The problem was that the Agency did not have much knowledge about such methods.

Lotta's story:

Ulf intervened in one of many meetings with a group of analysts that the Agency held and which I followed. The overall aim of my anthropological research project was to shed light on the Agency's internal research practices and the type of knowledge it applies. This included following how it made new policies, how these policies were implemented in the Agency's daily audit work, and how these policies, in turn, shaped the economic behavior of citizens. In this quest, I followed one risk assessment project at the Agency from start to finish. A group of three to five analysts met intermittently during 2010 - 2013 to address whether or not, and how, a certain selection of taxable entities' cost deductions posed a risk to the Agency's chances of fulfilling its aim to collect the right tax. It was a multi-sited ethnographic fieldwork (Falzon, 2012; Hannerz, 2006; Marcus, 1995) where I was present wherever and whenever work was collectively done towards it: during research meetings, at the Agency's random audit control department, at a private research consultancy that carried out an attitudinal study, and at most meetings throughout the Agency where management was informed about its progress. Throughout, I have been copied in on the e-mail correspondence and all other documents in progress that these analysts prepared with regard to this project.

Somewhat naively, I initially thought I was there to harvest knowledge. In the back of my mind echoed the advice of a senior colleague: "beware of contaminated fields." If there is ever such a thing as a "pure" field, this was not one. For one thing, my dissertation, *Illegal, Yet Licit* (Björklund Larsen, 2010), provided entry into this otherwise somewhat closed field. As an afterthought, it was not surprising that the Agency was interested in how a group of middle-aged Swedes justified their informal purchases of work, which is a type of tax cheating. My dissertation had raised questions about the interpretation of law at the Agency and thus my research interest had moved from tax cheaters to tax collectors. Questions about how the law was interpreted drew somewhat diverse responses from various people at the Agency. For example, a legal expert thought my concerns were silly non-questions and suggested the response was common sense. The head of the Analysis department thought otherwise and I was invited to follow the risk analysis project. Ulf became a member of that project in its second year.

To allow an external researcher to follow such a risk analysis project is, I assume, a way for the Agency to learn more about its own practices. However, the fact that my methodological approach was also of interest to an analyst that acted in the role of an informant was surprising.

Ulf and Lotta continued talking about differences between performing research in the academic world compared to the approach used at the Agency during their coffee breaks and on the subway going home. They concluded that a way forward was to talk with their respective managers about collaboration. A lunch followed, a month later, during which ideas about cooperation were put on the table. Encouraged by their managers, Ulf and Lotta decided to try to tease out what a learning experience would look like. As Ulf pointed out in an email: "There is a large imbalance in favor of the legal and economic sciences at the Agency. The great depth of knowledge within these disciplines is of course positive, but also risks narrowing future insights as well as measures required" (our translation).

At this point, Karin, who had been teaching a course on qualitative research for university students, came on board.

Karin's story:

My involvement started when Lotta asked me if I was interested in organizing a course or workshop with her for the Agency. She had met members of the Agency during her fieldwork. One person, Ulf, who worked as an analyst at the Agency, had introduced the idea. He wanted to increase the knowledge of qualitative methods in the analysts' department. That's how I perceived it. Lotta said she would arrange a meeting for the three of us to discuss how a course would be organized if I was interested.

Lotta and I knew each other through our common seminar group at the university, but we had not worked together on a common project. She asked me because of my experience teaching first year university students the basics of doing social science research, an introduction course that dealt with, amongst other things, the research process, quality criteria, and different traditions within the social sciences. Most of the students were in their 20s and had little or no work experience. Lotta's idea was that the combination of our respective experiences would turn out well. Lotta had gotten to know the workings of the Agency well during her fieldwork and, prior to working in academia, she had taught courses and workshops in corporations with a variety of qualified and experienced employees.

PLANNING AND ACCOMPLISHING THE COURSE

The aim of the course was to "provide new perspectives and tools" to the analysts at the Agency: to inspire them to look at their work tasks in new ways, to dare them to pose new questions, and also to give them at least an idea of what responses to qualitative research methods would require in terms of analysis. The course would, for example, provide tools so that the analysts would be able to inquire about the social and cultural reasons for people avoiding and complying with taxation obligations.

What became quite elaborative work on the course continued and included, among other things, making the financial arrangements, choosing literature and planning the course. The course content was built around three qualitative perspectives - realism, phenomenology, and constructivism - and loosely followed a book on qualitative methods by Lise Justesen and Nanna Mik-Meyer (2011). In addition, we aimed for a truly interactive course where participants would work with cases. Karin and Lotta constructed cases addressing contemporary and relevant tax issues that the analysts were familiar with. One of the cases was based on the proposed new law for making cash registers mandatory at public marketplaces. We found newspaper articles on the web as well as online commentaries that argued for and against this new law. We complemented this with a narrative of interactions between various participants at a contemporary outdoor marketplace.

In January 2013, Lotta and Karin delivered a pilot course to a small group of analysts who had volunteered to take it and to give extensive feedback. Ulf was one of the participants. All participants' expectations differed somewhat, yet they shared curiosity and openness to new ideas. The course days were full of impressions for participants, as well as for Lotta and Karin in their roles as course instructors. After the pilot course, an evaluation was performed and some minor adjustments were made. Three full courses were then delivered to larger groups of analysts.

Karin:

When we met to do the initial planning, Ulf had brought ten or so books with him. As I recall, he told us about their content in relation to the knowledge he thought was needed in the analysts' department, and how it could be mediated in the best way. The meeting also gave us a chance to discuss our different expectations. Without Ulf's curiosity and determination, the course would probably not have been offered.

We sat down to outline a rough draft. It resulted in a chronology of the research process, a logical and coherent structure for the more detailed content. I had used it in the introductory course. However, this time, the course wouldn't last for four full weeks, but for just three working days spread over three weeks. Our group would meet once a week for a day full of short lectures, group exercises, and discussions. Because of the intensity, it was necessary to vary the program. Lotta realized this early and I think it was crucial to how things turned out.

The teaching days went fast and I felt exhausted at the end of them. For me, lacking any experience in the tax field, there were many new things to learn. For example, one topic of discussion was the recent requirements for *kassaregister* (cash registers) at outdoor markets. I had never thought about this issue before planning the course, and I didn't understand its importance until I met the analysts. This experience has taught me much more about the world and the empirical challenges faced by the tax analysts. It was important to understand this in order to make qualitative methods meaningful and applicable for them, but it also gave me valuable insights. The participants were eager to discuss the implications that using the methods we taught would have for their work, so that they could decide whether or not these methods might be useful. I understood that the connection between theory and practice was crucial.

The intensity of the course days showed the necessity of having two instructors. Ulf provided good input and valuable advice. His critical yet humble approach to knowledge production was the source/start of the whole project, I believe. The second and third courses we taught were easier for me; I felt more comfortable and had gained some knowledge about tax realities. I knew more about what questions to expect. One challenge I had to deal with was to use the right words - to be able to translate the social science vocabulary - so as to connect with the knowledge practices in the tax field.

COLLABORATIVE INSIGHTS

We all had different motivations for running the course, and shared experiences after performing and participating in it (as Ulf did). So what did the three of us learn? What were the new insights we gained from planning and delivering this course together? Following up on the participants' feedback and our internal discussions, we identified four main points:

- The importance of addressing and dealing with existing knowledge;
- The necessity of modesty, curiosity and dealing with resistance in order to take in new knowledge;
- The ability of new perspectives and approaches to stimulate creativity;
- The importance of shaping "win-win situations" between academia and the Agency in order to sustain collaboration in the future.

Dealing with Existing Knowledge

The analysts were seasoned employees and, in addition to their disciplinary backgrounds, each had a deep empirical, almost tacit, knowledge about taxation practices. As with most tacit knowledge, this was seldom acknowledged or referred to in the Agency's reports and appeared instead, at best, as anecdotes and vignettes, but was often discussed in meetings in the form of metaphors or entertaining stories from the field. That the analysts needed a different pedagogy from first year students was clear. Lotta and Karin, the instructors, needed to show them that these different qualitative research perspectives could be useful in their analysis work and explain how such data ought to be taken seriously in its own right.

The course provided the analysts with tools to start building a bridge that would make it possible to simultaneously address the knowledge the Agency holds about audit controls and tax law with ethnographic material about how Swedish taxpayers think about and practice tax issues. Such an approach would supplement, but also challenge, the analysts' anecdotal knowledge about how people comply, or don't comply, with taxation. When instructors and participants discussed taxation issues on the bases of the cases provided, we were all "valuing our values" as we tried to find common ground for an understanding. The assumptions we all carry about taxpayers' and tax auditors' behavior respectively were challenged. Applying qualitative methods would make it possible to include other types of knowledge in the analyses. This is just one illustration that new knowledge is, by definition, collaborative and the result was that it could simultaneously break up internalized ways of thinking both among the analysts and the researchers delivering the course. We can describe it as a "dispersed collaboration" (Konrad, 2012, p. 10): "New forms are emerging together with new knowledge-making forms" (ibid.).

The course became, in itself, a manifesto against the warning about "contaminated fields" **-** a traditional realist view that the "pure" knowledge of the informants should not be subject to impact by the researchers' views and interpretations (Lederman, 2007; Björklund Larsen, 2013). As the course developed, the new methods we introduced also provided a means by which to critically assess previous assumptions about the tax issues researched. Many of the participants saw that by inquiring ethnographically about what people/taxpayers do, they could also see what they might have missed in previous reports; from this perspective, the course became an anthropology of their own assumptions (cf. Elyachar, 2012, p. 77).

Modesty, Curiosity and Resistance

Questioning one's own assumptions and practices can be somewhat painful and previous analysis work might seem insufficient in retrospect. We were aware of this risk from the start and partly addressed it by naming the course "A Social Science Toolkit." Our point was to emphasise that the course was not designed with the intention of replacing existing analysis methods, but with the aim of providing the analysts with additional analytical tools for their already well-stuffed toolkits. By emphasizing "additional" rather than "other" methods, we wanted to communicate that the course was complementary **-** not a substitute. The course was "an eye-opener," to quote one of the participants. The new tools made it possible to see "that it could be otherwise" (Latour, 1990).

When the course was repeated and experiences from the increasing numbers of participants accumulated, it seemed as if the analysts (course participants) could be divided, roughly, into three groups based on ways in which they saw the society they were set to analyze. These three view types intersected somewhat and were not restricted to each participant's disciplinary background.

The first group of participants displayed a humble approach; we refer to them as *the humble ones*. They saw the benefits of posing a question from the "outside"; for example, from a phenomenological perspective, which was one of three perspectives used to contrast diverse methodologies. These humble analysts could see the benefit of trying to understand what is going on "out there" in another person's life-world. They recognized that trying to understand someone else's reality provides new insights that can be used in an analysis, both as an ethnographic account in itself and when posing questions from the methodological perspectives they are used to applying. The course seemed to widen their analytical gaze. Åsa, one of the participants at the pilot, gave us a compliment after the first day of discussing investigation aims: "I went back and read some of our reports. Now I understand better why the good ones are good and the bad ones bad."

This insight brings us to the second group: *the quants*. These analysts took the stance that reality is complex, but the best way to provide useful knowledge of this reality is by means of quantitative methods. In this view, research requires systemic measurement of societal phenomena. Several analysts in this group displayed a double stance towards the new toolkit: scepticism coupled with curiosity. Yet, their curiosity differed from that of the first group; what these analysts considered as quantifiable expanded with the accumulation of new perspectives on how to perform analysis.

The third group is best described as *old-fashioned controllers*. Their attitude is very different from the one that the Agency has promoted and trained its employees to have during the last 20 years. The Agency's strategy is to be serviceable and helpful, and thereby make taxpayers comply. The few analysts who comprised this group viewed taxpayers as potential cheaters; no matter how much we try to understand the taxpayers or measure what they do, it is of no use. The old-fashioned controllers' view was that taxpayers cheat by definition and therefore it is "we," at the Agency, who have to control "the others'" tax behavior in society. The only recourse for the Agency is to prevent cheaters from fulfilling their aims and to make them pay up.

This multiplicity in views is based on our experiences during the courses and, as such, it is our interpretation. However, this observation reinforces findings in other studies (cf. Björklund

Larsen, 2017). Implicit in these three groups of tax analysts' views on understanding tax compliance are research methodologies (cf. Braithwaite, 2003 etc.). The qualitative research methods provided in the course allow the Agency to learn more about taxpayers' reasoning, which can ameliorate its strategies to make taxpayers more compliant. Our experiences of these three type of views are thus not an example of epistemic crossings (Konrad, 2012, p. 14), but rather of multiple ontologies.

New Insights Shape Creativity

The new insights provided the analysts with new means of acquiring knowledge of tax compliance and tax deviance. We explored each of the three perspectives – realism, phenomenology, constructivism – when posing research questions, when looking for empirical data to address the questions, and when analyzing the data collected. An important conclusion we reached is that the interaction between researchers and practitioners led to new insights which, in turn, seemed to stimulate a new level of creativity that we otherwise would not have been able to reach. Ulf felt he got an answer to his original question, but in an unexpected way. It was not, foremost, the analytic creative tools that were missing; rather it was new, other, scientific methods that enabled the analysts to be creative in new ways.

Discussions amongst us (participants and instructors) were often more formative than the actual tasks the participants were set to do. On several occasions, we gratefully acknowledged the creative force of playfulness. For instance, we laughed with, and at, the various roles and personalities the course participants created during an exercise in the outdoor market context. These "role-plays" identified stereotypes in new settings, playing on participants' tacit knowledge – right or wrong – on who cheats and in what way in Swedish outdoor marketplaces. We can just propose that the role of laughter in collaborations and how such laughter underlines which issues are at stake ought to attract more research attention.

The respective disciplinary backgrounds among the course participants also carried some weight. One participant, Åke, working exclusively with statistical analysis, thought that the three qualitative perspectives we proposed were too similar. "Is it not enough with one?" he asked. Karin and Lotta answered, in different ways, that the aim was precisely the opposite; that through discussions, it is possible to tease out what insights the different approaches can produce, rather than giving contained and seemingly precise definitions for each perspective. However, Åke was insistent and suggested a matrix showing how one perspective diverged from the others with one label for each. We eventually settled on a matrix and three concepts in a playful way, although we instructors also underlined that it was just an exercise. Discussions like these sharpened our own understanding of what was at stake when performing qualitative research and, not least, they showed us how diverse the approaches can be when we try to understand tax (non-) compliance in society.

Unknown knowledge also surges when taking a holistic approach to collecting data. One example came to the fore when the analysts tried the anthropologists' flagship method of participant observation. The analysts were given the task of observing payment procedures during the lunch break. Afterwards, one smiling yet slightly horrified participant noted: "Goodness, how easy it is to note people's pin codes [to their credit cards]!" Anecdotal, yes, but also an eye-opening example of the residual insights that the holistic participant observation method for studying taxpayer behavior can give us.

In summary, the course gave the analysts new perspectives on methods, data and analysis, which, in turn, created curiosity that further triggered the creative process about learning more. However, most importantly, the diversity of methods we presented created new knowledge about how to understand taxation; knowledge that we would not otherwise have acquired.

Creating Platforms for Further Collaboration

Many of the issues discussed above show that, in this case, cooperation was profitable, as it created new knowledge for all parties. In order to repeat such collaboration, we would argue that a stable foundation is needed. From experience, Ulf knew that most attempts at collaborative work between agencies or organizations come to nothing. Unlike ad hoc co-operations, a longer-term collaboration requires common, repetitious and various points of departure. Most importantly, each party has to expect some achievement from the collaboration. If the collaborating parties do not experience a win-win situation, the interaction will run out of steam.

We thus identified three points that we ought to work on continuing our collaboration, a list that is by no means exhaustive. Firstly, any future collaboration needs to show explicitly what the interaction will relate to. Here, it was teaching a course on new methods and the aim was to put new methodological tools in the analysts' toolkits. As we said in the introduction: "We will give you new tools and teach you the most basic ways to use them, then it is up to you to acquire expertise using them in your work."

Secondly, it is essential for collaborators to share a common language. If a common language does not exist, it is necessary to strive for development of one. Although we might use shared words and concepts, these might not mean the same thing in different disciplines or when applying different research methods. For example, 'validity' is used both in qualitative and quantitative research, yet has a different meaning in each.

Thirdly, an agreement needs to be reached about the level of expertise at which the collaborators will meet; it needs to be a level at which everyone can relate to the issues discussed. This is, of course, obvious when teaching new theories but is also relevant when suggesting cases to apply the theories to.

CONCLUDING COMMENTS

Our collaboration was a response to the Agency's interest in learning more about ways of acquiring knowledge about societal issues that might prevent it from collecting taxes in an ineffective way. As the analysts at the Agency create knowledge and decision-making support for the management and leadership at the Agency, this collaboration could also have an impact on how the entire Agency regards tax compliance in Swedish society. A modern society will, in future, make far greater demands on the authorities in terms of being able to develop work according to scientific principles and evidence best practices. We thus want to emphasize the importance of doing ethnography when we study the knowledge that shapes our everyday lives (e.g. Latour & Woolgar, 1986; Callon, 1999; Knorr-Cetina, 1999; Mol, 2002).

This collaboration taught the three of us a number of things. Diverse experiences of teaching and analyzing gave the course a good direction. The combination of Karin's theoretical and pedagogical background, Ulf's quest for knowing more about qualitative research, and Lotta's instructional experiences outside academia and knowledge of some concerns of the Agency's

analysts provided a good start for sketching a proposal for a course. Overall, in order to achieve such a profitable synergy, we continuously questioned and consolidated our knowledge; this article is another such building block in our collaborative interaction.

Pedagogically, we instructors had to understand the analysts' reality and their concerns. We had to detach ourselves somewhat from our own vocabulary and create an atmosphere in which everybody – including us - could be humble and curious about other ways of thinking. The discussions with the analysts taking the course were fundamental to our gaining new insights about taxation in practice. Indeed, it was a collaboration.

Many tax administrations view academics with suspicion, but this paper demonstrates the value to be gained from collaboration for both parties. The analysts have expanded their concepts and tools when analyzing taxpayers' practices and reasoning in a qualitative and even more nuanced way. This is just one little course, but Ulf hopes that acknowledging such insights will ultimately lead to a better relationship between taxpayers and tax collector. The outcome for the Agency, in the long run, is hopefully the development of a more encompassing view on the role of taxation in society, a more efficient way of working and increased tax compliance among Swedish taxpayers.

In an increasingly complex and changing world, it will not be enough that a public authority, like a tax administration, depends entirely on its own experience and learning. Even if a tax collecting authority operates in a non-competitive environment, it is not far-fetched to imagine that increasing demands will be placed on the quality of its decision-making. In order to maintain taxpayers' confidence and continue the development of a modern tax collecting authority, creating new knowledge requires the usage of scientific methods. We are convinced that this requirement can be met by increased cooperation between the Agency and universities; a collaboration that both parties may benefit from in the long-run.

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TAX COMPETITION, TAX CO-OPERATION AND BEPS

Richard Collier[1]

Abstract

The OECD Base Erosion and Profit Shifting (BEPS) project was initiated to tackle the cross-country tax avoidance practices of multinational companies (MNEs). We argue that the BEPS project inevitably impacts a range of existing tax competition policies pursued by states to lower the costs of capital with a view to attracting mobile investment and profits, and, hence, MNEs. Despite the measures to be introduced by BEPS, tax competition practices will continue, mainly because coordination is not incentive-compatible. However, the nature of tax competition will change as a result of BEPS. Before BEPS, tax competition policies were a mix of low statutory rates and specialised regimes designed to accommodate specific activities or transactions. After BEPS, tax competition policies are likely to become more rate-based. Governments will have to tighten some specific regimes aimed at attracting highly mobile capital and profits, such as the patent box regime, rulings arrangements and interest deductions. At the same time, they may reduce the tax burden on mobile and non-mobile activities by implementing economy-wide cuts (chiefly through tax rate cuts) allowed under BEPS. Many countries, including France, Italy, Japan, Spain and the UK, have announced cuts in the corporate statutory tax rate. To foster real investment, governments could also increase depreciation allowances or introduce an Allowance for Corporate Equity (ACE). The interesting feature of the ACE in the context of BEPS is that it reduces the incentive to classify financing instruments as tax-advantaged debt.[2]

1. INTRODUCTION

The Organisation for Economic Cooperation and Development (OECD) has, since 2012, worked on a major overhaul of the international tax system through the Base Erosion and Profit Shifting (BEPS) project. The BEPS project was initiated with the primary aim of combating cross-border tax avoidance by multinational firms (MNEs). The various measures proposed by the BEPS Action Plan will highlight the tensions between tax competition and anti-avoidance measures operated by states, with the former generally lowering the costs of capital and the latter increasing it. Governments could theoretically make a binary choice between tax competition and anti-avoidance policies but, as we argue in this paper, the more likely result is that they will seek to comply with the specific measures proposed under the BEPS project, whilst lowering the cost of capital for all factors, whether they are mobile or not. In other words, for those states which seek to maintain tax competition agendas, the result of BEPS is likely to be a reduction in general tax rates.

Multinational corporations are able to reduce their tax liabilities by exploiting specific regimes put in place by sovereign states with the aim of operating tax competition agendas to attract mobile profits and capital. Many of these tax competition-inspired specific measures and

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tailored tax regimes have been targeted by BEPS, hence explaining why it is considered that the project is, in fact, addressing tax competition between states.

We argue that the OECD BEPS project will not put a stop to tax competition between countries as, in the current environment, coordination between states is not incentive-compatible. There will always be a country, such as Ireland or the UK, for which there are gains to be made by competing against other jurisdictions. Nonetheless, the nature of the tax competition game will change.

Before the BEPS project, many countries, such as Ireland, the Netherlands and the United Kingdom, were very active in pursuing tax competition agendas with dual "rate-based" and "regime-based" approaches. Low general rates of corporate income tax were coupled with the introduction or maintenance of specific preferential tax regimes, such as the patent box rules that apply a lower corporation tax rate to income derived from patents or, in the case of Ireland, arrangements exploiting tax residence rules designed to allow income to be channelled to zero-tax jurisdictions.

Since the BEPS project is concerned with closing down these specific or tailored regimes which accommodate specific forms of business or transactions, it is expected that countries will tax compete on the basis of the dimensions of their tax systems to which BEPS is inapplicable.

To be compliant with BEPS, governments will have to tighten some specific measures aimed at attracting highly mobile capital and profits, such as the patent box regime and interest deductions. At the same time, they may reduce the general tax burden on both mobile and less mobile activities by implementing economy-wide cuts allowed under BEPS. Most likely, such cuts would come from reductions in the headline corporate tax rates. At the time of writing, many OECD and G20 countries have planned cuts in their corporate statutory tax rates. Such countries include Denmark, Estonia, France, India, Israel, Italy, Japan, Luxembourg, Norway, Spain, Portugal and the UK.[3]

Making cuts to the headline rate essentially reduces the taxation on profits, but it ignores the fact that for other decisions, such as real investment, including information and communication technology (ICT), other elements of the tax code (such as tax depreciation allowances) are important. To foster real investment, governments might also wish to consider the introduction of an Allowance for Corporate Equity (ACE). In the current environment of low growth and low productivity, encouraging investment is crucial: investment is a component of GDP and higher investment generally leads to higher labour productivity and, therefore, better living standards.

The remainder of the paper is organised as follows. The next section discusses the relationship between tax competition and anti-avoidance policies. Section 3 discusses how the OECD BEPS project affects tax competition policies. Section 4 details a case study investigating the position of the UK. Finally, section 5 draws relevant conclusions.

[3] See generally, OECD (2016), pp. 41-42.

2. TAX COMPETITION AND ANTI-AVOIDANCE MEASURES - ARE THEY RELATED?

Are tax competition and tax avoidance related? If so, how?

Tax competition practices occur when, through amendments to the tax system, countries lower the cost of capital for foreign direct investment (FDI) or for their multinationals operating abroad. The intention is typically to attract mobile investment or to make domestic multinationals more competitive in foreign markets.

Conventional economic theory suggests that unconstrained tax competition will lead to under-provision of public goods, relative to what is regarded as the social optimum: on this view, in equilibrium, the tax rate is too low and all countries would benefit from a small, uniform increase in tax rates. In other words, under tax competition, the government will only be able to charge a low tax rate and this will not generate enough revenue to provide what is regarded as the optimal level of public services, such as education and health care. Hence, it is argued, coordination among countries would improve the citizens' overall welfare (Keen and Konrad, 2012). Nonetheless, coordination across countries is not incentive-compatible and, therefore, it has proved very difficult to achieve. Smaller jurisdictions have an incentive to undercut larger countries so as to attract investment and profits. When coordination is not possible and countries pursue disparate approaches, economic theory suggests that individual countries have an incentive to reduce their tax burden to attract mobile activities from other jurisdictions, i.e. they tax compete to attract investment. In equilibrium, there will be different tax rates across countries. More generally, equilibrium tax rates will be lower in jurisdictions with smaller endowments of capital, which are more productive and value public spending less (Keen and Konrad, 2012).

In broad terms, anti-avoidance measures increase the tax burden for some companies instead and, therefore, they tend to increase their cost of capital. This would lead to the opposite result than is achieved by tax competition practices and, hence, be in conflict with it. Nonetheless, the relationship between anti-avoidance legislation and tax competition is more nuanced.

Anti-avoidance legislation can be seen as a way to address distortions in the economy: companies with aggressive tax planning strategies can lower their tax burden, for example, by shifting profits to low tax jurisdictions whilst less aggressive companies are unwilling (or less willing) to do so. Because of a lower tax burden, tax-aggressive companies could, in principle, sell at lower prices and gain market share, and also pay higher salaries and guarantee higher returns to their shareholders than other companies. In this sense, avoidance distorts competition; hence a state's anti-avoidance actions may not necessarily and in principle be at odds with the intention to make that state highly competitive. This would be on the basis that tax competitiveness is understood as providing generally (i.e. across the market) a lower cost of capital and that anti-avoidance action is a way to resolve distortions (that apply unevenly across the market) created by the tax system.

In the public domain, competitiveness and anti-avoidance are often seen at odds with each other, with respect to their distributional effects on society. The argument is simple and initially might seem appealing: a competitive tax system lowers the burden on rich corporations whilst anti-avoidance action makes wealthy companies pay their fair share of tax. Leaving aside the notion of the "fair" amount of tax, the argument is misconceived, as it does not consider that corporations are legal entities and hence cannot, ultimately, bear the burden of the tax. The tax

is borne by individuals connected to the company: its shareholders, its employees and its customers. There are two reasons why the corporate income tax has uncertain distributional effects. Firstly, there is uncertainty with respect to the real incidence of the corporate income tax. Much of the literature points to a large proportion of corporation tax being passed on in lower wages, although there are mixed results on this point.[4] Secondly, even if we knew who effectively bears the tax, we would not necessarily know whether such an individual is rich or poor. For example, the distributional implications of a tax borne by employees would be different depending on whether the employees were top managers or general employees.[5] For these reasons, it is difficult to draw straightforward distributional implications of either a tax competitiveness or an anti-avoidance agenda targeted at corporations. In summary, the benefits of tax competition depend on who the ultimate beneficiaries of the tax cuts are.

Anti-avoidance measures and tax competition policies generally have opposite effects on revenues: broadly, the former tend to increase revenues, whilst the latter tend to reduce them. Overall, this means that tax competition constrains the government's choice of optimal policies (i.e. the policies which could deliver the largest welfare gains for the population). If we assume we are dealing with a benevolent government that, before competition-induced tax cuts, was already implementing optimal policies, this could reduce welfare.

If, instead, there is room for improving the efficiency[6] and distributional properties of the tax system, the impact of changes in tax revenues will depend on how extra or fewer revenues are used, and which taxes are increased (or decreased), following a reduction (or an increase) in revenues from business taxation. The literature generally points to corporation tax as being one of the least efficient taxes, while taxes on consumption, land and immovable property are thought to be more efficient. Empirical evidence shows that an increase in recurrent property and land taxes, or in taxes on consumption, could generate an increase in the GDP growth, if accompanied by a reduction of the taxation of labour and profits. A change from income to property taxes generates a more positive effect than a shift from income to consumption taxes, and would also have the benefit of better distributional properties (Arnold et al., 2011). Other empirical evidence finds a strong, positive effect on per capita income of a tax shift from labour and capital taxation towards consumption taxation, but only in the short run (Arachi, Bucci, & Casarico, 2015). Overall, the evidence suggests that a change in the tax mix could therefore increase the efficiency of the system, at least in the short run. Distributional concerns should be addressed with personal income tax, inheritance tax and possibly recurrent taxes on property, as these taxes can be targeted more directly to the individual taxpayer's income and wealth.

In summary, raising more revenues from corporate taxation does not automatically mean a better distributional outcome for society.

How do tax competition and avoidance interact?

There are different ways in which a jurisdiction can compete. In an open economy, the government can attract capital in two ways. Firstly, it can lower the tax burden for all investors. Secondly, it can target the most mobile factors, such as productive capital and paper profits.

[4] See, amongst others, Arulampalam et al. (2012) and Fuestet al. (2015).
[5] Recent research shows that CEOs are able to shift increases in their personal tax burden onto the company, and possibly to other employees and shareholders (Ruf & Schmider, 2015).
[6] Efficiency should be intended as a state in which all resources in the economic system are allocated in the best way possible, so as to maximise the citizens' welfare.

Economic theory suggests that it may be optimal to reduce the cost of capital only on the most mobile factors (Keen, 2001), such as the capital of multinationals deciding to invest in one jurisdiction out of many possible choices. The implication is that governments should compete only on mobile factors. This policy approach would have two main advantages. Firstly, it would attract mobile productive capital, and hence investment, which would instead leave or avoid a high-tax jurisdiction. Secondly, by only targeting a group of firms and taxpayers, it would allow revenues to be maintained. It would be more costly in terms of lost tax revenues to lower the tax burden for the whole economy, including the less-mobile factors (Keen & Konrad, 2013). It must be noted that targeting only mobile factors could also create inefficiencies: mobile firms could be given an advantage with respect to immobile ones, creating distortions in the market, and this could offset the aforementioned efficiency gains. We will discuss this point further below.

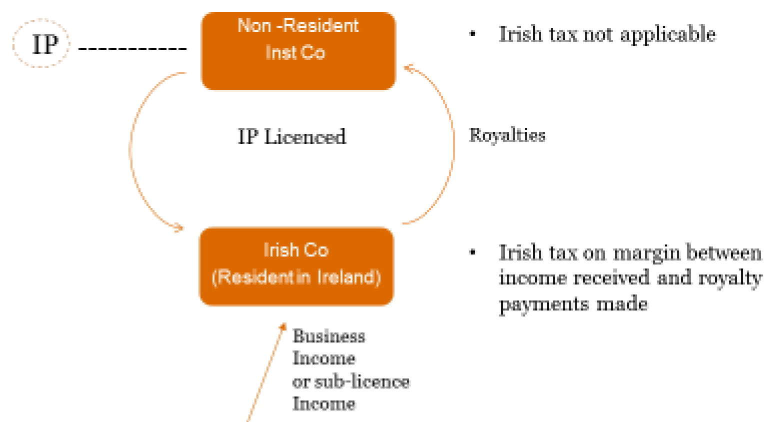
If economic theory provides some foundation for the strategy of targeting internationally mobile capital and profits, the political reality is that a country acts in an international environment, where jurisdictions with different economic structures and different tastes for public spending levy different tax burdens on capital and profits. In this context, measures that may be justifiable from a purely domestic perspective - such as lowering the tax burden on mobile activities - are, in fact, often regarded by other countries as providing unfair, or at least questionable, opportunities for shifting profits away from their higher tax jurisdictions. In other words, tax competition measures for one jurisdiction are seen as measures facilitating tax avoidance by other jurisdictions.

For example, the competitiveness of the tax regimes in Ireland and the Netherlands has been crucial when it comes to those nations attracting FDI and profits. In 2014, Ireland had the highest share of FDI flows over GDP in the OECD (34.6%) and, in 2013, it had the second largest share of FDI stock over GDP (231%) after Luxembourg (301%).[7] In 2014, the Netherlands attracted the largest amount of FDI flows in the world, with 4 million USD (5.5% of GDP)[8], whilst in 2013, it ranked fourth in the OECD in terms of FDI stock as a share of GDP (134%), after Luxembourg, Ireland and Switzerland (194%).

[7] As a reference, in 2014, outside of the OECD, the only developed economy with a higher share of FDI over GDP is Hong Kong (39.9%). Germany, France, the UK and the US instead display ratios of 0.2%, 0.3%, 1.5% and 0.8% respectively. This is not surprising, because these are large countries which are traditionally capital exporters.

[8] In 2014, the US attracted 2.9 million USD, China and Luxembourg 2.3 million USD, and the UK 1.7 million USD.

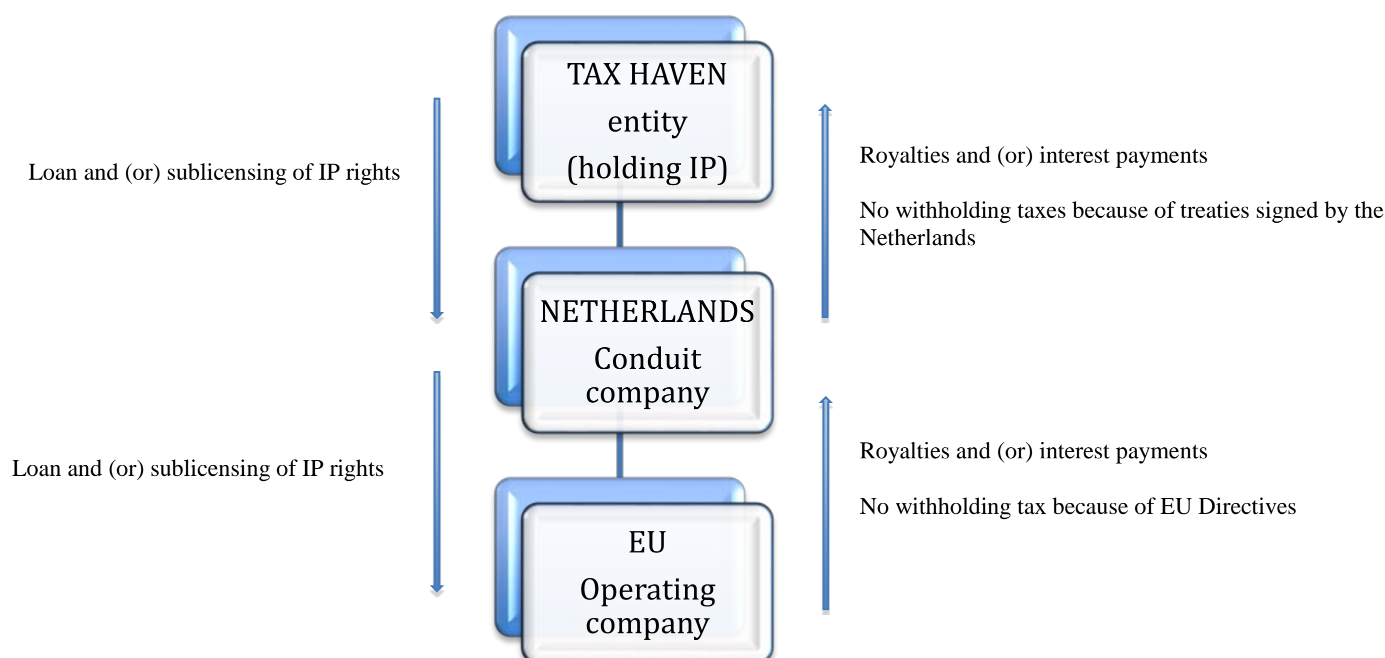
Figure 1. Double Irish Structure



At the same time, both Ireland and the Netherlands have been seen as encouraging companies to avoid tax in other, high-tax, jurisdictions. One recent high profile case involved the so-called "double Irish" structure, which delivers an effective tax rate that is competitive with what might otherwise be achieved by the use of a no-, or very low-, tax state, notwithstanding the general 12.5% Irish corporate tax rate. As illustrated in Figure 1, in broad terms, the structure involves two Irish companies, one of which is not resident (and therefore not taxable) in Ireland as a result of the Irish "central management and control" test of residence. As far as the Irish tax authority is concerned, the company is incorporated in Ireland, but is resident in a tax haven because its central management and control is located there. Typically, it is this company that holds valuable intellectual property (IP), which it licences to the second Irish company, which in turn either uses the IP in its business or on-licences the right to use the IP to the rest of the MNC group. In such a case, this second Irish company, which is resident in Ireland for tax purposes, will receive and pay tax on the income it receives but may claim a deduction for the onward payments to the second Irish company, which is outside the scope of Irish taxation. The result is that Irish tax at the 12.5% rate is levied only on any margin arising from the receipt and payment of royalties in the hands of this second Irish company and the bulk of the income escapes Irish taxation. In the face of significant international pressure, the Irish government has now accepted that the structure should be countered (McDonald, 2014). A new rule therefore provides that companies will no longer be able to incorporate in Ireland without also being tax-resident there.[9]

[9] The new rule took effect from 1 January 2015. (See section 23A Taxes Consolidation Act 1997, as amended by s.43(1)(a) Finance Act 2014). It also provided that companies already using these arrangements would have a five-year window in which exit them (see s.43 (2) Finance Act 2014).

Figure 2. Dutch Entity



Another example relates to the Netherlands. The tax system of that country: facilitates the use of Dutch companies for the holding and financing of international groups, given that the Netherlands has a very wide tax treaty network that will reduce withholding taxes on inbound payments; allows the tax-exempt receipt of dividends and capital gains from overseas subsidiaries; has no CFC rules;[10] and imposes no withholding tax on interest and royalties, and limited withholding tax on dividends paid out of the country. Figure 2 shows how a Dutch conduit company could be employed to shift income out of a high-tax EU jurisdiction. In 2013, international treaty-shopping concerns, relating to the ease with which these Dutch tax benefits might be accessed, led to the Netherlands acting unilaterally to tighten the circumstances under which Dutch treaty benefits may be available.[11] The package of unilateral measures included: substance requirements; more pro-active exchange of information arrangements with foreign states; curtailed tax rulings for companies without sufficient substance; and anti-abuse measures in tax treaties with developing countries.

Other examples relating to the UK may also be cited, such as the pressure from other states on what are perceived to be the UK's over-limited CFC rules, the over-generous interest deduction that has been available under existing UK tax law and, of course, the UK Patent Box rules, the latter of which have already been redrawn due to international pressure in the BEPS process. All of these UK examples are discussed further below.

[10] It should be noted, however, that an overseas low-tax or no-tax company holding portfolio/passive assets may be taxed in the Netherlands on a fair value basis by way of exception to the Dutch participation exemption under Art. 13a Corporate Income Tax Act.
[11] See the announcement contained in the letter to Parliament from the Dutch Minister for Foreign Trade and Development Co-operation and the Deputy Minister of Finance, dated 30 August 2013. The measures were made effective from 1 January 2014 – Decree of 18 December 2013, Stb 569, 2013, published 30 December 2013.

As the examples discussed above illustrate, the competitiveness and the anti-avoidance agendas will often conflict in the international arena when specific measures lowering the cost of capital for mobile activities (competitiveness) attract tax bases from high-tax jurisdictions, facilitating what is perceived by other states as aggressive tax avoidance.

It is also important to clarify that, unlike other commentators and policymakers, we make no distinction in this discussion between "harmful" and "non-harmful" tax competition. Those using this distinction usually intend the latter term to refer to policies that are generally meant to attract "real" investment, whereas the former term is typically used to refer to tax incentives that function more like formal "loopholes", attracting mere "financial" investment without directly involving a great deal of economic activity or substance. [12] The distinction is arguably a long way from being so straightforward. Tax competition is designed to lower the cost of capital to stimulate real investment (whether domestic investment or foreign direct investment). It is possible to lower the cost of capital with measures that either directly target real investment or that lower the cost of financing such investment, i.e. with measures that target financial investment that will therefore indirectly target real investment. Given that targeting both financial and real investment lowers the cost of capital, in this context, any attempt to distinguish the two different types of tax competition or investment will not obviously be founded on economic principle. Accordingly, it is considered that there is no useful distinction to be drawn between harmful and non-harmful tax competition, or between real and financial investment.

3. TAX COMPETITION POLICIES AND BEPS

Having considered the general relationship between anti-avoidance measures and competition policies, it is now appropriate to turn to the particular issues for such policies raised by the BEPS project.

In the first BEPS paper released by the OECD, it is acknowledged that jurisdictions are free to set up their own tax systems as they choose and it is their sovereign right to implement the tax measures that they judge to be right (OECD, 2013a, pp28-29, OECD 2013b, p15) .

This could be taken to suggest that the BEPS project has no impact on tax competition, particularly as neither of the initial papers on BEPS released by the OECD (OECD 2013a, 2013b) (which set out the OECD's concerns relating to BEPS practices) contain any extended discussion on the need to address tax competition practices.[13] However, despite not seeking to tackle tax competition practices head-on, most of the individual action points that are being pursued as part of the BEPS project have the potential to create an adverse impact on tax rules that are designed to give effect to a tax competition policy. This is because, although the proposed BEPS changes are directed largely at situations where the existing international tax rules are regarded as either not working or as being too vulnerable to aggressive tax avoidance by MNEs, the effect of the proposed countermanding action will hit tax competition practices by states. This should not be particularly surprising, as many of the practices of MNEs, which are seen as aggressive tax avoidance (and which are therefore targeted by BEPS), are simply cases of MNEs making full use of tax regimes created by states in pursuit of a tax competition policy.

[12] We thank Wolfgang Schön for his comments on this point.

[13] There is a brief discussion of the historical work of the OECD on harmful tax practices, but little discussion about the tension contribution of tax competition policies to the creation of BEPS opportunities - see OECD (2013a), pp. 28-29.

Apart from the digital business issue (which is recognised as raising some specific issues), the BEPS Action Plan groups the bulk of its identified actions to address BEPS practices by referencing three main themes:

(1) increasing transparency;
(2) realigning taxation with substance, which means taxing profits where they are substantively created;
(3) ensuring the "coherence" of the system, which means getting rid of loopholes, gaps or mismatches in the interaction of countries' domestic tax laws that can be exploited.

Each of these themes, which will be considered briefly in turn, contains specific actions that may impact tax competition practices.

3.1 Transparency

The BEPS work on transparency includes a wide variety of new measures pursuant to: Action 11 on the collection and analysis of data on BEPS; Action 12 on the disclosure of aggressive tax planning arrangements; and Action 13 on the overhaul of transfer pricing documentation, including the new country-by-country reporting obligations, and the broadening of the reporting required in the "local file" and the "master file" for each business.[14] Work on the BEPS transparency package is likely to have a material impact on the operation of tax competition policies by states, because it will lead to the ready identification and broad disclosure of tax rulings and subsidies etc. that are otherwise intended to remain private, and of specific tax authority practices that vary from accepted standards. This, in turn, is likely to lead to increased challenges, most likely for MNEs taking advantage of the relevant tax rules, but possibly to the states operating those regimes.[15]

3.2 Taxation and economic substance

The BEPS work on "realigning taxation with substance" is based on the desire to restore the intended effects and benefits of international tax standards by ensuring that the allocation of income for tax purposes is closely aligned with the economic activity that generates that income.[16] This includes work streams on: treaty abuse (Action 6 of the Action Plan); preventing

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[14] See further OECD (2015j). This document sets out the two-tiered approach to transfer pricing documentation involving a master file (which would contain common standardised information relevant for all MNE group members, and set out a "blueprint" of the MNE group and its business) and a local file that supplements the master file and helps to meet the objective of ensuring the taxpayer concerned has complied with the arm's length principle in its material transfer pricing positions affecting a specific jurisdiction.

[15] Challenges to MNEs might be made on the basis of the specific BEPS action points, such as treaty abuse, permanent establishments, transfer pricing etc., and challenges to states might be possible under Action Point 5, the revamping of the harmful tax practices work. It is likely that the impact of the transparency measures will vary from state to state. It is not thought that the measures will be of special significance in relation to the UK. The European Commission has also been especially active in the area of transparency requirements – see, for example, European Commission (2015) and, more recently, the European Commission's Anti-Tax Avoidance Package of 28 January 2016, which includes a proposal for public country-by-country reporting (European Commission, 2016).

[16] For a discussion of the problems relating to aligning taxation with substance, see Vella and Devereux (2014). It should also be noted that the European Commission has recently identified various key areas for action, including a focus on "bringing taxation closer to where profits are generated and ensuring effective taxation of profits," which is to involve further work on the PE and CFC rules - see European Commission (2015b). Further

artificial avoidance of the permanent establishment (PE) threshold (Action 7); and a cluster of transfer pricing actions, including work on intangibles, re-characterisation of transactions, risk, and capital (Actions 8, 9, and 10). These actions are very likely to impact cases where a tax base has been "poached" as a result of the operation of a tax competition policy. Such cases would be nullified by the realignment of taxing rights with the substantive activity giving rise to the income concerned. For example, where IP is legally owned by a company resident in a low-tax jurisdiction, or in a jurisdiction where a patent box or similar relief is available, but all the development work on that IP is subcontracted to a European affiliate, the actions referred to above will make that structure much more difficult to sustain in light of the beefed-up BEPS transfer pricing and PE rules.[17] The same would be true in cases where specific risks - and, therefore, more income - are allocated to a low-tax company, but all risk management functions are subcontracted to an affiliate. The BEPS proposals on treaty abuse will also make the intermediation of tax-advantaged legal entities more difficult to defend, e.g. in the case of regional holding companies or single asset holding companies, where the choice of location of the entity is driven mainly by tax factors. Variants of these types of challenges have been seen already[18], but they are likely to increase due to BEPS changes to the international tax rules.

3.3 Coherence

For the OECD, the aim of restoring "coherence" to the international tax system as a whole is about dealing with the unintended and distorting gaps or mismatches between tax systems that can make income disappear for tax purposes. What this means in practice includes ensuring that a payment that is deductible in one state is taxable when received in another.

Four action points are grouped under the coherence theme:

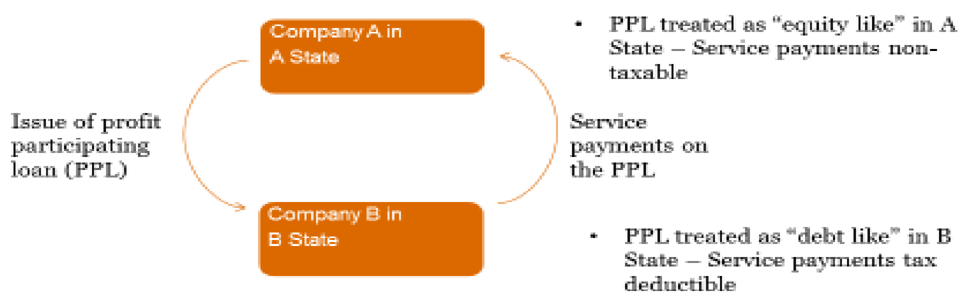
1. Neutralising hybrid mismatch arrangements (Action 2);
2. Strengthening CFC rules (Action 3);
3. Limiting interest deductions and other financial payments (Action 4);
4. Revamping the harmful tax practices work itself (Action 5).

detailed measures have also been proposed under the European Commission's Anti-Tax Avoidance Package of 28 January 2016 – see generally European Commission (2016).

[17] The BEPS transfer pricing work may mean that the financial rewards from the legal ownership of the IP are not respected for tax purposes, or that the amount due to the affiliate under the transfer pricing rules for its work on developing the IP represents the overwhelming bulk of the IP profits arising. The PE measures may alternatively mean that the low-tax company has a taxable presence in the jurisdiction of the affiliate and is taxable there on all, or most of, its profits.

[18] See, for example, the Canadian case of Velcro Canada v The Queen, 2009 DTC 5053 (FCA).

Figure 3. Example of Hybrid Financial Instrument



The BEPS work on hybrids is arguably the most complex of the BEPS action points. Broadly, the hybrids targeted include hybrid instruments and hybrid entities. Hybrid instruments are typically characterised differently as equity or debt for tax purposes in the jurisdictions of investor and issuer. Hybrid entities are again characterised differently for tax purposes in two or more jurisdictions, typically by reference to whether the entity concerned is transparent or not for tax purposes. The work on neutralising hybrids intends to reverse the intended tax effect of such instruments (for example, in the case of cross-border hybrid financial instruments such as profit participating loans). The usual objective for such instruments, as illustrated in Figure 3, has been to secure tax deductions for the relevant service payments in the hands of the payer (on the basis that the payer's jurisdiction treats the instrument concerned as "debt-like") yet with those service payments being regarded as non-taxable receipts in the hands of the recipient (on the basis that the recipient's jurisdiction would characterise the instrument as "equity-like" giving rise to receipts akin to dividends). The reversal of the expected tax benefits of such instruments is achieved either by denying a tax deduction for a payment under the instrument or by taxing the corresponding income.

The aim of the work on limiting interest deductions is to hit what the OECD sees as unwarranted tax deductions for such payments, given that the corresponding payments may not be taxed (or may be taxed at a low rate) and this will obviously affect regimes to the extent that their tax rules for interest deductions are at the generous end of the scale.

The BEPS work on CFC rules is intended to lead to a more comprehensive countering of BEPS practices, protecting the parent jurisdiction as well as having positive spillover effects for tax revenues in source countries (such as developing countries), because the effect of such rules should mean that taxpayers have a much-reduced incentive to shift profits into any third, low-tax jurisdiction, given that any such shifted profits would fall within - and therefore immediately be taxed by - a comprehensive CFC regime of the type favoured by the OECD.

The "coherence" actions also include the specific BEPS work stream, conducted under point 5 of the Action Plan (OECD, 2013b, pp17-18, OECD, 2015e.), on revamping the OECD's

harmful tax practices initiative of the late 1990s. This is the only part of the Action Plan that directly targets certain tax competition practices by states, specifically those regarded as "harmful tax practices" that represent a subset of tax competition practices.[19] In the BEPS interim report on this topic, it is stated that: "…the work is about reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place" (OECD, 2014b, 2015e).

This work stream within BEPS focusses on individual tax regimes for particular types of geographically mobile activity and a key theme is to ensure that any such tax regime is suitably substance-based, in that any tax benefit is commensurate with the level of substantive activity that may be involved.[20]

Given the direct focus of the BEPS work on certain tax competition practices of states, it will be obvious that, if successfully pursued, the work is likely to have an adverse impact on at least some tax competition practices carried out by states. For example, as will be discussed further below, this harmful tax practices work of the OECD has already been in conflict with what has been one of the primary features of the UK tax competition policy, namely the UK Patent Box.

It should be emphasised that the discussion here is not seeking to assess the effectiveness of responses to tax competition through the BEPS project, but rather simply to establish that the work on BEPS will clearly have an effect on tax competition policies, even though it is usually interpreted as reining back the activities of multinationals. The conclusion on the BEPS action points is therefore that, as a general matter, there will be a number of different BEPS actions that are likely to have negative impacts on measures that are created in pursuit of tax competition policies, even though those action points are not, apart from the specific work on harmful tax practices, dealing with "tax competition" issues head-on.

It is also relevant to note that economic theory already forecasts that closing preferential regimes for highly mobile activities could shift tax competition to other parts of the tax systems, possibly involving larger welfare losses (Keen, 2001).

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[19] The landmark OECD (1998) report referred to "Harmful Tax Competition" in its title.

[20] The substance requirement here seems to be based on the distinction between tax measures attracting "real" investment (which are regarded by the BEPS project as potentially acceptable) and tax incentives that function more like formal "loopholes" attracting mere financial investment but that do not directly involve a great deal of economic activity or substance (which tend to be regarded as unacceptable by BEPS). As we have argued in Section 2, the distinction is not based on economic principles, as lowering the tax burden on both financial and real investment reduces the cost of capital and hence stimulates real investment. At a practical level, it may well be that countries with a lot of real investment (such as Germany) or a lot of consumers (such as the UK) have concerns that jurisdictions like Ireland can extract tax base from them, even if almost nothing is produced or consumed in Ireland. It is therefore not, in practice, surprising that substance requirements are introduced into the debate with a view to constraining this type of "financial investment" form of tax competition. However, the concern remains that the contrast so created between financial and "real investment" will add yet another questionable distinction to the international tax framework, particularly as it is, in turn, founded on the vague notion of adequate "substance." Rather, it may ultimately prove difficult to distinguish the two types of investment meaningfully.

4. A CASE STUDY: THE UK TAX COMPETITION AND ANTI-AVOIDANCE AGENDAS

Over the years, various OECD countries have pursued tax competition agendas, with varying degrees of aggressiveness. Smaller jurisdictions, such as Belgium, Ireland, Luxembourg, the Netherlands and Switzerland, have openly employed their tax systems as key tools to attract investment. Larger countries, such as the US, have employed their tax systems in less visible ways, in order to make their multinationals more competitive in foreign markets.[21] In this section, we will focus on the case of the UK, a jurisdiction in which the tension between the competitiveness and the anti-avoidance agendas is particularly apparent. The conclusions are potentially valid for any other country engaged in tax competition, at least at some level, and at the same time, trying to conform to the measures proposed by the OECD BEPS project, and more generally to the public pressure in support of introducing more rigid anti-avoidance measures. For example, the conclusions drawn will have some relevance to Ireland, which has recently decided to reform its rules on corporate tax residence and, at the same time, has announced the intention to bring in a “knowledge development box” at a rate of 5% for income derived from patents. Both measures are part of a clear (and ongoing) effort on the part of Ireland to remain as competitive as it can be in attracting and retaining FDI (Department of Finance, Ireland, 2014).

4.1 Tax competition

On setting its approach to international tax competition, the current and previous UK governments have been responding to two complementary issues. One has been the need to placate the concerns of UK-headquartered multinationals (MNEs). This became particularly important in the period 2007 to 2010 in order to prevent the growing head of steam for “inversions”, i.e. the moving of the “tax domicile” or headquarters of such multinationals abroad.[22] The second was what came to be known as the “open for business” agenda of creating an attractive, competitive UK tax regime to bring new investment to the UK, with a particular focus on activities related to innovation and intellectual property.

It is worth noting at the outset that the aims of the Conservative government - and those of its predecessor, the Coalition government - of creating a highly competitive tax regime and countering tax avoidance are not new, but are, broadly, a continuation of the agenda from the earlier Labour government.[23] It was the earlier Labour administration that introduced a number of important reforms which are today regarded as the bedrock of the UK’s competitive corporate tax position, such as: the capital gains exemption for substantial shareholdings in 2002; the “foreign profits” reform of 2009, which introduced an exemption for foreign dividends received in the UK; the decision to maintain interest deductions for the financing of

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[21] The US check-the-box rules often allow US multinationals' foreign income to go untaxed if located in a low or zero tax jurisdiction.

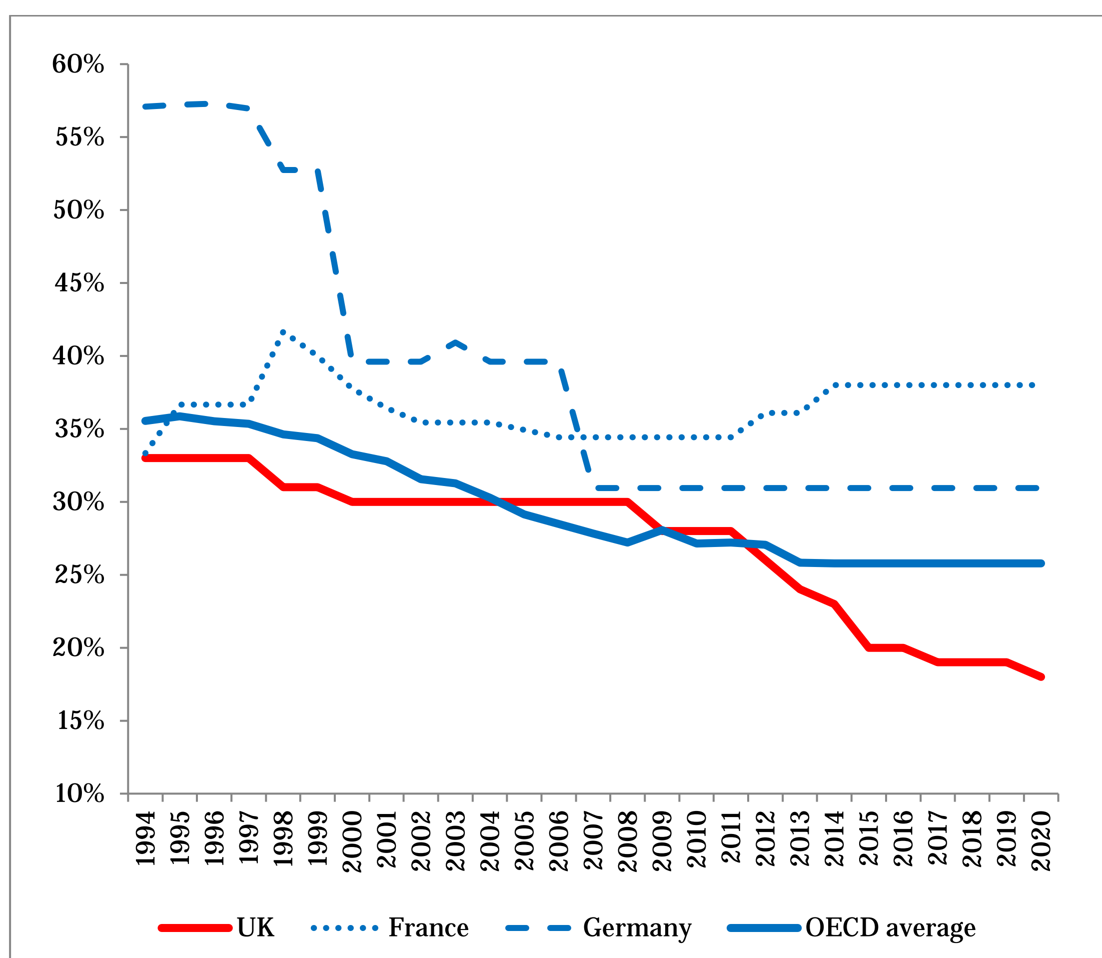
[22] At this time, a number of UK companies took steps to do just this, with WPP, Henderson Group, United Business Media, Shire and Ineos etc. all moving from the UK. In December 2009, the *Financial Times* reported that a number of FTSE heavyweights were considering leaving the UK (Houlder, 2009). See further, Clements (2013).

[23] The previous Labour government did not identify becoming the most competitive tax regime in the G20 as its goal, but the tax competitiveness of the UK was an important priority for Gordon Brown as far back as 1999. In that year, following the reduction of the corporation tax rate (to 30%), he emphasised that it was: "now the lowest rate in the history of British corporation tax, the lowest rate of any major country in Europe and the lowest rate of any major industrialised country anywhere including Japan and the US". See HM Treasury (1999).

overseas investments, giving rise to tax exempt income; and the foreign branch exemption[24] initially canvassed by a Labour government but enacted by the Coalition in 2011. It was the earlier Labour government that also started the long-running reform of the UK CFC rules and that brought the rate of corporation tax down to 28% from its previous rate of 33% in the previous John Major administration. The approaches taken by UK governments to matters of international tax policy have therefore been extremely consistent for a number of years.

Unsurprisingly, the tax competition agendas pursued by successive UK governments have been widely supported by business and are generally regarded as having been successful. Many indicators show that the UK tax system has become more competitive in the last few years. Three measures are used to assess the tax costs associated with corporation tax and hence the competitiveness of the UK system versus that of other countries: the main statutory rate, and two summary measures that account for both the statutory rate and the tax base. These are the effective average tax rate (EATR) and the effective marginal tax rate (EMTR).

Figure 4. Statutory Corporate Tax Rates (1994-2020)

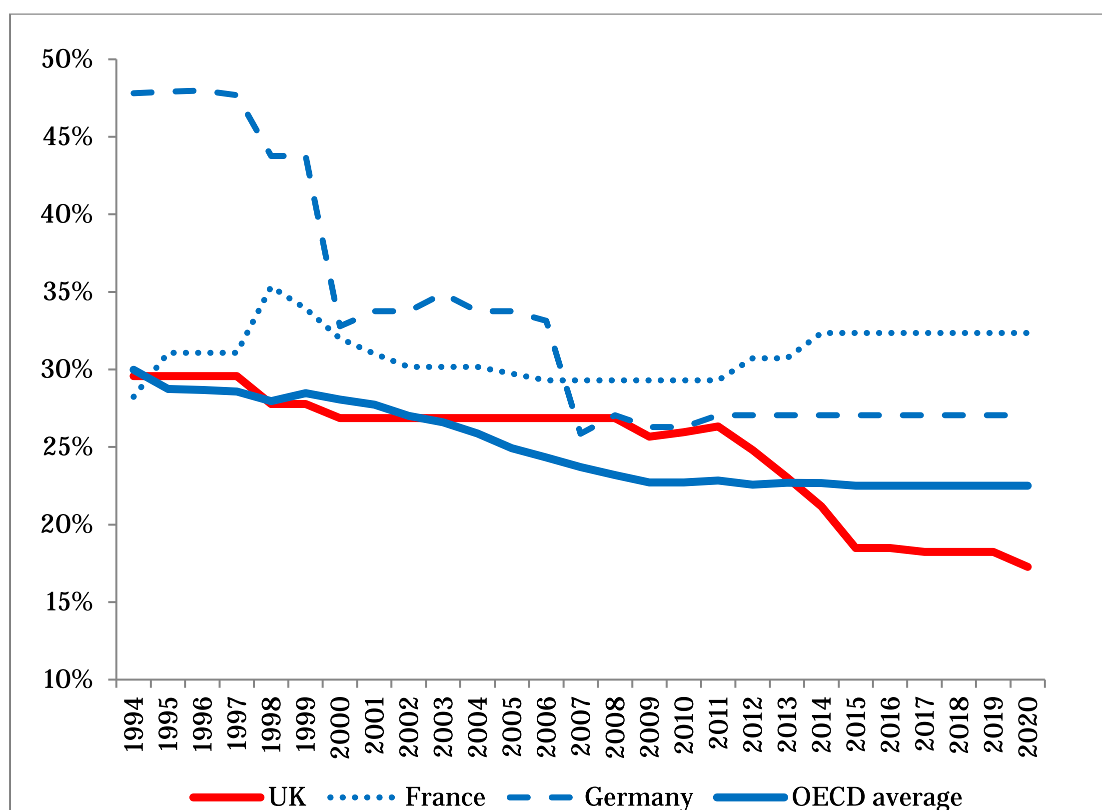


Source: OUCBT tax database. www.sbs.ox.ac.uk/ideas impact/tax/publications/data

[24] UK resident companies can elect that the future results of their present and future non-UK branches be excluded from UK taxable profits, with the exception of non-trading branches. The election is irrevocable and applies to all of a company's branches.

The statutory tax rate measures the attractiveness of a jurisdiction for mobile paper profits.[25] Figure 4 shows that in 2015, the UK rate was about 7.5 percentage points lower than the OECD average[26] and it will be 7.8 percentage points lower in 2020. Although the UK rate is consistently lower than the French and German rates, smaller, low-tax jurisdictions (such as Ireland) have had lower rates that have attracted activities and structures yielding after-tax benefits. Such small jurisdictions have now become relatively less attractive when compared to the current UK corporate tax rate of 20%, reducing to 17% in 2020[27], or to the 10% rate available with the Patent Box.

Figure 5. Effective Average Tax Rates (1994-2020)

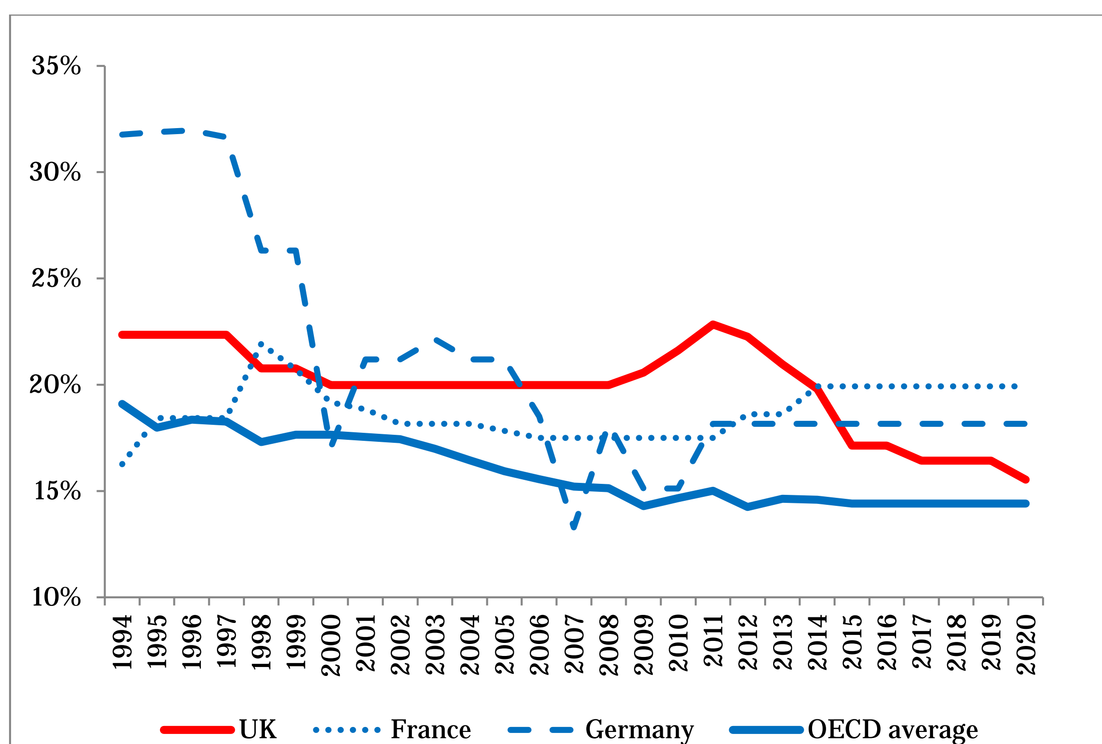


Source: OUCBT tax database. www.sbs.ox.ac.uk/ideas-impact/tax/publications/data

Figure 5 shows the evolution of the EATR[28] that affects the location of investment in the UK, i.e. it affects inward foreign direct investment (FDI). In 2015, the UK EATR was well below the OECD average and it will be even lower in 2020.

[25] The statutory corporate tax rate affects profit-shifting as the marginal incentive to shift an additional unit of corporate profits after all deductions depends on the corporate statutory tax rate.
[26] The OECD average excludes the UK and is unweighted. The same applies for the OECD average EATR and the EMTR shown in Figures 2 and 3.
[27] The further reduction in the UK corporation tax rate to 17% (from the previously planned 18%) was announced in the UK Budget on 16 March 2016.
[28] The EATR depends on the statutory rate and on capital allowances. It is the proportion of pre-tax profit of a typical investment project that would be taken in tax.

Figure 6. Effective Marginal Tax Rates (1994-2020)



Source: OUCBT tax database. www.sbs.ox.ac.uk/ideas-impact/tax/publications/data

Since Nigel Lawson's 1984 Budget, the UK has pursued a corporate tax policy of rate cuts and base broadening. Such a policy has a less direct effect on decisions such as expanding investment, in relation to which other elements of the tax code, such as the availability of capital allowances, are more important at the margin than the statutory corporate tax rate. For this reason, if the UK has improved its competitive position substantially in terms of attracting profits and FDI, the EMTR that affects the size of investment remains relatively high.[29] The tax base and hence capital allowances are very important for the marginal investment project and that is why the UK ranks low on this measure: the UK capital allowances regime is one of the least generous in the OECD.[30] The UK EMTR declined after 2011, but in 2020 it will still remain above the OECD average (Figure 6). This could be problematic. Historically, the UK has had low levels of investment when compared to other developed economies, such as France, Germany and the United States.[31] This could also partially explain why labour productivity is also low.

Although relatively less attractive to industries with large investments in tangible assets because of a relatively high EMTR, overall, today's UK tax system makes the nation a very attractive location for companies to have their headquarters and, more generally, for multinational companies to carry out activities. There are seven main reasons. First, the

[29] The EMTR measures the proportionate increase in the cost of capital due to the tax. It accounts for both the statutory rate and for capital allowances. It affects the size of investment, given the decision to locate in the UK. The EMTR focuses on the margin, i.e. it focusses on a project that just breaks even by earning a return equal to the cost of capital.

[30] See Oxford University Centre for Business Taxation (2015).

[31] London School of Economics Growth Commission (2013).

exemption system of taxation of foreign profits introduced under the Labour government allows parent companies located in the UK to receive dividends from subsidiaries that are exempt from UK corporate income tax. Because of the substantial shareholding exemption introduced in 2002, foreign capital gains are also exempt. Second, the rate of corporate income tax is low with respect to other OECD countries, being 20% in 2015 and with a planned further reduction to 17% by 2020. Third, the presence of a patent box regime with a rate of 10% lowers the tax burden on very mobile factors, such as intangibles and, together with a relatively generous and simple research and development (R&D) tax incentives regime, makes it more attractive to research and own UK-developed patents in the UK, rather than locating them in a low-tax entity.

Fourth, the new and limited CFC regime allows important exemptions that essentially lower the tax burden on CFCs located in low-tax jurisdictions. In particular, the finance company exemption allows the financing of high-tax subsidiaries via a low-tax CFC. Fifth, historically the UK system does not charge withholding taxes on dividends paid from UK companies to their foreign shareholders. The UK has also signed a large number of tax treaties reducing withholding taxes on dividend and interest payments, and on royalties paid to the UK. Sixth, (although the position will, of course, change in due course as a consequence of Brexit, which is discussed later) the UK is part of the European Union: the EU Parent-Subsidiary Directive provides that intra-EU dividends paid by EU subsidiaries to an EU parent are exempt from withholding taxes, and the Interest and Royalties Directive provides that withholding taxes on intra-EU royalty and interest payments are set to zero. Finally, the UK has had generous rules for the deduction of interest payments. Although a worldwide debt cap[32] for large companies was introduced in 2009 under the Labour government, current interest rules remain relatively generous by international standards, although these are to change and become more restrictive, as discussed later.

4.2 Avoidance

Turning to the UK government's stance against avoidance and its support for BEPS, the UK has been widely regarded as one of the leading and most enthusiastic states in the prosecution of that global initiative. George Osborne, Chancellor of the Exchequer between 2010 and 2016, described the UK as having "led the way" in this international action, with the UK "pushing […] for global solutions".[33] The message is echoed from all quarters of government. For example, the Prime Minister at the time of the development of the BEPS policy measures, David Cameron, spoke of his putting the BEPS project at the heart of the G8 agenda and of his call to other G20 leaders to get behind the action plan (Cabinet Office, 2013). In June 2015, the then Financial Secretary to the Treasury (and later Chief Secretary to the Treasury), David Gauke, confirmed that the Conservative government was determined to take the BEPS project ahead and maintain its momentum in order to create a coherent tax system that is fit for purpose for the 21st century (HM Treasury & Gauke, D., 2015). The strong UK championing of BEPS

[32] The debt cap disallows the deduction of costs of net borrowing by relevant UK companies where the finance expenses on these borrowings exceed the gross worldwide external group finance cost. It only affects large groups with 250 or more employees. The debt cap only applies where the aggregate net debt of each relevant group company (calculated on an entity-by-entity basis, excluding debt of less than £3m in any company) exceeds 75% of the worldwide gross debt of the group.

[33] See HM Treasury and HM Revenue and Customs (2014), Foreword by George Osborne, pp 3-4. Also, an early call for action on BEPS was made by George Osborne and Germany's Minister of Finance, Wolfgang Shauble, at the time of the November 2012 G20 meeting.

has led to the UK being the first country to commit publicly to adopting the country-by-country reporting (CBCR) template developed as part of the BEPS Action Plan.

Given that the BEPS project was initiated in 2012, it post-dated the previous Labour government, but the Labour Party has expressed strong support for the initiative whilst in opposition.[34]

4.3 Impact of BEPS on Existing UK Policies[35]

Given the discussion above, it is perhaps not surprising that it has been widely observed that there is a contradiction, or at least a major tension, between the UK's leading role on BEPS and its aggressive tax competition agenda. The government, HM Treasury, and HM Revenue and Customs have all consistently argued that there is no such contradiction or tension. Until very recently, the point has not been directly tested, largely because there have been relatively limited instances in which *actions* have been taken that highlight this clash of agendas. This state of affairs has now changed: the recent UK government proposal to restrict interest deductibility in compliance with BEPS Action 4, not to mention the changes made to the UK Patent Box rules (see further below), show how BEPS measures can affect the UK's competitiveness agenda because the UK regime on interest deductibility is one of the pillars of the UK's competitiveness position (see section 4.1).

A key feature of multilateral, rather than unilateral, measures directed at combatting tax avoidance is typically a loss of total control of the agenda by any single state. This is equally true in the case of the BEPS project, where the agenda is set by a large group of states, some with interests and priorities that are quite different from those of the UK. Germany, for example, has historically been strongly opposed to tax competition. In the BEPS discussions on CFC rules under Action Point 3 of the BEPS Action Plan, the United States is known to have favoured an appreciably tougher and more extensive application of CFC rules to BEPS practices than the more limited CFC approach taken by the UK. Non-OECD member countries directly participating in the BEPS project, such as India and China, wish to adopt a much more expansive approach to the transfer pricing rules than states like the UK. Unsurprisingly, the result is that the proposed actions under the BEPS project are not readily aligned with the domestic UK agenda to create the most competitive tax regime in the G20. As discussed in the previous section, the BEPS project is now heading towards required implementation actions by states, including the UK, that will actively constrain and hinder tax competition policies. This, in turn, means that it will be increasingly difficult, if not impossible, for the UK to maintain its leadership role in delivering BEPS *and* its objective of maintaining a highly competitive tax system simultaneously. It seems likely that it will have to make choices about its real priorities instead.[36] The tensions are likely to be amplified by the implications of Brexit (see below).

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[34] See, for example, the comments made about BEPS by Shabana Mahmood, then Shadow Minister (Treasury) in the debate on the diverted profits tax (Hansard, 7 January 2015, c29WH), and the Labour Party (2014), p. 18.

[35] Whilst the UK may represent an interesting example of a country supporting BEPS and pursuing a tax competition policy, the analysis would, of course, be different in the case of a country generally opposed to tax competition but supporting BEPS. For example, a consideration of Germany, which has historically been a strong opponent of tax competition, would lead to different issues in relation to its support for BEPS, such as whether Germany may be forced into some level of tax competition (e.g. introducing patent box rules) as a result of the agreement in BEPS on patent boxes.

[36] Such choices are already emerging in period of implementation of the BEPS measures. Though a number of the BEPS proposals (such as those relating to hybrid mismatches, interest deductions and country-by-country

This point can be tested by considering various examples of specific rules from the BEPS project that would seem to present material difficulties to the UK if it were to seek to maintain both its leading role in advancing the BEPS project and its drive to maintain a highly competitive tax system.

CFC rules: The work on CFCs within BEPS is intended to strengthen CFC rules. The OECD has recognised, from an early stage, that whilst many countries have introduced CFC and other anti-deferral rules, they do not always counter BEPS practices in a comprehensive way.[37] The point is highly relevant to the OECD's discussion of the purpose of CFC rules. In the lengthy Discussion Draft of 12 May 2015, the OECD recognised that CFC rules may be used to prevent the shifting of income either from the parent jurisdiction alone or from the parent and other tax jurisdictions (OECD, 2015f) The OECD document draws a clear conclusion about the merits of these two approaches:

> CFC rules that focus only on parent jurisdiction stripping may not be as effective against BEPS arrangements for two reasons. First, it may not be possible to determine which country's base has been stripped (for example, in the case of stateless income). Second, even if it were possible to determine which country's base was stripped, the BEPS Action Plan aims to prevent erosion of all tax bases, including those of third countries. This issue is of particular relevance for developing countries. (OECD, 2015f).

These points, and CFC issues more generally, are highly relevant to the UK's position, given that they raise significant competitiveness issues.[38] As is well known, the UK has taken what is essentially a tax competition-led decision (in response to the pressure for tax inversions in the period to 2010) in order to lighten the impact of its CFC regime, so that it functions only to prevent the artificial diversion of profits from the UK, not from third countries. The competitiveness basis of the UK's CFC measures is also reflected in the rules accommodating offshore treasury operations, whereby only a quarter of the profits of a controlled foreign finance company are subject to the UK corporate tax, resulting in a tax charge at the level of 5% or less in 2015.[39] The BEPS work on CFC rules therefore raises some important issues with regard to the UK's trade-offs between its anti-avoidance agenda and competitiveness issues.[40] The OECD work also raises three immediate issues for the UK. Firstly, there may be some degree of pressure on the UK to beef up its CFC rules[41]. Secondly, the increased focus on CFC measures may make other states more inclined to bring UK activity within the ambit of their own CFC rules.[42] Thirdly, it is possible (but does not currently seem very likely in practice)

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reporting) are being taken up by the UK government, there are some BEPS measures (such as the package of CFC measures and certain proposals on permanent establishments) which are not.

[37] See, for example, OECD (2013b, p 16. The point is also emphasised repeatedly in the OECD (2015b), pp. 2 and 6.

[38] As is noted in the OECD Discussion Draft, states with CFC rules may be at a competitive disadvantage relative to jurisdictions without such rules (and, similarly, MNCs headquartered in states with robust CFC rules may find themselves at a disadvantage in competing in foreign markets with MNCs headquartered in countries without such rules). See OECD (2015f), pp. 15-16

[39] It is understood that the level of the (5%) tax charge set for finance companies is the result of a wholly pragmatic approach being reflected in the law.

[40] For this reason, it may prove difficult for states that currently have no CFC measures, such as Ireland and Switzerland, to be persuaded by the BEPS process to adopt them.

[41] At the time of writing, this seems a distant prospect, as the UK seems committed to maintaining its current approach to the operation of CFC rules.

[42] By being less than 25%, the rate of UK corporation tax already brings UK activities potentially within the CFC regime of Germany, where the relevant German conditions of passive income (being all income that is not

that the OECD's investigation of "special measures" to supplement the CFC rules may at some point in the future be revisited, resulting in increased foreign taxation by third party states where an effective CFC rule is not in place.[43] Each of these issues has the potential to reduce the UK's competitiveness position, also based on light CFC rules.

Harmful tax practices work and the UK Patent Box: The harmful tax practices work under Action 5 has already led to an instance in which the BEPS project has had the effect of reining back an important component of the UK's tax competition measures; in this case, the Patent Box. Specifically, the 2015 OECD Forum on Harmful Tax Practices (FHTP) reached an agreement about the new rules that will determine what will constitute the required level of "substantial activities" in the context of preferential IP regimes (OECD, 2015a). The compromise agreement was, in turn, based on a UK-German agreement for a proposal (HM Treasury, 2014), which adopted, though in a varied form, the "modified nexus approach" as set out in the earlier OECD BEPS paper, "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance" (OECD, 2014b). The modified nexus approach essentially provides that the development of the patents has to be carried out in the jurisdiction granting the patent box benefits.[44] The UK-German agreement was the result of some intense pressure from a number of countries about the position of the UK (which was seen as overgenerous) in relation to the scope of the UK Patent Box regime. The FHTP agreement will mean that all preferential IP regimes are applicable only to patents (or patent-like assets) and may only confer benefits in line with the modified nexus approach.[45] One practical result of this is that the preferential IP regimes covered by the FHTP agreement will become common in many countries, thus potentially reducing the benefits of more bespoke regimes, such as the one that has operated in the UK.

Interest deductions: The tax treatment of related party debt financing and, specifically, the tax deduction that is generally available for interest and other financial payments, has been a key area of concern since the BEPS project's inception.[46] The discussion of the issue in the Action Plan identifies two situations (both illustrated in Figure 7) in which the deduction of interest can give rise to double non-taxation. From an inbound perspective, the concern is primarily with lending from a related entity that benefits from a low-tax regime to create excessive interest deductions for the issuer without a corresponding interest income inclusion by the holder. From an outbound perspective, a company may use debt to finance the production of exempt or deferred income, thereby claiming a current deduction for interest expense while deferring or exempting the related income (OECD, 2013b). The relevance of these situations to the tax competition agenda of the UK is centred on the second (outbound) perspective, because the current UK rules potentially facilitate the exact situation that is targeted by the

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mentioned in a list of activities that are considered active) and control are met. The UK rate would potentially bring UK entities within the scope of the Japanese CFC rules but for the fact that the effective tax rate threshold of those rules (which was, until recently, 20% or less) has now been changed to less than 20% by the recent Japanese tax reforms (applicable for fiscal years beginning on or after 1 April 2015) in order to ensure UK companies fall outside this threshold test. The Japanese CFC rules will again become an issue for UK entities when the projected corporation tax rate reductions scheduled for 2017 and 2020 are activated.

[43] In 2014-15, this work on special measures was pursued by Working Party 6 in the area of transfer pricing as part of Actions 8-10 of the BEPS Action Plan.

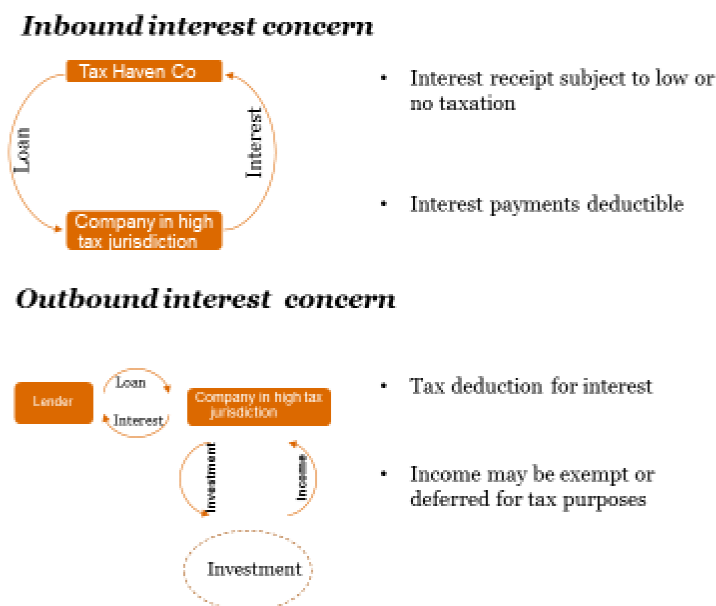
[44] The Germany-UK agreement provides that up to 30% of the patents can be developed in outsourcing.

[45] Under the proposal, new entrants will be allowed under existing patent box rules until 30 June 2016. To allow time to transition to the new regime based on the modified nexus approach, the IP that is within existing regimes will be able to retain the full benefits of these until June 2021. As with other aspects of the BEPS programme, there are open questions as to whether the OECD proposals on patent box regimes and the nexus approach can be readily reconciled with EU law. This matter is beyond the scope of this article.

[46] OECD (2013b), pp. 6, 10, 37, 43, and 48. See also the finalised report, OECD (2015g).

OECD. The inbound concern would clearly be relevant to the offshore finance entities that are treated benignly by the UK CFC rules.

Figure 7. Inbound and Outbound Interest Concern



Under the current UK tax rules, interest deductions are, in principle, available notwithstanding that the debt in respect of which that interest is paid may be financing overseas subsidiaries held from the UK that give rise to tax-exempt foreign income. For example, since 2009, foreign dividends have been exempt from the UK corporate income tax. In many other European countries, however, where such tax-exempt foreign income is received, an interest deduction would typically not be available. The availability of an interest deduction in these circumstances has been a significant factor in encouraging businesses to use the UK as a regional holding location (Section 4.1).

The OECD proposals on interest are intended to lead to significant reductions in the level of interest deductions available to MNEs. The Final Report, released in October 2015, considers two options. Firstly, a fixed ratio test, such as allowing a deduction for interest up to a given percentage of an entity's taxable earnings before interest, taxes, depreciation and amortization (EBITDA). Secondly, a group-wide allocation of interest based on the external interest expense (i.e. loans from unrelated parties) but with the worldwide interest expense being allocated globally rather than being fully deductible in each territory, as the rather more generous UK debt cap allows (OECD, 2015g).

Targeted anti-avoidance rules restricting deductibility in specific situations are considered appropriate when used in conjunction with a general rule, but are not sufficient to prevent BEPS on their own (OECD, 2015g, pp.71-72).[47] The implications for the UK are, therefore, that a new general rule would need to sit alongside the current targeted anti-avoidance rules.

[47] In broad terms, the final OECD proposal on this action point is for an interest restriction based on a fixed ratio of interest: EBITDA (10%-30% at a country's choosing) though potentially subject to the actual ratio of a group's external debt if higher and certain other exemptions apply.

Although the UK debt cap rule is in place, so far the restriction on deductibility has generally been pitched at such a high level that it has not affected a significant number of groups, meaning that other anti-avoidance, interest deductibility provisions are generally more relevant.[48] Just prior to the Brexit vote, it was announced that new rules were to be introduced in the UK from 1 April 2017 to apply the OECD BEPS measures on interest deductibility, resulting in a significant change from the previous position (discussed earlier).[49]

Increased Source Country Taxation: Although the BEPS project has not set out to deliver a change in taxing rights between source and residence countries,[50] it has been widely acknowledged, including implicitly by the OECD,[51] that this will be an incidental effect of a number of the BEPS action points, as a result of what it refers to as the restoration of both source and residence country taxing rights, given that source taxing rights typically take precedence.

Increased source taxation will arise from a number of the BEPS action points. This includes various proposed PE changes from the work on Action 7 of the Action Plan, including: the widening of the dependent agent PE rule; the narrowing of the independent agent exemption; the narrowing of the specific activity PE exemptions of Art. 5 (4) of the OECD Model; and the introduction of an anti-fragmentation test to prevent attempts to circumvent the application of the threshold PE test. Increasing source taxation will also arise from an increase in payments that are no longer to be tax-deductible, e.g. under the proposals for dealing with hybrid instruments under Action 2, or as a result of the focus on management fees and head office expenses under Action 10. Finally, increased source taxation will also arise from payments that are no longer recognised in whole or in part, e.g. under the various transfer pricing actions under Actions 8 - 10. There will be two effects for source countries: tax revenues will probably increase but, at the same time, investment may decrease because of higher local taxation. This is relevant for both developed and developing economies. Developing economies tend to have higher inbound than outbound FDI as a share of their GDP (Figures 8 and 9), but inbound FDI is also very large in developed economies (Figure 9). The effect on MNEs active in various source jurisdictions but headquartered in capital exporting countries, such as the UK, (Figure 8) will be that such multinationals will invest less or will shift their investments to different jurisdictions to get to the same post-tax return to capital.

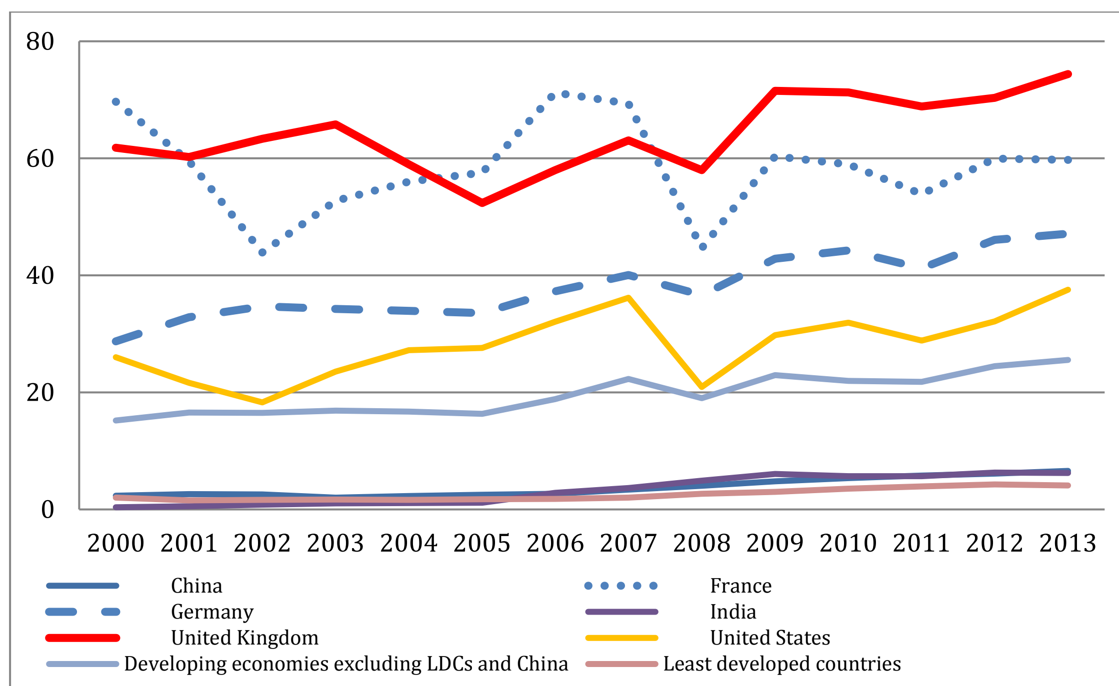
[48] The UK debt cap operates, broadly, by capping the amount of UK deductible interest by reference to the amount of total interest paid globally by the group as a whole to third parties - see Taxation (International and Other Provisions) Act (TIOPA) 2010, Part 7. Other interest deductibility anti-avoidance provisions that are more likely to apply include restrictions as a result of the transfer pricing/thin capitalisation doctrine (see TIOPA 2010, Part 4) or the unallowable purposes rule of CTA 2009, s.441.

[49] See further, HM Treasury & HM Revenue and Customs (2015). The OECD proposals on Action Point 4 also suggest that a general rule restricting interest deductibility should apply to: companies in a group, including PEs; connected parties not in a group (e.g. if there is control by an individual, fund, or trust); and related parties (e.g. where there is a significant relationship but not enough to establish control). Such a rule would therefore apply more widely than the UK debt cap and only single entities would be carved out - see OECD (2015g), Chapter 3. However, unlike a number of the other BEPS proposals, the work on interest deductions under Action Point 4 is designed to identify best practice options available to states. The non-mandatory nature of the output therefore gives states some flexibility - and the ability to not adopt the proposed options without being in breach of the BEPS requirements.

[50] A "source" country is one in which the income of a non-resident arises and is typically subject to tax in that country, whether as a result of that state specifying that the source of certain types of income is in that state or by specifying the items of income that are taxable in the hands of a non-resident in that state. See further Avery Jones et al. (1998), p. 78.

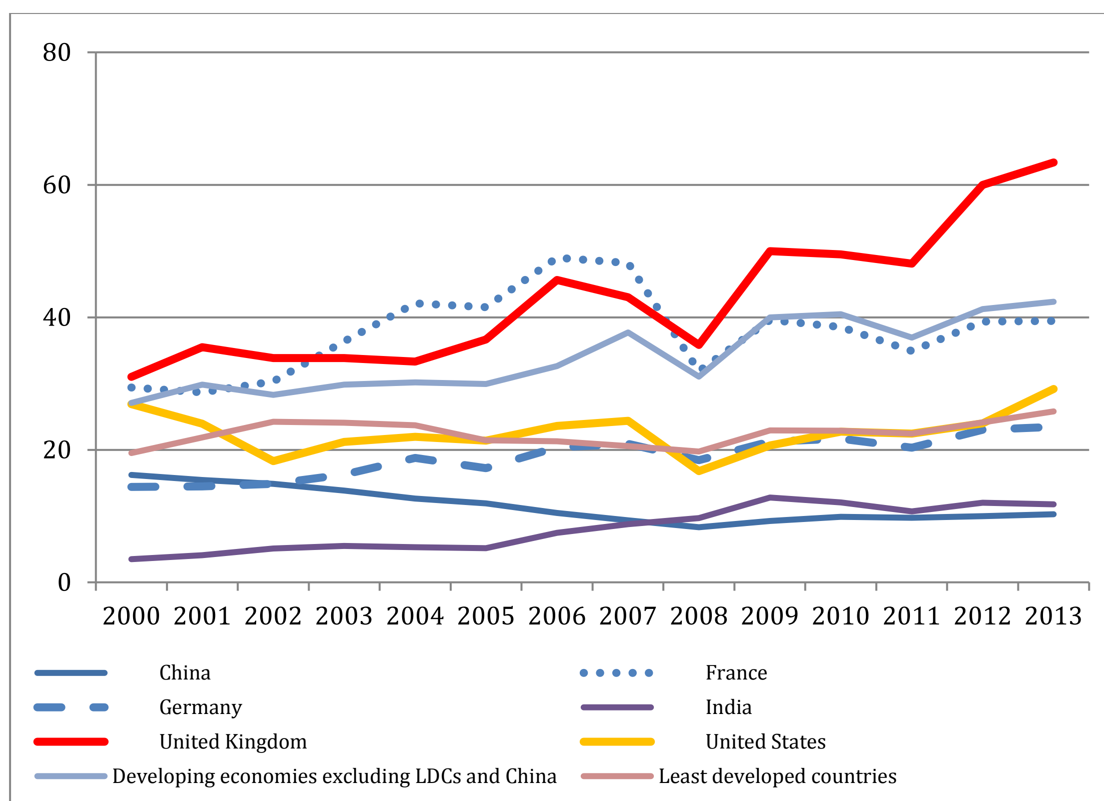
[51] See, for example, OECD (2015c), p. 9, paragraph 3, and the more general discussion of source taxing rights at OECD (2013a) pp. 35-36. The initial OECD position was a greater enthusiasm to take the source versus residence allocation of taxing rights head-on. See further OECD (2013a), p. 7, although this was soon modified.

Figure 8. Outward Stock FDI (% GDP) (2000-2013)



Source: UNCTADStat, www.unctadstat.unctad.org

Figure 9. Inward stock FDI (% GDP) (2000-2013)



Source: UNCTADStat, www.unctadstat.unctad.org

OECD proposals on treaty abuse: A similar point to the one made earlier about increased source taxation relates, in particular, to the use of separate or intermediate vehicles, such as regional holding companies receiving dividends, group treasury companies receiving interest, or companies holding IP rights and receiving royalties. Such companies seek to benefit from tax treaties, usually in order to reduce or remove withholding tax that is otherwise levied in the source country (Figure 2). This follows on from the BEPS work on Action 6, Prevent Treaty Abuse, which is designed to prevent the granting of treaty benefits in inappropriate circumstances.[52] Given that UK's tax competition policies are directed at attracting businesses that often use this type of vehicle, it seems likely that there would be some level of impact on inbound payments to the UK.[53] It might also be argued that any such change would also benefit the UK, if using other jurisdictions for intermediate vehicles were to become more difficult.

Wider Impact of Harmful Tax Practices Work: The harmful tax practices work has been considered earlier in relation to the agreement reached about using the modified nexus approach for IP regimes. However, the intention is that the work under Action 5 should proceed on a much broader footing, including ensuring an appropriate 'substantial activity' test in any preferential regime. It is possible that this may, in the future, raise further issues of relevance to the UK, although at this stage there is nothing to suggest this would be the result. The general point, however, is that the BEPS project's revamp of the OECD's focus on harmful tax practices may be unhelpful to those states wishing to pursue aggressive tax competition agendas.

The likely effect of each of the above examples of work under the BEPS project will be to challenge, to some degree, the competitiveness of the existing UK tax regime. The BEPS project will, therefore, clearly put pressure on the UK's tax competition agenda. This will make the UK's simultaneous championing of the two agendas (i.e. strong support for the BEPS agenda and the aggressive tax competition agenda) more difficult, if not impossible, in the absence of either a tempering of the ambitions of the BEPS project, or some material changes to the way in which the UK seeks to deliver on its tax competition ambition, or both (see below).

Notwithstanding these comments, it is possible to envisage a contrary line of argument to the effect that, in practice, the BEPS project will actually help the UK's tax competition/"open for business" agenda, primarily by bringing about the relocation to the UK of capital, entities, and activities that were formerly based in tax haven or low-tax states, such as Luxembourg and Ireland. The argument would presumably be based on the incremental difficulty - due to the OECD actions under the BEPS project - of operating in such states, when compared to operating in the UK, coupled with the attraction of the relatively low UK tax rate, as now prospectively reduced to 17% by 2020. The likelihood of this result is not considered to be especially strong, particularly given that the UK is heavily reliant on its competitiveness with regard to a number of measures that are targeted by the OECD BEPS project, such as the UK's generous interest deduction and its CFC rules. Also, some countries, like Ireland, currently

[52] It is proposed that states could achieve this by taking one of three possible approaches to curb treaty abuse: namely by introducing (1) a limitation on benefits (LOB) provision accompanied by a principal purpose test (PPT); (2) a LOB accompanied by a narrower anti-abuse rule; or (3) a stand-alone PPT. See further, OECD (2015i).

[53] Though not a BEPS measure per se, the 2014 changes by the OECD to the beneficial ownership test in tax treaties (which, in practice, functions in a very similar way to the type of anti-abuse mechanisms being discussed in the work on Action Point 6) are already being advanced by some tax authorities as the reason for restricting treaty benefits, and this includes in relation to payments made to the UK. See further OECD (2014a).

compete largely on a rate-based approach. This would suggest that such countries would be less vulnerable to the BEPS agenda, which is much more focussed on specific tax regimes than on the level of the tax rate itself.

4.4 Options for the UK

There has not been a great deal of discussion as to whether or not tax competition is the best way forward for the UK. As we have highlighted in Section 2, depending on the circumstances, tax competition could reduce or increase welfare.

Also, there has been little discussion about the kind of investment that is worth attracting to the UK. Headquarters operations generally pay high salaries and employ highly skilled workers but, in an economy with low productivity and low investment, the composition and type of investment that the government wants to stimulate is very important. Historically, UK investment levels have been lower than those of other developed economies, such as France, Germany and Japan (London School of Economics Growth Commission, 2013). In the wake of the global financial crisis, investment levels have dropped substantially. Whilst economic growth and employment levels in the UK have recovered after the crisis, productivity growth has stalled and output per hour is still well below its pre-crisis trend (London School of Economics Growth Commission, 2013). Economists have debated which factors have contributed to the low UK productivity growth.[54] Views differ, but there is consensus about one factor: low investment especially low investment in equipment that includes information and communications technology (ICT), is a key, although not the sole, determinant. New, more technologically advanced, plant and machinery, and ITC would produce efficiency gains that would increase labour productivity.

A further factor to be considered is the impact of Brexit. As a general matter, the government has put material emphasis on the UK's "open for business" stance since the Brexit decision of 23 June 2016.[55] In that context, it has taken very little time for questions of tax policy, particularly the UK's intention to remain as tax-competitive as possible, to feature in the discussion. Within days of the Brexit vote, the then Chancellor of the Exchequer, George Osborne, was talking of the possibility of a 15% UK corporation tax rate (Parker, 2016). The corporation tax rate issue has arisen again more recently, in the context of a discussion about the possibility of a "hard" Brexit, this time with suggestions that it could be halved if necessary (Kentish, 2016), suggesting the possibility of a rate of less than 10%. Inevitably, much of this discussion is somewhat speculative, but it does underline the significance of tax measures to any general competitiveness or "open for business" agenda. It is also a salutary reminder of how swiftly (and emphatically) political agendas (including those related to tax policy) can change.[56]

Given that remaining highly competitive is therefore a key part of the UK government's economic policy agenda, we will now investigate the different ways in which the UK tax

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[54] See, for example, Goodridge, Haskel, and Wallis (2015); Pessoa and Van Reenen (2013).

[55] See, for example, amongst numerous instances, Prime Minister Theresa May reinforcing the UK's "open for business" stance to U.S. business leaders on 19 September 2016 ("Prime Minister Theresa May: Britain is Open for Business") and the same message being delivered to the G20 as reported in the Guardian (Khomami, 2016).

[56] It is not suggested here that the UK government's wish to counter BEPS practices by MNEs has ceased, but it does seem likely, based on the emphasis from government on the "open for business" agenda, that the consequences of Brexit will affect the relative level of prioritisation of the tax competition agenda as compared with the position prior to the Brexit vote.

system can remain attractive whilst being compliant with the OECD BEPS initiative. In this scenario, the government will have to implement revisions to some specific measures aimed at attracting highly mobile capital and profits, such as the Patent Box regime and, possibly, interest deductions. At the same time, the UK would reduce the tax burden on both mobile and less mobile activities by implementing economy-wide cuts. Three main measures may be considered:

1. **Reduction in the headline corporate tax rate**. This is an option that was immediately pursued by the Conservative government, with the inclusion within its Budget announcement of 8 July 2015 of the intended reduction in the UK Corporation Tax rate to 19% in 2017 and 18% in 2020. Whilst, arguably, giving the UK an early-mover advantage in the post-BEPS environment, it seems likely that pressure on the UK corporation tax rate will continue as other states also reduce their tax rates for corporates.[57] This seems to have been borne out by the subsequent Budget announcement of 16 March 2016, which stated that the 18% rate planned for 2020 would be reduced further, to 17%. Reductions in the rate of corporation tax will increase the incentive for businesses to locate profits and FDI in the UK. It will also, to a lesser extent, increase the incentive to expand physical investments, once investments have been located in the UK. Table 1 shows that a further cut in the corporate statutory tax rate to 15% would substantially reduce the EATR from 18.49% in 2015 to 14.04%, and the EMTR from 17.14% in 2015 to 12.77% (bottom panel). The UK EATR would become the lowest in the G20 (having been the fifth lowest in 2015), and its EMTR would become the fifth lowest (up from the tenth lowest).

[57] It seems likely that states such as Luxembourg, which have pursued tax competition policies based on the availability of specific tax regimes, may find such an approach significantly harder as a result of the OECD BEPS project. The result is likely to be that, for such states, future competitiveness will be based more on the rate of tax, which is therefore likely to lead to future cuts in the headline rate. Also, the United States may, for quite different reasons (in particular, the long discussed US tax reform) reduce its rate of tax on corporates.

Table 1. UK EATRs and EMTRs Under Different Scenarios.

	EATR (18.49% in 2015)	EMTR (17.14% in 2015)
Capital Allowance 20%	15.71%	14.11%
Capital Allowance 25%	15.49%	13.33%
Corp. Tax Rate 17%	15.82%	14.51%
Corp. Tax Rate 15%	14.04%	12.77%
Allowance for buildings 4%	15.04%	11.67%
ACE	15.40%	4.08%
G20 Ranking		
	EATR (5th in 2015)	**EMTR (10th in 2015)**
Capital Allowance 20%	1st	8th
Capital Allowance 25%	1st	6th
Corp. Tax Rate 18%	1st	8th
Corp. Tax Rate 15%	1st	5th
Allowance for buildings 4%	1st	5th
ACE	1st	2nd

Note: With the exception of the case in which the corporate tax rate is 15% or 17%, the EATR and EMTR have been calculated using a corporate statutory tax rate of 17%.

2. **Increase in capital allowances**. In an environment of low corporate rates, it is unclear how low the rate should go.[58] Further cuts will entail additional revenue losses but, given that the current 20% rate is (without taking account of the future reductions referred to above) already lower than that of many of the UK's competitors, it is not clear how much extra capital a further reduction would attract.[59] Additionally, tax policy primarily based on headline rate cuts does not take into account the fact that, when making decisions such as expanding investment in physical capital and ICT, capital allowances are also important in reducing the user cost of capital.

   Increasing capital allowances affects the incentives to locate FDI in the UK and also to expand investment once investment has been located in the UK. Recent evidence from the UK and the United States shows that an increase in capital allowances stimulates investment in equipment (including IT and software) substantially and also rather quickly.[60] Capital allowances could be important in

[58] It is recognised that, in addition to any international tax aspects of the rate of tax, there will also be a number of very significant domestic matters that will need to be considered.
[59] The answer will clearly depend on the reaction of other jurisdictions.
[60] For the UK, see Maffini, Xing, and Devereux (2016). For the United States, see Zwick, and Mahon (2017).

increasing productivity growth in the UK via providing further incentive to increase capital stock. Raising general capital allowances for plant and machinery to 20% would reduce the EATR and the EMTR to 15.71% and 14.11% respectively (Table 1). A more robust increase to 25% would reduce the EATR to 15.49% and the EMTR to 13.33%. In this case, the UK EATR would become the lowest in the G20, but the EMTR would become the sixth lowest, up from the tenth lowest rate in the G20 (Table 1).[61] Re-introducing capital allowances for commercial and industrial buildings at 4% would reduce the EATR to 15.04% and the EMTR to 11.67%. In principle, this would improve the competitive position of the UK: the EATR would become the lowest and the EMTR the fifth lowest. Nonetheless, evidence shows that, whilst investment in equipment is responsive to changes in the EMTR, investment in structures is rather insensitive to the EMTR (Bond & Xing, 2015).

3. **Introduction of an allowance for corporate equity (ACE).** Under an ACE, an imputed return on equity is deductible from the tax base, to mimic the tax break on debt.[62] An ACE would affect the incentive to locate real investment in the UK and also to expand investment once investment has been located in Britain. The difference between increasing capital allowances and introducing an ACE is that the latter will affect incentives to locate and expand real investment in the UK only if such investment is financed by equity. Increasing capital allowances affects all types of investment, independently of their financing. The ACE has some interesting properties in the context of the BEPS project: since it allows a deduction for the costs of equity financing, it removes the traditional distortion of the corporate income tax system, which favours tax-driven excessive levels of debt. Additionally, since both debt and equity costs are deductible, in principle, there should not be any need to define debt and equity for corporate income tax purposes. This would make a major contribution to simplifying UK tax law, given the large number of separate provisions seeking to police the debt-equity border for tax purposes. This would also make tax planning based on such distinctions (such as hybrid financial instruments) otiose and, therefore, help with a key part of the BEPS agenda.

   Restricting the generous UK interest deduction (in implementing the BEPS measures on the restriction of interest) whilst, at the same time, introducing an ACE would potentially assist with: compliance with a key part of the BEPS agenda; maintaining UK competitiveness; and generally improving the efficiency of the UK tax system by reducing the incentive to leverage.

   Introducing an ACE would reduce the EATR to 15.40%, without affecting its G20 ranking. Instead, the EMTR would drop substantially from 15.82% (calculated using the 17% statutory rate available from 2020 onwards) to 4.08%, and the UK EMTR would become the second lowest in the G20 (up from the tenth lowest).

[61] An increase in the threshold of the Annual Investment Allowance (AIA) will only affect the EMTR for firms with investment below the threshold. This implies that only firms with investment below such threshold will see their incentives increase. Overall such firms only contribute to a small share of aggregate investment and, hence, the effect of the overall AIA is likely to be small, unless the AIA threshold is set at very high levels.

[62] The ACE was first proposed by the IFS Capital Taxes Group. For more details, see IFS Capital Taxes Group (1991). The introduction of an ACE in the UK has also been proposed by the Mirrlees Review (The Institute for Fiscal Studies (IFS) & Mirrlees, 2011).

> Resistance to the introduction of an ACE seems to come from the idea that the corporate statutory tax rate would need to increase to compensate for the lost revenues (de Mooij & Devereux, 2011). One compromise would be to introduce an ACE only on new capital. This would limit revenue losses at the onset.[63] Also, since new capital is more likely to flow to more efficient, more productive businesses with better outlooks, the tax system would allow for a better allocation of capital in the economy.
>
> In a submission to HM Treasury's consultation of October 2015 on restricting interest deductibility (see 4.3 above), we have suggested allowing the same notional deduction for debt and equity financing, so as to eliminate the tax incentive for debt financing relative to equity financing. The change would also remove the incentive for tax planning arrangements designed to exploit the inherent debt bias in the tax rules (Collier, Devereux & Maffini, 2016).

Since countries are constantly changing their own tax rates and bases, and will also need to address their own priorities in accepting and implementing the BEPS package, the maintenance of a highly competitive position for the UK will inevitably depend on what other countries decide to do when implementing the specific recommendations of the OECD BEPS project.

CONCLUSIONS

The following conclusions may be drawn on the basis of the above discussion:

- The OECD BEPS project set off to combat tax avoidance by multinational companies but, in fact, it is inherently a project about limiting tax competition between countries. Multinationals avoid corporate and other business taxes by exploiting specific tax regimes put in place by sovereign states in order to attract mobile capital and profits from other jurisdictions.
- Nonetheless, the OECD BEPS project is unlikely to stop tax competition. In the current climate, coordination is not incentive compatible. This means that there are countries, mostly small open economies, which will gain from tax competition with larger jurisdictions.
- With BEPS, the nature of the tax competition game will change, however. It will become more difficult to compete through individual tax regimes targeted at mobile capital and profits (i.e. multinationals). At the same time, countries will still have a number of tools at their disposal which will enable them to reduce the cost of capital and, hence, attract investment.
- Most likely, some countries will cut their corporate statutory tax rate in order to attract mobile capital and profits. In summer 2015, the UK announced a further 2 percentage point cut in the corporate statutory tax rate so as to reach 18% by 2020, with a further rate cut (to 17% by 2020) announced in the Spring of 2016. In a few years, because of BEPS, we may end up with a much lower average corporate statutory tax rate in the OECD. In fact, many OECD and G20 countries have recently implemented or planned

[63] Though this might be problematic whilst the UK is still a member of the EU, the position may be viable post-Brexit. For example, Turkey has introduced an ACE for newly-issued equity as from 1 July 2015 – see OECD (2016), p. 42.

cuts in their statutory corporate tax rates. Such countries include Denmark, France, India, Italy, Japan, Luxembourg, Spain, Portugal and the UK.

- In order to attract or retain mobile profits arising from the exploitation of patents, the countries which do not already have patent boxes will probably adopt versions which are compliant with the BEPS modified nexus approach. Ireland has announced the introduction of a knowledge development box with a rate of 5%. Despite not being particularly aggressive in terms of tax competition, Italy introduced a patent box with effect from 1 January 2015.
- Countries could also increase the depreciation allowances for investment. This would decrease the cost of capital and, hence, have the potential to boost both FDI and domestic investment.
- Another way of reducing the cost of capital under BEPS would be to introduce an Allowance for Corporate Equity (ACE). Surprisingly, the ACE was not discussed in the OECD BEPS project but it has characteristics in line with some of its key aims. In particular, the ACE reduces the incentives to finance investment and activities with debt instead of equity and, at the same time, by treating debt and equity in a similar way, it reduces the incentives to classify financing instruments as debt (instead of equity). To eliminate such incentives entirely, the tax system could give the same notional deduction for both debt and equity financing, as we argue in a parallel work.[64]
- With the exception of the patent box, the tools mentioned above lower the tax burden on all types of capital and profits, whether they are mobile or not. This has the advantage of providing the same tax incentives for both domestic and multinational activities but, as shown in Keen (2001), this could entail larger welfare and revenue losses than a tax competition strategy that only targets mobile capital and profits. Hence, the overall effect of BEPS on citizens' welfare is unclear a priori. The distributional implications of BEPS and of a different type of tax competition are also unclear a priori. Since both BEPS and tax competition target corporations and not individuals directly, we cannot derive any implications as to whether or not BEPS will improve the distributional properties of the tax system.

[64] If adopted on a wider footing by states, such an approach would also potentially remove the incentive for tax-driven use of many hybrid financial instruments which are otherwise targeted by extremely complex rules. See further OECD (2015h).

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THE IMPACT OF TAX COMPLIANCE COSTS ON TAX COMPLIANCE BEHAVIOUR

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Abstract

This paper is based on a study that determined whether or not an increase in income tax compliance costs leads to a decrease in income tax compliance.

The tax context experiment involved 75 small and medium entrepreneurs based in Dar es Salaam, Tanzania's business hub. The participants were first randomly assigned to one of the three experiment treatments. In the first treatment, the tax compliance cost was TAZ 50,000; in the second, it was TAZ 100,000; and in the third, it was TAZ 166,667. Each participant in each treatment received income of TAZ 1,000,000. TAZ is a laboratory currency which, at the end of the experiment, was exchanged at the rate of TAZ 120 for 1 actual Tanzania shilling (Tsh). Generally, the results indicated that tax non-compliance significantly increased as tax compliance costs increased.

Although the study used small samples of SME taxpayers, therefore the results may not be generalisable, the results imply that tax compliance costs may be responsible for the unsatisfactory tax compliance levels of SME taxpayers. Therefore, there is a need for tax system simplification.

INTRODUCTION

Considerable literature on the complexity of tax laws and tax compliance costs has primarily centred on: the simplification of tax laws; causes of complexity in these tax laws; the measurement of the complexity of tax laws; the impact of such complexity on tax compliance costs; and the estimation of tax compliance costs (Heyndels & Smolders, 1995; Cuccia & Carnes, 2001; Forest & Sheffrin, 2002; Evans, 2003). So far, however, little attention has been paid to the impact of tax compliance costs on tax compliance behaviour, particularly in the context of developing countries, such as Tanzania. In fact, a review of literature on value-added tax compliance costs by Luca, Richard and Jaime (2012) concluded that literature examining this relationship was missing. This conclusion prompted them to call for further studies in this area, arguing that "it might be productive to pursue this line of research, most probably through a variety of survey instruments, and with appropriate country specificity" (Luca, Richard, & Jaime, 2012, p.58).

Tax compliance definitions include the voluntary payment of taxes in accordance with the spirit of the tax laws (i.e. committed tax compliance); the payment of tax for fear of penalties and audits in line with the spirit of tax laws (i.e. capitulative tax compliance); and the paying of taxes after arranging taxpayers' activities to minimise tax liabilities by complying with tax laws (James & Alley, 2002; McBarnet, 2001). Tax compliance has also been defined as occurring when a taxpayer "register[s] with the revenue authority as required; files the required returns on time; accurately reports tax liability (in the required returns) in accordance with the

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prevailing legislation, rulings, return instructions and court decisions; pays any outstanding taxes as they fall due; and maintains all records as required" (McKerchar & Evans, 2009, pp. 172-173). In this study, however, tax compliance refers to the reporting and paying of tax liabilities in order to comply with tax laws. Therefore, the study excludes some aspects of tax compliance identified in other studies.

Tax compliance occurs when taxpayers obey tax laws (Kirchler, Muehlbacher, Kastlunger, & Wahl, 2007). Yet, tax compliance costs are incurred exclusively for a tax compliance purpose; in essence, such costs are only avoidable when taxation is abolished (Sandford & Hardwick, 1989; Ariff, Ismail & Loh, 1997). This paper investigates the impact of tax compliance costs on the tax compliance behaviour of Small and Medium Enterprises (SMEs) in Tanzania experimentally. In this study, SMEs constitute enterprises with between five and 99 employees, or whose capital investment (in assets) ranges from 5 million Tanzanian shillings (Tshs) (about £2,000) and 800 million Tshs (about £320,000) (*Small and Medium Enterprise Development Policy*, 2003).

Generally, tax compliance costs tend to be regressive in nature (Sandford & Hasseldine, 1992; Pope, 1995; Schoonjans, van Cauwenberge, Reekmans, & Simoens, 2011). In fact, SME taxpayers may face economic hardship as a result of proportionately higher compliance costs (Schoonjans et al., 2011) and their tax compliance levels may be lower (Arachi & Santoro, 2007). High tax compliance costs may explain why SMEs' tax compliance levels are lower than expected, as many of these business entities may perceive the tax systems to be unfair. Subsequently, knowing whether tax compliance costs impact on the SMEs' tax compliance is useful when considering how to combat their tax non-compliance. In this regard, this paper explores whether or not an increase in income tax compliance costs leads to a decrease in levels of income tax compliance.

The paper makes four contributions to tax compliance literature. Firstly, it contributes to the literature on the relationship between tax compliance costs and tax compliance behaviour. Secondly, it adds to the growing body of tax compliance costs literature from developing countries' perspectives. Many such studies have been conducted in developed countries. At the local level of Tanzania, only one such study has been conducted, measuring the tax compliance costs of excise duty (Shekidele, 1999). Additionally, differences in willingness to comply with tax obligations, the efficiency of tax authorities and resource utilisation might hamper the effective application of tax compliance factors which have been developed and tested in developed countries in developing countries. Thirdly, the study has used SME taxpayers in the laboratory experiment. Only a few researchers, such as Torgler (2003a) and Cadsby, Maynes, & Trivedi (2006), have used taxpayers in laboratory experiments. Finally, tax authorities can enhance their tax simplification programmes by focussing on reducing tax compliance costs. The results suggest that a decrease in tax compliance costs can increase SMEs' tax compliance levels.

Section 2 reviews the prior tax compliance literature and develops the hypotheses for this study. Section 3 presents the research method. Section 4 presents data analysis and, finally, Section 5 discusses the results, before presenting a conclusion.

2. PRIOR LITERATURE AND DEVELOPMENT OF HYPOTHESES

SMEs' Income Tax Administration in Tanzania

The Tanzania Revenue Authority (TRA) is responsible for administering income tax collection in Tanzania. Specifically, in Tanzania, the payment of income tax is based on self-assessment; however, all corporate taxpayers are required to have their tax returns signed by tax consultants (The Income Tax Act, 2004). A corporation is any company with incorporated or unincorporated association of persons, excluding partnerships (The Income Tax Act, 2004). Thus, corporate taxpayers include corporations of all sizes (small, medium and large). Tanzania's corporate SMEs have to keep complete records regardless of their turnover, which may increase their tax compliance costs. Sole traders with turnovers of below TZS 20,000,000 (£8,000), however, may opt to use a presumptive tax system for their liabilities to be charged on turnover. Presumptive tax systems base their imposed taxes on sales, rather than on profits (Arachi & Santoro, 2007). Currently, the authority is attempting to reduce tax compliance costs by increasing the application of information technology for filing tax returns online, keeping records through Electronic Fiscal Devices (EFDs) and paying taxes using mobile banking, hence saving time and money for taxpayers.

Tax Compliance and Complexity of Tax Laws

Tax law complexities relate to the specialised nature of the tax laws, which complicate the calculation of tax payable (Mulder, Verboon, & De Cremer, 2009). Essentially, tax law complexities are of two types: content complexity and compliance complexity. While content complexity involves difficulties inherent in comprehending tax laws, compliance complexity refers to hurdles that need to be overcome in order to comply with tax laws (Mulder et al., 2009; Saad, 2010).

Generally, tax laws serve several purposes: revenue generation; equity; efficiency and social purposes; however, this might be at the expense of tax law simplicity. It can be argued that the main goal of tax laws is to raise tax revenue (Quandt, 1983; Forest & Sheffrin, 2002). This goal is achievable through the enactment of tax laws aimed at preventing tax evasion and avoidance. Taxpayers evade taxes when they intentionally and unlawfully reduce their tax liabilities. Tax avoidance, on the other hand, refers to the use of legal means for reducing tax liabilities (Alm, 1999b; Slemrod, 2007).

Consequently, government actions towards tax revenue collection and dealing with non-compliant taxpayers shape the content of tax laws. In this regard, the reaction of the government to taxpayers' actions resembles a 'cat-and-mouse' game (Picciotto, 2007). On the one hand, taxpayers strive to find ways of minimising their tax liabilities; on the other hand, governments attempt to find means for minimising tax liabilities. Over time, the re-enactment of tax laws and regulations to prevent the reduction of tax liability results in complex tax laws (Quandt, 1983; Oliver & Bartley, 2005). Although these tax laws define taxable income, consumption or wealth, both the classification and measures of taxable items might prove difficult (Oliver & Bartley, 2005).

Tax laws are also designed with the aim of attaining fairness among taxpayers (Paul, 1997; Forest & Sheffrin, 2002; Oliver & Bartley, 2005). For the sake of fairness, some taxpayers with or without a certain level of income might be exempted from paying taxes, or may be charged low tax rates, particularly in progressive tax systems. When tax exemptions and tax rates are

too numerous, they may cause confusion, making it difficult for taxpayers to comply with tax laws (Oliver & Bartley, 2005).

Moreover, tax laws spell out the responsibilities of the taxpayers in order to achieve efficiency by collecting tax liabilities at minimal costs (Forest & Sheffrin, 2002). In particular, self-assessment tax regimes impose tax compliance responsibilities on taxpayers (probably because these taxpayers tend to know more about their income and expenses than the tax authorities). Such systems, however, may only reduce tax compliance costs when the taxpayers understand the tax laws; otherwise, these systems shift tax compliance costs from the tax authorities to the taxpayers (Paul, 1997; Oliver & Bartley, 2005).

Furthermore, tax laws targeting harmful social behaviour, such as alcohol consumption, may further complicate the tax regime, for example, by resulting in more tax laws and taxes, and confusing the taxpayers even more (Quandt, 1983; Forest & Sheffrin, 2002; Oliver & Bartley, 2005). Complexity also arises because tax laws' competing objectives may not work well together and therefore may translate into complex tax laws. For example, increasing the number of exemptions to improve vertical equity may increase tax compliance costs, contrary to the efficiency criterion.

As tax laws through which tax policies are implemented tend to be written in legal jargon, they tend to be doubly difficult for many taxpayers to understand (Picciotto, 2007). In addition, ambiguous and unstable tax laws can sometimes be interpreted in multiple ways, especially in the absence of a uniform training system for taxpayers, tax return preparers and tax officials (Alm et al., 1992; Picciotto, 2007). According to Oliver and Bartley (2005), the complexity of tax laws stems from the government's and taxpayers' actions.

Tax Compliance and Tax Compliance Costs

Complexity in tax laws and tax compliance costs are positively interlinked (Evans, 2003; Marcuss, Contos, Guyton, Langetieg, Lerman, Nelson, Schafer & Vigil, 2013). Marcuss et al. (2013), using survey data and secondary data from the US Internal Revenue Service (IRS), found a positive relationship between the level of complexity of income tax and the level of tax compliance costs. Additionally, in self-assessment tax systems, complex tax laws may compel taxpayers to hire paid tax return preparers. In addition, complex tax laws may require sophisticated accounting records, which may necessitate hiring bookkeepers, therefore increasing tax compliance costs (Schoonjans et al., 2011).

Taxpayers incur two main types of compliance costs: gross monetary compliance costs and psychological costs. Gross monetary compliance costs include both actual money paid and opportunity costs relating to the time and other resources expended when complying with tax laws (Evans & Tran-Nam, 2014). Psychological costs, on the other hand, involve the estimation of stress and anxieties resulting from complying with tax laws, normally measured using a Likert scale (Evans & Tran-Nam, 2014). Some researchers have calculated net compliance costs which deduct cash flow benefits, tax relief and managerial benefits resulting from tax obligation from the gross compliance costs (see, for example, Sandford, Godwin & Hardwick, 1989; Tran-Nam, Evans, Ritchie &Walpole, 2000). Taxpayers benefit financially from using tax collected before their due for payment to a tax authority (ibid.). Similarly, taxpayers reduce their tax liabilities by deducting tax compliance costs when calculating income taxes. Finally, the improvement in accounting information, for example, might enhance

taxpayers' decision-making abilities. In this study, tax compliance costs refers to the actual money paid in the process of complying with tax laws.

Tax compliance costs can arise for many reasons. Shaw, Slemrod and Whiting (2008), who reviewed the causes of tax compliance costs in the UK, and Shekidete (1999), who studied them in Tanzania, established that tax compliance costs decreased with a reduction in the number of tax rates, coupled with the harmonisation of definitions and compliance procedures. Likewise, KMPG (2006) in the UK, and Evans (2003) in the UK and Australia, reported that tax compliance costs decrease with an increase in the stability of tax laws coupled with less frequent introduction of new tax laws, because taxpayers incur fewer costs and lose less time as they become conversant with the existing tax laws. Lignier and Evans (2014) attributed the increase in tax compliance costs of Australia's SMEs to the introduction of sales taxes, which required extensive accounting records. Other facilitative factors include the introduction of a self-assessment tax system and withholding of transfer compliance costs by taxpayers from tax authorities (Slemrod, 2009).

Many researchers have attempted to estimate tax compliance costs. In the US, the IRS commissioned a study carried out by Arthur D. Little, as reported in Slemrod and Venkatesh (2002), which collected businesses' tax compliance cost data on behalf of the Internal Revenue Service (IRS). The data comprised tax compliance costs relating to the keeping of accounting records, equipment, the hire of tax return preparers, and the submission of businesses' tax returns (Slemrod & Venkatesh, 2002). Hall (1996) used the data, and found that tax compliance costs were significant and that small firms paid more than larger ones relative to their sales or assets (i.e. regressive nature). The regressive nature of tax compliance costs indicates that tax compliance costs are fixed, with larger taxpayers enjoying a relative advantage over others.

Nevertheless, the data lacks reliability, because taxpayers might overstate tax compliance cost estimates or might not remember all the tax compliance costs they incurred (Slemrod & Blumenthal, 1996). Moreover, the respondents' bias might affect the data, as affirmed by the response rates of between 30% and 40% (Slemrod & Venkatesh, 2002). Slemrod and Venkatesh (2002) suggested that bias might reduce the tax compliance cost estimation when tax compliance costs of non-respondent taxpayers are excluded. Moreover, the separation of tax compliance costs from others is difficult, especially in the absence of exclusive accounting or tax departments in organisations (Slemrod & Venkatesh, 2002).

On the other hand, a survey of self-employed taxpayers' tax compliance costs established that these taxpayers were more likely to hire tax preparers and spend more time on complying with tax laws than larger taxpayers (Slemrod & Sorum, 1984; Blumenthal & Slemrod, 1992). A similar pattern was evident in larger companies, whose tax compliance costs decreased with an increase in values of assets in the US (Slemrod & Blumenthal, 1996). The implication is that Arthur D. Little's survey data is generally useful.

Several other studies, such as those by Sandford and Hasseldine (1992) carried out in New Zealand, Pope (1995) in Australia, James and Wallschutzky (1997) in Australia and the UK, Schoonjans et al. (2011) in Belgium, and Coolidge (2012) in developing countries using World Bank data, reported similar results. Coolidge (2012) established that, although larger taxpayers can spend 1% of their turnover on tax compliance costs, SMEs can spend from 5% to 15% or more of their revenue on this. Evans, Hansford, Hasseldine, Lignier, Smulders, & Vaillancourt (2014) reported that the tax compliance costs of SMEs in Australia, Canada, South Africa and the United Kingdom were significant and regressive, and were increasing over time. Similar

trends of regressive tax compliance costs were reported in Canada (Vaillancourt, Roy-César, & Silvia Barros, 2013), in Botswana for VAT (Makara & Pope, 2013), in Ethiopia for VAT (Yesegat, 2009) and in Tanzania for excise duty (Shekidete, 1999). Evans and Tran-Nam (2014), who comprehensively reviewed research on tax compliance costs in New Zealand, and compared the findings to research findings drawn from other countries, concluded that tax compliance costs there are large and regressive, with tax reforms failing to reduce them. The results of Lignier, Evans and Tran-Nam's (2014) survey of 10,000 SME taxpayers in Australia, which aimed to estimate the tax compliance costs of all taxes, indicated that SMEs faced high, regressive and increasing tax compliance costs. Similarly, Chittenden and Poutziouris (2005) reported that PAYE-NIC compliance costs incurred by SMEs in the UK were regressive.

A review of tax compliance costs literature by Luca, Richard and Jaime (2012) found that no extensive testing of how tax compliance costs relate to tax compliance levels has been carried out. They found a positive correlation between the Value Added Tax (VAT) gaps and value-added tax compliance costs, using VAT gap data collected by Reckon (1999) and estimates of tax compliance costs in the European Union carried out by the World Bank (2011). The authors acknowledged that the association established does not imply causality, because the data they used was highly skewed by both tax compliance costs and the VAT gap in new European Union member states. Consequently, the authors recommended carrying out further studies to ascertain the causality between tax compliance costs and tax compliance behaviour (Luca, Richard, & Jaime, 2012). A report by the consortium consisting of Ramboll Management Consulting, the Evaluation Partnership and Europe Economic Research (2013) for the European Union on the methods of measuring tax compliance costs methodologies suggested that reducing tax compliance costs might increase voluntary tax compliance costs. Tax systems with high tax compliance costs might appear to be procedurally unfair and, when taxpayers from SMEs know that they are in a disadvantageous position, they may find the tax system vertically unfair.

Tax Compliance and Vertical Fairness

Vertical fairness occurs when taxpayers with different tax payment abilities get different treatment, with the rich bearing the largest portion of the tax burden (Adams, 1965; Kinsey & Grasmick, 1993). Previous research shows that perceptions of vertical fairness may boost tax compliance (Kinsey & Grasmick, 1993; Roberts & Hite, 1994; Braithwaite, 2003). In Australia, as a result of vertical inequity, lower income earners appeared to have higher effective tax rates than higher income earners, apparently due to both tax avoidance on the part of the latter and the tax rate structure. Consequently, the majority of the respondents in one study in Australia recommended high taxes for high-income earners (Braithwaite, 2003).

Vertical fairness is therefore relevant to compliance behaviour. It is also, however, relevant for compliance costs. Some tax authorities mitigate SME taxpayers' heavy tax compliance cost burdens through simplified accounting records (Arachi & Santoro, 2007). In the UK, for example, small unincorporated businesses with annual cash receipts of less than £77,000 can deploy the cash-basis rather than the accrual-basis scheme (HMRC & Gauke, 2012). As such, they pay taxes based on the cash received and paid in a particular period. In Tanzania, sole traders with annual sales of up to 20 million Tanzanian shillings (Tshs) (£8,000) are allowed to have simplified accounts and pay taxes using presumptive systems (The Income Tax Act, 2004). As in the UK, corporate SMEs in Tanzania have to keep complete records, regardless of their annual sales levels.

Tax Compliance and Procedural Fairness

The presence of fair procedures has been shown by some scholars to increase tax compliance (Feld & Frey, 2007; Verboon & van Dijke, 2011). In terms of the complexity of tax laws, procedural fairness can refer to how easy it is for taxpayers to comply with tax laws. As previously stated, complex tax laws may necessitate the use of hired tax return preparers, hence leading to an increase in tax compliance costs and reduced net income. The consequent reduction in profit might motivate taxpayers to compensate themselves for the losses they incur through tax non-compliance. This argument and the vertical fairness consideration leads to the first hypothesis:

$H1_a$: The income tax compliance level decreases with an increase in income tax compliance costs.

Demographic Factors

Tax Compliance and Gender

Many studies have reported that male and female taxpayers display different levels of tax compliance (Friedland, Maital, & Rutenberg, 1978; Spicer & Hero, 1985; Cadsby et al., 2006; Alm, Cherry, Jones, & McKee, 2010b). Spicer and Hero (1985), for example, found that female participants were more compliant than male ones in a laboratory experiment. However, "women are more likely to evade [paying tax] than men, but underreport a much smaller fraction of their income than men" (Friedland, Maital & Rutenberg, 1978, p.113). Bordignon (1993) suggested that male taxpayers are greater risk-takers than their female counterparts, which may explain why male taxpayers comply less than female taxpayers. These findings lead to the second hypothesis:

$H2_a$: Female participants will be more compliant than male participants.

Tax Compliance and Age

Having many older taxpayers might be advantageous in terms of their contribution to overall compliance levels in a country. Previous research has found that the age of taxpayers correlates positively with the tax compliance level (Clotfelter, 1983; Kirchler, 1999; Fjeldstad & Semboja, 2001; Alm et al., 2010b). Clotfelter (1983) found that taxpayers aged 65 and above are more compliant than younger taxpayers. Older taxpayers' risk-averse attitudes may prompt them to comply more than younger taxpayers (Chang, Nichols, & Schultz, 1987), hence the third hypothesis:

$H3_a$: Participants aged above 30 will comply more than participants aged 30 and under.

Tax Compliance and Education

The impact of education on tax compliance also produces mixed results in tax compliance studies. Education and tax compliance levels might positively correlate (Jackson & Milliron, 1986; Dubin & Wilde, 1988; Richardson, 2006; Saad, 2010). Richardson (2006) found a positive relationship between education and tax compliance levels. Similarly, Dubin and Wilde (1988) demonstrated that taxpayers with high levels of general education are less likely to be non-compliant taxpayers than those with low levels of education. The positive correlation

between tax compliance and education level is attributed to improved tax fairness perceptions when taxpayers are better educated and with a capacity to deal with complex tax laws (Dubin, Graetz, & Wilde, 1990; Saad, 2010).

On the other hand, highly educated taxpayers also have the capacity to exploit loopholes in tax laws to reduce their tax liabilities (Jackson & Milliron, 1986; Dubin et al., 1990). Moreover, a high level of education may change the perceptions of the payment of income taxes from a reduction of income to a loss, consequently reducing tax compliance (Chang et al., 1987). Thus we present the fourth hypothesis:

$H4_a$: Participants with at least secondary education would be less compliant than participants with primary education.

Due to the individual effects of gender, age and education level, these factors might moderate how tax compliance costs and tax compliance relate. Also, they might moderate their own relationships with tax compliance costs, hence the fifth hypothesis:

$H5_a$: Age, gender and education levels may each moderate the relationship between tax compliance costs levels and tax compliance; when tax compliance costs are high, being a female aged above 30 and having primary education will be associated with higher tax compliance than being a male aged 30 or below and having above primary education.

3. METHODOLOGY

Method

Laboratory experimental methods are appropriate methods for studying causal-effect relationships (Alm, Bloomquist, & McKee, 2010a) because controlling the tax rate, audit rate and income level enables the examination of the impact of tax compliance costs on tax compliance behaviour (Torgler, 2002; Alm & Torgler 2011). Laboratory experiments follow certain accepted criteria to examine cause and effect relationships. Firstly, a laboratory experiment should control the participants' preferences through the rewards structure (Smith, 1982). Control is possible when participants need greater rewards, which is consistent with the assumption that taxpayers want to maximise their income after paying taxes. Moreover, the rewards on offer should depend on an individual's actions; for example, a non-compliant participant might get more than a compliant one if both are not audited as occurs in the real world (Smith, 1982).

Secondly, participants need privacy to ensure that they provide genuine responses, so that the data reflects individual rather than group reactions to the independent variables under investigation (Smith, 1982). Thirdly, the context of a given study is usually hidden to prevent the addition of extra information to experiments (Davis & Swenson, 1988; Wartick, Madeo, & Vines, 1999; Alm, 2010). Indeed, the context of a study prompts participants to use information from their life experiences, which may not necessarily be part of the experiment (Wartick et al., 1999). Consequently, without the context of the study, laboratory experiments measure the economic effects of independent variables on dependent variables only (Alm, 1991; Moser et al., 1995). In other words, the results from context-free studies may have limited external validity.

External validity refers to the transferability of results from a laboratory to a non-laboratory environment (Smith, 1982). As such, many laboratory experiments attempt to imitate real tax systems to increase the transferability of results to non-experiment environments (Spicer & Thomas, 1982; Alm et al., 2010b). In a self-assessment scenario, participants receive income, decide whether or not to file tax returns, and pay taxes on declared income, with some participants being audited and penalised when tax non-compliance is detected (Alm et al., 2010a; Alm et al., 2010b). Using tax and audit rates from real tax structures can further improve the external validity of laboratory experiment results (Alm, 2010). Furthermore, using tax-specific terminology, instead of context-free instructions, can improve the external validity of laboratory experiment results (Wartick et al., 1999; Alm et al., 2010b).

Conversely, laboratory experiments have limitations. Firstly, these experiments normally use students who are not necessarily representatives of taxpayers (Torgler, 2003a; Cadsby et al., 2006; Choo, Fonseca, & Myles, 2015). On the one hand, Choo, Fonseca and Myles (2015), who conducted a study in the UK to determine whether the tax compliance behaviour of students, employees and self-employed participants differed in a randomised control trial, found that self-employed participants reported the highest income, followed by employees, with students reporting the lowest income. On the other hand, Alm et al. (2010a) reported that student and non-student participants might have similar tax compliance responses. Secondly, results from laboratory experiments largely depend on the appropriateness of experimental design (Alm et al., 2010a). This current study has used an instrument previously used by Cadsby et al. (2006)[2], with the consent of the authors, after piloting and amending it to include tax compliance costs. With the exception of using tax terminology, the present study has complied with acceptable standards of laboratory experiments.

Participants, Experimental Design and Procedure

The participants were recruited via invitation letters, which were hand-delivered to the SME owners and managers' offices. This physical recruitment method also facilitated the clarification of details about the experiment when potential participants raised concerns. The experiment was carried out in 2013 and involved 75 entrepreneurs with SMEs, who were based in Dar es Salaam, Tanzania. Of these participants, 57% were female. In terms of their educational background, 52% had primary education and 48% had at least secondary education. The mean age was 37, with an age standard deviation of 8.72. Although the experiment offered maximum earnings of 25,000 Tanzanian shillings (Tshs)[3] (£10) per person, the actual payment made to each participant depended on his or her tax return. The mean payment was 16,000 Tshs (£6.40).

The participants were first randomly assigned to one of the three experiment treatments. In the first treatment, the tax compliance cost was TAZ 50,000; in the second, it was TAZ 100,000; and in the third treatment, it was TAZ 166,667 (see Appendices 1 and 2). The income the participants received in each treatment was TAZ 1,000,000. The selection of tax compliance cost values was based on evidence that tax compliance costs of SMEs in developing countries range from 5% to 15% or more of their respective turnover (Coolidge, 2012). TAZ was defined as a laboratory currency exchangeable with the actual money at TAZ 120 for 1 actual

[2] These authors examined the impact of audit rate, penalty rate and obedience to authority on tax compliance manually.

[3] The hourly wage rate is Tshs 20,000.

Tanzanian shilling at the end of the experiment. As such, only tax compliance costs were manipulated. The experimental design was 1 x 3, as indicated in Table 1.

The participants were then asked to pick an envelope containing experimental instruments. The envelopes contained consent forms, tax return forms in duplicate[4] and instruction sheets. Thereafter, each participant was asked to read and sign a participant information sheet and a consent form. The researcher then read out the information applicable to all of the participants[5]. The participants were instructed to work independently and verify their documents, and were told not to talk to each other during the experiment. The researcher also read out information about the income the participants had received, the tax rate and the audit rate. All participants received identical information.

Table 1: Experimental Design

Treatments	1	2	3
Tax compliance costs	TAZ 50,000	TAZ 100,000	TAZ 166,667
Participants	[n=25]	[n=25]	[n=25]

Based on the assumptions of economic tax compliance theory, the participants were made aware of the tax rate, the income, the income tax penalty rate and the audit rate (Allingham & Sandmo, 1972; Yitzhaki, 1974); however, these factors were fixed so as to remove their impact on tax compliance behaviour (Hanlon & Heitzman, 2010). The tax rate was set at 30%; the tax penalty rate was double the tax owed[6]; each participant had a 10% chance of being audited; and the gross income was TAZ 1,000,000. Moreover, full tax compliance was required. This requirement was contrary to many experiments, which allow participants to report any income from 0 to the actual income received (Moser, Evans III, & Kim, 1995; Alm et al., 2010b). Consequently, results from these studies have limited applicability outside the laboratory situations (Webley & Halstead, 1986; Cadsby et al., 2006). Finally, the participants went through information on tax compliance costs individually.

The experimental procedure can be summarised as follows. Participants familiarise themselves with details of the income, the tax rate, the audit rate, the penalty rate and the tax compliance costs. They then complete and file the tax return, and the audit takes place. Tax penalties are imposed on non-compliant taxpayers, and these are indicated on the duplicate tax returns. Finally, one period concludes before a fresh one begins. In all, three periods were conducted, following a question and answer session, and a practice round. The experiment took 80 minutes to complete and ended with a debriefing before the experimental tokens were exchanged for payment.

[4] Participants retained the duplicate tax returns and the duplicates were used for payment of the experimental token.
[5] Some items differed as experimental treatments.
[6] These two variables reflected Tanzania's income tax structure.

4. EXPERIMENTAL RESULTS AND DISCUSSION

Data Screening

Fifteen (15) observations (six in the first round, four in the second and five in the third) were excluded from the analysis because the observations exceeded TAZ 1,000,000 of the gross income given in each session. It cannot be ascertained why these participants reported more than the amount given in the instruments; it is probable that they either wanted to cheat or that their actions resulted from misunderstandings of the rules of the game. Since no taxpayer wants to pay more than required, these observations were omitted. This omission left 210 [64 (30.48%) for treatment 1; 75 (35.71%) for treatment 2; and 71 (33.81%) for treatment 3] observations for analysis. One participant did not indicate their gender and four others did not indicate their education levels; these observations were not imputed and, hence, were excluded from the subsequent analysis of the impact of gender. The imputation of the missing categorical data is discouraged, as precise, rather than continuous estimation of the data (for example, an estimation of the gender of a participant), is required (Hair, Black, Babin, & Anderson, 2010).

The hypotheses were examined using the analysis of variance[7] (ANOVA) approach because of the presence of a single dependent variable, that is, tax compliance, and many independent variables (Mitchell & Janina, 2013). However, data was not normally distributed, because the Shapiro Wilk test indicated $p < .001$. Also, an assumption of a homogeneity of variance was not met as Levene's test was $p < .001$. The data was rank transformed before the ANOVA test was performed. The rank transformed data changes data to distribution free (Timothy, Donald, & Larry, 1985), consequently overcoming both normality and heteroscedasticity problems (Conover & Iman, 1981; Timothy et al., 1985).

In addition, the partial eta squared (η_p^2) measure was used to test the significance of the results. The η_p^2 measures the overall effect of an independent variable on a dependent variable; where η_p^2 is ≥ 0.01, the effect is "small"; when η_p^2 is equal to $\geq .06$, the effect is "medium"; and when η_p^2 is $\geq .14$, the effect is "large" (Cohen, 1988; Richardson, 2011). As demonstrated later, all of the significant independent variables had medium-sized effects.

The tax compliance rate [(income reported less tax compliance costs reported) / (gross income given less gross tax compliance costs given)] measured tax compliance. The participants were divided into two age groups: ≤ 30 years old, and over 30. These classifications are similar to those used in Fjeldstad and Semboja's (2001) survey study, which was conducted in Tanzania and established that taxpayers aged over 29 complied more than their younger counterparts. Finally, as the sample was rather small, the participants were divided into two groups by education level: primary education and post-primary education.

[7] Both the results from individual rounds and those from the entire experiment indicated a similar nature.

Results and Discussion

Generally, means of tax compliance rates were 99% (SD =.12), 91% (SD = .27) and 80% (SD = .34) for treatments 1, 2 and 3, respectively, whereas the median tax compliance rate for all three treatments was 100%. This trend of compliance rates was similar to the results that Cadsby et al. (2006) came up with, implying that tax compliance might be high when it is enforced. Specifically, when the participants were allowed to report any amount from zero to the correct amount, their average compliance was 57%, while the mean compliance rate from participants who were required to comply fully was 99.5% (Cadsby et al., 2006).

Table 2: Analysis of Variance

Dependent Variable: Rank of compliance rates

Source	Type III Sum of Squares	Df	Mean Square	F	Sig.	Partial Eta Squared
Corrected Model	67765.116	14	4840.365	2.577	.002	.160
Intercept	1153936.361	1	1153936.361	614.276	.000	.764
Gender	18010.443	1	18010.443	9.588	.002	.048
Age	1538.577	1	1538.577	.819	.367	.004
TCC	11960.112	2	5980.056	3.183	.044	.032
Education	3111.172	1	3111.172	1.656	.200	.009
Gender * Age	11841.715	1	11841.715	6.304	.013	.032
Gender * TCC	11617.373	2	5808.687	3.092	.048	.032
Gender * education	3582.465	1	3582.465	1.907	.169	.010
Age * TCC	454.463	2	227.231	.121	.886	.001
Age * education	744.375	1	744.375	.396	.530	.002
TCC * education	1043.882	2	521.941	.278	.758	.003
Error	356920.806	190	1878.531			
Total	2659890.000	205				
Corrected Total	424685.922	204				

Adjusted R Squared = .098)

Note: TCC is tax compliance costs

Table 2 shows the results of analysis of variance. A 2 x 3 x 3 x 3 analysis of variance of age (≤30 years old and > 30 years old), education (primary level and above primary education level), tax compliance costs (TAZ 50,000, TAZ 100,000 and TAZ 166,667) and gender (female and male) between subjects was run to test the hypotheses.

In contrast with what was expected in hypothesis 2_a, the main effect of gender on tax compliance was insignificant: F (2, 187) = 3.38, ns, η_p^2 = .03. This result is consistent with the findings by Cadsby et al. (2006), which indicated that male participants and female participants comply similarly.

Fig.1: Mean Ranks of Tax Compliance Rates vs. Gender

However, consistent with hypothesis 5_a, a significant interaction between gender and tax compliance costs qualified this relationship: F (2, 187) = .3.69, p = .03, η_p^2 = .04. Figure 1 shows this interaction. Thus, using the traditional Bonferroni test, when tax compliance costs were TAZ 50,000, the women's rates and men's mean rank of tax compliance rates were similar: M_{diff} = .42, 95% CI [-35.01-35.84], p =.98. Similarly, when the tax compliance costs were TAZ 100,000, the mean differences were insignificant: M_{diff} = 27.92, 95% CI [-4.07-59.92], p =.11. However, at the tax compliance cost level of TAZ 166,667, the women's mean rank of tax compliance rates differed significantly from that of men: M_{diff} = 64.07, 95% CI [36.67-91.47], p < .001. Consequently, at the low tax compliance costs levels, both men and women may comply more when tax compliance costs are low than when their tax obligations are at higher levels; in fact, their compliance levels decrease with an increase in tax compliance costs, albeit at unequal rates.

With regard to the age variable, the main effect of age on the tax compliance was insignificant: F (1, 187) = .02, p =.90, η_p^2 = .00. This result suggests that the age of a person may not necessarily influence tax compliance. This result contradicts initial expectations reflected in hypothesis 3_a. Also the interaction between age and education was found to be insignificant (F (1, 187) = .06, p = .81, η_p^2 = .00), as was the case with the interaction with gender (F (1, 187) = 1.59, p = .21, η_p^2 = .01) as well as its interaction with tax compliance costs (F (2, 187) = .03, p = .97, η_p^2 = .00). These findings imply that tax compliance rates may be similar, regardless of the gender, education and age of the taxpayer.

The main effect of education on tax compliance was insignificant: F (2, 187) = .56, p = .57, η_p^2 = .01, contrary to hypothesis four. Furthermore, the interaction between education and tax compliance costs was insignificant: F (2, 187) = .35, p = .71, η_p^2 = .01. As hypothesis 1_a anticipated, the main effect of three conditions of tax compliance costs on tax compliance was significant: F (2, 187) = 3.13, p = .04, η_p^2 = .04. This finding means some of the experimental treatments may differ from each other significantly. However, a further analysis using Tukey's honesty test was required in order to determine which of the treatments differed significantly (Mitchell & Janina 2013). The test results indicated that the mean rank of tax compliance rates for the TAZ 50,000 condition was significantly higher than that of the TAZ 166,667 condition (p = .04). However, the mean rank of tax compliance rates of the condition of TAZ 100, 000 did not significantly differ from that of the condition of TAZ 50,000, (p = .60) or from the condition of TAZ 166,667, (p = .99).

Taken together, these results suggest that high levels of tax compliance costs do have a bearing on tax compliance levels. Specifically, the results suggest that when tax compliance costs are high, taxpayers may be more inclined to evade tax. However, it should be noted that the level of tax compliance costs must be high enough to be able to see an effect, because small variations in tax compliance costs did not appear to reduce tax compliance significantly. Finally, all other interactions between variables were insignificant and irrelevant to the hypotheses tested, all $F \leq 2.79$, $p \geq .10$ and $\eta_p^2 \leq .02$.

5. CONCLUSION

Tax compliance costs literature shows that tax compliance costs can be large and regressive, but the relationship between tax compliance costs and tax compliance behaviour is not clear. This study investigated this relationship and its results reveal that tax compliance costs have a significant negative impact on tax compliance behaviour, albeit only at high levels of tax compliance costs. These results were consistent across genders, despite female participants being found to be significantly more compliant than their male counterparts. The findings were also consistent across the age groups and education levels tested.

These findings are important for tax authorities aiming to increase tax compliance levels, as lowering tax compliance costs appears to improve them. Consequently, tax authorities should consider the effect of tax compliance costs when introducing new taxes. In fact, some already do. Moreover, tax authorities should continue to reform tax systems in order to reduce tax compliance costs.

The current findings also add to the growing body of literature on tax compliance costs by establishing how tax compliance costs and tax compliance levels are related. The study also used taxpayers in an experiment conducted in a developing country context.

However, as the data was based on a rather small sample, it is important to be cautious, as the study's findings might not necessarily be transferable to the general taxpayer population. Thus, future research could replicate the study, using a larger sample to confirm the current results and to generate generalisable findings. A further limitation of the study is that the model does not explain more than 12% (adjusted R-squared) of variability in the tax compliance level. However, this statistical effect is in line with other studies on the effect of procedural justice considerations on tax compliance (Wenzel, 2002; Wenzel, 2004; Murphy & Tyler, 2008).

Procedural justice considerations probably account for a small part of tax compliance behaviour. In other words, improving procedural justice considerations alone may be an ineffective tax compliance measure. In conclusion, the regressive nature of tax compliance costs might explain why SMEs' tax compliance levels are lower than those of larger taxpayers.

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APPENDICES: EXPERIMENTAL INSTRUCTIONS

Appendix 1: Experimental instruments

Treatment 1: Instruction sheet

1. *Setting*: You are responsible for completing and then filing a tax return form. Please read all the sections of this brief before starting the task.

2. *Documentation*: You will be requested to select a large envelope randomly from a set of envelopes provided by one of the supervisors. Each large envelope contains 4 tax return forms, and this instruction sheet. Please verify these documents, if there are any discrepancies, please raise your hand and inform a supervisor accordingly immediately before beginning work on filing the tax returns.

3. *Confidentiality*: You alone are aware of the number associated with the material you have randomly selected. Neither the supervisors of today's session nor those who will analyse the tax returns subsequently will know your identity. Thus, your privacy is completely guaranteed, thus enabling you to respond truthfully to the questions posed without worrying about your responses ever being linked directly to you.

4. *Independence*: Please do not communicate with other participants either verbally or in any other manner. Complete privacy is important, and we expect your co-operation. We must ask anyone found communicating with others in any manner to leave the room and to return the contents of the large envelope. If you have any problems, please raise your hand up and a supervisor will come to your aid.

5. *Your income*: Your income is set at the beginning of the session at TAZ 1,000,000. TAZ is a laboratory currency and at the end of the exercise TAZ 120 it will be exchanged for 1 actual Tsh. The amount you can retain is described below.

6. *Taxation*: You should fill in the tax return form correct information as required. The tax return form will enable you to file a complete and reliable tax return. However, there is a cost associated with production of tax returns. In your case you have to pay a tax deductible expense amounting to TAZ 50,000. There are also considerable costs involved in running these sessions. To help defray these costs, you are required to submit 30% of the income after deducting the above tax return form expense as taxation.

7. *Penalty*: The income given to you and tax return expenses must be reported on the tax return forms. If detected cheating, see *section 9 Auditing* below, you will pay double the amount of tax underpaid.

8. *Tax return form*: On the tax return form, please indicate the total amount of TAZ shown in number 5 above which represents your income and costs of tax return shown in number 6 above. Keep a copy of the tax return form for your records. In the space provided, multiply the amount indicated after deducting the expenses of a tax return form by 30% to arrive at the tax payable. You may use a calculator to ensure the accuracy of your tax return. Transfer the information of tax returns on the copy of the tax return; this copy belongs to you. You will be paid an amount equivalent to the remaining amount of income [70%]. At this point, you should quietly raise your hand up. Please do not speak or shout. It is important to maintain

silence so that those still working are not disturbed. A supervisor will take you to another room nearby where you may be audited.

9. Auditing: Although we do not have time or resources to check everyone's tax return, 1 in 10 (10%) will be checked for correctness. You will be required to pick a piece of paper from a larger envelope; if you pick a piece of paper written "1" you will be audited. If you are selected for the audit:

> i. Your tax return will be compared to the information provided in this instruction sheet and your own copy of tax return in private.
> ii. If the tax amount is correct, you are free to go to the next round.
> iii. However, if the tax amount is incorrect, we will deduct double of the tax unpaid by recording on your copy of tax return and then you go to the next round.

If you are not selected for audit, we will not check your tax returns. You are free to go to the next round.

10. *Assistance*: If you have any problems, please raise your hand and a supervisor will come to your aid.

Treatment 2: Instruction sheet

1. *Setting*: You are responsible for completing and then filing a tax return form. Please read all the sections of this briefing document before starting the task.

2. *Documentation*: You will be requested to select a large envelope randomly from a set of envelopes provided by one of the supervisors. Each large envelope contains 4 tax return forms, and this instruction sheet. Please verify these documents, if there are any discrepancies, please raise your hand and inform a supervisor immediately before beginning work on filing the tax returns.

3. *Confidentiality*: You alone are aware of the number associated with the material you have randomly selected. Neither the supervisors of today's session nor those who will analyse the tax returns subsequently will know your identity. Thus, your privacy is completely guaranteed, thus enabling you to respond truthfully to the questions posed without worrying about your responses ever being linked directly to you.

4. *Independence*: Please do not communicate with other participants either verbally or in any other manner. Complete privacy is important, and we expect your co-operation. We must ask anyone found communicating with others in any manner to leave the room and to return the contents of the large envelope. If you have any problems, please raise your hand up and a supervisor will come to your aid.

5. *Your income*: Your income is set at the beginning of the session at TAZ 1,000,000. TAZ is a laboratory currency and at the end of the exercise TAZ 120 it will be exchanged for 1 actual Tsh. The amount you can retain is described below.

6. *Taxation*: You should fill in the tax return form correct information as required. The tax return form will enable you to file a complete and reliable tax return. However, there is a cost associated with the production of tax returns. In your case, you have to pay a tax deductible

expense amounting to TAZ 100,000. There are also considerable costs involved in running these sessions. To help defray these costs, you are required to submit 30% of the income after deducting the above tax return form expense as taxation.

7. *Penalty*: The income given to you and tax return expenses must be reported on the tax return forms. If detected cheating, see *section 9 Auditing* below, you will pay double the amount of tax underpaid.

8. *Tax return form*: On the tax return form, please indicate the total amount of TAZ shown in number 5 above which represents your income and costs of tax return shown in number 6 above. Keep a copy of the tax return form for your records. In the space provided, multiply the amount indicated after deducting the expenses of a tax return form by 30% to arrive at the tax payable. You may use a calculator to ensure the accuracy of your tax return. Transfer the information of tax returns on the copy of the tax return; this copy belongs to you. You will be paid an amount equivalent to the remaining amount of income [70%]. At this point, you should quietly raise your hand up. Please do not speak or shout. It is important to maintain silence so that those still working are not disturbed. A supervisor will take you to another room nearby where you may be audited.

9. *Auditing*: Although we do not have time or resources to check everyone's tax return, 1 in 10 (10%) will be checked for correctness. You will be required to pick a piece of paper from a larger envelope if you pick a piece of paper written "1" you will be audited. If you are selected for the audit:

> i. Your tax return will be compared to the information provided in this instruction sheet and your own copy of tax return in private.
> ii. If the tax amount is correct, you are free to go to the next round.
> iii. However, if the tax amount is not correct, we will deduct double of the tax unpaid by recording on your copy of tax return and then you go to the next round.

If you are not selected for audit, we will not check your tax returns. You are free to go to the next round.

10. *Assistance*: If you have any problems, please raise your hand up and a supervisor will come to your aid.

Treatment 3: Instruction sheet

1. *Setting*: You are responsible for completing and then filing a tax return form. Please read all the sections of this brief before starting the task.

2. *Documentation*: You will be requested to select a large envelope randomly from a set of envelopes provided by one of the supervisors. Each large envelope contains 4 tax return forms, and this instruction sheet. Please verify these documents, if there are any discrepancies, please raise your hand up and inform a supervisor accordingly immediately before beginning work on filing the tax returns.

3. *Confidentiality*: You alone are aware of the number associated with the material you have randomly selected. Neither the supervisors of today's session nor those who will analyse the tax returns subsequently will know your identity. Thus, your privacy is completely

guaranteed, thus enabling you to respond truthfully to the questions posed without worrying about your responses ever being linked directly to you.

4. *Independence*: Please do not communicate with other participants either verbally or in any other manner. Complete privacy is important, and we expect your co-operation. We must ask anyone found communicating with others in any manner to leave the room and to return the contents of the large envelope. If you have any problems, please raise your hand up and a supervisor will come to your aid.

5. *Your income*: Your income is set at the beginning of the session at TAZ 1,000,000. TAZ is a laboratory currency and at the end of the exercise every TAZ 120 will be exchanged for 1 actual Tshs. The amount you can retain is described below.

6. *Taxation*: You should fill in the tax return form correct information as required. The tax return form will enable you to file a complete and reliable tax return. However, there is a cost associated with the production of tax returns. In your case, you have to pay a tax deductible expense amounting to TAZ 166,667. There are also considerable costs involved in running these sessions. To help defray these costs, you are required to submit 30% of the income after deducting the above tax return form expense as taxation.

7. *Penalty*: The income given to you and tax return expenses must be reported on the tax return forms. If detected cheating, see *section 9 Auditing* below, you will pay double the amount of tax underpaid.

8. *Tax return form*: On the tax return form, please indicate the total amount of TAZ shown in number 5 above which represents your income and costs of tax returns shown in number 6 above. Keep a copy of the tax return form for your records. In the space provided, multiply the amount indicated after deducting the expenses of a tax return form by 30% to arrive at the tax payable. You may use a calculator to ensure the accuracy of your tax return. Transfer the information of tax returns on the copy of the tax return; this copy belongs to you. You will be paid an amount equivalent to the remaining income [70%]. At this point, you should quietly raise your hand up. Please do not speak or shout. It is important to maintain silence so that those still working are not disturbed. A supervisor will take you to another room nearby where you may be audited.

9. *Auditing*: Although we do not have time or resources to check everyone's tax return, 1 in 10 (10%) will be checked for correctness. You will be required to pick a piece of paper from a larger envelope if you pick a piece of paper written "1" you will be audited. If you are selected for the audit:

> i. Your tax return will be compared to the information provided in this instruction sheet and your own copy of tax return in private.
> ii. If the tax amount is correct, you are free to go to the next round.
> iii. However, if the tax amount is not correct, we will deduct double of the tax unpaid by recording on your copy of tax return and then you go to the next round.

If you are not selected for audit, we will not check your tax returns. You are free to go to the next round.

10. *Assistance*: If you have any problems, please raise your hand up and a supervisor will come to your aid.

Appendix 2: Tax Return Form

Taxpayer information	Tick one	
Gender	Male	Female
Your age		
What business are you in?		
Your education level		

Income information

Item	Notes	TAZ
Total income received	A	
Less:		
Expenses of tax return form	B	
Net income before tax	C=A-B	
Taxation	D=30%xC	
Net income	E=C-D	

Notes

A. Total income received

B. Expenses of tax return form as indicated in the instruction sheet

C. The difference between A and B

D. Net income

ADMINISTRATIVE LAW'S GROWING INFLUENCE ON U.S. TAX ADMINISTRATION

Kristin E. Hickman[1]

Abstract

In its 2011 decision in *Mayo Foundation for Medical Education and Research v. United States*, the United States Supreme Court declared itself reluctant "to carve out an approach to administrative review good for tax law only." Since then, the government in litigation has conceded and lower courts have recognized that tax administration in the United States is subject to the Administrative Procedure Act, which imposes procedural requirements for and authorizes judicial review of the actions of federal government agencies. A growing body of tax jurisprudence in the United States explores which tax administrative practices are susceptible to legal challenge under the Administrative Procedure Act and whether particular provisions of the Internal Revenue Code justify tax-specific departures from general administrative law norms, doctrines, and requirements. This essay explores three cases that are particularly illustrative of this trend and, in turn, draws attention to the role of judicial review as a tool for prompting improvements in the administration of the tax laws.

1. INTRODUCTION

Judicial review can be a powerful tool for prompting improvements in tax administrative practices. In the U.S., cases challenging Treasury Department (Treasury) and Internal Revenue Service (IRS) actions under the Administrative Procedure Act (APA)[2] are driving just such change. The result will be greater transparency and accountability in the administration of the U.S. tax laws.

In 2011, in *Mayo Foundation for Medical Education and Research v. United States*, the U.S. Supreme Court declared its reluctance "to carve out an approach to administrative review good for tax law only."[3] "To the contrary," said the Court, "we have expressly '[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action.'"[4] In making that statement, the Court was reiterating a longstanding judicial policy - derived from the APA - of applying general administrative law requirements, doctrines, and norms uniformly across government agencies and regulatory subject matters absent a good reason for deviating in a particular case. Courts and commentators have read the Court's *Mayo Foundation* decision broadly as repudiating tax exceptionalism from general administrative law requirements, doctrines, and norms absent clear statutory evidence that Congress intended otherwise. The government in litigation has conceded, and United States Tax Court has correspondingly recognized, that "Treasury is subject to the APA" absent such justification.[5]

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[2] 5 U.S.C. § 551, et seq.
[3] Mayo Foundation for Medical Education & Research v. United States, 562 U.S. 44, 55 (2011).
[4] *Id.*
[5] Altera Corp. & Subs. v. Comm'r, 145 T.C. 91, 119 (2015).

Notwithstanding the sweeping proclamation against tax exceptionalism for which it is credited, the *Mayo Foundation* decision really only resolved a single doctrinal question - that courts should apply the general *Chevron* standard,[6] rather than the tax-specific (and arguably less deferential) *National Muffler* standard,[7] in reviewing whether Treasury regulations interpreting the IRC are consistent with the statute or within the range of discretion.[8] But many questions remain. How far should courts, and the tax administrators subject to their commands, take the Supreme Court's rejection of tax exceptionalism? Which tax administrative practices are susceptible to legal challenge under general administrative law principles? Do particular provisions of the Internal Revenue Code (IRC) in fact justify certain tax-specific departures from general administrative law requirements, doctrines, and norms?

A growing strand of U.S. tax jurisprudence today explores these questions. Legal scholars have identified numerous ways in which tax administrative practices arguably have deviated from general administrative law requirements, doctrines, and norms.[9] Litigators representing taxpayers and others subject to the tax system's commands are doing all they can to push the boundaries of the Supreme Court's rejection of tax exceptionalism. The Department of Justice is fighting those cases tooth and nail, doing all it can to limit *Mayo Foundation*'s reach. Several cases of note have been decided or are pending in the courts. The results thus far are both mixed and unsettled. Nevertheless, at least one such case has already resulted in changes to Treasury and IRS administrative practices; and, although change is coming slowly, these cases, collectively, could alter tax administrative practices dramatically.

Three cases are particularly illustrative of the trend. First, in *Altera Corp. & Subsidiaries v. Commissioner*, the United States Tax Court unanimously invalidated a Treasury regulation as arbitrary and capricious under the APA because Treasury and the IRS failed to link their interpretation to evidence contained in the administrative record and, instead, ignored contrary evidence provided by taxpayers in the notice-and-comment rulemaking process.[10] Second, in *Florida Bankers Association v. United States Department of the Treasury*, a divided panel of the D.C. Circuit Court of Appeals considered whether the Anti-Injunction Act precludes pre-enforcement judicial review of APA-based challenges to Treasury regulations.[11] Lastly, in *QinetiQ U.S. Holdings, Inc. v. Commissioner*, the Fourth Circuit Court of Appeals evaluated whether IRS deficiency notices are reviewable under the APA's arbitrary and capricious

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[6] *See* Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984) (holding that review courts should defer to reasonable interpretations of ambiguous statutory text adopted by administering agencies).

[7] *See* National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (calling on reviewing courts to evaluate whether Treasury regulations "harmonize[] with the plain language of the statute, its origin, and its purpose" as well as various contextual factors such as contemporaneity with statutory enactment, the longevity of the regulation, the consistency with which the IRS has applied the regulation, and congressional scrutiny of the regulation in revisiting and amending the statute).

[8] *Mayo Foundation*, 562 U.S. at 55.

[9] *See, e.g.,* Michael Asimow, *Public Participation in the Adoption of Temporary Treasury Regulations*, 44 Tax Law. 343 (1991) (complaining about Treasury's issuance of temporary Treasury regulations without first allowing interested members of the public to offer comments); Kristin E. Hickman, *Coloring Outside the Lines, Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727 (2007) (documenting the rate of Treasury's noncompliance with APA public participation requirements); Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012) (detailing Treasury's failure to comply with the APA's requirement that agencies justify their regulations when issuing them).

[10] *Altera Corp.*, 145 T.C. at 121-31 (2015).

[11] Florida Bankers Association v. United States Dept. of the Treasury, 799 F.3d 1065 (D.C. Cir. 2015).

standard.[12] Other cases are pending or contemplated raising the same issues addressed in these three cases, generating significant debate among tax litigators, legal scholars, and tax administrators - in addition to judges - regarding the precise relationship between the IRC and the APA.

All of these cases, and others like them, aim ultimately to require Treasury and the IRS to do a better job of complying with APA procedural requirements and explaining their actions at the time they undertake them - and thereby provide for greater transparency and accountability for Treasury and the IRS. The purpose of this essay is to summarize the *Altera*, *Florida Bankers*, and *QinetiQ* cases and to consider their implications for transparency and accountability in U.S. tax administration.

2. THREE KEY CASES

2.1 *Altera Corp. & Subsidiaries v. Commissioner*

A driving principle of the APA and of U.S. administrative law more generally holds that, in exercising discretionary power, agencies must engage in reasoned decision-making, typically demonstrated at the time such decisions are made. Section 706(2)(A) of the APA requires an a reviewing court to set aside agency action found to be "arbitrary, capricious, an abuse of discretion, or not otherwise in accordance with law."[13] In 1983, in *Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, the Supreme Court interpreted this arbitrary and capricious standard as requiring agencies to provide contemporaneous explanations for their actions.[14] In other words, when adopting a regulation that features a choice between competing reasonable interpretations of a statute or alternative reasonable approaches to implementing a statutory mandate, an agency cannot make its choice by arbitrarily throwing darts at a dartboard. Rather, according to *State Farm*'s interpretation of the arbitrary and capricious standard, the agency must explain and offer good reasons for its choice. A court will not just assume that the agency had good reasons, nor will a court accept reasons offered after the fact in litigation.[15] Rather, a court will carefully review the administrative record to satisfy itself that the agency articulated and explained its reasoning at the time the agency adopted the regulation in question.

Historically, Treasury and the IRS have not done a great job in explaining their interpretive choices in the preambles to Treasury regulations.[16] Until 2014, the Internal Revenue Manual (IRM) instructed Treasury and IRS regulation drafters that "it [was] not necessary to justify the rules that are being proposed or adopted or alternatives that were considered"**-** precisely the opposite of *State Farm*'s requirement.[17] The IRS amended the IRM to eliminate that particular

[12] QinetiQ U.S. Holdings, Inc. v. Comm'r, 845 F.3d 555, 559-60 (2017).
[13] 5 U.S.C. § 706(2)(A).
[14] Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 42-44 (1983).
[15] *Id.* at 43; *see also* Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 419-20 (1971) (rejecting "post hoc rationalizations" as "an inadequate basis for review."); Securities and Exchange Commission v. Chenery Corp., 318 U.S. 80, 95 (1943) ("We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.").
[16] Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012).
[17] *Id.* at 274 (quoting Internal Revenue Manual § 32.1.5.4.7.3(1) as written in 2012).

instruction in 2014, but the IRM now merely tells regulation drafters "describe the substantive provisions of the regulations in clear, concise, plain language without restating particular rules contained in the regulatory text."[18] However, old habits die hard, and the preambles to Treasury regulations did not change noticeably as a result of that modification; then came *Altera*.

In the *Altera* case, the Tax Court considered a challenge to the validity of Treas. Reg. § 1.482-7(d), which required participants in qualified cost-sharing arrangements to include stock-based compensation costs in the cost pool in order to comply with the arm's length standard for transactions between affiliated enterprises.[19] The Tax Court unanimously invalidated those regulations on the ground that they were not the product of reasoned decision-making as required by the APA and *State Farm*.[20] In particular, the court noted: that Treasury's assumptions in adopting the rule were unsupported by evidence regarding real-world practices; that commentators introduced "significant evidence" in the rulemaking process that contradicted Treasury's assumptions; and that Treasury failed to respond to much of that evidence.[21] The Tax Court also rejected the government's claim that deficiencies in Treasury's regulation represented harmless error for purposes of APA § 706.[22]

The government has appealed the Tax Court's decision in *Altera* to the Ninth Circuit Court of Appeals. Among other arguments, the government contends that *State Farm* review is not appropriate for evaluating most Treasury regulations because they merely interpret and implement the terms of the IRC, rather than imposing obligations on the basis of scientific or empirical evidence like regulations issued by some other agencies. The government's distinction between statutory interpretation and empirical analysis is a weak one for two reasons.

Firstly, although it is always dangerous to say "never" or "always" with respect to U.S. administrative law, courts have often applied *State Farm* review not only when regulations rest on empirical analysis but also in requiring agencies to explain their reasoning for choosing one interpretation of a statute over another. For example, in *Judulang v. Holder* - admittedly an immigration case rather than a tax case - the Supreme Court relied on *State Farm* in rejecting a Board of Immigration Appeals interpretation of the Immigration and Nationality Act because the Court found the agency's reasoning in its support of its interpretation to be inconsistent with the statute's structure and purposes.[23] In other words, the issue in *Judulang* concerned statutory interpretation supported by policy preferences rather than empirical analysis, yet the Court resolved the case using *State Farm*'s arbitrary and capricious review.

Secondly, in recent years, the Supreme Court has begun to more explicitly link *State Farm* analysis with the second step of the *Chevron* standard for reviewing agency statutory interpretations. The *Chevron* standard calls for a reviewing court to evaluate first whether the statute an agency has interpreted is clear or ambiguous.[24] If the statute's meaning is clear, that

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[18] *See* Internal Revenue Manual § 32.1.5.4.7.3(1) (Oct. 20, 2014).

[19] Altera Corp. & Subs. v. Comm'r, 145 T.C. 91, 92 (2015); *see also* Final Regulations: Compensatory Stock Options Under Section 482 (T.D. 9088), 68 Fed. Reg. 51,171 (Aug. 26, 2003) (adopting Treas. Reg. § 1.482-7(d)).

[20] *Altera Corp.*, 145 T.C. at 121-31.

[21] *Id.*

[22] *Id.* at 132-33.

[23] Judulang v. Holder, 565 U.S. 42 (2011).

[24] *Chevron*, 467 U.S. at 842.

is the end of the court's inquiry, for courts and agencies alike must respect the clearly-expressed intent of Congress.[25] But, if the statute is ambiguous, *Chevron*'s second step calls for the court to defer to the agency's resolution of that ambiguity so long as the agency's interpretation is reasonable. But what does reasonable mean for purposes of *Chevron* step two? Obviously, the agency's choice is limited to plausible interpretations of the statute's text, history, and purpose.[26] However, in both *Judulang v. Holder*[27] and *Encino Motorcars, LLC v. Navarro*[28], the Court's opinion included rhetoric explicitly linking *State Farm* analysis with *Chevron*'s second step and suggesting that the agency must also explain why it chose one plausible interpretation over another for the Court to deem the agency's choice reasonable under the *Chevron* standard of review.

Irrespective of how the Ninth Circuit resolves *Altera*, however, the Tax Court's application of *State Farm* and APA arbitrary and capricious review has prompted other cases raising similar challenges to other regulations.[29] Correspondingly, Treasury and the IRS are already approaching the regulation drafting process differently. Specifically, in three high-profile rulemakings in 2016 - concerning inversion transactions under IRC § 7874 and related provisions,[30] earnings stripping under IRC § 385,[31] and property transfers to foreign corporations under IRC § 367(d)[32] - Treasury and the IRS have included lengthier explanatory preambles offering greater insight into the drafters' thinking. Practitioners point to *Altera* as the reason.

2.2 *Florida Bankers Association v. United States Department of Treasury*

In 1967, in *Abbott Laboratories v. Gardner*, the Supreme Court interpreted the APA as adopting a presumption in favor of judicial review of final agency action - specifically including, but not limited to, legally-binding regulations.[33] As a result of the *Abbott Labs* decision, the norm for most U.S. administrative agencies is that courts will entertain challenges to the validity of agency regulations as soon as the agency finalizes them, before the regulations become too entrenched.[34] In short, when the Environmental Protection Agency, the Food and Drug Administration, or the Securities Exchange Commission issues a regulation, those

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[25] *Id.* at 842-43.

[26] *See, e.g.,* AT&T Corp. v. Iowa Utilities Board, 525 U.S. 366, 387-92 (rejecting a Federal Communications Commission interpretation of the Telecommunications Act of 1996 because, even though the statute's use of words like "necessary" and "impair" gave the agency interpretive discretion, the agency's chose interpretation was not within the range of reasonableness).

[27] *Judulang*, 565 U.S. at 52 n.7.

[28] Encino Motorcars, LLC v. Navarro, 136 S. Ct. 2117, 2125 (2016).

[29] *See, e.g., 3M Co. Argues IRS Can't Allocate Royalties from Brazil Subsidiary*, 2016 Tax Notes Today 128-23 (Mar. 21, 2016) (publishing opening brief in *3M Co. & Subs. v. Comm'r*, challenging the validity of Treas. Reg. § 1.482-1(h)(2)); Business Associations Ask Court to Invalidate Inversion Rule, 2016 Tax Notes Today 198-16 (Oct. 11, 2016) (publishing opening brief in *Chamber of Commerce of the United States of America v. IRS*, challenging the validity of Treas. Reg. § 1.7874-8T); *Estate Tax Regs May Exceed Treasury's Authority, Bar Group Says*, 2016 Tax Notes Today 228-25 (Nov. 28, 2016) (publishing comments submitted to Treasury and the IRS suggesting that proposed regulations under IRC §§ 2701 and 2704 may be arbitrary and capricious under *State Farm* because Treasury has "entirely failed to consider an important aspect of the problem" presented by the statute).

[30] T.D. 9761, 2016-20 I.R.B. 743.

[31] T.D. 9790, 2016-45 I.R.B. 540.

[32] T.D. 9803, 2017-3 I.R.B. 384.

[33] Abbott Laboratories v. Gardner, 387 U.S. 136, 140-41 (1967).

[34] *See* Richard J. Pierce, Jr., Administrative Law Treatise § 15.4 (5th ed. 2010) ("After *Abbott*, pre-enforcement review of rules became the norm in the large class of cases in which the challenge to the rule's validity raised one or more issues that were susceptible to judicial resolution before the rule was applied.").

agencies know that parties disappointed in the regulation's content will shortly file suit claiming one or more reasons why the reviewing court should invalidate the regulation. The rationale for pre-enforcement judicial review of agency regulations is that regulated parties should not have to choose between complying with regulations that they think are invalid or facing penalties for that noncompliance just to get to court.[35]

By comparison, a tax provision known as the Anti-Injunction Act expressly precludes judicial consideration of any "suit for the purpose of restraining the assessment or collection of any tax" except as otherwise provided in the IRC.[36] Whether this language supersedes the APA's pre-enforcement judicial review norm for Treasury regulations is unclear. For several decades, judicial review of tax cases has fallen almost exclusively into one of two enforcement-based categories: deficiency actions, where the IRS seeks to enforce the tax laws by issuing a notice of deficiency that the taxpayer can then challenge in the United States Tax Court, and refund actions, where the taxpayer pays the disputed taxes and sues the IRS for a refund.[37] The Supreme Court has often, though not always, construed the Anti-Injunction Act quite restrictively, and the tax community has, consequently, assumed that pre-enforcement judicial review of Treasury regulations is unavailable, irrespective of the APA.[38] However, that understanding was more an assumption than clearly established legal doctrine. For example, in 1987, in *Foodservice and Lodging Institute, Inc. v. Regan*, the D.C. Circuit held that the Anti-Injunction Act barred pre-enforcement challenges to three Treasury regulations but allowed the court to consider the validity of a fourth Treasury regulation that concerned only third-party reporting.[39]

In the post-*Mayo Foundation* era, taxpayers are pursuing clarification regarding the availability of pre-enforcement judicial review for challenges to the validity of Treasury regulations more aggressively. The case to address this issue most directly thus far is *Florida Bankers*.[40] Much like the *Altera* case, *Florida Bankers* involved a challenge to Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 on *State Farm* grounds.[41] In this instance, the regulations at issue require U.S. banks to report interest earned on U.S. bank deposits of nonresident aliens, and impose a penalty on banks that fail to file such reports.[42] Such interest is not taxable in the United States,[43] but the U.S. government wants the information to exchange with other governments for similar information about non-U.S. bank deposits of U.S. citizens and residents.[44] The banks challenged the regulations under the APA on a pre-enforcement basis, claiming the regulations violated the APA's reasoned decision-making requirement. The government sought dismissal based on the Anti-Injunction Act.[45]

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[35] *Abbott Laboratories*, 387 U.S. at 151-53.
[36] I.R.C. § 7421(a).
[37] *See* Gerald A. Kafka & Rita A. Cavanagh, Litigation of Federal Civil Tax Controversies § 1.01 (2d ed. 1995) (recognizing deficiency and refund actions as the two principal types of tax litigation).
[38] *See* Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. __ (forthcoming Dec. 2017) (analyzing the Supreme Court's Anti-Injunction Act jurisprudence).
[39] Foodservice and Lodging Institute, Inc. v. Regan, 809 F.2d 842, 846 & n.10 (D.C. Cir. 1987).
[40] Florida Bankers Ass'n v. United States Dept. of the Treasury, 799 F.3d 1065 (D.C. Cir. 2015).
[41] Brief for Appellants, *Florida Bankers Ass'n v. United States Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (No. 14-5036), 2014 WL 3556435 at *28-29.
[42] Treas. Reg. § 1.6049-4(b)(5).
[43] I.R.C. § 871(i)(2)(A).
[44] T.D. 9584, 2012-20 I.R.B. 900.
[45] Brief for Appellees, *Florida Bankers Ass'n v. United States Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (No. 14-5036), 2014 WL 4980262 at *26-34.

In a split decision, the D.C. Circuit held that the Anti-Injunction Act applied to preclude judicial review of the banks' challenge.[46] Although the banks rightly observed that Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 concerned third-party reporting obligations rather than any liability on their part to pay taxes, the court observed that the banks would be liable for penalties if they failed to file the required reports.[47] The court then cited a provision of the IRC specifying that such penalties "shall be assessed and collected in the same manner as taxes" and that references to "tax" within the IRC "shall be deemed also to refer to" penalties such as those imposed for failure to file information returns.[48] Accordingly, held the court, the penalties for noncompliance with the challenged regulations are taxes for Anti-Injunction Act purposes.[49] In other words, invalidating Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 pre-enforcement would deny the IRS the eventual opportunity to assess penalties against a bank that fails to comply with the regulations, and thus would restrain the assessment and collection of taxes.

The D.C. Circuit's *Florida Bankers* decision was not unanimous, as Judge Karen LeCraft Henderson wrote a scathing dissent.[50] Apart from its 1987 decision in the *Foodservice and Lodging Institute* case, the D.C. Circuit had issued two post-*Mayo Foundation* decisions that seemingly interpreted the Anti-Injunction Act as more limited in scope. In *Cohen v. United States*, the D.C. Circuit sitting en banc held that taxpayers could bring an APA-based challenge against IRS Notice 2006-50, which adopted special procedures for refunding a defunct telephone excise tax that the IRS had improperly collected for several years.[51] And in *Seven-Sky v. Holder*, a D.C. Circuit panel held that pre-enforcement constitutional challenges against Affordable Care Act penalties to be collected by the IRS were reviewable notwithstanding the Anti-Injunction Act.[52] Writing for the court in *Florida Bankers*, Judge Brett Kavanaugh contended that all of these precedents were distinguishable from the circumstances at bar. However, Judge Henderson accused the *Florida Bankers* majority of disregarding the court's own precedents for specious reasons.[53]

Also significant, the D.C. Circuit's *Florida Bankers* decision seems to contradict the Supreme Court's decision in *Direct Marketing Association v. Brohl*.[54] Like *Florida Bankers*, *Direct Marketing* concerned a third-party reporting requirement imposed by the state of Colorado on retailers. Unlike *Florida Bankers*, *Direct Marketing* concerned the Tax Injunction Act rather than the Anti-Injunction Act. Passed by Congress in 1937,[55] the Tax Injunction Act provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State".[56] In an opinion by Justice Thomas, the *Direct Marketing* Court recognized that the acts of assessment and collection are statutorily defined functions, and also that judicial review only enjoins, suspends, or restrains those actions when it actually stops them from

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[46] Florida Bankers Ass'n v. United States Dept. of the Treasury, 799 F.3d 1065, 1067 (D.C. Cir. 2015).
[47] *Id.* at 1068 (citing I.R.C. § 6721(a), imposing a penalty for failure to file an information return).
[48] *Id.* (citing I.R.C. § 6671(a)).
[49] *Id.*
[50] *Id.* at 1072 (Henderson, J. dissenting). It is worth noting that Judge Henderson is not known for writing scathing dissents.
[51] Cohen v. United States, 650 F.3d 717, 724-27 (D.C. Cir. 2011) (en banc).
[52] Seven-Sky v. Holder, 661 F.3d 1, 8-10 (D.C. Cir. 2012), *abrogated on other grounds by* National Federation of Independent Business v. Sebelius, 132 S. Ct. 2566 (2012).
[53] *Florida Bankers*, 799 F.3d at 1072-73.
[54] Direct Marketing Ass'n v. Brohl, 135 S. Ct. 1124 (2015).
[55] Pub. L. No. 332, ch. 726, 50 Stat. 738 (1937).
[56] 28 U.S.C. § 1341 (2012).

occurring.[57] By contrast, the Tax Injunction Act does not apply when judicial review would merely inhibit the acts of assessment and collection indirectly by making it harder for state taxing authorities to enforce the law, e.g., by denying them the information they would otherwise obtain through third-party reporting.[58] Although the wording of the Tax Injunction Act is slightly different from that of the Anti-Injunction Act, the Court has always counseled construing the two statutes similarly.[59]

It is hard to reconcile the D.C. Circuit's decision in *Florida Bankers Association* with the Supreme Court's decision in *Brohl*. If judicial review of third-party reporting regulations would not stop, and thus would not "restrain" the assessment or collection of taxes for purposes of the Tax Injunction Act, and the Anti-Injunction Act is to be construed similarly, then on what basis can judicial review of the third-party reporting requirements of Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 be said to stop or "restrain" the assessment or collection of taxes for purposes of the Anti-Injunction Act? The D.C. Circuit's only response was that no one in *Direct Marketing* suggested that penalties for noncompliance should be considered taxes - completely ignoring the Supreme Court's interpretation of "restrain" as to stop rather than to inhibit.[60] Moreover, the Court's reasoning in *Direct Marketing* arguably would seem to extend additionally to regulations that define taxable income.

Finally, one should never forget that the Anti-Injunction Act originated in 1867 to stop courts from enjoining the collection process for a short-lived income tax adopted to finance the Civil War.[61] Treasury regulations did not exist at that time, nor did the APA. Tax administrative practices of that era, however, are directly traceable to those utilized today *once the IRS has initiated enforcement* of the tax laws and not before.[62] Although "no recorded legislative history" exists explaining the scope of the Anti-Injunction Act,[63] its historical context strongly suggests that Congress did not intend the Anti-Injunction Act to cut off pre-enforcement judicial review of Treasury regulations in the manner claimed by the D.C. Circuit in *Florida Bankers Association*.

The current eight-Justice Supreme Court declined to consider whether the D.C. Circuit erred in *Florida Bankers*[64], but that denial may not hold in the event a circuit split develops. Tax litigators are endeavoring to create precisely that circuit split. For example, a case in the Western District of Texas, *Chamber of Commerce of the United States of America v. Internal Revenue Service*, challenges on a pre-enforcement basis the validity of Treasury regulations

[57] *Direct Marketing*, 135 S. Ct. at 1133.
[58] *Id.*
[59] *See, e.g.,* Hibbs v. Winn, 542 U.S. 88, 115 (2004); Enochs v. Williams Packing & Navigation Co., 370 U.S. 1, 6 (1962).
[60] *Florida Bankers*, 799 F.3d at 1069.
[61] Revenue Act of 1867, ch. 169, § 10, 14 Stat. 471, 475; *see also* Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Petitioners, *Florida Bankers Ass'n v. United States Department of the Treasury*, No. 15-969 (U.S. Sup. Ct. Feb. 29, 2016), *available at* 2016 WL 825989 (advancing this argument); Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. __ (forthcoming Dec. 2017) (offering more extensive historical analysis).
[62] *See* Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. __ (forthcoming Dec. 2017) (comparing and analyzing the Anti-Injunction Act in light of the evolution of tax administrative practices since the 1860s).
[63] Bob Jones Univ. v. Simon, 416 U.S. 725, 736 (1974); *see also* Erin Morrow Hawley, *The Equitable Anti-Injunction Act*, 90 Notre Dame L. Rev. 81 (2014) (noting an absence of any congressional record defining the scope of the Anti-Injuntion Act).
[64] Florida Bankers Ass'n v. United States Department of Treasury, 799 F.3d 1065 (D.C. Cir. 2015), *cert. denied*, 136 S. Ct. 2429 (2016).

issued in 2016 to curtail inversion transactions.[65] Moving for dismissal, the government has asserted the Anti-Injunction Act.[66] Whatever the district court's conclusion, its decision will be appealable to the Fifth Circuit, which is sometimes more demanding of agency compliance with the APA than other circuits' Court of Appeals. The government has also asserted the Anti-Injunction Act in a case in the Eastern District of Tennessee, *CIC Services LLC v. Internal Revenue Service*, challenging an IRS notice requiring information reporting in connection with certain captive insurance arrangements.[67] The district court's decision in that case will be appealable to Sixth Circuit Court of Appeals.

2.3 *QinetiQ U.S. Holdings, Inc. v. Commissioner*

The *Altera* and *Florida Bankers* cases involved challenges that Treasury regulations were arbitrary and capricious under APA § 706(2)(A) and the *State Farm* case. General administrative law doctrine does not, however, limit the applicability of APA § 706(2)(A) or *State Farm* to agency regulations. In *Judulang v. Holder*, the Supreme Court applied the same requirement in rejecting a Board of Immigration Appeals deportation order - i.e., an adjudication - as an unreasonable exercise of discretionary power.[68] For that matter, although *State Farm* itself required contemporaneous evidence of reasoned decision-making in the rulemaking context, the Court in that decision drew from existing precedents concerning judicial review of agency discretion exercised through adjudication. In *SEC v. Chenery Corp.*, for example, the Court declined to uphold an agency decision on grounds not offered by the agency in its original adjudicatory order.[69] Additionally, in *Citizens to Preserve Overton Park v. Volpe*, the Court interpreted APA § 706(2)(A) as requiring an agency to supply a contemporaneous administrative record to facilitate judicial review of an agency adjudicatory decision that lacks a formal order - or see agency officials hauled into court to explain their actions through sworn testimony.[70] In short, APA § 706(2)(A) requires government agencies to explain the reasoning driving their adjudicatory decisions, and to do so contemporaneously, just as with regulations. And, as with regulations, courts limit their review of the reasonableness of agency adjudicatory outcomes to those contemporaneous explanations and refuse to entertain justifications for agency decisions advanced for the first time in litigation.

Yet, statutory provisions governing judicial review of agency regulations tend to be relatively centralized in the APA.[71] By contrast, specific statutes that contemplate agency adjudications in the context of particular government programs often also address judicial review of those adjudications with some specificity. Although the APA instructs courts to interpret the APA and provisions of specific statutes to give maximum effect to both, the APA is a statute of general applicability, and standard rules of statutory construction say that specific statutes trump general ones.[72] Hence, courts are often called upon to evaluate whether and to what extent specific statutory provisions override APA provisions governing the availability and scope of judicial review of agency action and specific statutory provisions.

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[65] Chamber of Commerce of the United States of America v. Internal Revenue Service, No. 1:16-cv-944-LY (W.D. Tex. filed Aug. 4, 2016).
[66] Defendant's Motion to Dismiss for Lack of Subject-Matter Jurisdiction, *Chamber of Commerce of the United States of America v. Internal Revenue Service*, No. 1:16-cv-944-LY (W.D. Tex. Oct. 11, 2016).
[67] Defendant's Opposition to Plaintiffs' Motion for Expedited Hearing, *CIC Services, LLC v. Internal Revenue Service*, No. 3:17-cv-110 (E.D. Tenn. Apr. 5, 2017).
[68] Judulang v. Holder, 565 U.S. 42, 53 (2011).
[69] Securities and Exchange Commission v. Chenery Corp., 318 U.S. 80, 95 (1943).
[70] Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 414 (1971).
[71] *See* 5 U.S.C. § 553 (imposing procedural requirements upon agencies engaging in rulemaking).
[72] 5 U.S.C. § 559

The IRC contains several provisions governing the issuance and judicial review of tax deficiency notices. The IRC authorizes the IRS to send a taxpayer a deficiency notice when the IRS determines the taxpayer owes additional taxes.[73] This notice is supposed to "describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice."[74] "An inadequate description" in the deficiency notice, however, is not necessarily fatal to the IRS's position - "shall not invalidate such notice."[75] A taxpayer who receives a deficiency notice, meanwhile, may seek judicial review thereof in the United States Tax Court without first paying the taxes allegedly due.[76] The IRC gives the Tax Court "jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount" listed in the deficiency notice,[77] meaning that the Tax Court reviews deficiency notices de novo as to issues of both fact and law, without deference to or consideration of the administrative record developed by the IRS.[78]

In the *QinetiQ* case, the taxpayer - QinetiQ - received a deficiency notice denying its claim to a particular (and very large) tax deduction and, consequently, adjusting the taxpayer's income tax liability upward substantially. QinetiQ pressed its eligibility for the deduction in question first before the Tax Court and, subsequently, on appeal to the Fourth Circuit. QinetiQ also, however, challenged the deficiency notice itself as arbitrary and capricious under APA § 706(2)(A) and *State Farm*. QinetiQ acknowledged that "[t]he IRS had informally made various arguments about the appropriateness of QinetiQ's deduction during the preceding audit of QinetiQ, and QinetiQ had responded to those arguments in various filings."[79] QinetiQ complained, however, that the deficiency notice itself "provided no explanation of how, or why, the [IRS] had arrived at its final determination."[80]

Both the Tax Court and the Fourth Circuit categorically rejected the applicability of APA § 706(2)(A) and *State Farm* to IRS deficiency notices. The Tax Court offered little analysis of the issue. In a brief interlocutory order, Judge Goeke contended merely that the Supreme Court's decision in *Mayo Foundation* "dealt with agency rulemaking only" and did not "overrule more than 85 years of jurisprudence and practice reviewing deficiency determinations de novo."[81] While QinetiQ's appeal was pending before the Fourth Circuit, however, in *Ax Commissioner*, Judge Gustafson offered more extensive analysis of the relationship between the APA and the IRC's provisions concerning Tax Court review of deficiency notices.[82] According to Judge Gustafson, the APA contemplates that specific statutes will sometimes override its requirements.[83] As regards judicial review of deficiency

[73] I.R.C. § 6212(a).
[74] I.R.C. § 7522(a) & (b)(1).
[75] *Id.*
[76] I.R.C. § 6213(a)
[77] I.R.C. § 6214(a).
[78] Ewing v. Comm'r, 122 T.C. 32, 52-53 (2004) (Thornton, J. concurring) (discussing history of Tax Court de novo review), *overruled on other grounds*, 439 F.3d 1009 (9th Cir. 2006); *see also, e.g.,* Eren v. Comm'r, 180 F.3d 594, 597 (4th Cir. 1999) (acknowledging de novo review by Tax Court); Gatlin v. Comm'r, 754 F.2d 921, 923 (11th Cir. 1985) (same); Raheja v. Comm'r, 725 F.2d 64, 66 (7th Cir. 1984) (same).
[79] Brief for Appellant, QinetiQ U.S. Holdings, Inc. & Subs. v. Comm'r, 845 F.3d 555 (4th Cir. 2017), 2016 WL 303820 at *14.
[80] *Id.*
[81] Order of Dec. 27, 2013 at 2, No. 14122-13, available at https://www.ustaxcourt.gov/USTCDockInq/DocumentViewer.aspx?IndexID=6178478.
[82] Ax v. Comm'r, 146 T.C. 153 (2016).
[83] *Id.* at 162.

notices, by providing for trial de novo by the Tax Court, the IRC is just such a specific statute.[84] Subsequently, in rejecting QinetiQ's appeal, the Fourth Circuit reached a similar conclusion, holding that "the APA's general procedures for judicial review, including the requirement of a reasoned explanation in a final agency decision, were not intended by Congress to be superimposed on the [IRC's] specific procedures for de novo judicial review of the merits of a Notice of Deficiency."[85]

Yet, the Fourth Circuit's decision is not likely to be the last word regarding the applicability of APA § 706(2)(A) and *State Farm* to IRS deficiency notices. The Fourth Circuit was at least partly influenced in its decision by its own longstanding precedent holding that the APA's judicial review provisions do not apply to IRS deficiency determinations, but predate both *Mayo Foundation* or *State Farm* along with much contemporary administrative law jurisprudence.[86] By comparison, in *Fisher v. Commissioner*, the Tenth Circuit Court of Appeals rejected an IRS deficiency notice imposing penalties on a taxpayer because the IRS had offered no written explanation for declining to waive the penalty.[87] "It is an elementary principle of administrative law that an administrative agency must provide reasons for its decisions," said the court.[88] In dicta, the Ninth Circuit similarly has suggested that "major errors" in a notice of deficiency, though "quite rare," could invalidate a notice of deficiency, without specifying what such an error might look like.[89] Although these precedents fall a bit short of a clear disagreement among the circuits, the Tenth and Ninth Circuit precedents are likely to inspire taxpayers to continue to press the argument that courts should require deficiency notices to satisfy APA § 706(2)(A) and *State Farm*. Meanwhile, *QinetiQ* has filed a petition seeking Supreme Court review of the Fourth Circuit's decision in its case.[90]

Regardless, as has proven the case with respect to *Altera*, the mere possibility that courts might accept those arguments may be enough to persuade the IRS to incorporate more extensive explanations in its deficiency notices. Anecdotally, the IRS occasionally issues a deficiency notice without first having determined its own theory of the case - which occasions are precisely when the reasoned decision-making requirement APA § 706(2)(A) and *State Farm* would pose a problem for the IRS. In most cases, however, the IRS's own administrative record undoubtedly provides exactly the reasoning in support of the deficiency notice that would suffice to demonstrate reasoned decision-making. Incorporating analysis from the administrative record in future deficiency notices seems easy enough to accomplish. The IRS would still lose some deficiency cases on the merits, particularly given the Tax Court's de novo review. However, the deficiency notices themselves would generally no longer be susceptible to challenge under APA § 706(2)(A) and *State Farm*.

3. IMPLICATIONS

Jurisprudence exploring the boundaries of the *Mayo Foundation* decision's rejection of tax exceptionalism from general administrative law requirements is distinctly a work in progress. Although each of the three principal cases described above has been at least tentatively if not

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[84] *Id.*
[85] QinetiQ U.S. Holdings, Inc. & Subs. v. Comm'r, 845 F.3d 555, 561 (4th Cir. 2017).
[86] *Id.* at 560 (citing O'Dwyer v. Comm'r, 266 F.2d 575, 580 (4th Cir. 1959)).
[87] Fisher v. Comm'r, 45 F.3d 396 (10th Cir. 1995).
[88] *Id.* (quoting Harberson v. NLRB, 810 F.2d 977, 984 (10th Cir. 1987), in turn citing SEC v. Chenery Corp., 318 U.S. 80, 94 (1943)).
[89] Elings v. Comm'r, 324 F.3d 1110, 1113 (9th Cir. 2003).
[90] Petition for Writ of Certiorari, QinetiQ U.S. Holdings Inc. & Subs v. Comm'r, No. __ (U.S. Apr. 4, 2017).

conclusively resolved, the law is far from settled. Litigation continues and is likely to for some years to come. Is all of the resulting legal uncertainty worth it?

At least anecdotally, past and present government tax lawyers have suggested to this author that tax administration in the United States has functioned effectively for decades without the intrusion of general administrative law principles. Indeed, for many years, the IRS held a reputation as a particularly effective and efficient government agency.[91] However, the fact that a system has functioned well in the past does not mean that it continues to fire on all cylinders today. Today's IRS is struggling. Reasons for the IRS's difficulties abound, including but not limited to, political scandals[92]; budget cuts and staffing declines[93]; and an ever-expanding portfolio of programmatic responsibilities that the IRS is ill-equipped to handle.[94] Collectively, however, they add up to a corresponding crisis of legitimacy for the IRS and the tax system.

Meanwhile, the focus of tax administration in the United States has changed substantially. In addition to administering an array of government spending programs through tax expenditures, the IRS is one of the government's principal welfare agencies and is heavily involved in regulating the nonprofit and health care sectors of the economy.[95] Many actions the IRS seeks to shield from general administrative law procedure and process requirements, and judicial review, concern programs and functions other than traditional revenue raising.[96] Yet, as the IRS has transitioned from a mission-driven agency focused on tax collection to an omnibus agency that does many things, the rationale for tax exceptionalism from general administrative law norms - to the extent it was ever justified - has diminished substantially. Why should the IRS avoid general administrative law requirements when other agencies administering substantially similar programs must follow them?

Given the IRS's many problems, it would be foolish to suggest that increasing transparency and accountability by complying assiduously with general administrative law principles is a panacea. However, APA requirements and general administrative law principles emphasize transparency and accountability in the administrative process precisely because those features are thought important to perceptions of legitimacy for administrative action. Correspondingly, judicial review is the principal tool chosen by Congress to ensure that agencies follow the procedure and process requirements that facilitate transparency and accountability. The IRS's recalcitrance in this regard, as evidenced by the litigation described in this essay, demonstrates the importance of judicial review in protecting tax administrators from themselves.

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[91] *See, e.g.,* Jonathan Barry Forman, *Let's Keep (and Expand Upon) the Earned Income Credit*, 56 Tax Notes 233 (1992) ("The IRS is far and away one of the most efficient agencies in the federal government.").

[92] Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 99 Cornell L. Rev. Online 41, 49-51 (2013).

[93] U.S. Gov't Accountability Off., GAO-14-534R, Internal Revenue Service: Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performances 8-9 (2014), http://www.gao.gov/assets/670/662681.pdf [http://perma.cc/H9ER-49RE].

[94] Kristin E. Hickman, *Pursuing A Single Mission (Or Something Closer To It) For The IRS*, 7 Colum. J. Tax L. 169, 172-73 (2016).

[95] *Id.* at 174-79.

[96] *See generally, e.g.,* Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014) (studying subject matter of Treasury regulation projects over five-year period).

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TAX EXCEPTIONALISM: A UK PERSPECTIVE

Stephen Daly[1]

INTRODUCTION

In her article in this issue of the Journal of Tax Administration, Professor Kristin Hickman explores the relationship between the US Treasury and Internal Revenue Service ('IRS'), and exceptionalism to general administrative law principles, dubbed "tax exceptionalism". It builds upon work that Hickman has produced in response to the 2011 case of *Mayo Foundation for Medical Education and Research v. United States*[2] in which the Supreme Court is generally considered to have rejected the idea of tax exceptionalism. Indeed, Hickman's article deals a decisive blow to the idea of tax exceptionalism by noting that the functions of the IRS are not dissimilar to those of other administrative agencies. Why then "should the IRS avoid general administrative law requirements when other agencies administering substantially similar programs must follow them?" That does not mean that questions do not remain. Whilst it can be accepted easily that there should be no general exceptionalism, that tells us little about "which administrative practices are susceptible to legal challenge under general administrative law principles" or whether provisions of the tax code might in fact "justify certain tax-specific departures from general administrative law requirements, doctrines, and norms."

A similar dichotomy can be said to arise in the UK between, on the one hand, the idea that there are no special principles of public law which apply to tax law and, on the other hand, the fact that the application of general principles of law in respect of the tax administration, Her Majesty's Revenue and Customs ('HMRC'), will differ from treatment given to other administrative agencies. This article will explore this dichotomy by first exploring briefly the history of the prospect of tax exceptionalism in the UK, and thereafter looking in depth at instances where HMRC may be said, in practice, to benefit from distinct treatment. The article will further assess situations where greater tolerance was given to HMRC actions than ought to have been afforded.

A BRIEF HISTORY OF EXCEPTIONALISM IN UK TAX JURISPRUDENCE

The Oxford English Dictionary defines exceptionalism as being "[o]f the nature of or forming an exception; out of the ordinary course, unusual, special." The term is used, in many contexts, to connote different situations of "exception", such as in "just war theory" where exceptionalism seeks to establish that killing can be justified in war in instances which would not be justified outside of war.[3] It may refer to a nation's or supranational body's understanding of itself that it is for some reason distinct from traditional norms.[4] Exceptionalism might even relate to privacy, such as in the case of genetic exceptionalism, which treats genetic data as unique and thereby requiring of special, more rigid protection.[5] Exceptionalism at its core requires there to be some kind of distinct understanding of a particular entity, which would, in turn, dictate that different rules or principles would apply.

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[2] *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44, 55 (2011). Hickman K. (2013); Hickman K. (2014).

[3] See Allhoff, Evans, & Henschke (2013), p. 206.

[4] See, for instance, Hodgson (2009), p. 128; Kant (2016).

[5] Krajewska (2011), p. 55.

Does this kind of exceptionalism in terms of public law apply to HMRC? In *R. (Coughlan) v. North & East Devon Health Authority*,[6] this was decisively rejected by Lord Woolf: "It cannot be suggested that special principles of public law apply to the Inland Revenue or to taxpayers."[7]

That has not always, however, been the understanding. For instance, it was once the orthodox view that the interpretation of taxing statutes departed from the general rules of statutory construction in that "literal interpretation" should apply. As explained by Loutzenhiser, people were not to be taxed unless they were designated in clear terms by the taxing Act as taxpayers and the amount of their liability was clearly defined.[8] It was in this context that some of the most memorable statements about interpreting tax statutes arose. In the 1869 case of *Partington v. Attorney General*, Lord Cairns wrote that if the Crown "cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be." [9] In the 1921 case of *Cape Brandy v IRC*, Rowlatt J held that there is "no equity about a tax…Nothing is to be read in, nothing is to be implied."[10] Lord Tomlin in the 1936 *Duke of Westminster* case wrote that "[e]very man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."[11]

This approach by the courts, however, was considerably "softened"[12] by the notorious *Ramsay* case.[13] Lord Wilberforce held therein that the courts are not confined to literal interpretation: "There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded."[14] Thus, in *IRC v. McGuckian* Lord Steyn emphasised that there had been a shift away from the literalist approach to a purposive method of construction: "Where there is no obvious meaning of a statutory provision the modern emphasis is on a contextual approach designed to identify the purpose of a statute and to give effect to it."[15]

Besides the historical flirtation with statutory construction, general principles of public law have applied in the case of HMRC and its predecessor bodies, the Inland Revenue and Customs & Excise, just as they are applied with respect to other entities carrying out public functions. Indeed, judicial review cases of actions by the UK taxing authorities have contributed generously to the development of public law, such as in relation to the doctrine of legitimate expectations,[16] the use of Parliamentary materials in interpreting statutes,[17] and standing.[18]

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[6] R. (Coughlan) v. North & East Devon Health Authority [1999] EWCA Civ. 1871, [2001] Q.B. 21.
[7] Ibid., para 61.
[8] On which, see Loutzenhiser (2016), p.40.
[9] *Partington v. Attorney General* (1869) L.R. 4 H.L. 100, 122.
[10] *Cape Brandy v. IRC* [1921] 1 K.B. 64, p. 71
[11] Duke of Westminster v. IRC [1936] A.C. 1, p. 19.
[12] King (2008), p. 114.
[13] *Ramsay v. IRC* [1982] A.C. 300.
[14] Ibid., p. 323.
[15] *IRC v. McGuckian* [1997] 1 W.L.R. 991, p. 999.
[16] In Re Preston [1985] 2 W.L.R. 836; R v. Inland Revenue Commissioners, ex parte MFK Underwriting Agents Ltd [1990] 1 W.L.R. 1545; Matrix Securities Ltd v. Inland Revenue Commissioners [1994] 1 W.L.R. 334; R v. Inland Revenue Commissioners, ex parte Unilever plc [1996] S.T.C. 681.
[17] *Pepper v. Hart* [1992] S.T.C. 898.
[18] See R v. IRC, ex parte National Federation of Self-Employed and Small Businesses [1982] A.C. 617 ('Fleet Street Casuals').

THE DISTINCT TREATMENT OF HMRC

However, whilst there may no longer be "exceptionalism" in terms of the application of general principles of public law to HMRC, it does not follow that principles of public law apply in the same manner to the body as they do with respect to other entities carrying out public functions. For this reason, Lord Carnwath in *The United Policyholders Group v The Attorney General of Trinidad and Tobago* ('*The United Policyholders*'),[19] added a qualification to Lord Woolf's earlier assertion in *Coughlan*:

> "It is of course true that the Revenue is not governed by special principles of public law. But those principles take effect in a special context… The Revenue's function is not to make the policy, but to collect the tax. It has a wide managerial discretion... Even in that context, it is only in "exceptional circumstances" that the court will overrule the exercise of discretion by the commission…"[20]

The wide managerial discretion to which Lord Carnwath referred in this extract is derived from HMRC's primary statutory function which, by section 5 of the Commissioners for Revenue and Customs Act 2005 ('CRCA 2005'), is to collect and manage[21] taxes and credits.[22] This statutory provision places an overarching "managerial discretion" in the hands of HMRC as to how it carries out these functions.[23]

The breadth of the discretion was explained in *Fleet Street Casuals*, wherein the House of Lords endorsed an agreement by the Revenue effectively not to investigate tax evasion. A federation representing small businesses and self-employed individuals brought an application for judicial review of a Revenue decision to grant an "amnesty" to a group of "casual" newspaper workers. The "amnesty" purported to forego investigation into past tax liabilities of the group of casual workers in return for the completion of the two prior years' returns and future compliance.[24] For the Revenue, the reason underpinning the agreement to extinguish such past liabilities, which was estimated to cost the exchequer £1 million for each year[25], derived from the practical inability to obtain the requisite taxing information of the casual workers.[26] For instance, the workers used names such as "Mickie Mouse of Sunset Boulevard" and "Sir Gordon Richards of Tattenham Corner"[27] in order to hide their true identities from the

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[19] The United Policyholders Group v. The Attorney General of Trinidad and Tobago [2016] UKPC 17, [2016] 1 W.L.R. 3383.

[20] Ibid., para 114.

[21] Prior to 2005, taxes were said to be under the 'care and management' of the Inland Revenue and Customs and Excise. CRCA 2005 s. 51(3) ensures that the references to collection and management are to be understood as meaning 'care and management'. On which see: CRCA 2005, s.5 (2). On which, see: Inland Revenue Regulation Act 1890 ('IRRA 1890'), s. 1(1), s.13(1) and s. 39; Taxes Management Act 1970 ('TMA 1970'), s. 1; Customs and Excise Management Act 1979, ss. 1(1), 6(2); Value Added Tax Act 1994 Sch. 11(1).

[22] CRCA 2005, s. 5.

[23] See: *Fleet Street Casuals,* supra n. 18, p. 663 (Lord Roskill); p. 637 (Lord Diplock); p. 635 (Lord Wilberforce); p. 654 (Lord Scarman); *R. (Davies) v. HMRC; R. (Gaines-Cooper) v. HMRC* [2011] UKSC 47, para 26 (Lord Wilson), [2012] 1 All ER 1048; *R. (Wilkinson) v. IRC* [2005] UKHL 30, [2006] S.T.C. 270, paras 20-21 (Lord Hoffmann). Discretion in the hands of Customs & Excise in this regard was identical to that of the Inland Revenue: *R. v. Customs and Excise Commissioners, ex p. Kay & Co Ltd* [1996] S.T.C. 1500; *Fine Art Developments plc v. Customs & Excise Commissioners* [1994] S.T.C. 668; *Customs & Excise Commissioners v. Croydon Hotel & Leisure Co Ltd* [1995] S.T.C. 855.

[24] *Fleet Street Casuals*, supra n. 18, pp. 634-635.

[25] Ibid., p. 634.

[26] Ibid.

[27] R. v. Inland Revenue Commissioners, Ex p National Federation of Self-Employed and Small Businesses Ltd [1980] Q.B. 407, p. 418 (Court of Appeal).

Revenue. The trade unions did know the details of the casual workers, but there existed the potential of an industrial strike if the unions gave up the details of these workers.[28]

In the House of Lords' hearing of the case, the starting point for the Lords on the issue of HMRC's discretion lay in the "statutory code",[29] namely the primary statutory responsibility of the Revenue, upon which a few points merited elaboration. The first is that there exist two separate responsibilities: that of collection, and that of care and management.[30] Secondly, it is plainly impractical to collect *every* part of tax due. It is this impracticality, which necessarily conflicts with the duty of care and management, that was accepted as giving rise to managerial discretion.[31] In other words, the effect of the literally read duty to collect *every* part of tax is diluted by the duty to care and manage,[32] thereby creating partial autonomy, or *discretion*, for the Revenue.[33] Ultimately, their Lordships were satisfied that the arrangement arrived at between the Revenue and the workers, unions and employers fell within the Revenue's *wide* managerial discretion.[34] Lord Diplock went further, however, and explained that:

> "[T]he board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to the staff available to them and the cost of collection."[35]

This statement has generally been quoted approvingly in all subsequent cases dealing with HMRC's managerial discretion.[36] In the 2005 case of *R. (Wilkinson) v. IRC ('Wilkinson')*,[37] the House of Lords added some substance to Lord Diplock's explanation of managerial discretion. The applicant was a widower, whom, had he been a widow, would have been entitled to a widow's bereavement allowance under section 262 of the Income and Corporation Taxes Act 1988. Mr Wilkinson argued, *inter alia*, that HMRC could utilise its managerial discretion to extend the allowance to widowers. The House of Lords rejected the applicant's claim and held that the managerial discretion endowed upon HMRC cannot be so widely construed as to concede such an allowance which Parliament could have granted but did not grant.[38] Lord Hoffmann added that:[39]

> "This discretion enables the commissioners to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases

[28] Fleet Street Casuals, supra n. 18, p. 635.
[29] Ibid., p. 650 (Lord Scarman).
[30] For instance, see: *Gaines-Cooper,* supra n. 23, para 26 (Lord Wilson); *R. (Davies) v. HMRC; R. (Gaines-Cooper) v. HMRC* [2010] EWCA Civ. 83, (2010) S.T.C. 860, para 111 (Moses LJ).
[31] *Fleet Street Casuals*, supra n. 18, p. 650 (Lord Scarman); pp. 631-632 (Lord Wilberforce); p. 636 (Lord Diplock); p. 659 (Lord Roskill).
[32] cf *New Zealand Stock Exchange v. CIR* [1992] 3 N.Z.L.R. 1, p. 3; Griffiths S. (2012), "No discretion should be unconstrained": considering the "care and management" of taxes and the settlement of tax disputes in New Zealand and the UK. *British Tax Review, 2,* p. 167.
[33] *Fleet Street Casuals*, supra n. 18, p. 651 (Lord Scarman).
[34] Ibid., p. 663 (Lord Roskill); p. 637 (Lord Diplock); p. 635 (Lord Wilberforce); p. 654 (Lord Scarman). Lord Fraser declined to comment.
[35] Ibid., p. 636. This point was not expressly endorsed by the other judges in the case.
[36] See for instance, *Gaines-Cooper,* supra n 23, para 26 (Lord Wilson); *Wilkinson*, supra n. 23, paras 20-21 (Lord Hoffmann).
[37] *Wilkinson*, supra n. 23.
[38] Ibid., para 20 (Lord Hoffmann).
[39] Ibid., para 21.

> of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of Parliamentary time."

Decisions taken pursuant to HMRC's managerial discretion will only be disturbed by the courts where "exceptional circumstances" arise, as noted by Lord Carnwath. For instance, where HMRC has acted with "conspicuous unfairness", by departing without notice from a longstanding practice to accept late applications for tax relief,[40] or by refusing to give effect to legitimate expectations,[41] or by failing to take account of the comparative unfairness of applying dissimilar treatment to similarly placed taxpayers,[42] the courts will intervene.

In brief, as HMRC's wide managerial discretion derives from its primary function to collect and manage taxes and credits as endowed by Parliament, it is for the Revenue to establish the best means of facilitating collection and management of taxes, with the courts overruling the exercise of managerial discretion in exceptional circumstances only. Thus, whilst there is no special principle of public law which applies to HMRC only, HMRC's actions with respect to collection and management take place in a "special context" thereby requiring restraint on behalf of the courts.

THE DANGER OF DISTINCTIVE TREATMENT

If HMRC can persuade a court that an action falls within its wide managerial discretion, then the affected taxpayer will have little prospect of success. The courts will be highly reluctant to intervene if persuaded of such. That is problematic, however, as it may lead courts to mistakenly fail to apply even general principles of law correctly to HMRC. Several cases in recent years demonstrate this potential: namely *R* (*Ingenious Media*) *v HMRC* (*'Ingenious Media'*)[43]; *UK Uncut Legal Action Ltd v. HM Revenue and Customs ('UK Uncut')*[44]; and *R (Bampton) v HMRC* ('*Bampton*').[45] In *Ingenious Media,* the problem lay in conceptualising as a matter of discretion that which was actually a matter of common law confidentiality. In the latter two cases, the issue lay in failing to properly apply public law principles after accepting that the decisions fell within HMRC's discretion.

Ingenious Media

The author has written about the case in an extended case note for the *British Tax Review*[46] with the result that there is little purpose in reiterating the views expressed therein in any depth in this piece. The case concerned an "off the record" disclosure by David Hartnett, then Permanent Secretary for tax at HMRC, to journalists from *The Times*. The subject of the

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[40] *Unilever,* supra n. 16.

[41] R. (Cameron) v. HMRC [2012] EWHC 1174, [2012] S.T.C. 1691; R. (Greenwich Property Ltd) v. Commissioners of Customs and Excise [2001] EWHC 230, [2001] S.T.C. 618.

[42] *R. (Hely-Hutchinson) v. HMRC* [2015] EWHC 3261, [2016] S.T.C. 962 (on which, see: Daly, S. (2016), Fairness in tax law and revenue guidance: *R (Hely-Hutchinson) v HMRC. British Tax Review, 1,* 18-27. Note that the judgment in the appeal of this case is outstanding at the time of writing.

[43] R. (on the application of Ingenious Media and another) v. HMRC (Ingenious Media (HC)) [2013] EWHC 3258 (Admin), [2014] S.T.C. 673; R. (on the application of Ingenious Media and another) v. HMRC (Ingenious Media (CA)) [2015] EWCA Civ. 173, [2015] S.T.C. 1357; R. (on the application of Ingenious Media and another) v. HMRC (Ingenious Media (SC)) [2016] UKSC 54.

[44] UK Uncut Legal Action Ltd v. HM Revenue and Customs [2013] EWHC 1283 (Admin).

[45] *R. (Bampton) v. HMRC* [2012] EWHC 361 ('*Bampton*'); *R. (Bampton) v. HMRC* [2012] EWCA Civ. 1744 ('*Bampton* (CA)').

[46] Daly (2017).

conversation was tax avoidance schemes that were taking advantage of the "Film Partnership" legislative provisions. Over the course of the meeting, Hartnett referred specifically to the applicants, Ingenious Media and Patrick McKenna, as marketers of such avoidance schemes,[47] noted that they had contributed to depriving the public purse of circa £5 billion[48] and that McKenna had personally benefited from the tax relief[49], and denounced such schemes as "scams for scumbags".[50] Some of these comments were later quoted, albeit with anonymity attached, in two articles published by the journalists in *The Times* on 21 June 2012.[51] Perhaps unsurprisingly, Ingenious Media and McKenna (the Claimants) sought judicial review of the decision of Hartnett to disclose such information to *The Times* journalists.

The Claimants, inter alia, submitted that the disclosure of taxpayer information in the case breached section 18 of the Commissioners for Revenue and Customs Act 2005 (CRCA 2005). This prohibits HMRC officials from disclosing information which is held by HMRC "in connection with a function of" HMRC[52], except where the disclosure is "made for the purposes of a function of" HMRC.[53] HMRC's argument in response, with which both the High Court[54] and the Court of Appeal[55] agreed, was that the disclosure of taxpayer information was necessary for the purpose of tax collection. Both courts accepted that there was a rational connection between the function of HMRC to collect tax in an efficient and cost-effective way and the disclosures made by Hartnett in the course of the briefing.[56] Both accepted that the decision as to whether to disclose taxpayer information to the media was in the nature of an evaluative judgment, in relation to which the courts should not approach whether to condemn such decisions as if they were the primary decision-makers'.[57] The Supreme Court unanimously overturned this assessment. In the oral hearing of the case, Lord Toulson commented that "[t]he courts below proceeded on the basis that it was discretionary…There is a question mark whether in the area of duties of confidence you are in the territory of discretion properly so understood."[58] The written judgment of the court went on to reject the view that HMRC's duty of confidentiality should be approached as a matter of discretion and that the courts should not approach the disclosures as if they were the primary decision-makers.[59] The court ultimately found that HMRC's actions had resulted in a breach to the body's duty of confidentiality. The court regarded the idea of sharing confidential information with the media as "a matter of serious concern", justified only in extreme circumstances such as "where HMRC officials might be engaged in an anti-smuggling operation which might be in danger of being wrecked by journalistic investigations".[60]

The importance of this case for present purposes lies in the potential for courts to be led to error by conceiving of HMRC's actions as falling within its managerial discretion, to which the

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[47] *Ingenious Media* (CA), supra n. 43, para 9.
[48] Ibid., para 10.
[49] Ibid., para 11.
[50] Ibid.
[51] Mostrous, Schlesinger F. and Watson R. (2012); Schlesinger (2012).
[52] CRCA 2005 s. 18(1).
[53] CRCA 2005 s. 18(2)(a)(i).
[54] *Ingenious Media* (HC), supra n. 43, paras 38-51.
[55] *Ingenious Media* (CA), supra n. 43, paras 26-30, 37-47.
[56] *Ingenious Media* (HC), supra n. 43, para 39; *Ingenious Media* (CA), supra n. 43, paras 42-46.
[57] *Ingenious Media* (HC), supra n. 43, paras 40-42; *Ingenious Media* (CA), supra n. 43, paras 44-46.
[58] See the recording of the Supreme Court hearing on the Supreme Court's website, available at: https://www.supremecourt.uk/watch/uksc-2015-0082/040716-am.html [Accessed 13th April 2017] from 4.04mins to 4.37mins.
[59] *Ingenious Media* (SC), supra n. 43, para 29.
[60] Ibid., para 35.

courts rightly should only intrude in exceptional circumstances, when, in fact, the action could fall to be considered against ordinary legal principles. The assertion of "discretion" may lead the judge to continue driving at ordinary speed past an incident involving an HMRC officer on the side of the road when, in fact, the proper course would be to slow down to have a better look.

UK Uncut and Bampton

Where an official is vested with decision-making power, she must only direct herself to relevant considerations when arriving at a decision. Conversely, the official must not take into account irrelevant considerations. This basic principle is known as the *doctrine of relevancy* and where it has been usurped, the decision is said to be *ultra vires*. The general rule, however, is subject to a minor caveat; namely, where the official would *inevitably* have arrived at the same decision despite having taken into account an irrelevant consideration or having failed to take into account a relevant consideration. A decision will not be set aside accordingly where an irrelevant factor played an 'insignificant or insubstantial' role.[61] In the leading authority *R. (FDA) v. Secretary of State for Work and Pensions ('FDA')*,[62] Lord Neuberger (then Master of the Rolls) stressed that this would only arise exceptionally. In so doing, the learned judge cited approvingly the judgments of Purchas LJ in *Simplex G.E. v. Secretary of State for the Environment ('Simplex')*[63] and May LJ in *R. (Smith) v. North Eastern Derbyshire Primary Care Trust ('Smith'),*[64] which similarly emphasise the high threshold to be satisfied to disprove the impact that an irrelevant consideration played. In the former, it was held that:

> "It is not necessary for [the Claimant] to show that the Minister would, or even probably would, have come to a different conclusion. He has to exclude only the contrary contention, namely that the Minister necessarily would still have made the same decision."[65]

May LJ in *Smith* read the law as likewise importing such a significant hurdle: "Probability is not enough. The defendant would have to show that the decision would inevitably have been the same."[66] That it would be inconvenient for the decision-maker to retake a decision where it is probable, *but not inevitable*, that she would arrive at the same conclusion cannot be helped. As held by Atkin LJ in *General Medical Council v Spackman*, '[c]onvenience and justice are often not on speaking terms'.[67]

As such, it is incumbent on the court to interrogate the impact that an irrelevant consideration plays in the decision-making process where it is demonstrated one has been taken into account. In the case of *FDA*, which concerned a challenge to the Government's alteration to the basis upon which public service pensions are annually adjusted to take account of inflation, Lord Neuberger considered the matter *obiter*. Such adjustments are normally made each April by statutory instrument and, for many years, they had been up-rated in accordance with the

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[61] R (FDA) v Secretary of State for Work and Pensions [2013] 1 W.L.R. 444, para 67 (Lord Neuberger); Simplex G.E. v Secretary of State for the Environment and the City and District of St. Albans District Council (1989) 57 P & C.R. 306, p. 326 (Purchas LJ).
[62] *FDA,* supra n. 61.
[63] *Simplex,* supra n. 61.
[64] R. (Smith) v. North Eastern Derbyshire Primary Care Trust [2006] 1 W.L.R. 3315.
[65] *Simplex,* supra n. 61, p. 328.
[66] *Smith,* supra n. 64, para 10.
[67] General Medical Council v. Spackman [1943] A.C. 627, p. 638 as cited in R. v. Secretary of State for the Environment, Ex parte Brent London Borough Council [1982] Q.B. 593, p. 646 (Ackner LJ).

increase in the Retail Price Index ('RPI') over the year ending the previous September. However, the Government decided that, from and including April 2011, such adjustments should be made in accordance with the increase in the Consumer Price Index ('CPI'). It was this decision that formed the basis of the judicial review. One of the questions was whether the effect on the national economy was a relevant factor for considering a change from RPI to CPI. The court held that it was. If the court had found in the alternative, Lord Neuberger elaborated that the decision would have remained the same in spite of this irrelevant consideration. The evidence supporting this conclusion, in the case, was overwhelming. Indeed, there was *no evidence* cited in the judgment to the contrary. Various experts' statements were cited as evidence in the court that CPI was a more appropriate matrix; namely those made by a senior policy adviser to the Department of Work and Pensions, the Director of Public Spending at the Treasury, the Parliamentary Under-Secretary of State at the Department of Work and Pensions, and the Minister of State for Pensions.

The level of scrutiny afforded by Purchas LJ in *Simplex* to the impact that an irrelevant consideration had on the decision in question more forcefully illustrates the role that the court plays in ensuring that the decision-maker has exercised her powers appropriately. The appellants in this case claimed that the Secretary of State for the Environment had taken into account an irrelevant consideration when rejecting their planning appeals. The irrelevant consideration in question related to a study carried out on the use of green belt spaces in St Albans and recommendations related to that study. The Secretary of State misconceived this study, thinking that it recommended that the space in question be maintained as green belt. In fact, the study did not make a judgment about the appropriateness of allocating the land as green belt, but made recommendations simply on the use of green belt space. It was common ground in the case that the Secretary of State had erred in his understanding of the study. The question for the court was whether or not the Secretary of State would still have rejected the planning appeals had he not taken into account this irrelevant consideration. In seeking to answer this question, the Court of Appeal forensically interrogated the Secretary of State's "admirably succinct, skilfully and carefully drafted" decision letter.[68] On the whole, Purchas LJ, who gave the lead judgment in the unanimous decision, found it "impossible to consider" that the reference to the (misconceived interpretation of the) study in the decision letter had no impact on the decision.[69] In support of this assessment, Purchas LJ proceeded to go through the decision letter line by line in order to analyse the impact that the irrelevant consideration made on the decision:

> "[The Secretary of State] emphasised in the second sentence [of the letter] that he had had regard to the recommendations of the first inspector and mentioned the subject of a special study. The juxtaposition of that "special study" and the study referred to in the third sentence which the Minister records the council as having themselves "studied" is irrefutable and a logical step in the Minister's reasoning. Having referred to these matters and to further features of the planning context, the Minister starts the sentence in which he records his disagreement with the second inspector with the word "accordingly," thereby embracing the preceding considerations including the error relating to the Napsbury Policy 75C study."[70]

This reads like the analysis of a poem. There is meticulous attention to detail and that which can be extrapolated from the detail. The Secretary of State's letter begins by referencing a

[68] *Simplex,* supra n. 61, p. 326.
[69] Ibid.
[70] Ibid., pp. 326-327 (Purchas LJ); p. 329 (Staughton LJ); p. 329 (Sir Roualeyn Cumming-Bruce).

"special study"; given the sentence construction, this "special study" must be the study in question; this "special study" was then *studied* (therefore taken into consideration); and its conclusions *embraced* as implied by the use of the proceeding word "accordingly". The conclusion drawn from this mechanical scrutiny could only be that the irrelevant consideration was "undeniably" a significant factor in the decision-making process.[71]

UK Uncut

The zealous investigation of the claim that an irrelevant consideration did not impact the decisions at issue in *FDA* and *Simplex* can be contrasted with that afforded to an HMRC decision in *UK Uncut*. This case concerned a tax settlement between Goldman Sachs and HMRC, which resolved a number of outstanding disputes between the parties. By way of background, Goldman Sachs, in addition to several other banks, had entered into tax schemes, which purported to have the effect of avoiding National Insurance Contributions ('NICs'). In 2005, however, all but Goldman Sachs had settled with HMRC on terms that they would pay 100% of the claimed NICs, but no interest. In 2010, Goldman Sachs agreed with HMRC to pay the disputed NIC amount, but not any of the interest that would be owed. The Goldman Sachs deal accordingly was settled on the basis of the 2005 terms, but without having to pay interest for the enjoyment of the monies in the intervening 5 years. It was leaked to the press that this particular interest amounted to £20 million,[72] although the true figure was probably closer to £10 million.[73] The decision of whether or not to settle disputes is a matter which falls within HMRC's managerial discretion. As noted by Nicol J, issues in relation to settlements are "quintessentially questions to be decided by the Commissioners themselves within the broad managerial discretion given to them by statute".[74]

An action group, UK Uncut, took a judicial review action claiming that the settlement went beyond the powers of HMRC. Of interest for present purposes is the claim that, when arriving at the settlement, HMRC took into account an irrelevant consideration, namely, "embarrassment to the Chancellor". David Hartnett, who led the settlement with Goldman Sachs and was its chief negotiator, conceded that this consideration was taken into account[75] and that it was irrelevant.[76] It was countered, however, that the decision would inevitably have been the same even without this irrelevant consideration.[77] Nicol J accepted HMRC's contention on the basis of three arguments.[78] First, David Hartnett asserted that there were other independent and substantial reasons for the decision. Second, that the same decision would have been reached is evidenced by the fact that Melanie Dawes, Director General for Business Tax within HMRC at the time, reached the same decision without regard to it. Third, an independent judge, Sir Andrew Park, produced a report for the National Audit Office in which he found the settlement to be reasonable. The court accepted that these arguments cumulatively had the effect of proving the irrelevant consideration had an insubstantial impact with an analytical brevity which contrasts the studious and comprehensive analysis undertaken in *FDA* and *Simplex*.

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[71] Ibid., p. 327 (Purchas LJ).
[72] Public Accounts Committee, (2011) *HM revenue & customs 2010-11 Accounts: Tax disputes.* HC 1531 (2010-12), p. 3.
[73] This was the figure which was discussed at the Public Accounts Committee hearing. Ibid., 'Minutes of Evidence' Q24 and Q26.
[74] *UK Uncut*, supra n. 44, para 63.
[75] Ibid., para 22.
[76] Ibid., para 34.
[77] Ibid.
[78] Ibid., para 57.

These reasons, however, are each fallible on closer inspection. As for the first, this naked claim by David Hartnett, as with the Secretary of State's assertion in *Simplex*, is unquestionably insufficient to shift the burden which requires that it be proved that the decision would have been inevitably reached. As for the second, the assessment of Dawes is likewise insufficient to shift the burden for two reasons. The first is that she came to the case at the end of November 2010 after the initial meeting with Goldman Sachs and promise of settlement (without interest) had taken place. As the court rightly conceded earlier in the judgment, it needs to be cautious of later reasons and be aware of the risk that they have been composed subsequently to justify the decision and are a retrospective justification of that original decision.[79] In this regard, the potential for unconscious retroactive justification by Dawes is particularly high given that between the end of November 2010 and the middle of December 2010, when the decision was approved, she had numerous, albeit brief, conversations with David Hartnett.[80] Whilst this does not render the evidence of Dawes without merit, it does warrant caution and greater scrutiny of this reason. The second, more powerful, reason is that focussing on Dawes' evidence is selective. Contemporaries within HMRC at the time, namely Solicitor and General Counsel to HMRC Anthony Inglese and other lawyers, seemed to suggest that a different deal including the interest element ought to have been secured:

> "On 8th December 2010 there was a meeting in the offices of Anthony Inglese, (Solicitor and General Counsel to HMRC). The others present were, it seems, other HMRC lawyers... There was concern among this group about a settlement with Goldman Sachs which omitted interest, in particular whether this was consistent with the *Litigation and Settlement Strategy* and whether it was right to impose no cost on Goldman Sachs for having resisted paying NICs so much longer than other companies who had adopted the same arrangement. Mr Inglese is recorded as saying,
>
>> [H]e would always want to assist [David Hartnett], but not if this were 'unconscionable'. He referred to the difficulty all those present at this meeting were having in justifying a settlement without an interest element[81]"

As such, the evidence of other similarly placed persons in HMRC counterbalances the evidence of Melanie Dawes. To this end, it cannot be concluded that a decision is inevitable if other senior HMRC officials have assessed that a different deal could have been done. As for the third reason that Park concluded that the deal was reasonable, there are several important problems which undermine the veracity of this justification. The first is a misconception; namely that Park was analysing the settlement from the perspective of a public authority properly carrying out its functions as prescribed by Parliament. There is a subtle but crucial distinction between the latter and the terms of reference for Park's study of the deal. Reasonableness is not a legal standard in Park's report, but rather is defined as follows:

> "In evaluating reasonableness, we have considered whether the settlements represent fair value for the Exchequer and were in the public interest. This included considering whether the settlement was as good as or better than the outcome that

[79] Ibid., para 56.
[80] Ibid., para 16.
[81] Ibid., para 17.

> might be expected from litigation, considering the risks, uncertainties, costs and timescale of litigation"[82]

This definition of reasonableness does not include other important factors that an HMRC official must take into account, such as, importantly, rationality, compliance with internal processes, and whether the settlement complies with HMRC's written guidance on settling disputes, the notorious *Litigation and Settlement Strategy* ('LSS').[83] Accordingly, reasonableness is used in a looser sense than as is used in a legal context and it is incorrect to say that a decision which satisfies the former will likewise satisfy the latter. Moreover, reliance upon the Park report is problematic in the circumstances as it selectively chooses extracts from the report which favour HMRC's case, but neglect the important qualifications which do not. For instance, the Park report also found that there were "significant errors in the process of reaching the settlement"[84] - was this agreement then in line with public law requirements? Similarly, Park and HMRC disagree on the flexibility of HMRC's LSS with which it should comply. Whilst Park's opinion was that the LSS "does not recognise the reality that when the Department and a taxpayer enter a process to resolve multiple complex, finely-balanced issues at once, interdependency is created between these issues",[85] HMRC's understanding, as recited by the court in *UK Uncut,* was that there could be no "horse-trading" or "package deals".[86] This is important as HMRC generally is required to comply with its published guidance,[87] which in this case it appears it did not. Park's conclusion that the deal was "reasonable" therefore does not take into account whether the deal was in line with public law requirements. In sum, HMRC and Park arrived at the same conclusion but for entirely different and opposing reasons. It feels closer to coincidence than inevitability that the results were congruous.

The three reasons that underpin the court's finding that the decision reached was inevitable accordingly are questionable when analysed more closely. Given the general principle that a significant threshold must be surpassed before it will be deduced that an irrelevant consideration played an immaterial role, the court's analysis is entirely unsatisfactory, particularly when contrasted with the approaches in *FDA* and *Simplex*. After recognising that the settlement was a matter which fell within HMRC's managerial discretion, the court went on to fail to properly apply legal principles. This error was different from what arose in *Ingenious Media* wherein the erroneous characterisation of the decision as a matter of discretion caused the error. In this case there was the characterisation of the matter as discretionary, followed thereafter by a judicial error. It highlights that even where a decision is discretionary, the courts should be wary not to misapply the relevant legal principles.

Bampton

A similar issue arises in the case of *Bampton*. The taxpayers sought judicial review of an HMRC decision to refuse late claims to group loss relief. HMRC has discretion to accept late claims but, in this case, refused. A question arose as to whether HMRC was entitled to take the

[82] National Audit Office (2012), p. 5.
[83] HMRC (2011).
[84] National Audit Office (2012), supra n. 82, p. 46.
[85] Ibid., p. 8.
[86] *UK Uncut,* supra n. 44*,* para 10. It is worth clarifying that although the LSS was updated in 2011, the remarks here both refer to the understanding of the LSS prior to 2011. It is also worth noting that Park found that the deal complied with the LSS. However, the reasoning underpinning this finding is conspicuously not provided in the report.
[87] See for instance, *R. v. Inland Revenue Commissioners, ex parte MFK Underwriting* [1990] 1 W.L.R. 1545, p. 1569 (Bingham LJ).

prospect of "tax avoidance" into account when exercising its discretion.[88] However, even if it were not a relevant consideration, both the High Court and Court of Appeal accepted that the same decision would have been arrived at in any event. The Court of Appeal only briefly dealt with the issue, as this ground was not argued explicitly on appeal,[89] so it is more prudent to investigate the High Court's reasoning.

Alan King of HMRC arrived at the relevant decision for the purposes of the review after having made a "technical submission" on the issue to Paul Jefferies and having received advice in response. Mr Jefferies was a policy and technical specialist with HMRC at the time. Blair J in the High Court accepted that in this "technical submission", the issue of tax avoidance loomed large, but that the response from Jefferies did not mention tax avoidance.[90] As this was the contemporaneous document upon which the decision was made, the learned judge concluded that tax avoidance was not a "driving issue" in the decision.[91]

This conclusion is problematic for two reasons. First, as stressed above, the test is not whether a consideration was the driving force behind a decision, but whether the role it played was "insignificant" or not. At any rate, even though it was not "driving" in the court's eyes, it nevertheless accepted that the matter loomed large in the mind of the decision-maker. This suggests that the matter was given some weight: a balancing between considerations in the mind of the decision-maker. That is not a standard of insignificance, as is required, but rather strays more towards one of probability, which was expressly rejected in *Smith*.[92] As such, the Court failed to apply the relevant test and standard. Secondly, and more importantly, the contemporaneous document, on closer inspection, does not support the court's assertion. It merely summarises HMRC's policy on late claims, sets out the facts of the current case, and concludes that: "Considering all the circumstances as presented, it would not appear to be unreasonable for HMRC to refuse the late group relief claim[s]".[93] This response is written in the negative. Moreover, recall that this was written in response to a submission in which the issue of tax avoidance had loomed large. When combined with the relative emptiness (by that I mean that it is a mere summary of facts and HMRC policy) of this contemporaneous document, it is suggested that Mr Jefferies response in fact merely confirms that Mr King's decision may take account of tax avoidance. In brief, the contemporaneous document does not support the case that the same decision would have been arrived at inevitably.
In the case of *UK Uncut* and *Bampton* then, the level of interrogation given to the importance placed upon irrelevant considerations failed to accord with the standard laid down in cases such as *FDA* and *Simplex*. Both *UK Uncut* and *Bampton* highlight the prospect of errors arising when dealing with discretionary decisions of HMRC.

CONCLUSION

Hickman writes that "[c]ourts and commentators have read the Court's Mayo Foundation decision broadly as repudiating tax exceptionalism from general administrative law requirements, doctrines, and norms". At the same time, however, "[l]egal scholars have

[88] Ultimately both Courts found that tax avoidance was indeed a relevant consideration, see: *Bampton,* supra n. 45, paras 128-129; *Bampton* (CA), supra n. 45, paras 106-109.
[89] That the same decision would have been arrived at anyway was accepted without question in the Court of Appeal, see: *Bampton* (CA), supra n. 45, paras 41, 63-64.
[90] *Bampton*, supra n. 45, para 127.
[91] Ibid.
[92] *Smith,* supra n. 64, para 10.
[93] *Bampton* (CA), supra n. 45, para 40.

identified numerous ways in which tax administrative practices arguably have deviated from general administrative law requirements, doctrines, and norms".

This article has looked at this dichotomy from the perspective of the UK, highlighting on the one hand the fact that there are no (longer) "special principles" of law which apply in the case of HMRC, whilst on the other hand acknowledging that decisions taken by HMRC pursuant to its discretion take place in a "special context". These decisions should, the Privy Council most recently told us in *The United Policyholders*, only be overturned in "exceptional circumstances".

This idea of deference to discretionary decisions, however, has the potential to lead the courts astray. When dealing with this "special context", courts should be careful about the application of general legal principles. Characterising as discretionary decisions which should not in fact be afforded such deference can lead the courts to fail to interrogate sufficiently the propriety of HMRC actions. In *Ingenious Media,* the problem of mischaracterisation *caused* the courts to approach the decision from the wrong perspective. Even where decisions are properly characterised as discretionary, the courts should be wary not to incorrectly apply legal principles. In the cases of *UK Uncut* and *Bampton,* the errors by the courts correlated with the fact that the HMRC decisions under review were discretionary. Whilst incorrect mischaracterisation will lead the judges to fail to slow down to take a good look at the action of the HMRC official on the side of the road, even correct characterisation may lead the judge to drive at the correct speed, but to pay insufficient attention to the HMRC official's actions.

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REVIEW OF RECENT LITERATURE

Lynne Oats[1]

A selection of recently published papers is reviewed below. The aim is to bring together tax administration-related papers from the diverse range of outlets in which they are published. The review is necessarily selective, and the Journal welcomes suggestions for inclusion of papers in subsequent reviews.

TAX EVASION

Alasfour, F., Samy, M. & Bampton, R. (2017). The Determinants of Tax Morale and Tax Compliance: Evidence from Jordan.

This paper explores **tax morale** in Jordan through a national survey of financially literate participants. There are very few studies that consider Middle Eastern countries, so this is a welcome addition to the literature, particularly in light of the growing awareness that, as the authors point out, 'the lessons learned from one environment cannot be generalised to countries with different cultural backgrounds and legal provisions' (p. 127). The study adopts an innovative approach to investigate the use of a multi-item measurement tool to capture dimensions of tax morale. The paper carefully describes the background literature that informs the construction of the variables.

The results suggest that tax evasion is considered to be morally acceptable in Jordan under some circumstances and, importantly, that tax morale and tax compliance are highly affected by the level of corruption in the government. The findings provide evidence of the possibility of increasing tax compliance by reducing corruption in government, reducing tax rates and addressing perceptions of unfairness.

Brink, W. D. & Porcano, T. M. (2016). The Impact of Culture and Economic Structure on Tax Morale and Tax Evasion: A country level analysis using SEM.

The study reported in this paper is concerned with developing a better understanding of how **cultural and economic variables** impact on tax evasion. It uses structural equation modelling (SEM) and regression analysis to examine the relationships between tax evasion, tax morale cultural dimensions (drawing on the work of Geert Hofstede), and country level metrics. An understanding of cultural features is important for policymakers; as the authors note, for example, 'some cultures will exhibit lower levels of tax evasion in response to increased regulation while others will exhibit higher levels. SEM is reasonably novel in compliance studies and allows the researcher to identify causal paths and, in this respect, can be considered to be more powerful than multiple regression analysis.

The authors confirm that both national culture and economic conditions impact on the level of tax evasion in a country. The unique finding is that 'many of these variables only impact tax evasion indirectly by changing individuals' tax morale attitudes.' The authors claim to lay the groundwork for further work in comparisons, for example, between developed and developing countries.

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Dharmapala, D. (2016). Cross-border tax evasion under a unilateral FATCA regime.

In this paper, the author develops a **simple theoretical model** to analyse the consequences of a unilateral FATCA regime, emphasising heterogeneous intrinsic motivations to comply with the tax laws of the country of residence. Assuming two countries, the US and a foreign country, each of which has a competitive financial sector, and finds that as information reporting makes compliance more costly for foreign residents there is increased incentive to evade. The paper provides an illustration of the 'complex and sometimes unintended interactions among information reporting, intrinsic motivation and tax evasion'.

Kuchumova, Y. (2017). The Optimal Deterrence of Tax Evasion: The Trade-off Between Information Reporting and Audits.

Here the author introduces information reporting as an addition to audit for enforcement, and attempts to model an optimal strategy to balance the two with constrained tax authority enforcement resources. The paper therefore responds to a gap in the game theoretic tax enforcement literature within public economics, which tends to assume tax audits are the only enforcement tool.

TAX COMPLIANCE

Onu, D. (2016). Measuring Tax Compliance Attitudes: What Surveys can tell us about Tax Compliance Behaviour.

In this paper, Diana Onu provides an **overview of survey methodologies** in the context of attempts to measure individuals' attitudes towards paying taxes. It is often assumed that attitudes are indicative of behaviour, although the relationship between the two is not straightforward. It is important to understand the circumstances in which attitudes can be more or less relevant in predicting behaviour; for example, attitude measures in surveys are most relevant when individuals feel strongly about the behaviour in question.

Rosid, A., Evans, C., & Tran-Nam, B. (2016). Do perceptions of corruption influence personal income taxpayer reporting behaviour? Evidence from Indonesia.

The empirical basis for this paper comprises a series of semi-structured interviews together with a field survey of self-employed and employed personal income taxpayers. The authors aim to develop a deeper understanding of the relationship between **perceptions of corruption** and compliance behaviour in a developing country context, drawing on the theory of planned behaviour. Structural equation modelling is used to test the hypothesised relationships and it is found that high levels of perceived corruption influence intentional underreporting.

Christian, C. (2016). A typology of sales tax noncompliance: Targeting enforcement to diverse intentions.

While considerable attention is given in the academic literature to income tax compliance by individual taxpayers, much less work has been done in relation to sales taxes. In this paper, the author studies rationales for tax evasion and theft in a sales tax environment. The setting is the US and the empirical data is drawn from criminal investigation case files and a series of interviews, collected while the author was working at the Florida Department of Revenue.

Content analysis was deployed as a mechanism for developing a **typology of non-compliance**. The author then identifies a need for appropriate enforcement strategies for the different categories of non-compliance, which is, of course, a central tenet of the well-documented responsive regulation approach.

Drumbl, M. L. (2016). Beyond Polemics: Poverty, taxes and noncompliance.

The earned income tax credit (EITC) is an earnings based refundable credit in the US which serves as an anti-poverty programme. In this paper, the political rhetoric that surrounds the EITC programme in relation to 'improper payments' is explored alongside the nature of **non-compliance in the EITC setting**. The article suggests that there is some commonality between intentional non-compliance by sole proprietor businesses and EITC claimants. Drumbl proposes modifications to procedures to improve compliance rates, including due diligence revisions that extend to taxpayers as well as preparers and a fast track process for those who are claiming for the first time and include supporting documentation.

Dulleck, U., et al. (2016). Tax compliance and Psychic costs: Behavioral experimental evidence using a physiological marker.

In this paper, the authors provide physiological evidence of an intrinsic explanation for tax compliance. Recognising the limitations of the economics of crime approach to understanding tax compliance decisions, they study the role of psychic stress by measuring heart rate variability to capture the psychic strain arising from contemplating actions, thus seeking to contribute to the development of a 'better microfoundation for compliance behaviour'. The authors find: women to be more compliant than men; a positive correlation between age and compliance; and associations between higher compliance and higher cognitive skills, higher levels of religiosity and greater risk aversion. They also find that higher psychic stress increases tax compliance and suggest that the **physiological measurement could be an indicator of moral sentiments** or psychic costs. Additional analysis leads to classification of taxpayers into three types: those with high tax morale and compliance but no psychic stress; those with high tax morale and compliance but high psychic stress; and those with lower tax morale and compliance and psychic stress somewhere between that of the two other groups. The authors suggest that this may mean that psychic stress is triggered by moral emotions, which motivate compliance decisions.

TAX ADMINISTRATIONS

US: Internal Revenue Service

The Columbia Journal of Tax Law published an issue in 2016 (available at https://taxlawjournal.columbia.edu/issues/vol-7-no-1/) containing papers reflecting on various aspects of US tax administration including, in particular, difficulties faced by the Internal Revenue Service (IRS). The papers were presented at a Tax Policy symposium on 'Reforming the IRS', organised by Kristin Hickman at the University of Minnesota Law School in March 2015.

Steve Johnson's paper, '*The Future of American Tax Administration: Conceptual Alternatives and Political Realities'*, suggests that the IRS faces a crisis that threatens its ability to perform its core mission of revenue collection, resulting from intersecting trends, specifically increased workload in terms of both volume and scope, and reduced resources. He observes that the

policy environment is transient, and that scholars and policymakers should explore good ideas irrespective of their political feasibility at a given point in time, while at the same time being alert to the threats posed by the emergence of obviously bad ideas.

Leandra Ledermann, in '*IRS Reform: Politics as Usual*?', reflects on the corrosive effect of the politicisation of tax administration, manifested in accusations starting in 2013, that the IRS 'targeted' particular non-profit organisations. These led to highly publicised government hearings which led to legislative reforms in 2015, akin to, but not as sweeping as, the 1998 IRS reform. She warns against **excessive oversight**, which is not only costly but can also influence *how* IRS employees do their job (for example, making them more risk-averse). Ledermann presents a careful analysis of developments during the period in which the IRS was under public scrutiny and traces IRS activity and resources over the 20 year period to 2014. She observes (at p.77) that 'the IRS is an easy target for politicians. Opprobrium for tax collectors has a long history…Politicians therefore have an opportunity both to criticise the IRS for simple political gain and to try to undermine the IRS as a way to undermine the effectiveness of a federal tax system they oppose.' As in other countries (such as the UK), the fundamental problem is 'Congress's lack of support for enforcement of the tax laws it has legislated'.

Lloyd Hitoshi Mayer's paper, *'"The Better Part of Valour is Discretion": Should the IRS Change or Surrender its Oversight of Tax Exempt Organisations?'*, proposes that to overcome the IRS's 'growing inability to oversee this area', oversight of charitable organisations should be removed from its remit. He traces the history of IRS oversight of exempt organisations before canvassing options for reform. Generic methods to improve compliance, such as third-party reporting, do not align well with the exempt organisation sector, which are additionally inclined to be pro-compliance and therefore not receptive to various cooperative compliance initiatives. Some streamlining of processes does appear to have been successful, but Mayer notes there is no obvious solution and suggests the time is right for the more radical option of '**rethinking the locus of oversight'** (p113).

Amy Monahan considers the role of the IRS in health care regulation in her paper entitled *'A Partial Defence of the IRS as Health Care Agency'*, drawing on the example of the **Affordable Care Act (ACA**) which considerably added to the IRS's responsibilities. She charts the history of the involvement of the IRS in employer-provided benefits and health plans in particular. The mechanism through which the IRS enforces health plan provisions is an excise tax, either self-reported or agency imposed. Excise taxes are considered to encourage compliance *ex ante* by discouraging the behaviour considered to be undesirable in a highly visible way. The ACA builds on the excise tax model, but with some additional rule-making and enforcement obligations. Monahan concludes that, while it is well recognised that the IRS is overburdened, in this case much of its involvement in ACA administration is both defensible and efficient.

Ajay Mehrotra's paper, *'From Contested Concept to Cornerstone of Administrative Practice: Social Learning and the Early History of US Withholding'*, provides a cogent reminder of the importance of paying due regard to historical developments, and setting tax administrative reforms against a backdrop of wider administrative reforms as well as economic, political and social context. As the author notes, history can 'provide a better understanding of current administrative practices and the promise of future reforms'.

Kristin Hickman considers the increasingly broad remit of the IRS in her paper, *'Pursuing a Single Mission (or Something Closer to it) for the IRS'*. She points out that the broadening of the scope of the IRS's activities to embrace social welfare and regulatory programmes

contributes in no small way to the current crisis of underfunding and poor service delivery. By considering reorganisations in other regulatory agencies, she is able to produce a vision of a slimmed-down scope through separating out non-revenue-raising functions, leaving the IRS better able to manage its **core function**.

TAX AGENCY EFFICIENCY

Höglund. M. (2016). The importance of staff to the efficiency of the tax agency.

In this paper, the author discusses organisational and psychological provisions and support for tax officials, using the Swedish Tax Agency as a case study. He observes that **tax agencies are Janus-faced**, with both public service and supervisory roles. In Sweden, a citizens' perspective has become increasingly important, which has implications for how tax agency staff interact with taxpayers and fulfil their roles. Höglund recommends paying more attention to the health of agency employees, particularly in respect of stress, and a transparent organisation with bottom-up incentives and without top-down governance.

TAXPAYER RIGHTS

The inaugural International Conference on Taxpayer Rights was held in Washington D.C., in November 2015, hosted by the National Taxpayer Advocate, Nina Olson. Four papers that were presented at that conference were subsequently published in a special issue of the *Tax Lawyer*, and are summarised below (in no particular order).

In '*How can Tax Collection be Structured to Observe and Preserve Taxpayer Rights: A Discussion of Practices and Possibilities*', Fogg and Jozipovic deal with the question of **debt collection**, which is problematic for all tax authorities. The authors conclude that the US system for both debt collection and debt forgiveness is flawed, particularly in relation to low income taxpayers. They propose that practical implementation of taxpayer rights can be seen in civil law models of taxpayer protection, considering the examples of Germany, Switzerland and Croatia and concluding that all are deficient in some respect. A solution for the US should rather consider reform of procedures that occur prior to enforcement action.

Leslie Book's paper is titled '*Bureaucratic Oppression and the Tax System'* and deals with the earned income tax credit (EITC), which is plagued by persistently high error rates and in which service to claimants is poor. The author rightly points out that lessons can be learned from the **experiences of other administrative agencies** in their interactions with low income individuals. The title of the paper is drawn from a 2012 article by Edward Rubin, in which the term bureaucratic oppression includes actions of agency employees that follow the rules but impose excessive burdens. Book concludes that an agency that prioritises expedience over experience has potential to 'jeopardise taxpayer rights and potentially undermine confidence in the tax system'.

Amanda Bartmann's paper, *'Making Taxpayer Rights Real: Overcoming Challenges to Integrate Taxpayer Rights into a Tax Agency's Operations'*, is concerned with ensuring that taxpayers are properly educated as to their rights and how these may best be exercised. It is also important that agency employees are appropriately trained to apply taxpayer rights when making decisions. Measuring how easily taxpayers exercise their rights is difficult, however, and **measuring employees' actions** may shed light on this question. Bartmann concludes that by 'incorporating taxpayer rights into its own measures and reporting on its progress, the IRS

can ensure efforts to operationalize taxpayer rights are effective, lending true meaning to the Taxpayer Bill of Rights.'

Abreu & Greenstein suggest that a failure to consider the views of those who mediate between taxpayers and tax agencies can undermine the legitimacy of the tax system and the tax agency. Their essay, *'Tax as Everylaw: Interpretation, Enforcement and the Legitimacy of the IRS'*, examines how tax exceptionalism, i.e. the belief that tax law is somehow different from other law, is prevalent among tax scholars. The authors note that 'when tax is thought to be fundamentally different in kind from other fields of law – it is deprived of the analytical tools and vocabulary commonplace in other fields of law…. creating a shroud of mystery and murkiness…' By **abandoning tax exceptionalism**, the IRS would be able to be more open and transparent about the positions taken in interpreting the law and exercising enforcement discretion, resulting in legitimacy gains.

In '*Taxpayer Rights in Australia twenty years after the introduction of the Taxpayers' Charter*', published separately from the *Tax Lawyer* special issue, Duncan Bentley sets out a proposal for a **legal rights pyramid** as an adaptation of the compliance pyramid, detailing classification of legal rights and mapping them against the dispute resolution processes by level of significance of the issue involved. Integrating a legal and compliance framework has the potential to bolster the stability of the taxpayer/tax authority relationship.

DISPUTE RESOLUTION

Tran-Nam, B., & Walpole, M. (2016). Tax disputes, litigation costs and access to tax justice.

This paper reviews **dispute resolutions mechanisms in Australia** and, in particular, effective access to such mechanisms. The authors examine key concepts such as tax complexity, tax disputes, litigation costs and tax justice. They also explain recent developments at the Australian Tax Office, and describe a research agenda including stakeholder identification and the development of a theoretical model as part of a research council funded project which aims to investigate whether or not: (i) access to independent dispute resolution is effective; (ii) taxpayers with greater resources may obtain more favourable outcomes; and (iii) alternative dispute resolution is an effective mechanism for resolving disputes.

TAX COMPLEXITY

Burton, H., & Karlinsky, S. (2016). Tax professionals' perception of large and mid-sized business US tax law complexity.

This paper reports the findings of a survey of tax directors of large US corporations, as well as professionals from international accounting and law firms, on the **perception of complexity** across 40 different tax issues. Perhaps unsurprisingly, international tax issues were found to be the most complex, indeed, the top ten issues rated as such. There was no significant difference in the perception of complexity based on experience, nor was there a difference between those participants in public practice and those in corporate tax departments.

TAX TRANSPARENCY

Kaye, T.A. (2016). Tax Transparency: A Tale of Two Countries.

Two important questions are asked in this paper: how much tax transparency is appropriate, and with whom should the information be exchanged? The author discusses the significance of the stark contrast between the EU and Luxembourg, which has a tradition of secrecy yet, in recent years, has become party to several information exchange and transparency measures promulgated by the European Commission, and the US which, while pushing for transparency and information from others, has resisted global disclosure standards of the common reporting system, stating that it will only exchange reciprocally with jurisdictions maintaining stringent privacy and technical standards, as well as resisting demands for public release of advance pricing agreements. In responding to the Panama Papers, the EU has reacted faster than the US and the latter, having led the charge with the enactment of FATCA, now appears to be falling behind in the global movement towards greater transparency.

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IFS RESIDENTIAL CONFERENCE 2016 – CORPORATE TAX AVOIDANCE: WHERE NEXT FOR POLICY AND PRACTICE?

Nigar Hashimzade[1]

The annual IFS Residential Conference was held on 9-10 September, 2016 at Magdalen College, Oxford. This was organised with the support of the Chartered Institute of Taxation (CIOT), the Economic and Social Research Council (ESRC), and the Tax Journal. Speakers and delegates from academic institutions, government departments, NGOs and the tax profession were welcomed by Malcolm Gammie (QC, IFS Tax Law Review Committee and One Essex Court) and Paul Johnson (IFS).

The focus of first day of the conference was primarily on the UK context. The first plenary session, chaired by Helen Miller (IFS), was dedicated to the design and assessment of measures to stop tax avoidance. The agenda for the panel was stated as follows:

> There have been many new anti-avoidance measures in recent years. This panel will explore what we know about how effective such policies have been to date, and whether policy – including the use of soft law – is moving in the right direction. An overarching question is whether assessments of past and proposed policies are fit for purpose, including to what extent they form the basis for designing more effective laws.

Surjinder Johal, from the Office for Budget Responsibility (OBR), revealed that the OBR has evaluated 59 anti-avoidance and operational measures announced since 2010, and concluded that there were more underperforming than over-performing measures. The number of anti-avoidance measures has been increasing since 2012. The cost-benefit analysis is characterised by high uncertainty - up to 74%, as estimated by the OBR - with a large proportion coming from the behavioural uncertainty. Continuing on this topic, John Whiting, from the Office for Tax Simplification (OTS), spoke about the effectiveness of anti-avoidance measures, and the links between the complexity of tax law and tax avoidance. One of the key recommendations of the research carried out by the OTS refers to tax policy design: it should not incentivise avoidance, for example, by tax rate differentials. The OTS research also suggests that tax law complexity can encourage avoidance.

Bill Dodwell (CIOT & Deloitte) talked about the role of the “soft law” in countering tax avoidance. He used two examples: the OECD guidelines on transfer pricing; and the EU Code of Conduct on harmful tax practices, such as the diversion of taxes by large multinational corporations (MNCs). A global forum on transparency could play a role in policing international agreements that are not part of legislation for some countries. Gentle enforcement of the “soft law” could be achieved by peer review, for example, of a country's tax collection methods or its ability to provide tax data on request. One way of influencing the behaviour of corporate taxpayers could be the publication of “tax strategy” by large companies. However, companies that are less in the public eye are likely to be less influenced.

In opposition to these practices, the General Anti-Abuse Rule, or GAAR, is “hard law”, and was discussed in a subsequent presentation by Patrick Mears (GAAR Advisory Panel), who

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spoke about the role of the Advisory Panel as a safeguard against an over-zealous tax authority, and the impact on taxpayers and the promoters of tax avoidance schemes.

Jennie Granger (HMRC) emphasised that voluntary compliance is strong in the UK, but more needs to be done to close the 6.4% tax gap. She outlined the importance of the behavioural insights and customer-based approach to compliance. One recent change introduced by the HMRC is the Accelerated Payment Notice (APN), which requires that taxpayers pay the avoided tax in full and then can challenge the decision in court. This has led to a £3 billion revenue increase, and all 5 GAAR cases that have been to court have been won by HMRC. Furthermore, HMRC publicises the cost of being involved in tax avoidance schemes, which deters taxpayers from taking risks. Another development is a shift in public attitudes: the focus is now on fairness, rather than the issue of legality, which means that aggressive tax planning activities may impact on the reputations of the businesses undertaking them.

The session concluded with a panel discussion, during which the conference participants asked questions and commented on issues raised in the presentations, such as: the accuracy and the components of the tax gap measure; the definition and the size of legal tax avoidance; the design of a good GAAR (with some discussion of the features of the Scottish GAAR); and the role of consultations between tax authority and taxpayers.

The keynote speech was delivered by Jane Ellison MP, Financial Secretary to the Treasury. She talked about the role of the tax system in creating a productive environment for businesses in the UK and helping them to succeed. She also emphasised the strong tax morale in society - the latest surveys have shown that more businesses believe that not paying tax is unacceptable - and the necessity to distinguish between competitiveness and unfair advantage in tax treatment. She also spoke about the importance of consultations and the effect of APNs on tax revenues. Questions and comments from the audience concerned: the review of the anti-avoidance provisions; tax exemptions and tax reliefs; the challenges of tax simplification; the post-Brexit opportunities for the UK; and importance of balancing the language and the context in the discussion of the tax gap (e.g. the tendency for "big company" to become a pejorative term).

The second plenary session, chaired by Heather Self (Pinsent Masons), focussed on what drives decisions, and included presentations from the HMRC and large corporate taxpayers. The agenda stated:

> Governments seek to shape the tax environment, including through legislation and regulation, while responding to the behaviours of businesses and the actions of other governments. Businesses in turn respond to government actions, but also to the demands of boards, investors and customers. This panel asks what drives the tax decisions of government and businesses. How do incentives differ, how are they shaped and how are they changing? The discussion will pick up on the role of institutions, including the audit committee and professional bodies, and on the effect of attempts to define and implement 'responsible tax' practices.

Jim Harra (HMRC) spoke about the drivers of taxpayers' decisions not to evade or avoid tax, such as social norms, as well as the detection and intervention by the tax authority and the reaction of public. He emphasised the importance of strengthening the social norm of compliance and public transparency, the link between the "Tax in the Boardroom" initiative and corporate social responsibility (CSR), and the related challenges involved in reaching small

businesses. Ian Brimicombe of AstraZeneca's presentation asked the question “Is the relationship between the corporate sector and the tax authority working properly?” He went on to talk about the role of the audit committee in risk management and its increased engagement in tax issues.

John Connors (Vodafone) expressed regret at how the debate on tax and the CSR is not always well informed, and noted the absence of recognition of good practices. Much of the tax avoidance debate is focussed on history, but the environment and attitudes have changed: a significant change, for example, was the introduction of the Disclosure of Tax Avoidance Scheme (DOTAS). In a global economic environment, in which countries compete to attract businesses, and small countries try to remain competitive without the benefits of large consumer and workforce bases, ensuring that rewards from outward investment are not penalised and that entrepreneurial activities are not distorted by tax are important issues for governments and businesses. Broad-based, efficient tax administration contributes to the stable environment for businesses who wish to avoid unnecessary disputes with the government. John Connors also touched upon the rhetoric of “fair”, as opposed to “correct”, amounts of tax. He emphasised the importance of economic rationale behind business transactions, and of fostering the culture of cooperative compliance and transparency.

Kate Thomson (BP) talked about BP's approach to tax planning, and the similarities between its risk management methods and those used by AstraZeneca and other corporate taxpayers. Tax cost and fiscal predictability, amongst other factors, play important roles when ranking feasible projects. She spoke about the need for the tax lawmakers to recognise changes in the ways in which value is created, and about the challenges involved in modernising tax law to reflect ongoing changes in technology and consumer behaviour. Other recurring issues were: the need to distinguish legitimate tax planning from illegal tax avoidance; the rhetoric of “illegal” and “immoral” tax behaviour, and the differentiated understanding of what is moral or fair among different groups in a society; and the related issue of the importance of educating the public in order to improve their understanding of the tax system and business activities.

The questions posed and comments made during the panel discussion were about the publicity, transparency and dubious merits of placing large volumes of data about business activities and taxes in public domain when this data may not be directly useful for the tax authority or understood by public. While Jim Harra (HMRC) said that he understood the burden of corporate tax reporting and sympathised with businesses, he called for the corporate world to act together in order to help to improve the public perception of their activities. Kate Thomson (BP) and Ian Brimicombe (AstraZeneca) mentioned the misplaced focus of public attention on corporation tax while issues such as, for example, BP's multi-billion investment in capital-generating operations in the North Sea and AstraZeneca’s contributions to pensions were ignored. Other questions and comments concerned: country-by-country reporting and ways in which it could be improved, given that large companies have only global tax strategies; changes in the tax law improving the alignment of the NIC rates and transparency in income tax; the need for the tax authorities to be more transparent with their calculation of the “reasonable” tax due; and the feasibility of a “clearance” system, whereby the legality of a tax scheme is known in advance.

Discussion of various issues continued at five parallel breakout sessions. John Cullinane (CIOT) and Ian Young (ICAEW) chaired two parallel sessions on tax avoidance, and the professional standards applying to tax agents and advisers. Gareth Myles (University of Exeter/TARC) and Helen Miller (IFS) chaired two parallel sessions about trends in anti-

avoidance policies. Gary Coombs (HMRC) chaired a session about changes in taxpayers' attitudes.

The sessions on anti-avoidance policies focussed on the effectiveness of these policies, the balance between hard and soft law, and future developments. One issue raised in the discussions was that of the timeliness of legislation: the court cases in the focus of the debate are 10 to 15 years old, so is legislation currently being brought in to deal with behaviour that has already changed? Another important question was about level playing fields: while European corporate tax directors are concerned with reputation and social responsibility in tax matters, American CFOs are explicitly instructed to minimise tax. The US government promotes and subsidises their multinationals who avoid paying tax in Europe. The right amount of tax, in the US understanding, is the smallest amount possible. While tax strategy in the US is to minimise tax, for corporate taxpayers in the UK, for example, the tax strategy amounts to "doing everything not to be criticised". It is difficult for British politicians to say that, by and large, the multinationals pay the right amount of tax. Cultural and political differences in attitudes make it difficult for companies to have global tax strategies - whether or not a company's financial strategy should be based on the tax system is questionable.

An interesting discussion revolved around the purpose test, or economic substance doctrine, as a philosophical concept: is it possible to have an objective test of subjective intention? Was the OECD's BEPS initiative caused by public discontent, or was it a natural evolution of the national tax systems into international coordination? What is the right balance of responsibilities between advisors, corporations and governments? The debate about future developments focussed on: uncertainty; the questionable necessity of GAARs; the growing complexity of tax laws: reasonable justification of tax reliefs as means to support certain economic activities, instead of direct spending programmes, for political reasons.

In the evening plenary session, Edward Troup, the Executive Chair and First Permanent Secretary (HMRC), delivered a keynote speech titled "Reflections on avoidance: From Bede to Wittgenstein and back again". It started with a historical excursion which took us as far back as the year 731, when Bede complained about "false monasteries" which, in reality, served the "own desires of laymen", thus abusing the law. The speaker also discussed Adam Smith's quote on "bounties" (subsidies) to fisheries (similar to business expansion schemes) and Wittgenstein's 1921 quote: "the limits of my language mean the limits of my world". There were more quotes about words and their meanings, with an interesting excerpt from Samuel Johnson's dictionary, which defined excise as a "hateful tax".

According to the speaker, however, in the UK, the current attitude to paying tax is remarkably strong: about 90% of tax is paid, some 3% is enforced, and about 7% is lost in the tax gap. He went on to talk about a change in attitude, especially among the corporate taxpayers, where the language of "impose" has been replaced by "contribute". The final quotes in the talk referred, once again to Bede and to the Bible, and mentioned various punishments for the sin of greed, in the context of the deterrence measures.

The talk was followed by a brief discussion between Edward Troup and Paul Johnson (IFS). One question raised was whether the cause of the change in the tax culture was as a result of campaigning, Margaret Hodge, or the work carried out by the HMRC: the answer was that it was a greater awareness of the taxpayers about how they were part of the society, and of how taxes represented a shift of resources from one set of people to another, rather than from people to the state. A discussion also took place about the role of the HMRC and the government in

cases where it has been emphasised that the authorities should relentlessly go out with information about the work of corporations and wealthy individuals (such as famous footballers stars and film-makers), and how communication and explanation are important parts of this work.

The second day of the conference was dedicated to international issues. The keynote speaker, Stephen Quest (DG Taxation and Customs Union, European Commission), outlined Brussels' perspective on tax avoidance issues. He mentioned economic and financial crisis, migration, security concerns, and Brexit as a backdrop for the debate, and talked about the frictions between the modern economy and the international tax law designed in the past. One positive development within the international scene is that coordination has become an accepted approach: more than 100 countries have signed up to the BEPS initiative, and a new political appetite for working together on corporate taxation has emerged amongst EU countries. There have also been visible changes in pace: new legislation is passed within months and weeks. The speaker emphasised how important it was for the member states to coordinate their actions in order to protect their tax bases and thus to reinforce the sovereign rights eroded by tax competition and tax avoidance. He also talked about what he identified as the two drivers behind the current process: social justice and fairness, and economic growth and prosperity. Transparency is seen as essential for fair taxation; however, not all countries show support for country-by-country reporting. As the natural next step, he mentioned transparency in beneficial ownership (following the "Panama Papers" revelations) and for tax advisers. Growth is important: anti-avoidance does not mean anti-business; businesses need simplicity, certainty and level playing fields. Simplicity can be achieved by coordination within the EU; certainty comes from using a binding EU law, rather than soft law; and the level playing field is achieved by ensuring that tax burdens on local companies are the same as on the multinationals (currently estimated as 30% higher for locals).

According to the speaker, another step that the EU could take would be to implement a single, simple, effective tax system, with the uniform corporate tax base. The Common Consolidated Corporate Tax Base (CCCTB) will eliminate cross-border losses, reducing compliance costs by at least 2.5% and possibly by as much as 10%. Double-taxation and related disputes will be eliminated, and simple resolution procedures will be in place for the remaining disputes. By focussing on fairness and tax system efficiency, a transparent common corporate tax rate will eliminate tax competition. It is important to ensure that tax does not distort investment: it is necessary to remove debt bias and to encourage equity investment. Finally, research and development can be encouraged by using tax incentives. All of these can be implemented in two stages: the first - and easiest one - is to establish a common tax base, and the second is to transform it into a consolidated tax base. While talking about new challenges, the speaker mentioned the digital economy, the sharing economy and the virtual economy.

The questions put to the speaker from the conference participants and the ensuing discussions concerned: the conflict between the transparency in beneficial ownership and privacy in tax; the assertion that the EU and the ECJ were disruptive forces, especially with regard to tax policy and the role of the UK in shaping the international agenda; the possibility of higher taxes on the digitized EU businesses pushing these businesses outside the EU; the EU's business interests in Asia and Africa, and the corporate tax base without consolidation; and the differences in the way in which the CCCTB was being implemented by EU member states.

The third plenary session, chaired by Paul Morton (RELX), was dedicated to the topics of international institutions and new directions in policy. The aim of the session was to:

> …address the key questions in international tax, including: after the BEPS agenda and proposals by the European Commission, where next for international coordination? Do we need a global tax body? How will the UK respond to international developments, and to what extent are policy choice constrained by other governments' actions? What are the views in favour and against the use of state aid rules in tax matters and how does competition policy interact with tax policy?

Jon Sherman (HMRC) spoke about the key role that the UK government played in the BEPS initiative in 2013, especially in terms of engaging with businesses. He outlined a number of HMRC developments, including the digital economy project, operational and policy collaboration, and capacity building in the developing countries with the Department for International Development (DfID). Commenting on BEPS, Paul Morton (RELX) pointed out that a concrete set of deliverables emerged after only two years of negotiations, thanks to active participation of tax authorities, and, primarily, the HMRC.

Diarmid O'Sullivan (ActionAid) started by providing delegates with basic information about his organisation, a development charity which works in 40 countries, and whose main concern is with poverty, especially among women and girls. He spoke about the central place of corporation tax in low-income developing countries (the source of 16% of total revenues, compared with 8% in the developed countries) because of inability to collect income tax. Thus, developing countries are more vulnerable to changes in taxation in other countries, but have little say on a global level; even the key decisions about BEPS were made before the developing countries joined in. According to the speaker, the anti-avoidance clauses "copied and pasted" in international tax treaties do not account for taxing rights and larger developing countries will inevitably come up with their own versions; hence, the necessity of a global institution. The interests of China, India and Brazil are not the same as, for example, the interests of African countries, and special economic zones may be worthwhile in China but not in Africa. Overall, countries need to move away from tax holidays to non-tax measures and, as a global economic power, the UK has a responsibility in this process.

Conor Quigley QC (Serle Court) spoke on the issue of state aid. While the basic definition of state aid is "the aid granted by state", the European Commission (EC) has offered its own interpretation, especially on tax ruling. The following five criteria apply:

(1) an intervention by the state equivalent to the deviation from the norm and constituting burden on state resources;
(2) an economic advantage by the virtue of that measure;
(3) selectivity, or favouring certain undertakings, while others do not benefit in a similar situation;
(4) distortion of competition;
(5) effect on trade.

Overall, these criteria include three types of advantages: economic, selective, and competitive. The question is, does it apply to tax? For example, lower tax rates or tax reliefs, or the discretion of the tax authority might be viewed as state aid. An important distinction in the case of tax ruling is that the assessment process is a norm and not a deviation. For example, a tax authority can agree with multinational corporation (MNC) on a particular split of profits across jurisdictions, but this is not an intervention or deviation. According to the speaker, the EC is

wrong in calling it state aid; the EC interprets any government action as intervention, but there must be a deviation from the norm. This was not, for example, the case in the agreement between Apple and the government of Ireland; other examples mentioned in this context were Starbucks and McDonald's. The repercussions were the recovery issues, whereby other countries were invited to submit claims; however, if a country's claim is based on its own assessment, this should be similarly classed as state aid, as was Ireland's assessment. Also, as a result, everybody can sue for damages from the tax authority for awarding state aid.

Stef van Weeghel (PwC), speaking on "Where Next for International Coordination?" painted a bleak picture: tax competition persists in spite of all talks; tax consequences of tax planning and accommodation for other countries continue; taxpayers and their advisers exploit tax system differences; anti-avoidance measures are not coordinated and lead to a "Not In My Back Yard" (NIMBY) attitude; the public perception is that the MNCs pay no tax, contrary to the facts in several independent reports. There seems to be a crisis of trust in taxation, partly due to lack of available information. With the development of the digital economy, profits will not be raised in EU or OECD countries, and so will not be taxed according to their rules.

Paul Oosterhuis (Skadden) talked about the U.S. perspective. The position of the USA on state aid is less concerned with the legality under the EU law, but more on the retroactivity, and on the international coordination and institutions, with some possible changes in the U.S. law. The U.S. views residual profits as a function of risk. The OECD transfer pricing guidelines are not part of U.S. tax law, although they are, for example, included in the U.S.-Japan treaty. As a result, U.S. multinationals will start moving their employees overseas, or hire locals in order to retain profits and pay low local taxes. Also, a new proposal on taxing destination cash flows causes serious issues with the WTO, but the U.S. may not care about this in the current climate. A comment from Jon Sherman (HMRC) concerned the possibility of tensions caused by the UK perspective on the U.S. position. There was a further brief discussion of the recovery of tax from Apple under Irish law, which has a time limit of 4 years, compared to 10 years under the EC regulation. An alternative interpretation of tax is the debt to the state; Irish parliament would have to pass a new law that differed from the national recovery rule. The speaker agreed that this case has raised a whole range of unique issues.

The wrap-up session, chaired by Malcolm Gammie QC (IFS Tax Law Review Committee and One Essex Court) focussed on the questions: "What are the lessons and what will be the challenges going forward?" Mike Williams (HMT) spoke on BEPS and transfer pricing, and the unresolved issues of source versus residence. Regional differences pose another challenge; the U.S. focusses on capital, Europe on labour, and large developing countries on consumers. To what extent is tax avoidance yesterday's problem? Settlements take time, and the rules developed in the past may not work in the changing economies. The speaker noted that there is no intrinsic virtue in having high corporate tax, and no wickedness involved in reducing the corporate tax rate. With regards to the state aid, he emphasised the importance of level playing fields and the support of the EC by the UK government in policing the state aid rules. He also warned that the UK needs to remain vigilant in ensuring that the "police" do not overstep the mark: there should be no place for creating parallel rules instead of enforcing the existing ones, for second-guessing the decisions of tax authorities, or for land-grabs being behind the decisions. Increased public scrutiny means that HM Treasury and tax professionals need to do more to explain the basis of various decisions; however, more transparency will not make everyone happy.

Heather Self (Pinsent Masons) gave a summary of the views of several speakers. She pointed out that the Parliamentary Commission chaired by Margaret Hodge is not particularly useful or necessary, and that putting more data into the public domain will not necessarily help, as the general public may not understand, for example, the tax treatment of losses. A bigger underlying problem is the meaning of tax avoidance: is it the same for the public as it is for HMRC or tax lawyers? Judith Freedman (University of Oxford) also spoke about the confusion in the public debate due to the usage of the term “tax avoidance” for many different issues. She also said that GAAR was not designed to deal with the BEPS-type behaviour, and so high expectations will eventually lead to disappointment. She added that transparency may create distrust if it does not come with good explanations, and that businesses should be more proactive in delivering information, as public opinion is currently based on information obtained from other sources. Paul Morton (RELX) noted that certainty is better than simplification, but that more rulings do not always reduce uncertainty: it is possible that negative rulings create more uncertainty.

Responding to a question about whether more policies should be introduced, the panel members spoke about: the need to understand the logic behind visible policies and to revisit issues such as source versus residence-based taxation; the number of anti-avoidance measures that were disproportionately large in the UK; the need for a more rigorous cost-benefit justification; and the need to think more holistically about policies. The discussion with the audience focussed on: direct communication to public; the irresponsibility of political rhetoric, especially in the mass media; and the need to resolve the crisis in trust.

In the concluding remarks, Sam Mitha (Charity Trustee), Malcolm Gammie, and Paul Johnson thanked the participants and organisers for an interesting and useful conference, and announced that the next conference will be held in 2018.

BOOK REVIEW: EVANS, C., KREVER, R., & MELLOR, P. (2015). *TAX SIMPLIFICATION*. THE NETHERLANDS: KLUWER LAW INTERNATIONAL

Dale Pinto[1]

The principles of a "good tax", commonly expressed in terms of simplicity, certainty, equity, neutrality and efficiency, are well-known and often-quoted in the tax literature. Tax simplification has been, and will continue to be, on the agendas of governments in many countries, including Australia. The UK, for example, has a formal independent Office of Tax Simplification.

A tax will be simple, relatively to others, if for each dollar raised by it the cost of official administration is small, and if the compliance costs – the costs in money and effort of all kinds to the taxpayer – are also small.

The seminal Asprey Report[2] notes that after equity, simplicity is perhaps the next most universally sought-after of qualities in individual taxes and tax systems as a whole. It then goes on to presciently observe that, like 'fairness', it is a word that, in this context, points to a complex of ideas.

So why bother about complexity? A quote in the UK context from Jolyon Maugham QC, in July 2015, will no doubt resonate in Australia:

> The UK's tax code runs to 22,298 single spaced, small font, heavily footnoted pages. That's two-thirds the page-count of the 32 volume Encyclopaedia Britannica, which affected to summarise the sum total of human knowledge.

The Australian context is no better – according to Robin Speed from the Rule of Law Association, if Australia keeps making new laws at the current rate, there will be 830 billion pages of tax legislation by the turn of the next century. To further complicate things, there are two main Acts in Australia (the original 1936 Act and the partially rewritten, but not finished, 1997 Act).

Even the judiciary encounters difficulties with the complexity of tax legislation. In 1991, for example, a High Court Justice criticised the complexity of the capital gains tax:

> The provisions of s.160M(5), (6) and (7) of the *Income Tax Assessment Act 1936* ('the Act') and provisions to which they are related are extraordinarily complex. They must be obscure, if not bewildering, both to the taxpayer who seeks to determine his or her liability to capital gains tax by reference to them and to the lawyer who is called upon to interpret them … successive administrations have

[1] Professor of Taxation Law, Curtin Law School, Curtin University, Western Australia; Adjunct Research Fellow in the Taxation Law and Policy Research Group, Monash University.
[2] Taxation Review Committee (1975).

> allowed the Act to become a legislative jungle in which even the non-specialist lawyer and accountant are likely to lose their way.[3]

Arguments in favour of reducing complexity include the substantial (though difficult to measure) economic costs it creates, the greater the number of errors and consequent higher administration costs, the fact that it can lead to a point where no-one understands it, and research which shows that people are more likely to comply with tax laws if they understand them. Despite these laudable ideals, as the editors of this book note, little has been achieved in the ongoing quest for simplicity.

Against this background, this book examines all aspects of tax complexity and simplification, from policy through to practice. Commendably, it takes both a theoretical and practical approach to the topic, which enables readers to understand tax complexity, assess its impact and identify potential means by which tax simplification might be achieved or at least complexity 'contained'. As such, the book would appeal not only to tax scholars and students, but to practitioners, policy makers, legislators and the judiciary as well.

The contributors to this book are highly respected academics, administrators and practitioners with direct knowledge of complexity and how attempts to achieve simplicity have fared in a variety of jurisdictions.

The book contains 19 chapters in total, which derive from a three-year, multi-university research project entitled 'Assessing and Addressing Tax System Complexity', funded by the Australian Research Council (ARC) together with the Institute of Chartered Accountants in Australia (ICAA). It is comprehensive and will provide an enduring legacy to the vexed issue of tax simplification in the tax literature. What follows is a summary of each of the chapters.

Chapter one examines the measurement of complexity and its causes. It also usefully covers why it is practically (and politically) so difficult to simplify tax legislation.

Chapter two explores notions of tax complexity, including the concept of hypercomplexity, relying on the works of sociologist Lars Qvortup, which posit that the growing level of complexity represents the basic challenge of our current society.[4] It then proceeds to look at the difference between anthropocentric and polycentric approaches to the income tax system, with the author of this chapter exploring the possibility that the tax environment may currently be in the midst of a period of transition between the two mindsets, and that one's understanding of the condition of the current tax system depends on whether one uses an anthropocentric or polycentric approach. Though this chapter is grounded in complex theoretical concepts, the author explains it in an accessible and practical manner.

Chapter three explores the issue of tax complexity and symbolic power. Four dimensions of tax complexity are explored by the authors of this chapter: code complexity (including the language of legislation, anti-avoidance rules and rules or principles); structural complexity (number of rates and provisions); policy complexity (socio-economic imperatives, tax expenditures and political goals); and administration and compliance complexity. Bourdieu's theory of social practice is next examined, and is followed by some observations about vested interests and symbolic power. Again, this chapter is grounded in complex theoretical concepts,

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[3] Deane J in *Hepples v FCT [No. 2]* (1991) 65 ALJR 650, 657.

[4] Qvortrup (2003).

but provides an important background to some of the challenges that are inherent in trying to reduce tax complexity.

Chapter four examines the important practical issue of measuring tax complexity, including *what* to measure and *how* to measure it, as well as examining the costs and consequences of tax complexity. This is an important chapter, as the issue of measuring tax complexity is important, as it can guide decisions as to where to direct efforts to reduce complexity.

Chapter five takes an integrated approach to the economic measurement of the costs of tax complexity. The chapter was motivated by the observation of the author that any first step toward tax simplification necessarily involves the measurement and monitoring of the adverse impacts of tax complexity. As the author of this chapter acknowledges, while there is a substantial body of literature on the 'collection costs' (tax compliance plus administration costs), these costs alone do not fully capture the costs of tax complexity and, accordingly, a systematic and integrated approach to measuring costs is put forward in this chapter.

Chapter six broadens the dialogue on tax complexity by examining 'Paying taxes', which is one of 11 indicators used by the World Bank in its annual *Doing Business* project, which measures the ease of doing business in 189 economies. The stated aim of this project is to provide an objective basis for understanding and improving the regulatory environment (which would include complexity) for domestic businesses around the world. A case study approach is adopted in this chapter, which is a very useful way of understanding the issues that are raised in the discourse.

Chapter seven follows neatly on from the previous chapter, with an examination of whether the 'Paying taxes' report will guide tax system simplification. The chapter notes that the need for the information contained in this report is going to become more prevalent as years pass, and that it will become important for governments to ensure their tax systems are simple to understand and comply with, yet remain robust enough to prevent potential abuses.

Chapter eight examines the important practical issue of measuring tax compliance costs for personal (non-business) taxpayers, small and medium enterprises (SMEs), and large businesses in an Australian context. As noted above, one critical dimension of simplification is the costs of compliance and hence the information in this chapter is practically a matter of great significance.

Chapter nine also examines measuring tax complexity, but this time in the context of an analytical framework and evidence for individual income tax preferences for Canada. It flows nicely from the analysis provided in the previous chapter.

Chapter ten looks at the complex practical issues of administering tax complexity versus simplicity in the US context. It also examines the important issue of the implications for tax administrations and judicial reviews.

Chapter eleven considers some of the reasons why complexity in the tax system, although generally unwelcome, may be necessary. The topical example of tax minimisation by multinational entities (MNEs), and the anti-avoidance responses to these activities, are usefully examined in this context. The author argues that the community cannot want (or afford) a tax system that is too simple, for such a system may not be able to withstand the efforts of some who are prepared to 'swim outside the flags' and test the law. Therefore, some complexity in

the form of anti-avoidance provisions may be needed to protect the integrity of tax systems. Also, the latter part of the chapter makes the argument that there might be a case for complex tax provisions in situations where complexity leads to greater operational or administrative simplicity, or if the outcome aligns with the community's expectations of equity.

Chapter twelve explores individual taxpayer perceptions of tax complexity, with the aim of investigating whether taxpayers were cognisant of any of the tax simplification measures available to them. The pilot study that this chapter details also investigated whether tax complexity influenced these taxpayers' tax burdens and analysed suggestions by respondents about how the tax system could be simplified for individual taxpayers.

Chapter thirteen highlights the complexity of sanctioning regimes and explores our limited understanding of the resulting incentives, using tax penalties as a primary example. This is a useful construct; tax penalties are often complex, so this is an appropriate lens through which to view tax complexity.

Chapter fourteen provides some cautions regarding tax simplification. The author concludes this chapter by noting that we should not have unrealistic expectations about the amount of simplification that can be achieved, referring to the observations of a former US Treasury official:

> The problem with simplification … is not that there's any disagreement that simplification is needed. The problem is that it's not really a priority. It's on everyone's list of important tax policy objectives, but it's never close enough to the top that it generates serious momentum.[5]

Chapter fifteen examines the UK's Office of Tax Simplification and its complexity index, including how the index may be used in practice to track the relative complexity of measures in the tax system, and to prioritise simplification reviews of the tax system. This chapter is a very useful and real example of an institutional measure that exists to try to overcome excessive complexity in tax systems.

Chapter sixteen examines the institutional framework for tax policy-making and oversight in the context of managing tax complexity. The chapter does not take issue with the view that complexity is not desirable, but accepts that it is, to some extent, inevitable. This is a theme that resonates with the authors of other chapters of the book as well. The chapter also deals with the question of simplicity as a driver for reform in the UK and the political background to this debate. It argues that there has been a proliferation of institutional approaches, including the Office of Tax Simplification (OTS) in the UK context, and goes on to argue that further institutional reforms are needed in order to tackle the problems at root, as it is not clear that institutions like the OTS have been able to achieve this.

Chapter seventeen looks at oversight mechanisms and administrative responses to tax complexity in the United States, providing another practical and real context within which readers can understand the many challenges associated with reducing tax complexity.

[5] Cummings and Swirski, *Interview with Robert P Hanson*, (2003). Mr. Hanson served as Tax Legislative Counsel in the US Treasury Department during the George W Bush Administration.

Chapter eighteen looks at possible pathways for tax policy and administration: institutions and simplicity. It is provided from an Australian perspective, by a former Commissioner of Taxation, and the insights provided as to whether existing institutions could be improved, or whether new institutions could make a positive difference in driving a simplification agenda, will be of great interest to policy makers.

The final chapter – chapter nineteen – examines simplified small business tax regimes in developing countries. This is an important practical issue, as the goal of simplified tax regimes for such businesses is to facilitate voluntary tax compliance and provide access for small businesses to the benefits of greater formalisation. The cases presented in the chapter provide empirical evidence for a number of problems associated with simplified regimes for these businesses. This information is useful from a policy perspective to guide decisions as to how these problems might be overcome.

In conclusion, this book provides a wealth of knowledge in the area of simplification and tax complexity. At the end of reading the book, readers might be left with a number of impressions, including that complexity is an inherent feature of the complex world we live in, that countries should not underestimate the challenges of achieving greater tax simplification and, finally, that there are rarely any "quick fixes". Tax will probably never be simple, but the book provides much hope and practical guidance as to how it could be made simpler.

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