TAX RULINGS - CONTRIBUTION TO CERTAINTY: A SOUTH AFRICAN PERSPECTIVE

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Abstract

This article considers the use of tax rulings by the South African tax authorities as a tool to provide legal and commercial certainty, in particular where either the tax administration or a taxpayer challenges an interpretation set out in a ruling. The role of tax rulings, in the form of binding general rulings and advance tax rulings, in providing certainty is analysed through the lens of the provisions of South African tax administration legislation and judgements made by the South African courts. The article finds that tax rulings and other South African tax administration publications play an important role in promoting certainty even where the interpretation set out in the rule is disputed. The role of rulings to support certainty is supported by both the provisions of the South African tax administration and the judgements made by the South African courts.

Keywords: Certainty, Tax Administration, Tax Publications, Tax Rulings, South Africa.

1. INTRODUCTION

Many tax administrations use tax rulings as a mechanism for early dispute resolution as they can provide legal and commercial certainty about taxpayer transactions.[2] South Africa's tax administration is no different and, while the form and process of tax rulings have changed over time, South Africa's tax legislation has always, in some form, provided for the tax administration to issue tax rulings to taxpayers.[3]

The role and legal effect of these tax rulings in achieving such certainty have, however, been put to the test in recent South African tax disputes which came before the South African Constitutional Court[4] and the South African Supreme Court of Appeal.[5] Through these decisions, the South African courts confirmed the certainty provided by tax rulings, but also potentially undermined the certainty provided by the interaction between tax rulings and other publications of the tax administration. Where the tax administrator argued that it was not bound by a tax ruling because the ruling was based on an incorrect interpretation of the law, the South African Supreme Court of Appeal held that the tax administration was bound by its ruling.[6] On the other hand, the South African Constitutional Court questioned the legal basis of using

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[2] See Alarie et al. (2014) on pp. 362-363; Van de Velde (2015). See also Waerzeggers & Hillier (2016).
[3] Prior to the enactment of the South African Tax Administration Act, No.28 of 2011, hereinafter referred to as the SATAA (2011), tax rulings were issued in terms of the South African Income Tax Act, No. 58 of 1962, hereinafter referred to as the Income Tax Act (1962). The South African tax administration is referred to in South African legislation as the South African Revenue Service (SARS). The phrases "tax administrator" and "tax administration", as appropriate, will be used in this article.
[4] *Marshall NO and Others v Commissioner for South African Revenue Service* 80 SATC 400 (CC), hereinafter referred to as *Marshall* CC (2018).
[5] *Commissioner for South African Revenue Services v KWJ Investments Service (Pty) Ltd* 81 SATC 1, hereafter *KWJ* (2018).The Supreme Court of Appeal is the highest court in South Africa for non-constitutional law disputes and for disputes that are not in the public interest. See sections 165 to 170 of the Constitution of the Republic of South Africa Act, No. 108 (1996).
[6] See *KWJ* (2018).

interpretation notes issued by the South African tax administration when interpreting a tax ruling requested by a taxpayer.[7]

The introduction of specific provisions dealing with rulings in the SATAA (2011) also potentially puts the certainty provided by tax rulings, particularly advance tax rulings, to the test by providing for circumstances to set aside or amend tax rulings, both prospectively and retrospectively.

It is this role of tax rulings to provide both legal and commercial certainty to both the taxpayer and the tax administrator in the context of decisions made by the South African courts and the provisions of the SATAA (2011) that this article will consider. The article will consider the role played by tax rulings in achieving administrative certainty for the South African taxpayer and the factors to consider when implementing a tax ruling system through the lens of the SATAA (2011) and the South African courts. The article will firstly provide an overview of the basis for introducing a ruling system, as compared to other publications issued by a tax administration, followed by an overview of the current ruling system in South Africa. The article will then consider the role of rulings and other publications of the South African tax administration in bringing about certainty for taxpayers through the binding nature of rulings as interpreted and confirmed by the South African courts.

2. TAX RULINGS AND CERTAINTY

The Role of Certainty in Tax Law

The authority to issue rulings and, in particular, advance tax rulings is introduced into tax legislation on the assumption that rulings "are useful instruments for reducing taxpayer uncertainty and are conducive to sound tax administration" (Alarie et al., 2014, pp. 364-365).[8] If rulings, and other publications issued by a tax administration, are needed to reduce taxpayer uncertainty, what causes such uncertainty for taxpayers? It is often said that taxpayer compliance with tax legislation can be difficult due to an element of uncertainty in applying the relevant tax legislative provisions to a particular set of facts. The difficulty and concomitant uncertainty faced by the taxpayer arises from, inter alia, the language used in tax legislation, the complexity of the tax legislation, the (at least) annual amendments to tax legislation, plus a possible complicated commercial transaction.[9]

While it is generally accepted and agreed that uncertainty is undesirable in a legal system and undermines the rule of law, there is a view that fostering uncertainty can increase tax compliance.[10] While uncertainty may increase tax compliance, the fostering of uncertainty goes against the rule of law,[11] particularly in relation to a government entity's decisions and actions, and so cannot be encouraged.

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[7] *Marshall* CC (2018).

[8] See also Van de Velde (2015) on pp. 9-10; Givati (2009) on pp.139 and 147-149; Waerzeggers and Hillier (2016) on p. 3.

[9] See Adam et al. (2011) on p. 42, where it is stated that "lack of simplicity and neutrality invites tax avoidance" and the perpetual revision of tax law and litigation against avoidance schemes add to complexity and to the cost of implementation". See also Alarie et al. (2014); Van de Velde (2015) on p. 9; Givati (2009) on pp. 139 and 144-145; Monroe (2017) on pp. 85-86 and 105-106.

[10] See Alarie et al. (2014) on p. 367. In the South African context, the argument of uncertainty is sometimes used for the sparse disputes on certain provisions of the Income Tax Act (1962), such as the lack of litigation in respect of the complex controlled foreign company provisions and the general anti-tax avoidance provisions.

[11] See Alarie et al. (2014) on pp. 365-369. See also Waerzeggers and Hillier (2016) on p. 1.

Certainty can, of course, be achieved by amending the legislation to clarify the outcome of the relevant provisions or by a court decision, but these two possibilities may not always be feasible. For example, a dispute must first arise, with parties willing to take the step to litigation, before there is even the possibility of a court decision being made. It is in this context that publications by the tax administration may provide certainty in the interpretation and application of certain provisions. Publications are used to inform taxpayers of the manner in which the tax administrator will apply and interpret certain provisions. In addition to publications, provision can also be made for a tax administrator to provide a taxpayer with an interpretation or view on its interpretation and application of specific tax legislation provisions in response to a specific tax liability question. The latter is commonly referred to as a "ruling" by the tax administration.

These rulings and publications may provide guidance to a taxpayer in relation to the tax administrator's interpretation of a particular provision of the legislation, exercise of its discretionary power, and treatment of certain transactions (Alarie et al., 2014). Besides providing certainty for taxpayers, rulings and publications are also useful tools for governments and tax administrators, allowing them to fill gaps where the courts have not yet pronounced on the specific law. The use of rulings and publications is, of course, not without risk to the fisc, as there may be circumstances in which the interpretation or view set out in the binding ruling or publication is not legally correct and the fisc will have to bear the risk of the revenue lost.[12]

While providing certainty with a risk element for the tax administration, rulings and publications can also be seen as "indirect and extra-legal means by which tax administrations seek to impose their view of tax law on taxpayers" (Alarie et al., 2014, p. 365). Publications, in particular, are a means of interaction between the tax administration and the public, as they can act as a "tax law intermediary" and potentially play an important role in creating certainty for taxpayers, especially those facing tax complexity.[13] This tax law intermediary role is particularly important to non-expert taxpayers and can be viewed by these non-experts as being more than just explanations of substantive law.[14]

The level of certainty provided by these publications depends on the type of publication, whether the relevant legislation provides that the tax administration is bound by the view and interpretation set out in the publication, and whether a court has adjudicated on whether the tax administration is bound by the publication. The category of the publication may well be the determining factor in its ability to provide certainty for the taxpayer.

Private and Public Rulings

A publication that is categorised as a private ruling is likely to provide greater certainty than one that is categorised as a public ruling.[15] Public rulings are generally written opinions that interpret and apply tax law to taxpayers or a class of taxpayers generally, whereas private rulings apply to a specific taxpayer with a stated set of facts. Public rulings usually reflect the tax commissioner's opinion of how a provision of a tax law is expected to apply and are usually published in the form of interpretative notes or public administrative guidelines. The full and detailed opinion is made available to the public and the tax administrator is not necessarily

[12] See Alarie at al. (2014) on p. 366; Waerzeggers and Hellier (2016) on pp. 4 and 7.
[13] See Monroe (2017) on p. 90.
[14] See Monroe (2017) on p. 91. See also discussion on quasi-law on later in this paper.
[15] See Waerzeggers and Hillier (2016) on p. 1.

bound by the view set out in the public ruling,[16] which potentially limits the role of such public rulings in providing certainty to the taxpayer. By contrast, the view and interpretation set out in the private ruling is likely to be binding on the tax administration in relation to the specific taxpayer's set of agreed circumstances. Such a taxpayer can therefore approach the transactions with knowledge and certainty of the tax liability.

Advance Tax Rulings

Of all the publications issued by a tax administrator, advance tax rulings are probably the best option in terms of ensuring that taxpayers are certain of their tax liabilities for prospective future transactions. To give the taxpayer the certainty required in determining their tax liability, the tax administrator must be bound by the interpretation and view set out in the advance tax ruling. In this way, advance tax rulings seek to promote clarity and consistency for both the taxpayer and the tax administration. While the purpose of introducing advance tax rulings may be to provide certainty in respect of taxpayers' future tax liabilities, taxpayers are likely to consider the certainty that advance tax ruling bring alongside other strategic considerations, such as the risk to the taxpayer and the cost of applying for a ruling.[17] Risk would include considerations such as the risk of audit by revenue authorities, scrutiny by capable public servants, the likelihood that the revenue examiner (auditor) is more likely to make a mistake in the assessment, the taxpayer's commitment to carrying out the transaction, and whether the ruling would impact on the actual transaction.[18]

While certainty would be an important consideration, a tax administration that wants to support certainty for taxpayers would have to ensure that the legislation for, and the practice of, advance tax rulings take into account the taxpayer's other strategic considerations and risk concerns.

The Binding Nature of Rulings

The certainty that rulings provide is that the tax administration cannot change the view and interpretation set out in the ruling provided to the taxpayer, or can only do so under limited circumstances. Put another way, certainty requires that the decision and view set out in the ruling must be legally binding on the tax administrator.[19] The binding nature of rulings should also protect the taxpayer, who relies on the ruling, from additional tax, penalties, and interest.[20]

Where the tax legislation does not provide that rulings and publications are binding on the tax administration, and such rulings and publications can be changed by the tax administration at any time, the certainty provided by the tax law intermediary is limited. A taxpayer can attempt to enforce the view or interpretation expressed by the tax administration in the ruling or publication through the use of the doctrine of legitimate expectations or a long-standing administrative custom. The use of litigation and dispute resolution mechanisms does, however, defeat the purpose of rulings and publications in achieving or supporting the achievement of certainty.[21]

[16] See Waerzeggers and Hillier (2016) on p. 1.
[17] See Alarie et al. (2014) on pp. 364 and 379-382.
[18] See Alarie et al. (2014); Givati (2009) on p. 140.
[19] See Seiden and Russell (2018) on p. 438; Alarie et al. (2014) on pp. 368 and 370-373.
[20] See Waerzeggers and Hillier (2016) on pp. 2 and 7.
[21] See Alarie et al.(2014) on pp. 382-383.

The Impact of Revising or Withdrawing a Ruling

The potential revision, withdrawal, or amendment of a ruling or publication clearly impacts on the level of certainty promised. Given the different levels of certainty provided by different types of publication, it can be argued that a taxpayer who relies on a ruling or a publication without checking the legal status does so at their own peril. A counter to the aforementioned statement is that there is a reasonable expectation that the tax administration will follow interpretations and views set out in publications, but this too can be countered as the certainty and reasonable expectation depend on the category of the publications and rulings. For example, the purpose of introducing private and advance tax rulings is to provide certainty as to the tax treatment of a specific taxpayer's transactions. For such rulings, the ability of the tax administration to ignore, revise, or state that a ruling no longer applies must be limited.[22] The ability to revise a private and advance tax ruling directly affects a taxpayer's entitlement to rely on a favourable ruling and defeats their expectation to be assessed for tax in accordance with the original ruling.[23] If such rulings can be revised or set aside, and to support certainty, the circumstances under which a ruling can be set aside and no longer followed must be clearly set out. The timing of that withdrawal and setting aside must also be clearly indicated, either in the relevant legislation that introduces the binding nature of the ruling or by the courts. A withdrawal and setting aside should be communicated timeously to taxpayers so that they can make the necessary adjustments in order to determine the tax liability based on the adapted version of the ruling or the tax administration's new interpretation. This would especially be the case where the tax administration finds that there is a mistake in its interpretation or application of the law.[24]

Assumptions and Certainty

Such a mistake or incorrect application can arise because of the assumptions made by the tax administrator when analysing and providing its view and legal interpretation. This may occur, in particular, where an assumption is made about a future event or other matter in a ruling. To ensure that such mistakes are limited, the tax administrator should notify the taxpayer applicant of the assumptions being made as reliance on assumptions has the potential to undermine the certainty of a ruling.[25]

The Relationship Between the Taxpayer and the Tax Administration

While the issue discussed in this article is the certainty that rulings and publications can provide, it would be remiss not to at least mention the view that rulings are seen as playing a role in reducing litigation and compliance costs, and in engendering a better relationship between the revenue authorities and taxpayers.[26] It is said that tax rulings can viewed as expressions of the trustworthiness of the tax administration where, for example, a binding ruling is offered when there is a gap in the law that has not been resolved either through the amendment of the legislation or the court's intervention.[27]

[22] See Azzi (2016) on pp. 1097 and 1116.
[23] See Azzi (2016) on p.1119.
[24] See Waerzeggers and Hillier (2016) on p. 7.
[25] See Seiden and Russell (2018) on p. 440.
[26] See Alarie et al. (2014) on p. 383.
[27] See Alarie et al. (2014) on p. 383.

The trust relationship will, according to the traditional view of rulings, be stronger if the taxpayer has certainty that the tax administrator will not subsequently challenge the interpretation or view set out in the rulings. Where a tax administrator subsequently changes its views, the trust relationship will suffer and will most likely have a negative impact on taxpayer morale, especially on the honest taxpayer who follows the rules and complies with the tax administrators' views.

One argument against the use of tax rulings in relation to trust and morale is that it may also induce a government that is seeking to attract foreign direct investment to influence or "persuade" the tax administration to issue a ruling in favour of a taxpayer where such a favourable ruling is linked to investment by the taxpayer. A taxpayer may also indicate that they will not proceed with an investment if the tax treatment in the tax ruling is not in their favour. This is a particular concern for countries that depend on foreign direct investment and where such governments actively seek such investment.

Certainty and the Binding Nature of Rulings

It is, of course, the binding nature of the tax ruling that is the foundation of its role in providing certainty to the taxpayer to whom the ruling applies. That binding nature can be found in the legislation, which provides that rulings are binding on the tax administrator so that if they change their view or interpretation, it has a limited effect on the taxpayer to whom the ruling applies. The binding nature can also be located in the doctrine of estoppel or the doctrine of legitimate expectations. In South Africa, that binding nature is located in legislation and in a ruling, or even a publication, being regarded as "practice generally prevailing" (Arendse et al., 2022, paragraph 2.35). The binding nature of rulings and other types of publication issued by the South African tax administration was formalised with the insertion of provisions into the Income Tax Act (1962) in 2004,[28] which dealt with rulings, but it was the introduction of the SATAA in 2011[29] that made rulings an integral part of the administrative aspects of the South African tax system.

3. THE INTRODUCTION OF TAX RULINGS IN SOUTH AFRICA

While the South African tax administration attends to both the charging and administrative aspects of the tax system, with the enactment of the SATAA (2011), the charging provisions of tax legislation were separated from the procedural provisions of tax legislation.[30] According to the South African National Treasury, the separation supported the effective and efficient collection of taxes.[31]

The procedural provisions in the SATAA (2011) include those setting out the legal implications of the different publications issued by the South African tax administration. These publications,

[28] Sections 76B to 76S were introduced by the Second Revenue Laws Amendment Act, No 34 of 2004 and repealed by section 271 read with paragraph 64 of Schedule 1 of the SATAA (2011).
[29] The commencement date of the SATAA (2011) is 1 October 2012.
[30] The charging legislation includes the Income Tax Act (1962) and the Value-Added Tax Act, No. 89 of 1991, hereinafter referred to as the VAT Act (1991).
[31] See section 2 of the SATAA (2011), which sets out the methods used to achieve this effective and efficient collection including, on the one hand, prescribing the rights and obligations of taxpayers and, on the other hand, prescribing the powers and duties of persons engaged in the administration of the SATAA (2011). See also the discussion paper published in 2003 by the South African Revenue Service (SARS) relating to the proposed system for advance tax rulings (SARS, 2003).

defined as "official" and "unofficial",[32] are in line with the mandate and vision of the South African tax administration to facilitate and provide "direction on the uniform application and interpretation of all tax legislation administered by [SARS]" (SARS, 2023e).

Official and Unofficial Publications

The difference between official and unofficial publications is that an official publication is classified as a "practice generally prevailing" and is binding on the South African tax administration.[33] Prior to the distinction being made between official and unofficial publications, the South African courts had pronounced on the binding nature of all types of publications issued by the tax administration.[34] The courts held that publications issued by the tax administration would only bind the South African tax administration if the relevant publication was classified as a "practice generally prevailing"[35] or met the requirements of the doctrine of legitimate expectations.[36] Neither the legislation at the time nor the courts distinguished between official and unofficial publications. Probably as a reaction to the decisions made by the courts and to distinguish between the various publications issued, section 5(1) of the SATAA (2011) now provides a list of official publications which qualify as being "practice[s] generally prevailing" and bind the tax administration to the views and interpretations set out in these publications. This means that a taxpayer now has certainty as to which publications are binding on the tax administration and the circumstances under which such a publication ceases to be a "practice generally prevailing".[37] As previously noted, the list of official publications includes binding general rulings, interpretation notes, practice notes, and public notices.[38] These are publications which are made available to the public at large: a type of "public" publication.

Private and Public Rulings

Official publications, while made available to the public at large, are not all necessarily public rulings as per the distinction between private and public rulings. This distinction would appear to apply to the SATAA (2011) distinction between binding general rulings on the one hand, categorised as public rulings, and binding private and binding class rulings on the other, the

[32] The definition of "official publication" in section 1 of the SATAA (2011) is "a binding general ruling, interpretation note, practice note or public notice issued by a senior SARS official or the Commissioner".
[33] Section 5(1) of the SATAA (2011) provides that a "practice generally prevailing is a practice set out in an official publication regarding the application or interpretation of a tax Act".
[34] See, for example, *Commissioner for Inland Revenue v SA Mutual Unit Trust Management Co Ltd* 1990 (4) SA 529 (A); *Commissioner for South African Revenue Service v Hulett Aluminium* (Pty) Ltd (337/98)[2000] ZASCA; 2000 (4) SA 790 (SCA).
[35] See, for example, *Commissioner for Inland Revenue v SA Mutual Unit Trust Management Co Ltd* 1990 (4) SA 529 (A); *Commissioner for South African Revenue Service v Hulett Aluminium* (Pty) Ltd (337/98)[2000] ZASCA; 2000 (4) SA 790 (SCA).
[36] See Arendse et al. (2022) at paragraph 3.30.
[37] See sections 5(2) and (3) of the SATAA (2011).
[38] See the definition of "official publication" in section 1, read with section 5 of the SATAA (2011). Although this discussion is beyond the scope of this article, it is questionable as to whether this is a closed list and precludes "unofficial publications" becoming "practices generally prevailing".

latter two being grouped as advance tax rulings.[39] Prior to the enactment of the SATAA (2011), the authority to issue rulings was found in the general legislation that imposed a particular tax. For example, earlier versions of the Income Tax Act (1962) contained provisions that authorised the tax administration to issue rulings to taxpayers.[40]

Since the enactment of the SATAA (2011), the authority for the tax administration to issue rulings is generally contained in that one statute,[41] although certain types of rulings are still provided for in certain charging legislation, such as those issued in terms of the VAT Act (1991).[42] The South African National Treasury (2011), when introducing the rulings provisions in the SATAA (2011), stated that:

> The advance ruling system currently regulated in the Income Tax Act and the Value-Added Tax Act is incorporated in the TAB [Tax Administration Bill]. The provisions establish the framework for the system and set out basic rules regarding the application process, fees, exclusions and refusals, the effect of rulings, the impact of subsequent law changes, retrospectivity and the publication of rulings. They also provide for specific rules in respect of the three primary types of rulings, i.e. binding general rulings, binding private rulings and binding class rulings. (p. 191)

It is worthwhile, at this point, to bear in mind that tax rulings (and other decisions) made by the South African tax administration fall into the realm of administrative actions.[43] Such an administrative action must, therefore, conform to the relevant provisions of the Constitution of the Republic of South Africa (1996)[44] and the Promotion of Administrative Justice Act 3 (2000). As administrative actions, these rulings (and decisions by the tax administration), being decisions of a public body, can be reviewed by the courts and set aside.[45] However, the ability of the courts to set aside such decisions is constrained by the SATAA (2011), which provides that rulings are binding on the tax administration and can only be set aside or amended in limited circumstances.[46] Likewise, the tax administration's ability to set aside, ignore, or withdraw a ruling is limited. In this way, rulings, through the limited ability to be set aside and amended, are able to provide a level of certainty for the taxpayer.

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[39] Section 75 of the SATAA (2011) groups the three types of rulings as advance tax rulings but distinguishes between binding general rulings on the one hand, and private and class rulings on the other. The South African tax administration also distinguishes between binding general rulings and "advance tax rulings", the latter comprising private and class rulings. Other South African tax administration publications, which are beyond the scope of the article, include interpretation notes, public notices, guides, and unofficial publications. The legal effect and legislative framework for publications by the South African tax administration is set out in section 5 of the SATAA (2011), read together with chapter 7 of the SATAA (2011) on advance tax rulings. The legislative framework of rulings consists of the Constitution of South Africa (1996), as the supreme law, the South African Revenue Services Act, No. 34 of 1997, and the SATAA (2011).

[40] See the now repealed sections 76B-76S of the Income Tax Act (1962).

[41] See sections 75-90 of the SATAA (2011).

[42] See section 41B of the VAT Act (1991).

[43] The South African tax administrator, referred to as SARS, is the established by separate legislation, the South African Revenue Services Act (1997), and is not part of the South African public service.

[44] Section 33 of the Constitution of the Republic of South Africa, Act 108 (1996) provides for just administrative action, and section 195 provides for the basic values and principles governing public administration.

[45] See *Wenco International Mining Systems Ltd. v CSARS* 83 SATC 463, hereafter *Wenco* (2021); Admin law text.

[46] See sections 5(2), 5(3), 85 and 86 of the SATAA (2011). The detail and circumstances of rulings and notices being able to be set aside in terms of the Constitution of the Republic of South Africa, Act 108 (1996) and the Promotion of Administrative Justice Act 3 (2000) is beyond the scope of the paper.

4. THE SOUTH AFRICAN TAX RULING SYSTEM

The SATAA (2011) sets out as its purpose as being the effective and efficient collection of taxes[47] and, based on the discussion above, rulings support this purpose by, inter alia, providing certainty and promoting the consistent (equitable) treatment of taxpayers. The role and need for certainty in the South African tax system has been recognised by the South African Supreme Court of Appeal. In *KWJ* (2018), the court stated that:

> This appeal involves a set of transactions designed to exploit the tax code in ways that would enhance the profitability of the participants, while avoiding any liability for tax. It also concerns the relationship between appellant's response thereto and the right of taxpayers to enjoy certainty in the administration of tax legislation. (paragraph 2)

If the purpose of advance tax and binding general rulings is to provide certainty for both the taxpayer and the tax administration, the SATAA (2011)'s provisions on rulings must have features which, on the one hand, enhance such certainty and, on the other, limit the risks and concerns of such a system. The ability of a South African taxpayer to rely on rulings issued by the South African tax administrator may also influence the trust relationship between the taxpayer and the tax administrator,[48] particularly where the taxpayer is certain that the tax administrator is bound by, or will follow, the rulings issued. But what if the taxpayer uses a ruling to support a tax avoidance scheme, particularly where the original ruling was issued in tax neutral circumstances and is subsequently used in a set of transactions that reduces its tax liability? Should certainty trump tax avoidance in these circumstances? Although decided under now repealed provisions dealing with rulings in the Income Tax Act (1962), the South African Supreme Court of Appeal answered the latter question in the affirmative in the matter of *KWJ* (2018). It is, however, questionable as to whether the certainty provided by the judgement has, to an extent, been eroded by the provisions of section 86 of the SATAA (2011), which allow the South African tax administrator to modify or withdraw advance tax rulings retrospectively if, inter alia, "the effect of the ruling will materially erode the South African tax base and it is in the public interest to withdraw or modify the ruling retrospectively".

Certainty in South African Tax Law: *KWJ* (2018)

In the case of *KWJ* (2018), the South African Supreme Court of Appeal had the opportunity to determine whether a taxpayer could rely on a ruling made by the tax administration and provide certainty to such a taxpayer. The tax administrator, despite having issued rulings indicating the tax treatment of the particular transactions, changed the way in which it assessed these transactions. It assessed the taxpayer on the basis that a dividend right was an amount that accrued to the taxpayer unconditionally. The disputed rulings were issued in terms of the now repealed provisions of the Income Tax Act (1962), which provided that a ruling made by a tax administrator was binding on the tax administration if the ruling was a "practice generally prevailing".

The question before the court was thus whether the particular ruling made by the tax administration was a "practice generally prevailing". The legal issues were twofold: one, whether the lower court was correct in its decision that the taxpayer was party to a tax

[47] See section 2 of the SATAA (2011).
[48] See earlier discussion. See also Alarie et al. (2014) on pp. 364 and 383; Van de Velde (2015) on p. 9.

avoidance arrangement, and two, whether the South African tax administration had, through its practice, "endorsed" the arrangement even though the tax administration had based its ruling on an incorrect interpretation of the law. Thus, the question of whether the taxpayer, KWJ, could rely on the rulings, binding the South African tax administration to the incorrect interpretation of the law, arose.

KWJ was an investment company, making a profit on the difference between the dividends received and paid. In terms of the relevant income tax law at the time, dividend income received was exempt from income tax, and KWJ's only tax liability was the secondary tax on companies payable by it on the distribution of dividends. The tax dispute arose when KWJ invested surplus investment capital and received a return described as the right to receive "dividends declared, but not yet accrued" with the value of the right calculated in terms of a formula (*KWJ*, 2018, paragraph 3). The substantive tax law dispute was whether this return (in effect, the right to receive dividends) was an amount which accrued to KWJ. In deciding that this right was a form of property with a monetary value, the Supreme Court of Appeal held that it was "an unconditional receipt of a right which has a monetary value" (*KWJ*, 2018, paragraph 41), a ruling in favour of the South African tax administration. A detailed analysis and critique of the substantive law ruling is beyond the scope of this paper, save to say that the decision is in line with earlier South African tax law decisions which held that, as long as a right has a monetary value, the value of that right can be included in the determination of the tax liability of the owner of the right.[49] A further point outside of the scope of this analysis but of interest is that the South African Supreme Court of Appeal did not consider, as did the court a quo, whether the accrual of that right was conditional.

Although the South African Supreme Court of Appeal agreed with the South African tax administrator's substantive law argument, the court found that the South African tax administrator could not enforce the "correct" interpretation and agreed with the taxpayer's reliance on rulings issued by the tax administrator. The South African tax administrator had sought to raise the additional tax assessment in 2011 based on its current interpretation of the relevant provisions. However, in terms of the provisions of the tax legislation at the time, an additional tax assessment could not be raised if the original 2008 and 2009 tax assessments were issued in terms of a "practice generally prevailing".[50] All the taxpayer had to do to prevent the additional tax assessment and the increased tax liability was to show evidence of a "practice generally prevailing".[51] The phrase "practice generally prevailing" was not defined in tax legislation, but the South African Appellate division had previously stated that:

> a practice "generally prevailing" is one which is applied generally in the different offices of the Department in the assessment of taxpayers and in seeking to establish such a practice in regard to a particular aspect of tax assessment it would not be sufficient to show that the practice was applied in merely one or two offices.
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> Moreover, the word "practice", in this context, means "a habitual way or mode of acting" (see Oxford English Dictionary, meaning 2.c); and consequently, in general, it would also not be sufficient to show that, in regard to an aspect of assessment, a certain attitude had been adopted by the assessors concerned only in some instances. (*Commissioner for Inland Revenue v SA Mutual Unit Trust Management Co Ltd* 1990 (4) SA 529 (A), paragraphs 21-22)

[49] See *CSARS v Brummeria 2007* (6) SA 601 (SCA); 69 SATC 205.
[50] In terms of the now repealed section 79(1)(b) of the Income Tax Act (1962).
[51] In terms of the now repealed section 79(1)(b) of the Income Tax Act (1962).

On the evidence presented before the court, the South African tax administration had been aware of the tax structure since 2000 and had issued rulings in 2003 exempting the disputed income from tax.[52] The taxpayer was able to present evidence of five transactions dealing with the right to receive undeclared dividends that the South African tax administration had assessed on the basis that exempt dividends were received, and not on the basis that the value of the right was an amount to be assessed.[53] The evidence also included a 2003 ruling sought by a financial institution and issued by a division of the South African tax administration.[54] This ruling dealt with an indivisible composite instrument made by a financial institution in favour of one dividend income fund and provided that the right to the ceded dividends was exempt from tax.[55] A similar ruling was issued later in 2003 with respect to another dividend income fund where, although the fund had taken the view that the receipt of rights to dividends was a separate accrual from the accrual of the dividends, the South African tax administration had concluded that there was no separate accrual of dividend rights.[56] The South African tax administration was also unable to show that it had assessed other taxpayers differently from its rulings. Thus, five transactions assessed by the South African tax administrator exempted the disputed income from tax and no other transactions were assessed differently from the practice. The South African tax administration sought to argue that "notwithstanding this evidence regarding other transactions, when it initially assessed respondent" it was in not in "possession of sufficient evidence to know about the cession of dividend rights and hence to levy tax thereon" (*KWJ*, 2018, paragraph 53).[57] The court, however, dismissed this argument as the taxpayer had submitted annual financial statements to the tax administration together with their income tax returns.[58] It appeared that the practice of the South African tax administration only changed after the rulings were made, which resulted in the attempt to issue an additional assessment on the taxpayer.

In considering the role of the rulings in providing certainty to the taxpayer, the South African Supreme Court of Appeal held that the taxpayer had provided sufficient evidence for the rulings by the South African tax administration to qualify as a "practice generally prevailing" and that the South African tax administration did not provide evidence to contradict that provided by the taxpayer.

Based on this judgement, South African law does take both commercial and legal certainty into account, ensuring that a taxpayer can follow the practices and rulings of a tax administration, even when the courts disagree with the interpretation of the law set out in a ruling by the tax administration. The case illustrates the tension between "certainty" in the application of the law through the practice of the tax administration and the correct interpretation of the law itself, with the judgement appearing to confirm the possibility that "certainty" for a taxpayer can trump the ability of the tax administration to apply anti-tax avoidance provisions. The hypothesis that *KWJ* (2018) appears to support is that, under certain circumstances, differing interpretations and practices of provisions of tax legislation can be resolved by tax administrator publications and practices, even though these are incorrect interpretations and practices of the provisions. These incorrect interpretations and practices may, furthermore,

[52] See *KWJ* (2018) at paragraphs 48-52.
[53] See *KWJ* (2018) at paragraph 48.
[54] See *KWJ* (2018) at paragraph 49.
[55] The dividends were exempt in terms of section 10(1)(k) of the Income Tax Act (1962) and the ruling further provided that neither section 24J nor section 24K of the Income Tax Act (1962) would apply to the transaction as set out in the statement of agreed facts.
[56] See *KWJ* (2018) at paragraph 49.
[57] See *KWJ* (2018) at paragraphs 44-45 and 53.
[58] See *KWJ* (2018) at paragraph 53.

apply to transactions made by a taxpayer who has acted on them even as the tax administrator has sought to amend them through litigation. It further illustrates that there are circumstances in which a court cannot undo the certainty created by the original incorrect publication and practice of the tax administrator. Any change to or withdrawal of a practice that qualifies as a "practice generally prevailing" cannot apply retrospectively, which would also imply that taxpayers must have been notified of the change or withdrawal. It must, however, be noted that *KWJ* (2018) was decided under now repealed provisions of the Income Tax Act (1962) and the question arises as to whether this decision by the court would still apply to the provisions in the subsequently enacted SATAA (2011).[59]

According to the judgement in *KWJ* (2018), the SATAA (2011) sought to abolish the principle of "practice generally prevailing".[60] The court is likely referring to the abolishment of the principle as interpreted by the courts because the SATAA (2011), as indicated earlier, now specifically states which publications qualify as being a "practice generally prevailing". Section 92 of the SATAA (2011) also provides that: "If at any time SARS is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the *fiscus*, SARS must make an additional assessment to correct the prejudice".

However, the ability of the South African tax administration to make an assessment, including an additional assessment, is limited if the original assessment was made or no return was required in accordance with a practice generally prevailing at the time of the original assessment, except in cases of fraud, misrepresentation, or non-disclosure of material facts.[61] While the tax administration may be able to make the additional assessment to correct the prejudice, such a correction is not possible where the tax administration has made a binding general ruling, even where it has applied or interpreted the law incorrectly to the "prejudice of" of the South African fisc. If such a correction can be made, the certainty that official publications seek to support would be undermined.

Advance Tax Rulings and Binding General Rulings

Unlike the earlier legislation relating to the provisions on rulings as considered in *KWJ* (2018), the SATAA (2011) distinguishes between private and public rulings. Private rulings are identified as advance tax rulings, where a taxpayer requests a ruling prior to undertaking the proposed transaction, and binding general rulings, which apply to all taxpayers.[62] Advance tax rulings are particularly important in providing certainty about a specific proposed transaction which is likely to be economically significant to the taxpayer. However, both private and public rulings are important where taxpayers are sensitive to the risk of future unexpected exposures. Both types of ruling can provide certainty and protection against unexpected additional future tax liabilities. The SATAA (2011) sets out the process and requirements for issuing binding general rulings and advance tax rulings.[63]

[59] The Income Tax Act (1962) did not provide for rulings but instead made provision for practices of the South African tax administration that would qualify as practices generally prevailing. See the now repealed section 79 of the Income Tax Act (1962).
[60] See *KWJ* (2018) at paragraph 45.
[61] See section 99 of the SATAA (2011).
[62] See section 75 of the SATAA (2011).
[63] Section 75 of the SATAA (2011) provides that a "binding private ruling" is "a written statement issued ...regarding the application of a tax Act to one or more parties to a 'proposed transaction', in respect of the 'transaction'" and that a binding class ruling is "a written statement issued...regarding the application of a tax Act to a specific 'class' of persons in respect of a 'proposed transaction'".

A binding general ruling is a "written statement issued by a senior South African Revenue Service official…regarding the interpretation of a tax Act or the application of a tax Act to the stated facts and circumstances" (SATAA, 2011, section 75).[64] According to SARS (2023c), as a public ruling, "a binding general ruling is issued on matters of general interest or importance and clarifies the Commissioner's application or interpretation of the tax law relating to these matters". The SATAA (2011), however, does not indicate which circumstances qualify as "matters of general interest and importance" (SARS, 2023c) and such circumstances will be determined by the tax administration. Binding general rulings have been issued for a wide range of matters (SARS, 2023g), from comments on decisions by the courts[65] and for the VAT treatment of e-commerce transactions.[66]

While a binding general ruling applies to all taxpayers, advance tax rulings only apply to the applicant taxpayers and to the "proposed transaction", defined as a "'transaction' that an 'applicant' proposes to undertake, but has not agreed to undertake, other than by way of an agreement that is subject to a suspensive condition or is otherwise not binding" (SATAA, 2011, section 75). Advance tax rulings can be categorised as written statements issued by the South African tax administration,[67] requiring an application to be made by the person(s) undertaking the proposed transaction.[68]

While the tax administration is bound by, and has to follow, the interpretations and decisions set out in both binding general rulings and advance tax rulings, the basis for being bound differs. A binding general ruling is listed as an official publication and the view set out in the ruling is therefore a "practice generally prevailing".[69] To distinguish, it is presumed, binding general rulings from other official publications (for example, practice notes), the publication must state that it is a binding general ruling and stipulate the period for which it operates.[70] A "practice generally prevailing" is defined as "a practice set out in an official publication regarding the application or interpretation of a tax Act" (SATAA, 2011, section 5) which has to be followed by the tax administrator.[71] If a taxpayer follows a practice generally prevailing and files a tax assessment in accordance with such a practice, as indicated earlier, the South African tax administration is limited in terms of its ability to challenge the assessment.

Advance tax rulings are not official publications and, accordingly, do not qualify as being a "practice generally prevailing". The binding nature of advance tax rulings is specifically set out in the SATAA (2011) which provides that if an advance tax ruling applies to a person, the South African tax administration "must interpret or apply the applicable tax Act to the person in accordance with the ruling" (SATAA, 2011, section 82).[72]

[64] Section 75 read together with section 89 of the SATAA (2011) provides that a senior SARS official may issue a binding general ruling that is effective for either a particular tax period, or other definite or indefinite period.
[65] See *Binding General Ruling (Income Tax) 8 (Issue 3)* (2022).
[66] See *Binding General Ruling (VAT) 28 (Issue 3)* (2023).
[67] See section 75 read with section 82 of the SATAA (2011). See also *Binding General Ruling (VAT) 28 (Issue 3)* (2023).
[68] See sections 75, 78, and 79 of the SATAA (2011).
[69] See section 5 of the SATAA (2011).
[70] See section 89 of the SATAA (2011), which also provides that a binding private ruling may be issued for an indefinite or finite period. See also sections 89(3) and 5 of the SATAA (2011).
[71] See section 5, read together with the definition of "official publication" in section 1, of the SATAA (2011).
[72] See section 82, read with section 83, of the SATAA (2011).

The SATAA (2011) provides that a Senior SARS official can issue a binding general ruling[73] while an advance tax ruling can be issued by the SARS.[74] The difference in who can issue a ruling may give rise to the expectation that binding general rulings carry more weight and provide more certainty.

While binding general rulings can be made on any provision of a tax Act,[75] the scope of advance tax rulings in the SATAA (2011) seems to indicate that advance tax rulings are issued for purely technical applications of a tax Act where no interpretation is required, while a binding general ruling involves interpretational issues.[76] These definitions are somewhat unfortunate, as a reading of the prescribed form and manner of applications of such rulings provides that the applicant, in addition to setting out a complete description of the proposed transaction, must provide:

> a statement of the applicants' interpretation of the relevant statutory provisions or legal issues, as well as an analysis of relevant authorities either considered by the 'applicant' or of which the 'applicant' is aware, as to whether those authorities support or are contrary to the proposed ruling being sought.(SATAA, 2011, section 79[4][i])

In addition, the types of advance tax ruling applications that the South African tax administration can reject include certain matters which include the interpretation of the law,[77] thus implying that advance tax rulings can include interpretation of the law—but limited to the specific set of facts as set out in the proposed transaction. While an advance tax ruling may be made on any provision of a tax Act,[78] certain matters fall outside the parameters of these rulings. These limitations are set out in the SATAA (2011).[79]

Reliance on Rulings

While the above is illustrative of the differences between the types of tax ruling, the main difference which affects certainty is the ability of taxpayers to rely on the rulings and the effect of such reliance. The South African tax administration and any taxpayer can rely on a binding general ruling in proceedings, including court proceedings, and may cite such a ruling,[80] whereas advance tax rulings can only be relied upon in proceedings involving the respective applicants.[81] The ability to use these rulings in court proceedings and the reliance placed upon them, therefore, differs. It does, therefore, appear that a binding general ruling creates greater certainty for all taxpayers while advance tax rulings (binding private and class rulings) only create certainty for the specific applicant taxpayer. The question is whether the level of

[73] See section 75, read with section 89, of the SATAA (2011).
[74] See section 75, read with section 78, of the SATAA (2011).
[75] See section 77 of the SATAA (2011).
[76] Section 75 of the SATAA (2011) defines a "binding private ruling" as a "written statement issued by SARS regarding the application of a tax Act" and defines a "binding general ruling" as a "written statement issued by a senior SARS official ...regarding the interpretation of a tax Act or the application of a tax Act to the stated facts and circumstances".
[77] Section 80(1)(a)(ii) of the SATAA (2011) refers to the interpretation of the laws of a foreign country, while section 80(1)(c) refers to the interpretation of a general or specific anti-avoidance provision or doctrine.
[78] See section 77 of the SATAA (2011).
[79] See section 80 of the SATAA (2011). See also Republic of South Africa (2013); and Republic of South Africa (2016), which sets out the categories of applications that the tax administration may reject.
[80] See section 82(3) of the SATAA (2011).
[81] See section 82(4) of the SATAA (2011).

certainty provided, namely the ability of the tax administration to withdraw or amend the ruling, differs.

However, before considering the potential differences in the level of certainty, it is interesting to note that sections 83 and 88 of the SATAA (2011) use the terminology of being able to "cite" the ruling in court to indicate the difference in who is bound by the tax ruling. The use of the word "cite" is a somewhat ambiguous and strange way of indicating who is bound, as the ability to cite a ruling or a case in court is different from that ruling or case being binding on the court. Being able to cite a ruling or a case can mean that the ruling or case is a precedent that has to be followed or can indicate how a court applied the law to a similar set of facts. Given that only the applicant taxpayer and the South African tax administration is able to cite the advance tax ruling in a court, another taxpayer who is aware of the ruling or who has a similar set of facts cannot rely on the advance tax ruling or cite it in court, except perhaps in the context of legitimate expectations.[82] It does seem odd that a taxpayer is not able to use the ruling as a type of persuasive or soft law but, as discussed later, the Constitutional Court may well be seen to agree with the South African tax administration on this point.

The reliance of only the party to the advance tax ruling and the inability of other taxpayers to cite or rely on rulings does, to a degree, validate the criticism that rulings may result in the privatisation of tax law.[83] This potential privatisation of the law is bolstered by a fee being charged for a ruling and the fact that rulings are limited to specific types of transactions. For a fee, taxpayers can get a specialist to provide a detailed legal opinion which is binding on the tax administration. Advance tax rulings can make the law directly applicable to individual taxpayers and, therefore, extensive detail is not needed in the legislation. In this sense, advance tax rulings can be seen as soft law. Given the binding nature of these advance tax rulings on the tax administrator, it could be argued that such a ruling has the force of a type of quasi-legislation. To prevent advance tax rulings from becoming quasi-legislation, only the applicant taxpayer can rely on the ruling, with no other taxpayer deriving legal rights from the ruling and no other taxpayer being able to formally cite the ruling as legal authority. The risk of a ruling being used in a more general application as a type of quasi-legislation is, therefore, limited, but the risk that a taxpayer can use the advance tax ruling system as its own quasi-legislation still exists. A further consideration is whether advance tax rulings must only consider issues of fact and not decide the law. If rulings only consider facts and not interpretation of the law, it may reduce the possibility that rulings are conceived as quasi-legislation.

However, as seen in the South African case of *KWJ* (2018), a general ruling can become de facto law, in that it has to be followed even if incorrect. The same concern about de facto law, however, does not necessarily apply to all publications issued by the South African tax administration. This notion of de facto or even quasi-legislation was questioned by the South African Constitutional Court in the case of *Marshall* CC (2018), where the court questioned the basis on which a court should defer to an interpretation note, referred to by the court as "an administrative body's interpretation of legislation" (paragraph 3). It is submitted that the same principle would apply to binding general rulings and advance tax rulings. The Constitutional Court is correct, it is further submitted, in making a distinction between those who are bound by the tax administrator's interpretation—the taxpayer, the tax administration, or a court?

[82] A discussion of legitimate expectations is beyond the scope of the article.
[83] See Waerzeggers and Hillier (2016) on p. 4; Givata (2009) on pp.158-161.

The taxpayer in *Marshall* CC (2018) had first appealed to the South African Supreme Court of Appeal[84] and then to the South African Constitutional Court. By way of background, the taxpayer applied for a binding private ruling in October 2012 in order to clarify that the payments that it had received from certain provincial departments for services rendered qualified for a VAT zero-rating. The South African tax administration took a different view and issued a binding private ruling stating that the services rendered were subject to VAT at the standard rate. In February 2013, the South African tax administration issued an interpretation note setting out the VAT treatment of contracts entered into between public benefit organisations and government authorities.[85] Based on the unsuccessful 2012 ruling, the taxpayer applied to the court for a declaratory order on the interpretation of the relevant provisions of the VAT Act (1991).

The substantive tax dispute on appeal was whether the taxpayer and the South African Red Cross Air Mercy Service Trust were "exempt from paying VAT on payments received for actual services rendered to provincial health departments" operated by the government (*Marshall* CC, 2018, paragraph 1). The interpretation note became an issue when the Supreme Court of Appeal used it to support its decision that the taxpayer did not qualify to be exempt from paying VAT.[86] In considering the interpretation note, the Supreme Court of Appeal stated that:

> These Interpretation Notes, though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provision in question. Interpretation Note 39 has been in circulation for years and has not been brought into contention until now. (Footnote omitted). (*Marshall* SCA, 2016, as cited in *Marshall* CC, 2018, paragraph 2)

On appeal to the South African Constitutional Court, the extent to which a "court may consider or defer to an administrative body's interpretation of legislation, such as the Interpretation Note" (*Marshall* CC, 2018, paragraph 3) was considered. The issue was whether the South African Supreme Court of Appeal should have considered the view expressed in the interpretation note. At least two views were presented to the Constitutional Court. The first view, espoused by the taxpayer, was that the interpretation note should not be considered at all.[87] According to paragraph 3 of *Marshall* CC (2018), the arguments for this view were that:

> a) "Courts must independently interpret the meaning of the relevant legislation";
> b) Taking an administration body's interpretation into account would breach sections 9 and 34 of the South African Constitution in that the litigating parties would not have a fair hearing;
> c) Taking the interpretation note into account would go against the contra fiscum rule;
> d) The interpretation note is "inadmissible opinion evidence";
> e) Consideration of the interpretation note would be inconsistent with the principle "that the content of a regulation made under powers derived from a statute may not be relied upon as an aid to the construction of the statute itself";
> f) The use of the interpretation note is "a relic of the outdated approach to interpretation, namely to seek to ascertain the subjective intention of the legislature

[84] *CSARS v Marshall* 79 SATC 49 (SCA), hereinafter referred as *Marshall* SCA (2016).
[85] See *Marshall* CC (2018) at paragraph 2.
[86] See *Marshall* CC (2018) at paragraph 2.
[87] See *Marshall* CC (2018) at paragraph 4.

> rather than to adopt the proper purposive interpretation", which seeks to determine the "objective purpose of the legislation".

The second view, argued on behalf of the South African tax administration, posited that a court:

> may have regard to an administrative body's interpretation of legislation only to the extent that this interpretation constitutes evidence that it has been interpreted in a consistent way for a substantial period of time by those responsible for its administration, in order to tip the balance in the case of marginal statutory interpretation. (*Marshall* CC, 2018, paragraph 5)

According to this argument, the Supreme Court of Appeal "interpreted the relevant provisions independently of the Interpretation Note and its reference to it only served to confirm its interpretation" (*Marshall* CC, 2018, paragraph 5). It is interesting that in *KWJ* (2018), the South African tax administration argued to ignore a long-standing practice while in *Marshall* CC (2018), the argument was to take its interpretation into account. *KWJ* (2018) involved a ruling given to taxpayers on the tax liability of a specific type of transaction, while *Marshall* CC (2018) involved an interpretation note, which was likely to fall into the category of a binding general ruling. A superficial comparison of the two cases makes the South African tax administration appear contradictory—on the one hand, it does not want to be bound by a tax ruling (*KWJ*, 2018) while on the other hand, it appears to want an interpretation note to be taken into account in a court's decision, which indirectly makes an interpretation note binding on a taxpayer and thus law, allowing the tax administrator to make law, taking over the role of the legislature, which is arguably not in line with the rule of law.

In considering the approach taken by the Supreme Court of Appeal, the Constitutional Court agreed that the Supreme Court of Appeal had correctly, in accordance with the concept of judicial precedent, taken the approach indicated in a 2015 Supreme Court of Appeal decision.[88] However, the Constitutional Court considered whether the approach required a re-examination[89] and, in particular, whether it took into account the change in South Africa from legislative supremacy to constitutional democracy[90] and the extent to which an administrative body's interpretation of legislation should be considered.[91] Referring to an interpretation note as an administrative body's interpretation of legislation, and commenting on the role of "a unilateral practice of one part of the executive arm of government in the determination of the reasonable meaning to be given to a statutory provision", the Constitutional Court stated that such a practice can "conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned", but cannot be justified "where the practice is unilaterally established by one of the litigating parties" (*Marshall* CC, 2018, paragraph 10). The Constitutional Court further stated that "it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts" and that "it is best avoided" (*Marshall* CC, 2018, paragraph 10).

[88] In *CSARS v Bosch* 2015 (2) SA 174 (SCA); 77 SATC 71 at paragraph 17, the Supreme Court of Appeal stated that there is authority that, if a provision "has been interpreted in a consistent way for a substantial period of time by those responsible for the administration of the legislation", such evidence "is admissible and may be relevant to tip the balance in favour of that interpretation". The court further stated that this approach is consistent with a contextual approach to interpretation and that the "conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision in question".
[89] See *Marshall* CC (2018) at paragraph 7.
[90] See *Marshall* CC (2018) at paragraph 10.
[91] See *Marshall* CC (2018) at paragraph 10.

Despite the role that publications play in providing certainty to the taxpayer, public, and tax administration, as seen in *KJW* (2018), it would seem that the Constitutional Court did not take kindly to them fettering the interpretation of statutory provisions and perhaps indirectly binding the taxpayer to the interpretation set out in the interpretation note. The Constitutional Court in *Marshall* CC (2018) is considered to be correct in making the distinction between a unilateral practice in determining the interpretation of legislation and a long-term practice (referred to in paragraph 9 of the judgement as "custom") which is used by all parties. In terms of the provisions of the SATAA (2011), the former may, if it meets the definition as set out in the Act, become a "practice generally prevailing". An interpretation note is specifically mentioned as a "practice generally prevailing" in the SATAA (2011) and, accordingly, the tax administration, but not the courts or the taxpayer, would be bound by the interpretation set out in the interpretation note. A long-term practice may also, when applying *KWJ* (2018), become a "practice generally prevailing" and bind the tax administration. However, the Constitutional Court is correct in stating that neither the court nor, for that matter, the taxpayer is bound by the interpretation set out in the interpretation note and, further, that the court does not have to consider the interpretation note when interpreting the provisions of tax legislation, especially when, as in the case of *Marshall* CC (2018), the interpretation note was issued subsequent to the unsuccessful ruling given to the taxpayer. In other words, an interpretation note is not quasi-legislation and is not retrospective.

Paragraph 10 of *Marshall* CC (2018) does raise the question of the point at which a unilateral practice becomes "an impartial application of custom recognised by all concerned". Based on this statement by the Constitutional Court, not only would the tax administration be bound by this practice, as per *KWJ* (2018) or SATAA (2011) provisions, but such a practice could then be considered in determining a "reasonable meaning to be given to a statutory provision" based on it being a "custom recognised by all concerned" (*Marshall* CC, 2018, paragraph 10). A further point raised by *Marshall* CC (2018) is whether the concept of a "custom recognised by all concerned" (paragraph 10) used by the Constitutional Court is different from the concept of a "practice generally prevailing", with the latter potentially only binding the tax administration and the former having a broader role in interpreting a provision? From the case law and the wording of the SATAA (2011), the concept of a "practice generally prevailing" only binds the tax administration and is not seen as an interpretative tool. The Constitutional Court, it seems, has now potentially added a further category, namely "long-standing custom", which can be used as an interpretative tool, but it is questionable as to whether this category binds any of the parties. It seems that even though the legislature has sought to abolish the case law concept of a "practice generally prevailing", the principle of the courts' interpretation of "practice generally prevailing" may have been resurrected by the Constitutional Court through the concept of "long-standing custom" which means that an unofficial publication can be binding on the tax administration. It also raises the question of the role played by the doctrine of legitimate expectations in binding the tax administration to interpretations and views set out in interpretation notes.[92] While a detailed discussion on the concept of "long-standing custom" and the doctrine of legitimate expectations is beyond the scope of this article, the use of these concepts can only support the certainty needed by a taxpayer who follows unofficial publications issued by the South African tax administration.

[92] See Arendse et al. (2022) at paragraph 3.30.

Consistency of Rulings

The certainty of long-standing custom and practices in both official and unofficial publications arises from the consistent treatment or application of particular provisions of the tax legislation. This consistency is seen through the long-term application of the particular interpretation, as seen in *KWJ* (2018) and in binding general rulings being treated as "practice[s] generally prevailing". Similarly, advance tax rulings, it is assumed, should be consistent with the similar or same treatment of taxpayers with the same or similar facts and legal issues. The limitation of being binding on the specific taxpayer or class of taxpayer, together with non-citation rule, makes it difficult to determine whether such a level of consistency has been achieved. The risk of differing advance tax rulings being made despite the same or similar facts and legal issues can be reduced if the officials who issue such rulings are highly-skilled tax professionals, and through the use of an internal peer review and committee decision-making when finalising a ruling. The employment of such a group of highly-skilled professionals by a tax administration must, however, be considered in the context of whether: a country has such professionals given the skill shortages in many developing countries; the tax administration is able to provide pay and benefits that are commensurate with those available in the private sector to these professionals; and such skilled professionals are willing to be employed by the tax administration.

The level of consistency in the decision-making process is, to some extent, assisted by the publication and reasoning of the rulings. The South African tax administration website provides a list of the advance tax rulings, referred to as binding private and binding class rulings, issued since 2007.[93] It is worth noting that not all of these were issued under the provisions of the SATAA (2011); some were issued under the now repealed provisions of the Income Tax Act (1962).[94] While binding general rulings are made available to the public, with the ruling setting out the reasoning and basis for its interpretation, the reasonings and bases for the decisions made in advance tax rulings are only made available to the applicant taxpayer, with a redacted version published and made available to the public.[95] These rulings are published for general information only and with the consent of the applicant or class of applicants, as provided in section 87(1) of the SATAA (2011). The redacted publication removes the content which could identify the taxpayer to whom the relevant advance tax ruling was issued and contains a general summary of the transaction. An "applicant" for a "binding class ruling" may consent in writing to the inclusion of information identifying it or the proposed transaction to facilitate communication with the "class members".

The redacted publication further sets out the conclusion, indicating how the relevant tax provisions applied to the transaction. Prior to its publication, the applicant is provided with a draft for review and editing. While the comments and proposed edits made by the applicant will be considered, the South African tax administration is not required to accept these. The publication of the redacted version is in line with the limited reliance on advance tax rulings as only the applicant taxpayer can rely on them. On the other hand, if the purpose is to just inform taxpayers generally that such rulings have been made and that they could apply for similar rulings, it would be more useful if greater detail of the analysis and application of the law is made available to the taxpayer. The publication of the redacted version does, however, promote transparency and supports the general objectives of certainty and consistency. The publication

[93] Between 2007 and October 2023, around 394 binding private rulings (SARS, 2023d) and 86 binding class rulings (SARS, 2023b) have been published.
[94] The now repealed sections 76B-76S of the Income Tax Act (1962).
[95] See section 87 of the SATAA (2011). See also Waerzeggers and Hillier (2016) on p. 8.

of rulings has the potential to reduce uncertainty, in that taxpayers will have some idea of and insight into the way in which the tax administration will apply the tax legislation. One criticism of the publication of redacted versions is that it may benefit the tax administration, in that it does not have to publicise the detail if it allowed or consented to a taxpayer friendly approach.[96] A second criticism is that, while the redacted versions of favourable advance tax rulings are published, rejected or unfavourable advance tax rulings are not published. For the purposes of certainty, clarity, and transparency, it would be useful if the tax administration published an annual report on the issuing of advance tax rulings, setting out the number of rulings granted and the number of rejected applications. An estimate of the revenue impact of the advance tax ruling system should also be included in such an annual report.

The Binding Nature of Rulings

The certainty provided by advance tax rulings is that the South African tax administrator is bound by the view or interpretation set out in the ruling in relation to the applicant or class of applications.[97] Similarly, a binding general ruling is binding on the South African tax administration with respect to the provisions indicated in the aforesaid ruling. This means that the South African tax administrator is bound by the interpretation, view, or opinion set out in the binding general and advance tax rulings. The binding nature of the advance tax ruling is, however, largely one-sided in that the rulings are only binding on the South African tax administrator and not on the taxpayer. Although the SATAA (2011) makes it clear that advance tax rulings are only binding on the parties to that ruling,[98] this element is clarified by a preamble on the published advance tax rulings. The preamble to the published binding private rulings states that the binding private ruling is published by consent and is not a "practice generally prevailing".[99] A similar preamble is included in published class rulings. The wording of the preamble to the published binding private ruling is as follows:

> This binding private ruling is published by consent of the applicant(s) to which it has been issued. It is binding as between SARS and the applicant and any co-applicant(s) only and published for general information. It does not constitute a practice generally prevailing. (*Binding Private Ruling 308,* 2018)

If the applicant disagrees with the advance tax ruling issued or the tax administration does not provide a favourable ruling, the applicant can either ignore the ruling and continue with the proposed transaction or take the ruling on review. There is a practice in the South African tax administration that the relevant tax officials will, prior to issuing an unfavourable ruling, inform a taxpayer that the ruling will be unfavourable, allowing the taxpayer an opportunity to withdraw it. The ruling will then not be issued, with the result being that the potential unfavourable ruling is not made available to other departments, such as the auditing department of the tax administration. The taxpayer who does not withdraw the application and is granted the unfavourable ruling, who then follows through with the proposed transaction, ignoring the unfavourable ruling, and who implements the transaction according to their own interpretation and legal opinion, takes their chances with the courts when the tax administration issues an assessment using the interpretation in the ruling.

[96] See SARS (2023f). See also SARS (2023h)
[97] See section 82(1) of the SATAA (2011).
[98] See section 82 of the SATAA (2011) read with sections 83 and 84.
[99] With effect from *Binding Private Ruling: BPR 308* (2018).

In *Wenco* (2021), the taxpayer applied to the High Court for a review of an unfavourable ruling made by the South African tax administration. The taxpayer wanted, firstly, the court to declare a VAT ruling unlawful and set it aside, and secondly, to direct the tax administration to issue a VAT ruling as per the taxpayer's interpretation of the relevant provisions.

Wenco was a company with a South African branch, both of which were incorporated in Canada. While Wenco's principal place of business was in Canada, its branch was registered in South Africa as an external company, with its principal place of business and registered address being in South Africa. While Wenco developed and supplied software to its South African clients, the branch provided related services to, inter alia, the South African clients for and on behalf of Wenco. The branch was paid a management fee for rendering these services.

In 2018, to obtain certainty on its VAT registration obligations, Wenco applied to the South African tax administration for a VAT ruling.[100] A similar ruling, which had been applied for in 2017, was subsequently withdrawn. The South African tax administrator issued an unfavourable ruling in respect of the 2018 application, resulting in the review application. Pertinent to this article, the taxpayer's basis for the review was that "the content of and conclusions reached in the VAT ruling" were, inter alia, "materially influenced by an error of interpretation and application of the law to the information that was provided in the application" and, further, "that the VAT ruling is not rationally connected to the purpose as envisaged in the aforesaid provisions of the VAT Act, the information before the respondent and the reasons given for it by the respondent" (*Wenco,* 2021, paragraph 10). The substantive law issue that required interpretation was the meaning and interpretation given to the phrase "carrying on an enterprise" (VAT Act, 1991, section 1[1] read together with section 8[9]) and whether Wenco and the branch were separate persons, each carrying on an enterprise, for the purposes of the VAT Act (1991). A discussion of the substantive issues is beyond the scope of this paper,[101] except to state that, in deciding on the interpretation of the relevant provisions of the VAT Act (1991), the Gauteng division of the High Court set out the way that statutes are to be interpreted in South Africa by referring to the Supreme Court of Appeal case, *Natal Joint Municipality Pension Fund v Endumeni Municipality* (2012),[102] and stating that:

> the process entails attributing meaning to the relevant statutory provision, in the light of the language used, the context in which the provision is set, including the material known to the drafters, and the purpose which the provision is intended to serve. In addition thereto, an interpretation that is sensible and business-like is to be preferred over one that leads to insensible consequences or those that appear to frustrate the statutory objective. (*Wenco,* 2021, paragraph 40)

The tax administration's tax treatment of the taxpayer and the decision of the High Court that there was no basis to set aside the ruling appear to have surprised tax commentators:

> since it has always generally been SARS' practice to allow for similar business structures to be arranged in such a manner to that of the applicants, thus effectively putting a South African branch structure on the same footing as a South African subsidiary structure for VAT purposes. (PricewaterhouseCoopers Tax Services [PwC], 2021, p. 2)

[100] In terms of section 41B of the VAT Act (1991).
[101] For a detailed analysis, see Kruger (2021).
[102] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) par [18].

Of interest is that the decision by the court, according to commentators, changed the long-standing practice of the tax administrator and taxpayers.[103] The judgement does not indicate whether the arguments before the court included whether there was a long-standing practice which was potentially a "practice generally prevailing" as per *KWJ* (2018) or custom as per *Marshall* CC (2018).

Information About and Knowledge of a Taxpayer

One of the concerns that arises in the context of a taxpayer deciding to ignore an unfavourable advance tax ruling and implement the transaction based on their own legal opinion is whether the unfavourable advance tax ruling is known to all departments of the tax administration. Does, or should, the tax administration department responsible for issuing advance tax rulings inform the auditing department about the unfavourable advance tax ruling with the intention that the auditors should monitor the taxpayer's transactions? Should there be a fire or ethical wall between those who issue advance tax rulings and those who issue assessments, with advance tax rulings being issued by a specialised unit, separate from the collection agents?[104] Should the two departments work together, co-operating in order to limit tax avoidance schemes?

As part of the application for an advance tax ruling, a taxpayer must not only set out all the details of the proposed transaction but also provide their own interpretation and legal opinion.[105] The taxpayer must provide all of the relevant information for the proposed transaction. In addition, when determining the veracity of the taxpayer's legal opinion and determining its own legal opinion, the tax administration may request information from the taxpayer.[106] When setting out their legal opinion, the taxpayer may attract the attention of the tax administrator's auditors, especially if the legal opinion is about a complex transaction which is of benefit to the taxpayer. Where the tax administrator agrees with the taxpayer's legal opinion, but that opinion is to the disadvantage of the tax administrator, the tax administrator may be disposed to propose an amendment to the law to remove the benefit. This amendment of the law may be problematic where the legislature applies the law retrospectively. In addition, providing detailed information means that the tax administration has access to information which it otherwise would not and the taxpayer possibly exposes themself to scrutiny and increased attention from the tax administration. This concern is especially pertinent where the proposed transaction is complex, novel, and provides significant tax benefits to the taxpayer. The taxpayer also risks receiving queries from the tax administration about issues related to the ruling requested but which the taxpayer may be reluctant to provide, especially if the tax administration can use such information for tax assessments, can re-open past assessments based on the information provided, or must provide information to a third party in response to a request for information. If the taxpayer gets a negative ruling or decides not to continue with the proposed transaction, such attention from the tax administration may increase. The possible exposure and attention, especially where the taxpayer is seeking a ruling on a complex transaction or seeking certainty about an ambiguous legal provision, may impact on their decision to request a ruling or to not use the private or advance tax ruling system. The South African advance tax ruling provisions do not directly deal with this concern. However, the practice of the relevant advance tax ruling department may attempt to separate the granting of

[103] See PwC (2021).
[104] See Waerzeggers and Hillier (2016) on p. 6.
[105] See Section 79(4) of the SATAA (2011). See also SARS (2013), paragraph 4.3.1, pp. 31-33.
[106] Sections 79(4), 79(5), and 80(3) of the SATAA (2011). See also SARS (2013), paragraph 1.22, pp 4-5, and paragraph 4.36, p. 35.

rulings and the information supplied from the auditing and assessment department. Whether or not such a practice exists is not clear, as this detail is not made available to the taxpayer. On the other hand, it can be argued that the taxpayer should not be afraid of sharing such information as it presumed that the taxpayer has nothing to hide from the tax administration. No comment is made on whether such a presumption is correct.

The Cessation of the Binding Nature of a Ruling

Once a binding ruling is issued, the certainty that the ruling provides is affected by the ability of the tax administrator to set aside, withdraw, or amend the ruling. While advance tax rulings are binding for a specific time period[107] and can be declared void,[108] provision is made for binding general rulings to cease to be binding on the tax administrator.[109]

According to section 84 of the SATAA (2011):

> (1) A 'binding private ruling' or 'binding class ruling' is void *ab initio* if—
> *(a)* the 'proposed transaction' as described in the ruling is materially different from the 'transaction' actually carried out;
> *(b)* there is fraud, misrepresentation or non-disclosure of a material fact; or
> *(c)* an assumption or condition imposed by SARS is not satisfied or carried out.
>
> (2) For the purposes of this section, a fact described in subsection (1) is considered material if it would have resulted in a different ruling had SARS been aware of it when the original ruling was made.

When a ruling is declared void, the South African tax administration, not being bound by the ruling any longer, it is presumed, can assess the applicant taxpayer accordingly. Given that the ruling is then void, meaning that it has no legal effect at all, it is, in effect, a nullity. A question that arises in the context of consistency and certainty is whether the ruling and reasoning behind the ruling would still apply if the same taxpayer brought another application based on the same set of facts and law, and meets the requirements? Or can a different ruling be given?

Advance tax rulings and binding general rulings, like other official publications,[110] cease to be binding when a provision of a tax Act is amended[111] or when a court overturns or modifies an interpretation of the relevant tax Act.[112] Unlike other official publications, an advance tax ruling and binding general ruling that is overturned or modified by a court remains binding if the court decision is appealed or is fact-specific, or if the comments by the courts are obiter dicta.[113] The South African tax administration may also withdraw or amend such rulings.[114] Likewise, other official publications may also be withdrawn or modified, with the withdrawn

[107] See section 78(3)(h) of the SATAA (2011).
[108] See section 84 of the SATAA (2011).
[109] See section 85 of the SATAA (2011).
[110] Such as interpretation notes, practice notes, and public notices. See the definition of "official publications" in section 1 of the SATAA (2011).
[111] Section 85(1)(a) of the SATAA (2011) provides that the amendment can be in the form of a repeal or in a manner which materially affects the ruling.
[112] Section 85(1)(b) of the SATAA (2011) provides for changes to advance tax rulings on subsequent changes to the law.
[113] Section 85(1)(b) of the SATAA (2011) provides for changes to advance tax rulings on subsequent changes to the law.
[114] Section 86 of the SATAA (2011).

or modified version ceasing to be a "practice generally prevailing". The certainty provided by rulings is, therefore, constrained by possible amendments to legislation, court decisions, and modifications to the rulings. When using interpretation notes, binding general rulings, and publications, taxpayers must be cognisant of any such changes.

The Costs of a Ruling System

Given the possibility of a review by a taxpayer taking place, and the binding nature on the tax administration, the costs of setting up a system to provide for tax rulings must be considered against the benefits of such a system. Where a country is still developing its tax administration and focussing on other critical tax reform priorities, the cost of administering a tax ruling system, whether in the form of advance tax rulings or binding general rulings, must be considered against the need for a different focus. The certainty provided by the taxpayer ruling system, being the major benefit of the system, especially in an advance tax ruling system, must outweigh the cost of the system. This cost must be considered from the perspectives of the taxpayer and the tax administration. The cost and benefit of an advance tax ruling includes the length of time it takes for a ruling to be issued or published. A lengthy delay may undermine one of the key objectives, especially in a commercial transaction, which is to provide certainty in the context of a particular transaction. Provision can be made for an expedited ruling process, which may then add an extra fee to the ruling request.[115]

If the taxpayer is charged a fee to obtain an advance tax ruling, the benefit to the taxpayer of having the certainty provided by the ruling must outweigh the cost of the ruling. Another way of stating this is that the elimination of the tax risk must outweigh the cost of the ruling. While there is no fee for a binding general ruling, the South African tax administration requires payment of a fee for advance tax rulings. This fee is said to comprise a cost recovery and research element.[116] The number of published advance tax rulings[117] would seem to indicate that the fee is not a deterrent to obtaining certainty and the type of matters ruled upon appear to indicate that certainty and the elimination of the tax risk outweighs the cost of the ruling.

5. CONCLUSION

Given the number of rulings requested and made, both binding general and advance, it would appear that they do provide tax administrative certainty. The certainty is supported by the South African ruling system through the SATAA (2011) and judgements made by the South African courts. Certainty, as seen in the case of *KWJ* (2018), trumps the changed view and interpretation of the South African tax administration, even where the tax administration attempts to renege on the certainty provided and even where fisc may be prejudiced. The courts and the SATAA (2011) are also clear that the view and interpretation provided by the tax administration must be honoured by the tax administration, and that it is the tax administration, and not the court or taxpayer, that is bound by the ruling or interpretation note, as illustrated in *Marshall* CC (2018). Tax administrative certainty is supported by both binding general rulings and advance tax rulings, even though the basis for such certainty differs, the former being a "practice generally prevailing" and the latter being based on specific provisions in the SATAA (2011).

[115] See SARS (2023a). See also SARS (2013), paragraph 2.3.1, p. 9.
[116] See section 81 of the SATAA (2011) read together with Republic of South Africa (2013), which provides details of the cost recovery fees for binding private and binding class rulings.
[117] See SARS (2023b) and SARS (2023d).

General rulings, advance tax rulings, and even interpretation notes differ and are used by different taxpayers for different reasons. It is likely that the target market for advance tax rulings are those taxpayers who are undertaking economically significant transactions, who are sensitive to risk of future unexpected exposure, and whose management of the tax risk is critical to their financial and reputational standing. For these taxpayers, the decision to apply for a tax ruling is, therefore, both a strategic and a cost consideration. It is, thus, imperative that the ruling system provides certainty for these taxpayers on conclusion of the transaction and once the transaction has been implemented. For the targeted taxpayers, the certainty that the tax administration cannot, without reason, change the legal implications of the ruling is paramount. By limiting the circumstances under which the South African tax administration can change its view or interpretation and apply that changed view or interpretation to an issued ruling, the SATAA (2011) ensures that the taxpayer has this certainty.

The target market for binding general rulings or interpretation notes is the broader taxpayer community. The provisions of the SATAA (2011) and judgements made by the South African courts both enable and support the certainty provided by binding general rulings and even by other publications, such as interpretation notes. Court decisions, such as *KWJ* (2018), recognise the certainty provided by a long-standing practice and, despite the reluctance of the Constitutional Court in *Marshall* CC (2018) to give interpretation notes quasi-law status, the court recognised that interpretation notes are binding on the tax administrator. The inclusion of the binding nature of a "practice generally prevailing" in the SATAA (2011), and the possibility that a long-standing practice can be custom and binding, support tax certainty, taxpayer trust, and confidence in the rulings and publications issued by the South African tax administration.

While the ruling system may attract some criticism, it is clear that the rulings and publications issued by the South African tax administration provide certainty in a cost-effective and efficient manner. Given the hurdles that must be overcome in order to achieve certainty in the interpretation of tax legislation, or even just a consistent application of an interpretation, and the possibility that the tax administration may change its view on the interpretation and application of provisions of tax legislation, the ability to rely on binding general rulings and advance tax rulings does provide certainty about the tax outcome for the taxpayer who applies for an advance tax ruling and the taxpayer who uses the view and interpretation in a binding general ruling. Despite the fact that issues such as the possible privatisation of the law attract criticism, the use of this system of tax rulings in South Africa has the potential to reduce conflict before a formal dispute arises and create a relationship of trust (or even just non-conflict-based interaction) between the South African taxpayer and the South African tax administration.

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TRANSFER PRICING LITIGATION: HOW COULD THE PORTUGUESE TAX AUTHORITY IMPROVE ITS SUCCESS RATE?

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Abstract

Purpose: Between 2011 and 2019, 52 transfer pricing cases were decided in tax arbitration courts in Portugal. The Portuguese tax authority prevailed in only seven. The research question that this paper seeks to address is: "What strategic and operational measures can the tax authority implement in order to improve its success rate in transfer pricing litigation?".

Approach: This paper is based on a blend of the case study method and legal research approach. Six decisions made during 2011 to 2019 are analyzed in detail in order to find similarities in court reasoning that can be used as a basis for the proposed changes to tax audits.

Findings: The main conclusions drawn from the research relate to the need for changes to performance metrics, careful planning for transfer pricing audits, solid analysis of comparability issues in auditing work, more intervention by senior staff acting as filters in respect of unsubstantiated audit reports, and the dissemination of best practices in audit and litigation procedures.

Implications: By considering the arbitration court case outcomes, strategic and operational procedures can be applied in the planning, execution, and follow up of transfer pricing tax auditing.

Originality: The tax authority's performance in transfer pricing arbitration court cases between 2011 and 2019 is discussed and forms the basis for recommendations to enhance the tax authority's litigation success rate. Transfer pricing is a globally litigated matter, with modest success rates for tax authorities. Thus, the conclusions presented in this paper are useful for policymakers worldwide.

Keywords: Portuguese Tax Authority, Transfer Pricing, Litigation.

1. INTRODUCTION

Tax authorities (TAs) have been adopting strategic goals and managing daily practices that are increasingly based on quantitative metrics (OECD, 2017). New management trends and the capabilities of information systems are important reasons for this (Scott & Robbins, 2010).

TAs use management tools with the aim of enhancing citizens' and businesses' engagement with tax collection in order to reinforce voluntary compliance. According to the OECD (2014), "compliance, and by extension revenue, flows from taxpayers' belief in the willingness (trust) and ability (confidence) of the revenue body to conduct its business fairly and objectively" (p. 77). The perception of the benefits of active tax compliance has been highlighted in the literature (Serem et al., 2017). Several studies emphasize the importance of trust in relation to taxpayers' willingness to cooperate and comply with TAs (De Widt & Oats, 2022; Gobena &

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Van Dijke, 2016). Others focus on the relationships between tax equity, tax morale, and tax compliance (Castañeda, 2019). Nevertheless, auditing activity in order to control compliance is a major area of interaction between businesses and TAs.

The number of audits carried out and the subsequent additional assessed revenue earned play central roles in the evaluation of a TA's goals (Serra, 2005). Given the pressure on tax collection, multinational businesses are increasingly being audited by TAs for transfer pricing (TP) used in related party transactions (Bradley, 2015; Muhammadi et al., 2016; OECD, 2017). The arm's length rule is the basis of TP legislation and the benchmark used by taxpayers, TAs, and courts when litigation arises.

The OECD (2020) addressed some practical questions relating to the application of the arm's length principle in the context of the COVID-19 pandemic. The OECD guidance focuses on four issues: "(i) comparability analysis; (ii) losses and the allocation of COVID-19 specific costs; (iii) government assistance programmes; and (iv) advance pricing arrangements (OECD, 2020, p. 1). The OECD emphasizes the consequences of the unique economic conditions that arose as a result of the pandemic for TP analysis performed by multinational businesses and TAs with the main purpose of preventing litigation. In fact, TP audits are mainly directed at multinational companies that have the resources to litigate and courts have often decided on such disputes (Cooper et al., 2016). Following a general trend, the Portuguese TA has been auditing multinational firms and tax adjustments based on TP are quite common (Taborda da Gama, 2013). In Portugal, after tax arbitration was introduced in 2011, courts have ruled on many TP cases (de Sousa da Câmara, 2015).

Martins et al. (2020) studied 32 TP arbitration cases decided in Portugal in the period from 2012 to 2017 and found that the Portuguese TA was successful in only three cases. Using the same methodology for the period 2018 to 2020, we found twenty more TP cases on the website of the Administrative Arbitration Centre (CAAD)[3]. The Portuguese TA won only four of these (there was also a mixed decision).

Several decisions highlight one of the gaps in the audit reports: the TA often misapplies the comparability concept by using operations and prices that do not comply with the requirements established in TP regulations as comparables. The TP methods, e.g., comparable uncontrolled price (CUP) and net margin[4] used were often disallowed by tax arbitrators, because of flawed justifications found in audit reports.

The paper addresses the following research question: What policy measures can the Portuguese TA implement to improve its success rate in TP litigation? Our contribution centers on strategic and operational procedures that can be applied to the planning, execution, and follow up of TP tax auditing with the aim of providing TAs with a more robust foundation in order to improve their position in tax arbitration courts. As TP is a globally litigated matter, with modest success

[3] See Centro de arbitragem administrativa [CAAD] (n.d.) where all tax cases are published (omitting the real names of the litigants).

[4] The traditional transaction methods are the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method. The transactional profit methods are the transactional net margin method (net margin) and the transactional profit split method (OECD, 2022). The CUP and net margin methods are referred to in next sections. According to OECD (2022), "the CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances" (p. 97). The net margin "examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction" (OECD, 2022, p. 113).

rates for TA, we believe that our contribution can be useful for policymakers and TAs worldwide.

The main recommendations derived from the analysis presented in the paper concern modifications in performance metrics (focusing simply on additional revenue may produce skewed audits), careful planning for TP audits, solid analysis of comparability issues in auditing work, improved filtering of unsubstantiated audit reports by senior staff, and dissemination of best practices in audit and litigation procedures.

The paper is organized as follows. Section 2 introduces the literature review, section 3 deals with methodology, section 4 presents data on TP arbitration court outcomes, section 5 develops proposals to improve TA litigation standing, and section 6 concludes.

2. LITERATURE REVIEW

2.1. Trends in TA Management

Many countries' public sectors have adopted a managerial, results-oriented approach by implementing enhanced accountability and performance measurements, and setting explicit targets (Schedler & Scharf, 2001; Scott & Robbins, 2010). Given their public relevance and daily interactions with citizens and businesses, TAs have been significantly influenced by this trend (Péteri, 2008; Yilmaz & Beris, 2008). The achievement of efficiency is one of a TA's imperatives.

The TA is usually the visible face of tax policy, one of the most important government policies. It is expected to act with transparency, guaranteeing legal certainty, improving the quality of service, and collecting revenue. It is expected to foster voluntary compliance, at a minimum cost, with proper respect for the rights of taxpayers (Beesley, 2008; OECD, 2017).

TAs in various countries have been subject to a number of changes. Robbins et al. (2015) report that the introduction of the Revenue Online Service, one of Ireland's first e-government resources, reduced the TA's administrative burden in relation to the processing of income tax returns. This burden was transferred to citizens and accounting/tax practitioners, but did not increase their compliance costs, thanks to the TA's use of online filing and payment processes. Unger (2014) sustains that taxpayer charters and ethic codes introduced in Australia and the United Kingdom are relevant references for TAs elsewhere. Closs-Davies et al. (2021) show how the introduction of a performance management system redirected workers within United Kingdom's TA towards organizational targets, making them follow rigid scripts, with the result that they scorned citizen's real needs.

Some countries have introduced semi-autonomous revenue agencies: Peru, for example, established the *Superintendencia Nacional de Administración Tributaria* in 1988.[5] This type of agency differs from the conventional TA, as it is situated outside of the ministerial structure and enjoys independent legal status. In order to exercise their tax collection powers effectively, semi-autonomous revenue agencies are endowed with management autonomy and have their own budgets, materials, and human resources, as well as regulatory and sanctioning powers in respect of tax legislation (von Haldenwang et al., 2014). Another trend is the adoption of customer segmentation practices. This ensures that taxes are properly collected, while focusing

[5] Law 24829, 1988.05.31. Available at https://www.sunat.gob.pe/legislacion/sunat/ley-24829.pdf

on certain taxpayer groups (Tuck, 2013). The literature provides us with some results relating to the comparative efficiency of TAs across multiple countries and emphasizes the importance of measuring TA performance, offering guidelines for best practices and supporting tax design (Alm & Duncan, 2014; Nguyen et al., 2020).

According to the Autoridade Tributária e Aduaneira (2017, 2020), a results-oriented strategy has been increasingly gaining ground within the Portuguese TA. Specific areas in which this strategy has been applied include: the segmentation of taxpayers with a focus on big companies; the application of information technology in order to maximize the effectiveness of audits; the use of monetary incentives related to the detection of taxpayer noncompliance; and the establishment of special services in order to fight sophisticated tax avoidance and evasion.

The evolution of the Portuguese TA may be characterized by its modernization of technical tools, the clearer notion that it has of risky taxpayers, and its intensification of audits related to international tax issues. The TA has also implemented performance metrics, such as audits per service and employee, the amount of monetary adjustments made, and the number of abusive tax planning schemes successfully detected.

In this organizational setting, how is TP auditing evolving in Portugal? On the positive side, the TA's staff have been gaining new capabilities that enable them to challenge taxpayers´ reports. Additionally, certain databases (e.g., SABI, BACH and ORBIS) that the TA requires access to if it is to counter firms' computations of TP adjustments are now also at the organization's disposal.

However, we believe that two factors have been hampering the quality of TP audits in Portugal. Firstly, the pressure to increase the number of audits means that highly complex cases of related party transactions, and their economic and legal bases, are not thoroughly apprehended during tax audits. Therefore, adjustments often rest on fragile justifications. Secondly, performance metrics based on the monetary amount of tax corrections made by the TA mean that tax auditors have a propensity to find flaws in TP reports that are often not well grounded in the law. In particular, the "comparability issue" is frequently overlooked, putting the TA in a weak position when litigating.

Multinational business auditing is a sensitive matter for a TA. The concentration of corporate revenue among large taxpayers, and the tax sophistication of these entities, turn auditing into a challenging task. TP is a prime target for tax auditing, given the monetary amounts usually at stake in transnational transactions (Braithwaite, 2007). van der Hel-van Dijk et al. (2015) emphasize the importance of co-operative compliance between TAs and taxpayers (usually large businesses) to improving compliance.

2.2. The Role of Tax Auditing with an Emphasis on TP

Kaplanoglou and Rapanos (2012) state that political factors can heavily impact a TA's behavior when carrying out auditing processes. In many European Union (EU) countries, an excessive reliance on budgets has been a major cause of gaps between revenue estimates and the final amounts collected (Jonung & Larch, 2006). TAs were pressured to comply with revenue goals and auditors were aware that revenue adjustments had to be found during auditing assignments, as their career advancement could be adversely affected if the audits produced no additional income.

G. Yin (2012) states that "effective tax administration must involve some level of real and perceived auditing" (p. 398). However, if the process is seen to be excessively harsh, it can hamper "the development of a positive tax culture" (G. Yin, 2012, p. 398). In China, Li et al. (2019) found "that after firms have been audited they significantly raise their effective tax rates" (p. 91).

In many countries, a number of factors influence the way in which tax audits are conducted, including: the need for tax receipts; the increasing capacity of information technology systems to cross-match third-party data; the growing importance of performance measures for TA staff; the career concerns of auditors; the proximity between TA and legislators; and the positive social feedback due to having a strong hand when fighting evasion (Wolpe, 2015; Zandi & Elwahi, 2016).

The distribution of gains between the entities of a business group, when these entities are located in jurisdictions with different tax rates, affects the sharing of tax revenue between countries. Sikka and Willmott (2010) show that corporate TP policies affect the quality of data held in respect of imports, exports, national income, corporate profitability, and balance of payments, etc.

The problematic effects of TP in the EU have been addressed in many ways. One proposed method was the Common Consolidated Corporate Tax Base (CCCTB), under which domestic TP would become less relevant, i.e., the manipulation of corporate profits by TP would be reduced, and there would be fewer cases of litigation between corporations and TAs. However, as fiscal policy is one of the last sovereign instruments available to member states, there were a number of obstacles that would have needed to be overcome in order to implement a CCCTB and, in 2021, the framework was replaced (European Commission, 2021).

Therefore, the methods used to determine the tax base in each jurisdiction are a major factor in group taxation. In OECD member countries, tax laws and regulations dealing with group transactions are based on the arm's length principle (OECD, 2022). This implies the obligation, when valuing transactions between related parties, to use the same prices that would be charged in comparable operations between independent entities.

Although the principle is simple to grasp, it may be difficult to apply to the day-to-day practices of multinationals. Global companies are, by nature, entities for which the control of TP is difficult (Bradley, 2015). Economies of scale (often the main motivation for investments), the importance of intra-group transactions, geographical diversification, the internationalization of production chains, intra-group service centers, and the uniqueness of intangible assets all create problems in respect of the appropriate computation of TP, because they impact the comparability process (OECD, 2017). This is the reason why, in many cases, conflicts arise between the TA and taxpayers, and litigation follows (Levey & Wrappe, 2013).

In the TP auditing area, the adoption of new management principles based on quantifying and measuring outputs has induced new assessments or tax-based adjustments that potentially increase tax revenue. The career advancement of auditors is perceived to be linked to the amount of tax revenue brought in through new assessments. Moreover, in some cases, regional services within TAs compete to generate the highest amount of additional revenue. Senior managers know that they can use this method to secure more resources and enhance their reputation. Since TP is an area in which significant amounts of money are at stake, it constitutes a common target for tax audits (Levey & Wrappe, 2013).

Multinationals usually have complex business models and geographically extended operations. Any tax audit that is carried out with the main aim of finding additional revenue at any cost will be doubly damaging to the fostering of a healthy relationship between a TA and its taxpayers. Firstly, tax auditors tend to overlook business specificities that could explain the logic of the transactions and prices used, and therefore render assessments unnecessary. Secondly, in a litigation setting, if decisions are taken largely in favor of firms, a feeling of unfairness arises regarding the true purpose of TP audits (Bakker & Levey, 2012).

TP audits require, among other things, access to a wide range of data, the use of selected comparables, risk assessment techniques, financial ratings evaluation, and careful observation of business transactions. The selection of a business to audit is usually made on the basis of some indicators, e.g., net profit or operating margins (Martins, 2017).

There are several instances in which TP law is unclear or did not foresee certain circumstances under which different interpretations may arise. In TP auditing, the need to interpret concepts such as "comparable", "adequate margin", or "similar economic circumstances" often arises. The complexity of TP rules and their execution has led some authors to argue that the whole TP system should be redesigned (Wilson-Rogers & Pinto, 2015).

3. METHODOLOGY

This paper is based on a blend of the case study method (R. Yin, 2018) and the legal research approach, the latter of which adopts the evaluative perspective highlighted by Van Hoecke (2011). The case study is an established research tool. In the tax field, case studies have been used by researchers such as Marriott (2017) and Tjen and Evans (2017). In this paper, we discuss the performance of the Portuguese TA in TP arbitration court cases between 2012 and 2020, and use this information to provide recommendations in order to enhance the TA's litigation success rate.

Case studies like the one presented in this paper highlight lessons learned from observation and can be used by public actors, such as TAs, to inform strategic and operational changes. Given TP litigation outcomes around the world, this case study provides insight into court outcomes in TP-related cases.

The legal research method can be used in different contexts when applied to TP rulings. A comparative angle is utilized when studying different country's rules and how they are applied. An interpretative view is employed when courts must apply TP rules to specific cases in order to deal with interpretation complexities (policy recommendations may follow as a result of this analysis). An evaluative perspective can also be used to check whether rules produce efficient economic and social outcomes.

In this paper, given the interpretative margin that TP regulations present, we use arbitration court cases and their specifics, as analyzed in section 4, to substantiate a proposal for a change in TA audit practices in order to obtain more favorable court outcomes. Thus, the empirical side of our legal analysis is related to concrete TP cases that present common traits. These traits inform our policy recommendations, and we use the Portuguese TA as an institutional case study and the TP court cases as raw data.

It is well known that TP requires lengthy rules and regulations given the complexity of the operations of multinational companies. The TA is bound by the legality principle, which

requires a legal basis for audit assessments. The OECD's guidelines (OECD, 2022) are the backbone of TP tax treatments and its base erosion and profit shifting (BEPS) report puts considerable emphasis on the topic (OECD, 2013).

Even if TP regulations are regularly revised and improved, their implementation by tax auditors is a crucial test of their usefulness. If litigation often follows, and the TA loses the majority of the cases, an appraisal of the impact of the legal framework for audit strategies is called for, as is rethinking the existing paradigm (Wilson-Rogers & Pinto, 2015).

4. PORTUGUESE TP LITIGATION: TAX RULES AND THE ROLE OF THE ARBITRATION COURTS

4.1. A Note on Tax Arbitration

Before 2011, the taxpayers and the TA were obliged to litigate in the judicial courts. However, the conditions that prevailed in state judicial courts, with overextended timelines for reaching a decision, called for the use of alternative mechanisms.

Law Decree 10/2011 of 20th January 2011 provided an alternative option for tax dispute resolution: the CAAD. In most cases, the taxpayer can now decide to use either the judicial tax courts or the CAAD, with the Portuguese TA being forced to accept their choice (Article 4 of Law Decree 10/2011).

In Portugal, there are three levels of judicial tax courts: first level courts, appeal courts, and the supreme tax court. There is no publicly available data for the cases decided in the first level courts. These courts receive and decide the majority of cases. Therefore, it is not possible to examine differences between cases taken to the judicial and the arbitration courts. Nonetheless, two additional observations can be ventured.

Firstly, a petitioner is more likely to choose to take their case to an arbitration court when they want a faster resolution mechanism, as arbitration courts have six months to make a decision—with extensions available of up to one year (Article 21 of Law Decree 10/2011—while a case heard by a first level judicial court could easily take years to resolve.

Secondly, if a TP case focuses on legal interpretation but also has a strong accounting, financial, or statistical angle, an arbitration court will probably be chosen. This is because judges in judicial courts are only legally trained persons. CAAD arbiters can be economists, managers, or chartered public accountants (Article 7 of Law Decree 10/2011). The diverse composition of arbitration courts can, therefore, be a determining factor in the submission of more complex TP cases.

In comparison with the judicial tax courts, arbitration courts must also decide cases in strict accordance with tax law, and they face fewer limitations in terms of claim values and fewer appeal possibilities (de Sousa da Câmara, 2015). In addition, the procedural steps taken within arbitration courts are less formal than those taken in judicial tax courts, and information technology is extensively used for the provision of documental proof and for witness hearings (de Sousa da Câmara, 2015).

Given the backlog in the judicial courts, there is ample room for tax arbitration courts in Portugal. As TP cases often arise in multinational companies, a significant number of these cases are being brought before arbitration courts.

4.2. TP Rules, Litigation Principles, and the TA's Organization

We begin by noting that the Mutual Agreement Procedure (MAP) is not commonly used to reduce TP litigation in Portugal. In fact, in our sample, there is not a single case in which the MAP was used before the taxpayer challenged the tax adjustment in an arbitration court.

This is not to say that the MAP is never used. Based on field experience, it is mostly used in cases where a taxpayer located in a foreign country wishes to challenge a TP adjustment related to transactions with a Portuguese affiliated entity with the TA. If, for example, the foreign entity sells products to the Portuguese affiliate for €100, and the foreign TA adjusts to €110, then the Portuguese entity initiates a MAP with the local TA in order to reduce the taxable base (by increasing the purchasing costs) in Portugal. A correlative adjustment may follow.

Why is the MAP rarely used when the Portuguese TA makes a TP adjustment?

Firstly, because two different ways of administrative appellation are open (and usually followed): the right to be heard (Article 60 of the General Tax Law[6]) and, if this fails, the hierarchical appellation (Article 80 of the General Tax Law). The first one happens when the taxpayer receives the first version of a tax audit report. The taxpayer may submit a rebuttal of the report's conclusions to the tax auditor. If this is not successful, the taxpayer may submit a formal rebuttal to the highest-ranking officer of the Portuguese TA. The success rate of taxpayers based on these two procedures is very low. When a tax auditor finds a TP adjustment, it is not easy to find, within in the higher levels of TA staff, someone who will contradict the adjustment.

Moreover, Portuguese tax law does not mandate the use of the MAP before litigation (in the judicial or arbitration courts). Therefore, and taking into consideration the fact that the Portuguese tax litigation is merely a nullifying process (if the court finds a flaw in the TA audit, the adjustment is totally nullified), there is an incentive to litigate. If the taxpayer prevails, there is no need to enter a MAP, because the total amount of the previous TP adjustment is disallowed.

The incentive to litigate is greater (and firms' propensity to enter a MAP is accordingly lower) the lower the TA's success rate in TP cases. That is why, in our view, recommendations to the TA—potentially increasing its success rate—may be a factor in using the MAP more frequently.

The use of the MAP implies that the taxpayer wants to discuss potential "middle ground solutions" (for example, that a margin of 3% was corrected by a tax audit to 6% and the firm is open to accept 4.5%). However, by litigating *in the first place*, the whole adjustment may be invalidated and the MAP rendered unnecessary.

The legal basis of the TP regime in Portugal is Article 63 of the Corporate Income Tax Code (CITC) and Regulation 1446-C/2001. These legal rules closely follow the OECD guidelines

[6] Law Decree 398/98 of 17th December 1998.

on TP (OECD, 2022). Article 63 of the CITC establishes the arm's length principle, the situations in which a related party does exist, and the methods used in TP, as well as the reporting obligations that entities with related party transactions must submit to the TA. Regulation 1446-C addresses core issues like comparability, assets, functions, and risks; presents a more detailed characterization of TP methods; and deals with advance price and cost sharing agreements. These sources expressly state that the OECD's guidelines (OECD, 2022) should be referred to when legislation requires interpretative work.

The most common source of litigation is the implementation of TP methods. The comparability principle is often subject to litigation when CMP is used. The net margin method can generate a range of outcomes, depending on factors such as the appropriate arm's length range, the point of the range to adopt (e.g., first quartile, median, or mean), the existence of outliers, and the accounting nature of the profit level indicator.

As previously mentioned, in Portugal, tax litigation in judicial and arbitration courts operates under the so-called *mere nullification principle*. There is typically an "all or nothing" outcome. This means that when the TA conducts an audit and adjusts (increases) the tax base, and the taxpayer challenges the adjustment, if the legal basis upon which the adjustment was made is found to be inadequate or wrongfully applied, the whole amount of the adjustment is disallowed by the court. In fact, under the constitutional principle of the separation of powers, judicial bodies control the legality of government activities. In this context, court decisions assess whether the TA acted in accordance with the legal rules in force; courts cannot replace the executive power, adjusting the tax base (Vieira de Andrade, 2014).

To exemplify, suppose that an audit involving a TP case increases the tax base by €10 million through the application of the CUP method. Let us also assume that the taxpayer used the net margin method and found that no adjustment was called for. If the court finds that the tax audit misapplied the CUP (for example, by using an unacceptable comparable), the whole adjustment of €10 million is disallowed. In another hypothetical case, if by using the net margin method, the taxpayer adjusted their profit level indicator to the first quartile of the range and the tax audit adjusts it to the median, if the court finds that the choice of the median does not have a sound legal basis, the whole tax adjustment made by the TA is cancelled. The court has no obligation to decide on any alternative quantification.

Thus, in this paper, when the taxpayer prevails, it means that the whole amount of the tax adjustment resulting from a tax audit is nullified. When the TA prevails, the court finds that the tax audit meets all legal requirements and is well grounded, and the whole amount stands up to court scrutiny.

The Portuguese TA has a central department that deals with litigation (in the judicial and the arbitration courts). Usually, if a taxpayer challenges a tax audit, the basic working materials for the TA's legal staff are the audit report and the filed petition. In TP, the tax examiner (who usually has an accounting or a financial management background) may be called upon by the department's staff to assist in more complex issues, such as financial valuation, accounting standards concerns, or statistical matters (Article 3 of the Tax Auditing Procedure).[7]

Additionally, the TA (defendant) may designate the tax examiner as a witness. This is understandable, because corporations often designate their chief executive officers, chief

[7] Law Decree 413/98, of 31st December 1998.

financial officers, marketing staff, and even external experts from consulting firms that were involved in TP reports as witnesses.

From our experience, a more intense cooperation between these two sides of the TA would probably strengthen its position in courts. Often, even where legal staff are experienced in interpreting the TP rules, they are not fully trained in relevant subjects, such as financial and management accounting, intangible asset valuation, rating and its interest rate impact, and discounted cash flow models.

4.3. Main Reasons to Pursue Litigation and Trends in Court Rulings

According to Correia and Martins (2018), a total of 32 arbitration court cases heard between 2012 and 2017 dealt with TP. The TA won three of these. The total monetary amount related to the cases that the TA won represents 14% of the total litigated value.

Overall, when we consider the data from 2012 to 2017 as well as the cases exhibited in Table 1 (below), it is arguable that, in terms of cases won, the Portuguese TA's success rate is quite low. Even in monetary terms, when considering both periods (almost one decade), the TA did not perform well in arbitration courts as far as TP litigation is concerned. Thus, we believe that it is important for the TA to take strategic and operating measures to improve its success rate.

Comparability issues and TP methods are common reasons for disallowing audit assessments (Martins et al., 2020). Table 1, which relates to the period 2018-2020, shows that the results remained quite unfavorable to the TA. The total amount in dispute in the period was €8,166,915.61. The TA won four cases, which accounted for about 44% of the total litigated amount, excluding the amount involved in the mixed decision. However, Table 1 reveals that a single case (808/2019-T; more than €2 million) heavily influences the percentage of the monetary rate of success for the TA.

As shown in the literature review, the practical application of the comparability concept, and the economic and accounting issues that arise when selecting TP methods are complex areas. When audits are carried out with the overarching purposes of finding additional revenue, they may overlook some details in respect of the application of TP regulations. In court, this is a basis for an unsuccessful position. Thus, the international trend previously documented is also observed in Portugal.

In light of the TP litigation outcomes for the Portuguese TA, the next section analyses a sample of lawsuits. This paper could hardly accommodate a full analysis of all TP cases judged by the arbitral court between 2012 and 2020. Therefore, six cases were selected, based on our judgement rather than at random, as required by the case methodology described in section 3. For this purpose, we established three criteria: the inclusion of foreign companies; the diversity of arguments held by both parties; and the range of issues under discussion (cash pooling agreement[8], investment management fees, loans, intangibles, distribution services, and sales of goods).

[8] This means a system of centralized cash management. A number of companies combine their cash balances to save costs.

Table 1: Arbitration rulings in TP cases in Portugal (2018-2020)

Case	Amount (€)	Decision
828/2019-T	142,406.09	Taxpayer
808/2019-T	2,090,550.08	TA
473/2019-T	87,252.40	TA
385/2019-T	209,751.61	Taxpayer
381/2019-T	822,955.85	Taxpayer
360/2019-T	32,762.70	Taxpayer
253/2019-T	5,131.79	Taxpayer
196/2019-T	125,808.93	Taxpayer
106/2019-T	377,951.46	Taxpayer
524/2018-T	267,879.70	Mixed
511/2018-T	740,185.08	TA
384/2018-T	815,763.96	Taxpayer
359/2018-T	288,053.57	Taxpayer
337/2018-T	720,866.70	Taxpayer
336/2018-T	157,851.72	Taxpayer
274/2018-T	569,310.40	TA
216/2018-T	182,248.27	Taxpayer
162/2018-T	110,257.82	Taxpayer
161/2018-T	287,822.98	Taxpayer
70/2018-T	132,104.50	Taxpayer

Source: CAAD (n.d.)

4.4. An Applied View of Approaches Taken by Litigants and Courts to TP Cases: A Case Study

Six decisions are now analyzed in order to find similarities in court reasonings that can be used as a basis for proposed changes to tax audits.

The first case (55/2012-T) relates to cash pooling. A German parent company and a Portuguese subsidiary (the petitioner) entered into a cash pooling agreement with a financial institution. Given the related party context, the TA claimed that the liquidity surpluses of the Portuguese company, which were deposited into that bank on a daily basis, increased the guarantee effect for the parent company and reduced the interest rate paid on loans. Consequently, the Portuguese company's deposits should be channeled into the cash pooling remunerated in normal market conditions. The TA's audit report sustained that, based on the CUP method, an interest rate agreed between independent entities under comparable circumstances should be applied to this relationship. For this purpose, the TA identified an independent financial institution that offered higher remuneration to the petitioner and introduced a positive adjustment to its taxable income.

The claimant considered this adjustment to be poorly justified considering the methodology used to quantify the additional taxable income. It also argued that, given the special nature of the cash pooling, no comparable situation was found between independent entities, and the CUP was not applicable. Accordingly, only the profit split method would be suitable for this situation. The court concluded that the demanding and strict requirements of the CUP method were not followed by the TA.

When considering the specific conditions of the cash pool agreement, we can see that the audit report fails to reasonably justify the method employed and the comparable price used by the TA, therefore compromising the legality of the assessment. The adjustment to taxable income made by the tax audit (€6,403,689.43) was denied. A flawed use of the comparability principle was at the root of the court's view.

The second case (716/2014-T) relates to investment management fees. The petitioner provided investment management services to an offshore entity. These services were charged at a fixed price on a quarterly basis. A related party relationship was legally existent, leading to the application of the TP rules.

Following the CUP method, the tax audit looked into prices negotiated in presumably comparable transactions between autonomous entities. The TA argued that the fees should be established depending on the value of the assets managed and, for an independent financial institution (bank), it identified that a 0.5% fee should be applied to the average monthly value of the assets under management. This analysis supported significant adjustments being made to the petitioner's taxable income (€1,506,922.16 in 2010 and €1,574,925.47 in 2011).

The petitioner argued that the identified comparable was inadequate. The contractual relationship did not involve a bank and the nature of the service was subcontracting, not a primary contract between a client and a bank with the latter acting as a portfolio manager.

The court did not accept the TA's position, since the comparability analysis was not correctly conducted. Indeed, the agreement established with the offshore company consisted of an investment management firm subcontracting between non-banking financial operators.

Conversely, the comparable selected by the TA was a customer investment management contract with a bank. Once again, the practical use of the comparability principle in tax auditing was considered inadequate by the court.

Case 687/2016-T concerns a loan made by a Dutch parent company to its Portuguese affiliate. The loan (€50 million), which was disbursed in 2013, was payable within 10 years. The annual interest rate charged was 13%. This rate included 8% for country-specific risk, given that Portugal, at the time, was being bailed out by the International Monetary Fund, the European Central Bank, and the European Commission in the wake of the 2008 financial crisis.

The tax audit argued that the CUP method should be used and found that a rate of 5.2% should apply (the arm's length average rate applied by Portuguese banks on loans of above one million euros, when the loan's life was in excess of one year). Additionally, the tax audit mentioned that the financial soundness of the parent company had the consequence of providing implicit support when the affiliate asked for loans to independent entities, therefore enabling them to obtain an interest rate of less than 13%.

The tax court denied the validity of the tax audit report. Firstly, it stated that the 5.2% interest rate found to be comparable did not take variables like the affiliate's rating as a standalone entity into consideration. Secondly, the amount and life of the loan were not comparable to the benchmark used in the audit report. Thirdly, the tax report did not analyze country and sector risks and, therefore, failed to produce the broad economic analysis that the CUP method requires and that is established in the Portuguese TP regulations. Given the flaws in the implementation of the comparability principle, the court ruled in favor of the petitioner.

In case 216/2018-T, a French parent company had stakes in three Portuguese firms: a steel producer (A) and two distributors (B and C). When A implemented a new commercial strategy, the previous distributor (B) was replaced by a new one (C). The Portuguese TA audited B and sustained that B's intangibles (e.g., customer portfolio, trade know-how etc.) were made available to C. As the operation happened between related parties, TP rules were applied. A tax adjustment was made, given that no revenue was recorded by B when the new strategy was implemented.

Litigation followed, because the group sustained that the previous distributor did not hold any intangible assets, there were no comparable operations between independent entities upon which to base an arm's length comparability analysis, and tax auditors applied the wrong financial model when calculating the hypothetical price.

The petitioner also argued that there was a formal defect in the lack of reasoning regarding the methodology used to quantify the taxable adjustment. The tax audit report refers to the CUP method, but the auditors did not use such a method and did not identify a comparable operation. The audit did not show the comparable operation or the comparable price on which the TP adjustment had been based. Instead, the tax auditors quantified the profit lost by B based on its financial statements. That is an ex ante and ex post analysis. The court sided with the petitioner, agreeing that neither internal nor external comparable prices had been used. Thus, it ruled for the petitioner based on the erroneous application of the comparability principle.

Case 106/2019-T involved a limited risk distribution (LRD) activity. The claimant also provided procurement services to the businesses held by the parent company. Within this context, the claimant executed several purchase orders on behalf of a related company,

assuming a mere agent role. The TA alleged that these prices were not the normal market prices between unrelated parties.

The comparable operations used by the TA were the sale and supply of goods between independent companies, neglecting the fact that the specific relationship between the claimant and the related company was supported by a mandatory contract, as provided by the Civil Code. Additionally, the TA applied a 5% net margin to the purchase orders on the basis that soft law—the OECD's guidelines (OECD, 2010)—allows it to choose a margin between 3% and 10%. According to the TA, the OECD guidelines (OECD, 2010) allow for it to dispense with the need to search the market for a comparable competitive margin.

The court ruled in favor of the claimant, arguing that the comparables were not suitable in this case for several reasons. Firstly, a mandatory contract is distinct from an ordinary sale and supply operation. Secondly, although the court recognized that the OECD's guidelines (OECD, 2010) have a major influence on Portuguese legislation, it argued that the two do not overlap. They form a valuable interpretative element that should be carefully adapted in cases where internal law contains different solutions. The OECD guidelines (OECD, 2010) were wrongly applied by the TA, because the TP legal regime in Portugal does not allow for a margin observed in a similar operation to be replaced by a specific value within a given range.

The last case (609/2015-T) concerns the sale of goods and the result was in favor of the TA. The petitioner sold goods to a foreign related company. In the TP file, the net margin method was used to justify the arm's length nature of the transactions. According to the TA, the indicator used by the petitioner did not follow the arm's length principle, although the TA agreed with their use of the net margin method and the selection of the sample (17 companies) to build a range for the net operating margin (-2.19% to 9.48%).

The issue under dispute concerned the application of a net operating margin of 2.91%. The petitioner argued that this net margin respected the full competition principle, because it was included in the range established in the Portuguese TP legislation.

The tax audit included a thorough analysis of the functions, assets, and risks borne by the petitioner and concluded that the petitioner was responsible for much more than a productive function. In fact, purchases, sales management, and financing risk were also in the petitioner's remit.

Therefore, the only point in the range that is appropriate for the TA is the one that economically represents the relationship between functions, assets and risks, and the rate of return. It is not enough to choose any operating margin included in the range and a more accurate analysis should be performed in order to comply with the comparability principle.

The court decided in favor of the TA, mainly quoting OECD recommendations. Briefly, the court sustained that the selection of a value within the range, capturing the specific circumstances of the case, would reflect a more realistic market relationship. Furthermore, the TA performed a strict analysis of the activities carried out by each entity and the risks involved, concluding that a 2.91% margin did not reflect the specific conditions of the operation. Having considered the characteristics of the goods, the contractual terms, the industrial and commercial strategies, and the functions performed, among other conditions, a margin of 5.76%, representing the median of the range, was found to be more appropriate by the TA, and the

court agreed with this. In this case, it is quite clear that the production of a carefully substantiated audit report put the TA in a better position.

5. A PROPOSAL FOR IMPROVING THE PORTUGUESE TA'S STANDING IN TP LITIGATION

The overall success rate of the Portuguese TA, both in the judicial courts and in the CAAD, is around 40%, well above the rate found in the sample of TP cases used in this study.[9] In light of what has been shown about TP-related tax litigation, this section submits proposals for improving the TA's standing in such cases.

In recent years, the TA has hired and trained staff who specialize in the TP area, and has sought inspiration from international audit best practices. However, we believe that what follows will be useful from the perspective of an entity, such as the TA, whose task is indisputably difficult. TP's undeniable legal, economic, and accounting complexity helps to explain the low litigation success rates of TAs globally. Nonetheless, if TAs chose certain strategic and procedural options when conducting tax audits, it could have a significant impact on litigation outcomes.

5.1. The External Context Faced by the TA and its Impact on TP Audit Control

As shown in Table 2, between 2012 and 2020, Portugal's total public revenue ranged from 42.4% to 4.9% of its gross domestic product (GDP). The TA does not intervene in the collection and monitoring of the entire revenue but, given the size of the state revenue (comparable to the European Economic Area), the role that it plays is quite demanding.

Table 2: Portuguese Public Finance (2012-2020) as a Percentage of GDP

Variable/Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Total public revenue	42.7	44.9	44.4	43.8	42.9	42.4	42.9	42.6	42.8
Total public spending	48.9	49.9	51.7	48.2	44.8	45.4	43.2	42.5	48.4
Deficit	-6.2	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.7
Public debt	129	131.4	132.9	131.2	131.5	126.1	121.5	116.8	133.6

Source: INE/BP/PORDATA[10]

The pressure to reduce the Portuguese public deficit, and the public debt, implies that there are growing demands from tax policymakers in relation to the TA's strategic and daily operations. The use of more resources, the efficient management of existing ones, and regular negotiations

[9] See OECD (2017) for state judicial courts and https://www.caad.org.pt/ (communication area) for arbitration courts.

[10] See https://www.pordata.pt/Portugal/Administra%c3%a7%c3%b5es+P%c3%bablicas+despesas++receitas+e+d%c3%a9fice+excedente+em+percentagem+do+PIB-2788 (2021.03.26) and https://www.pordata.pt/Portugal/Administra%c3%a7%c3%b5es+P%c3%bablicas+d%c3%advida+bruta+em+percentagem+do+PIB-2786 (2021.03.26)

with political leaders, in the context of a strong requirement for fiscal revenue, are important strategic issues.

The demand for tax adjustments, and the increased use of metrics that evaluate performance based on audit and additional assessed revenue, comprise a worldwide trend in tax administration (Serra, 2005).

In addition, as stated by the OECD (2017),

> the challenge of efficient and effective tax administration is not only to raise the revenue needed to fund public services - and increasingly to provide some of those services - but also to minimize burdens on taxpayers. Maintaining trust in the efficient operation and fairness of the tax system is key to its sustainability. (p. 5)

In other words, TAs around the world face multiple challenges when seeking to control taxpayers effectively while carrying out work that is perceived to be equitable and productive. The recent legislative impact of the BEPS project has given greater visibility to TP control, enhancing the role played by global TAs in this area.

The use of TP as an evasive mechanism at the global level has often been the subject of analysis (Chand, 2016; OECD, 2013). Table 3 shows that, in Portugal, between 2012 and 2019, the total number of annual corporate tax returns received increased from 421,430 to 510,158. In the same period, the number of entities opting to be assessed under the special regime of group taxation (with the advantage of offsetting profits with losses in the same tax year) also increased from 3,495 to 4,637. We do not have the data showing how many individual companies were included in groups but if, hypothetically, each group contains an average of five entities, more than 20,000 resident firms would have been assessed under this regime in 2019. This is important, given the number of TP corporate (self) tax adjustments that occurred, as shown in the table.

Table 3 also reveals that the full amount of tax adjustments increasing taxable profit (e.g., provisions, depreciations, impairments, and other accounting expenses that are not tax deductible) fluctuated between €33.3 billion (2012) and €52.4 billion (2014). The last two lines of the table show that TP corporate (self) adjustments were negligible, considering the universe of taxpayers potentially involved in intra-group transactions. In 2019, up to 23 companies adjusted their taxable profit by their own initiative, applying TP tax rules.

In terms of the value, the only year in which there was a significant amount was 2015 (€179 million). Even then, TP self-adjustments accounted for only 0.47% of the total corporate tax adjustments. This may be as a result of companies believing that they had applied fully-fledged prices and there would be no adjustments to be made under TP rules. However, this could cause a TA to engage in intense activity, conducting, for example, audits and internal checks.

What does this data mean for the central thesis of this paper? Given that the Portuguese TA is under pressure to find additional revenue, and in view of the self-declared TP adjustments taking place, it is to be expected that TP tax audits will become more intense. This will probably result in more court cases taking place, because groups have the expertise and the financial means to litigate.

TP litigation cases reinforce the idea that there is much scope for TP tax audit. If this is a foreseeable scenario, it is of paramount importance that TAs prepare their audit reports carefully in order to buttress their court standings.

Table 3: Annual Corporate Tax Returns in Portugal Showing TP Corrections (2012-2019)

Variable/Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Total number of tax returns	421,430	424,913	421,737	452,683	464,780	475,119	492,935	510,158
Total number of group tax returns	3,495	3,516	3,902	4,101	4,188	4,385	4,506	4,637
Total amount of (self) corporate adjustments favorable to tax authorities (million euros)	33,350	33,606	52,441	37,782	41,148	36,083	38,973	37,269
Number of tax returns with TP corporate (self) adjustments	28	22	20	26	30	32	24	23
Amount of corporate (self) adjustments (million euros)	29	2	2	179	7	5	4	11

Source: Portuguese TA[11]

The improvement of the TA's success rate in TP litigation will not have a big impact on global tax inflows. However, other factors relating to public finance contribute to the argument that the TA should increase its efforts in order to attain a better performance in TP-related court cases.

Firstly, and as previously shown, only a tiny fraction of Portuguese corporations that belong to groups and are involved in related party transactions declare self-adjustments in their corporate

[11] See http://info.portaldasfinancas.gov.pt/pt/dgci/divulgacao/estatisticas/Pages/default.aspx

tax returns. There are many as yet unexplored audit opportunities that, if audited to a satisfactory quality, will generate significant amounts of additional tax receipts. Given the weak state of public finances, this is not an issue to be overlooked.

Secondly, even when corporations declare self-adjustments, if the TA is equipped with good databases and well-trained staff, and follows some sound recommendations when planning and executing TP audits, the final outcome can be more satisfactory to the public finances. Suppose a company uses the net margin method and produces an adjustment of €3 million. The TA consistently challenges the margin, increases the taxable income to €6 million, and the audit is sustained in court. Such an outcome may cause taxpayers to believe that tax auditors are adequately prepared and may take a closer view of other complex areas of corporate taxation, such as exit taxation, or mergers and acquisitions, where important amounts of tax receipts may be at stake.

In this general TP environment, what major potential actions can be highlighted in order to improve the TA's legal standing?

5.2. Audit Planning

A procedure that greatly affects the result of a tax audit is the careful selection of targets. Planning procedures aimed at efficient audit targeting should result in the TA choosing targets whose audits are most likely to result in upward adjustments.

According to the OECD (2017), the ability to analyze an increasingly large volume of taxpayer-reported information is a requirement for ensuring TA efficiency. TA management practices should focus heavily on data collection and analysis in order to originate better targeted audits.

In this context, the assessment of tax returns and TP reports (to analyze the reasonableness of the results and margins) as well as TP files constitutes a major step toward the overall preparation of a tax audit report. In this assessment, the following topics are of special interest:

i) A detailed description of business transactions between related parties.

ii) The economic and financial strategies underlying certain operations and their business rationality. To take a hypothetical example, in the relationship between a parent company located in Portugal and a subsidiary based in Slovakia, prices that differ from those of comparable independent entities can be charged, with the justification that the participating company is supporting the strategy of market entrance by the subsidiary. The economic and financial appraisal of such motives, and their full documentation, should be subject to detailed evaluation.

iii) The analysis of the chosen TP method and why it was selected. For example, asserting in a TP file that the CUP method cannot be used (because operations with independent entities are not comparable in terms of distribution channels, payment terms, and technical specifications) calls for a detailed review by the tax auditor. This is rarely consistent with very strict (and tight) auditing deadlines, and the pressure exerted on auditors to find substantiated TP adjustments within a few weeks.

iv) The analysis of the criteria used to choose comparable entities or operations, as well as the justification for the choice of certain indicators (e.g., operating margins) as benchmarks.

v) If the entity has made adjustments, an assessment of whether the legal and statistical basis are appropriate.

vi) Whether the paper proof attached to the TP file is of good quality in terms of documenting transactions, legal obligations, prices, and financial arrangements.

The TA's performance depends on it having a similar level of business knowledge to corporations. If a taxpayer uses an international database when selecting a comparable sample of firms, the TA will be in a complex position when validating such information. Any counterargument in an audit report (or even in litigation) will be more complete if the source of information is comparable.

The additional investment that the TA can make in the continuous development of a model report on TP matters, which includes mandatory aspects to be analyzed and documented, may be very effective in TP litigation. By producing audit reports that are substantiated, carefully reasoned, and based on solid evidence, the TA can improve its chances of success in courts. Quite often, pressure to make a major monetary tax adjustment in order to fulfill assessment targets clouds the reasoning of TA staff, who regard their mission to have been accomplished if an additional (even if superficially detailed) assessment is found. Given the number and complex nature of legal, economic, accounting, and business issues that may emerge in TP litigation, this is an approach that bodes ill for court success.

5.3. The Audit Phase: Some Aspects to Emphasize

The duration of an audit is a variable that influences the depth of the analysis and the quality of the evidence presented in TP assessments. The central question of comparability of operations implies, first of all, a clear understanding of the type of transactions and the specifics they may present. Given the complexity of many intra-group operations, their full apprehension is not easily accomplished through superficial analysis and succinct audit reports. Interaction with the audited entity's managers is essential if the nature of the business and the importance of intra-group transactions are to be understood. Their explanations must be carefully scrutinized and not lightly dismissed in order to produce additional revenue assessments (Bradley, 2015).

For example, in an automobile group, controlling certain TP-related transactions requires a prior study of TP's multiple aspects. There are issues related to technology, markets, business strategies, financing sources, pricing, and many other matters, which influence the value of transactions. If a TP audit overlooks some of these factors, the company's lawyers will usually stress the negligible treatment of core issues. In some cases, this is an attempt to underestimate tax auditors' findings. However, in other situations, such incomplete and superficial analysis may actually have been observed and will weaken the TA's standing in the courts.

In addition, during the audit phase, the comparison between the economic, legal, and accounting characteristics of the transactions and the content of the TP file presented by firms is very important. In order to accept or reject the approach taken by the audited entity in its TP file, the TA must conduct a substantial study of, and appreciate, the economic rationale of the transactions under review.

Suppose that an entity in the furniture industry uses the net margin method in its TP file, because it believes that there is insufficient comparability to use the CUP method. If tax

auditors challenge such an approach and conclude that the CUP is the appropriate method, a critical, well-grounded assessment of the approach taken by the entity is required. The burden of proof is then on the TA to disallow the method selected by the taxpayer.

In the event of a dispute, if reasonable doubt arises about the TA's procedures, the court decision is likely to be in favor of the taxpayer. Since the comparability factors are listed in TP tax rules, it is sometimes enough for companies' lawyers to show that one of these factors was neglected by tax auditors, and an entire argumentative effort, which may be solidly described in the TA audit, is nullified by the court.

Intra-group financial transactions also deserve reflection—in particular, the determination of the debtor's rating, the explicit versus implicit support from the parent company, the consideration of the country's risk, and the calculation of the spreads used in determining the interest rates considered to be at arm's length (Bakker & Levey, 2012).

The TA's middle managers, and even its senior directors, play important roles in the process. It is not uncommon for a senior auditor, or a person with experience in the subject, to detect gaps in TP audit reports that, if uncorrected, would considerably reduce the TA's success rate in the event of litigation. The implementation of continuous technical filters may reduce the number of TP cases that come to the courts in which the TA is in a fragile position, especially in respect of issues relating to comparability or methods used.

There are additional reasons for interactions between the various operational levels of the TA to intensify. This is an area in which there is increasing economic, accounting, legal and even statistical sophistication (Bradley, 2015; Martins, 2017). Imagine a case in which the net margin method was used. It is assumed that the sample encompasses ten companies and that one of them has a negative operating margin of -8%. Is this company an outlier and should it be removed from the sample, using the median, the interquartile range, or the lowest value of the sample?

Such discussion includes the definition of outliers in small samples, via several methods, leading to different results (Rousseeuw & Verboven, 2002). The opinion of expert witnesses may prove to be important in court. The TA should be open to this possibility and gather the resources required to follow such a strategy.

Finally, mention should be made of the desirable increase in the dissemination by regional and local TA structures of good audit and litigation practices. If, for example, in a given local TA office, there is a well-grounded audit report that has been proven to be robust in litigation, the dissemination of the methods and procedures used to produce it will be useful. Of course, in TP every case is a case. Nonetheless, disseminating good examples of TA increases the quality of audit reports, hence reducing the likelihood of both litigation and of unfavorable legal decisions.

Instead of making frequent adjustments in TP, it may be preferable for the Portuguese TA to proceed only with those that, in the balanced judgment of the different members of the TA, are well-grounded. There is already a small body of cases in which the courts (judicial and arbitration) have accepted the TA's position. In such cases, the comprehensiveness and consistency of the audit reports (and, indeed, the preparation of the inspection actions) may be used as benchmarks when conducting research on TAs in this complex and uncertain subject area.

6. CONCLUSION

The Portuguese TA faces a complex and difficult situation when participating in TP auditing and litigation. The implementation of TP rules is a complicated process and multinationals are prone to litigating. Firms also have the economic and legal resources to seek court decisions on additional audit revenue assessments.

It is true that the Portuguese TA has sought to modernize its performance, in terms of setting strategic goals and quantifiable objectives, making important investments in information technology, hiring new and specialized staff, and providing staff members with training in respect of auditing practices. However, it can also be observed that the pressure placed on auditors to fulfill revenue assessment targets, senior staff resistance to filtering weak audit reports for fear of being regarded as "taxpayer friendly", and the deficient planning of litigation procedures have been producing a string of court rulings that are unfavorable to the Portuguese TA.

Policy suggestions for the management of international TAs focus on modifying performance metrics (as prioritizing additional revenue may produce skewed audits), carefully planning TP audits, enhancing intervention by senior staff in order to filter unsubstantiated reports, and disseminating best practices in audit and litigation procedures.

A limitation of this study is that it focuses only on arbitration courts, ignoring judicial court decisions about TP-related cases. Future research could appraise TP litigation outcomes and assess whether or not the Portuguese TA will adopt some of the changes proposed here with the aim of minimizing its losing streak in this area.

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THE IMPACT OF PRESUMPTIVE TAX ON HOUSEHOLD INCOME DISTRIBUTION AND POVERTY ALLEVIATION IN TANZANIA: TAZMOD APPLICATION

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Abstract

The government of the United Republic of Tanzania (URT) has managed to improve domestic revenue mobilization in recent years in order to increase tax revenues in comparison to GDP. This increase also affects presumptive tax positively. This paper analyzes the impacts of social benefit policy reforms, with a focus on presumptive tax effects on government revenue, household income distribution, and poverty in Tanzania. The study uses a static microsimulation model for Tanzania: TAZMOD v2.4. TAZMOD is based on EUROMOD software, and concepts and variables are implemented in a similar way to those used in the SOUTHMOD project. The simulation model was based on amending the upper presumptive tax policy turnover threshold from TSh100,000,000 to TSh50,000,001 (a 50% decrease) and imposing a 7% marginal rate. The sources of the data are the Tanzanian mainland's 2011/2012 and 2017/2018 household budget surveys. The results reveal that the reforms would have a positive effect on presumptive tax on government tax revenue, household income distribution, and poverty. Likewise, the findings reveal a significant relationship between presumptive tax and the reduction of household poverty.

Keywords: Presumptive Tax, Microsimulation, Poverty, Tax-Benefit Reforms.

1. INTRODUCTION

Taxation policies are used by the government to mobilize resources for development, but they have an impact on income distribution. It is in the interests of researchers to understand how taxation policies affect income distribution and the reduction of poverty among different segments of the population in the economy. Micro-simulation models, such as EUROMOD, were developed to simulate taxation policy outcomes for European countries. However, due to their flexibility in terms of functionalities, these have been modified so that they can be used in other countries. According to information provided in Leyaro et al.'s (2019) report:

> SOUTHMOD is a joint project between the United Nations University World Institute for Development Economics Research (UNU-WIDER), the European Union Tax–Benefit Microsimulation Model (EUROMOD) team at the Institute for Social and Economic Research (ISER) at the University of Essex, and Southern African Social Policy Research Insights (SASPRI) in which tax–benefit microsimulation models for selected developing countries are being built. (p. ii)

Leyaro et al. (2019) note that "these models enable researchers and policy analysts to calculate, in a comparable manner, the effects of taxes and benefits on household incomes and work incentives for the population of each country" (p. ii). Their report discusses TAZMOD, the

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SOUTHMOD model developed in respect of Tanzania (Leyaro et al., 2019)[2]. In addition, they state that:

> The TAZMOD model and its documentation in this country report has been prepared within the UNU-WIDER project on 'SOUTHMOD—simulating tax and benefit policies for development', which is part of a larger research project on 'The economics and politics of taxation and social protection'. (Leyaro et al., 2019, p. ii)

They also note that:

> As Tanzania's financial year runs from 1 July to 30 June, it has been decided that TAZMOD's systems for each year should reflect the position as at 1 July in each year, rather than selecting a time point in June. So, for example, TAZMOD's 2015 system refers to the arrangements that were applicable from 1 July 2015. (Leyaro et al., 2019, p. 4)

Like other developing countries, Tanzania is reliant on taxes as a source of revenue (Osoro, 2010). Evidence shows that domestic resource collection in Tanzania has resulted in a significant increase in local government revenues. According to J. Semboja and Msafiri (2022), Tanzania's tax structure is divided into "five major categories of tax revenue, namely income tax, value-added tax (VAT), excise duties, import duties, and others" (p. 1). They note that, "from the tax revenue growth perspective, the performance during 1999/00-2020/21 is considered to be good" (J. Semboja, & Msafiri, 2022, p. 1). Tax collection increased by 2.429 percent (rising from TZS685 billion to TZS17,318 billion) while GDP increased by 1.937 percent (J. Semboja & Msafiri, 2022, p. 1). J. Semboja and Msafiri also note that "the best performer was income tax whose collections rose by 2,773 percent, followed by excise tax by 2, 773 percent and VAT by 2,248 percent. Import duty collection also grew by 1,406 per cent" (p. 1).

They state that "the more appropriate tax revenue performance criterion is to compare the tax revenue collected with the performance of the economy or the respective tax base" (J. Semboja & Msafiri, 2022, p. 2). Their research reveals that "the total tax to GDP ratio rose slowly from 8.9% in 1999/00 to 11.5% in 2008/09 but fluctuated between 10.6% and 12.5 % during 2008/09-2020/21" (J. Semboja & Msafiri, 2022, p. 2). They add that:

> The best performer has been income tax, whose ratio increased from 2.2% in 2000/01 to 5.0% in 2013/14 but declined gradually to 3.8% in 2020/21. VAT, whose ratio rose gradually but consistently from 2.9% in 1999/00 to 4.1% in 2004/5, fluctuated thereafter between 2.9% and 4%. The other tax categories either showed fluctuating or declining performance (J. Semboja & Msafiri, 2022, p. 2)

Similarly, Local Government Authorities (LGAs) set a collection target of TZS687 billion for the year 2017/2018 but were only able to collect 41 percent of that amount (TZS281 billion) (URT, 2020). However, in most cases, tax was collected unwillingly, as armed police officers

[2] SOUTHMOD models are currently available for Ecuador (ECUAMOD), Ethiopia (ETMOD), Ghana (GHAMOD), Mozambique (MOZMOD), Namibia (NAMOD), Vietnam (VNMOD), South Africa (SAMOD), Tanzania (TAZMOD), Uganda (UGAMOD), and Zambia (MicroZAMOD). The models are updated to recent policy systems using national household survey data.

staying at roadblocks were observed assisting local government tax collectors who were collecting taxes (Fjeldstad, 2001).

Presumptive tax is tax that is collected from individuals based on their annual turnover rather than their profit. H. Semboja (2015) states that:

> presumptive income taxation, therefore, seemed to be a very appropriate method of tax administration for a specific relatively low income group of people earning less than TZS20m; especially those in semi-informal firms who do not keep records and do not qualify for VAT registration. (p. 75)

Income taxpayers within this system are not required to prepare and submit audited accounts to the Tanzania Revenue Authority (TRA). However, they may opt not to apply the system, and to prepare audited accounts and pay taxes based on profits instead. Conditions that qualify a taxpayer for inclusion in the presumptive tax system are as follows: the taxpayer must be a resident individual; the annual turnover of their business must not exceed the threshold (TSh100 million); and they must only derive their income for the year from business sources within the URT and not be engaged in any other activities, such as employment or investments (TRA, n.d.).

The term "individual" refers to sole traders and people on salaries who are subject to a progressive individual income tax rate. This rate can vary from 9% to 30%. However, non-resident individuals pay 20%, charged on their total income. The other method of tax administration requires sole traders, by law, to file an income estimate within three months of the start of the accounting year. According to Thuronyi (1996), "the best remedy is to bring inflation under control; when this is not possible, it is often desirable to adjust the tax system to inflation in some manner" (p. 434). Likewise, taxpayers need to complete a tax return even though tax evasion and avoidance are still quite widespread (H. Semboja, 2015). H. Semboja (2015) notes that "Tanzania uses turnover-based presumptive taxation as an effective domestic finance resource policy instrument for reducing SME [small and medium-sized enterprises]'s compliance burden and bringing informal SMEs into the tax net" (p. 87). H. Semboja (2015) also states that "the total presumptive income tax in Tanzania has been very small (about 0.4 percent between 2008/9-2014/15) compared with other forms of income taxes, number of taxable entities and desired tax transformation targets" (p. 73).

The TRA initially designed a presumptive scheme that would only apply to small business individuals who did not maintain sets of business accounts. However, it decided to extend the scheme's application to similar small businesses keeping complete records as a mechanism by which to promote, formalize, or induce the former to emulate the latter. The presumptive tax was designed to serve two functions. Firstly, it was designed to reach those who were not reachable through the formal Personal Income Tax (PIT) and ensure an equitable tax system. Secondly, it aimed to institute in-built attributes in order to motivate operators under the presumptive scheme to graduate into the preferred tax system. When the scheme was introduced in Tanzania, it was meant to cover all taxpayers not registered under the VAT scheme. In July 2004, a dual reform was undertaken to revise the VAT threshold from the annual turnover of TSh20 million to TSh40 million per annum and merge the presumptive income tax and the receipt-based stamp duty schemes (H. Semboja, 2015).

George and Olan'g's (2020) study of Dar es Salaam street vendors reveals "that TRA has set the lowest rate for presumptive income tax (Tshs. 100,000 per annum) payable in four

installments" in order to simplify the registration, formalization and taxpaying processes (p. 3). They note that "this rate applies to businesses with an annual turnover of more than Tshs. 4,000,000 but less than Tshs. 7,000,000" that "do not have complete records" (George & Olan'g, 2020, p. 3)

According to H. Semboja (2015), "the current Tanzanian presumptive income tax is rationalized and/or based on solid sector and fiscal policy foundations" (p. 74). Likewise, H. Semboja (2015) notes, in July 2004, the government of Tanzania, through the Income Tax Act 2004, later amended in 2006, "formalized the presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes" (p. 75; see also George and Olan'g, 2020). H. Semboja (2015) adds that "the rationalization of the presumptive scheme has been in line with the National Small and Medium Enterprise Sector Policy of 2003", noting that "the policy has the objectives of enhancing business registration and simplifying the tax system" (p. 74). According to H. Semboja (2015), the 2003 policy, the first Five Year Development Plans, FYDP I and II (URT, 2016; URT, 2021), and annual budgets "seek to simplify the tax system and introduce tax incentives" for the benefit of SMEs (p. 74).

Mas-Montserrat et al. (2023) state that presumptive tax regimes (also known as simplified tax regimes) simplify the tax compliance process for micro and small businesses. They note that these regimes "aim at encouraging tax compliance and business formalization by reducing tax compliance costs and by levying lower tax rates as compared to the standard system" (Mas-Montserrat et al., 2023, p. 3).

2. METHODOLOGY

2.1. TAZMOD

The study uses a static microsimulation model for Tanzania (TAZMOD) to simulate the effect of indirect tax-benefits on poverty and income distribution. TAZMOD is based on EUROMOD software, and concepts and variables are implemented in a comparable way to the SOUTHMOD modeling conventions in order to provide an overview of EUROMOD's status in European nations (Decoster et al., 2019). TAZMOD collects information about income taxes, social security contributions, turnover taxes, VAT and excise taxes, and other taxes and benefits to the extent that the underlying data permits this. The TAZMOD model uses data from the 2011/2012 and 2017/2018 Tanzanian mainland household budget surveys produced by the National Bureau of Statistics (NBS) (NBS, 2014, 2020), which is based on probabilistic sampling. TAZMOD utilizes data relating to 10,186 households containing a total of 46,593 individuals. Policies were simulated for the years 2012, 2015, 2016, 2017, and 2018 by updating household-level data from the year 2011/2012 (Wright et al., 2019). Consumption was used when calculating and estimating indicators of poverty and income distribution over income, which is underreported in the household budget surveys, and this can affect the interpretations. Additionally, in Tanzania's economy, household consumption is viewed as a better measure of poverty than income. The scale of this study is consistent with similar poverty and income distribution-related studies conducted in Tanzania.

Tax-benefit policies usually contain the description of one tax or benefit, where this description is made up of functions. The functions used here are as follows: *Elig* determines eligibility/liability for benefits/taxes; *BenCalc* calculates the benefit/tax amount for all eligible

units; *ArithOp* is a simple calculator, allowing for the most common arithmetical operations; *SchedCalc* allows for the implementation of the most common (tax) schedules; *Allocate* allows for the (re)allocation of amounts (incomes, benefits, and taxes) between members of assessment units; and *Min* and *Max* are simply minimum and maximum functions.

In addition, *ils_dispy* describes one of the most important EUROMOD concepts: standard disposable income. In general, the following components make up disposable income in EUROMOD: original income (essentially employment and self-employment income; capital, property, and investment income; and private pensions and transfers), plus benefits (cash transfers, i.e., unemployment benefits, public pensions, family benefits, social transfers, and other country-specific cash transfers), minus direct taxes (income tax, turnover tax, and other country-specific taxes, as well as social insurance contributions, which are paid by employees and the self-employed).

2.2. Data Sources

The data sources used are the 2011/12 and 2017/18 Tanzanian mainland household budget surveys produced by the NBS (NBS, 2014, 2020). In the analysis, the baseline system uses the 2017 tax-benefit calculation rules and upgrading factors are applied to update revenue components for the 2017 policy year. The tax and benefit policies that are simulated in TAZMOD version 2.4's 2021 system use 1 July 2021 as the time point. This is later than the time point for the 2017/18 NBS household budget survey data (NBS, 2020). The study adopted EUROMOD and TAZMOD v2.4. They provide the simulation with indirect tax-benefit analysis, while the Gini coefficient provides us with income inequality information.

3. RESULTS AND DISCUSSIONS

The study of microsimulation uses the effects of the presumptive tax on poverty. It is divided into three parts: the budgetary influence, the household income disparity effect, and the effect of poverty. To illustrate the types of results and analysis that can be provided, two hypothetical policy reforms are considered. As indicated in the previous section, TAZMOD refers to 2021.

The simulation results discussed here focus on the fiscal implications for the government budget, as well as the impact of amending presumptive tax on the Tanzanian mainland on poverty and inequality. 2021 was selected as the time point (the baseline time point), because it matches the date of the survey. For the 2012, 2015, 2016, 2017, and 2018 simulations, variables in the 2011/12 and 2017/18 were uprated to a 2012, 2015, 2016, 2017, and 2018 time point respectively, using the Consumer Price Index for food and non-food items.

Proposed Reform Used in Microsimulation

It was assumed that the Tanzanian government had amended the presumptive tax policy, reducing the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001, and imposing a 7% marginal rate.

The above reform was used to demonstrate the effect that such a policy amendment might have on government revenue and expenditure, income distribution, and poverty. The baseline microsimulation system used for the analysis of the study was for 2017.

3.2. Budgetary Effect

According to the reform imagined above, the Tanzanian government amended the presumptive tax policy, reducing the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001, and imposing a 7% marginal rate. The microsimulation results reveal that government revenue through taxes, social security contributions (SSCs), and indirect taxes would increase by 5.33 percent (from TSh8,870,422.74 to TSh9,370,185.65) as a result of this reform. The direct taxes would decrease by 6.04 percent. Cognizant, indirect taxes would increase by 9.88 percent. Social security contributions (employer, employee, and self-employed) would increase by ten percent and social assistance would surge to 31.87 percent. This contradicts the findings of H. Semboja (2015), who suggests that "the total presumptive income tax has been very small when compared with other forms of income taxes, the number of taxable entities and desired tax transformation targets" (p. 81). In the short term, taxing SMEs could result in the receipt of increased revenue for fiscal expenditures. Tax education is expected to help taxpayers to understand tax laws and procedures, and to contribute to the creation of a positive tax compliance attitude (Sheikh Obid, 2007).

Table 1: Tax Benefit Policy Yearly (TSh)

	tz_2018 (base)	**tz_2021_reform_1**	**Difference to base**	**Percentage change**
Government revenue through taxes, SSCs, and indirect taxes	8,870,422.74	9,370,185.65	499,762.91	5.33
... direct taxes	2,881,905.38	2,717,637.92	-164,267.47	-6.04
... indirect taxes	3,433,457.72	3,810,020.04	376,562.33	9.88
... SSCs (employer, employee and self-employed)	2,555,059.64	2,842,527.69	287,468.05	10.11
Government expenditure on social transfers	175,559.09	257,683.87	82,124.78	31.87
... child benefits	0.00	0.00	0.00	-
... social assistance	175,559.09	257,683.87	82,124.78	31.87

3.3. Poverty Effect

The findings show that when the upper turnover threshold for presumptive tax is reduced from TSh100,000,000 to TSh50,000,001, and a 7% marginal rate is imposed, poverty decreases by 0.55 percent. Poverty in male-headed households decreases by 0.68 percent while poverty in female-headed households decreases by 0.16 percent. Poverty in households with children decreases by 0.56 percent. The average normalized poverty gap decreases to -4.38 percent, while the poverty gaps for male-headed households and female-headed households are reduced to -4.31 percent and -4.61 percent respectively.

Table 2: Poverty Effect

	tz_2018 (base)	**tz_2021_reform_1**	**Difference to base**	**Percentage change in 2021**
Poverty				
All	26.38	26.24	-0.14	-0.55
... male-headed households	26.06	25.89	-0.18	-0.68
... female-headed households	27.39	27.34	-0.04	-0.16
... households with children	28.01	27.86	-0.16	-0.56
... households with older persons	30.36	30.31	-0.06	-0.19
Poverty Gap				
All	6.16	5.90	-0.26	-4.38
... male-headed households	6.17	5.91	-0.25	-4.31
... female-headed households	6.14	5.87	-0.27	-4.61
... households with children	6.57	6.30	-0.28	-4.42
... households with older persons	7.14	6.84	-0.30	-4.35
Absolute national poverty line, in national currency, yearly	591,842	658,429	66,588	10.11

3.4. Household Income Inequality Effect

The data reveals that households in the 20th to 80th quintiles would have benefited slightly more in 2021 than in the baseline year. The remaining groups of households would have been affected more: for example, the income of households in the 40th quintile would have increased by TSh84,135.95 billion, while the income of households in the 50th quintile would have increased by TSh96,629.73 billion. The income of households in the 60th quintile would have increased by TSh114,565.78 billion and the income of households in the 80th quintile would have increased by TSh185,289.65 billion. Thus, the results show that the reform would have a more positive impact on consumption-based income distribution as it relates to poor households. Furthermore, they indicate that the consumption-based distribution of income for poor households would have a positive effect.

Table 3: Annual Consumption-Based Income Distribution after Taxes and Transfers

	tz_2018 (base)	**tz_2021_reform_1**	**Difference to base**	**Percentage change in 2021**
Gini coefficient (household income)	0.3800	0.3811	0.0010	0.27
P80/P20 ratio	2.68	2.72	0.04	1.36
20th quintile	533,349.29	594,293.73	60,944.44	10.25
40th quintile	719,147.78	803,283.73	84,135.95	10.47
50th quintile	836,192.64	932,822.37	96,629.73	10.36
60th quintile	966,720.45	1,081,286.23	114,565.78	10.60
80th quintile	1,428,841.91	1,614,131.57	185,289.65	11.48
The absolute national poverty line in the national currency (annual)	591,842	658,429	66,588	10.11

In this case, we equate the Gini coefficient and the P80/P20 ratio of equivalent disposable earnings. The results suggest that the reform would boost inequality by 0.27 percent. Overall, the P80/P20 ratio would increase by 1.36 percent as household income inequality expanded, hence income inequality in society would increase slightly (Table 4). Overall, as household income inequality increases, the P80/P20 ratio also rises by 0.5 percent, and therefore income inequality in society slightly increases. The study is in line with Jara & Varela (2017)'s research relating to Ecuador, which shows that "direct taxes (social insurance contributions) reduce inequality, as measured by the Gini coefficient, by only 0.1 (0.9) points based on" data from Encuesta Nacional de Ingresos y Gastos de Hogares Urbanos y Rurales, that is the National Survey of Income and Expenditures of Urban and Rural Households, or ENIGHUR, 2011-2012, "whereas the effect is 0.9 (1.5) points based on ECUAMOD simulations" (p. 2). They "discuss possible reasons for the observed discrepancies and highlight the advantages offered by ECUAMOD for distributional analysis and ex-ante policy evaluation" (Jara & Varela, p. 2).

Table 4: Annual Household Inequality after Taxes and Transfers

	tz_2018 (base)	***tz_2021_reform_1***	***Difference to base***	***Percentage change in 2021***
Gini (household income)	0.3800	0.3811	0.0010	0.27
P80/P20	2.68	2.72	0.04	1.36

4. CONCLUSION

This study used a microsimulation model based on amending the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001 (a 50% decrease) and imposing a 7% marginal rate. The data obtained from the microsimulation revealed that a government revenue increase of 5.33 percent (from TSh8,870,422.74 to TSh9,370,185.65) would occur as a result of this reform. In the microsimulation, poverty decreased by 0.55 percent, with poverty within male-headed households decreasing by 0.68 percent and poverty within female-headed households decreasing by 0.16 percent. There was also a decrease in poverty within households with children. Moreover, the poverty gap decreased. It was further noted that the poverty gaps for male-headed households and female-headed households were reduced. The effects of the Gini coefficient in relation to income disparities and the P80/P20 equivalent disposable income ratio have been calculated. The results indicate that the reform would increase inequality by 0.27 percent. Overall, the P80/P20 ratio would increase by 1.36 percent, with household income inequality and thus income inequality in society slightly increasing. The improvement in human capital behavior would have far-reaching, long-term macroeconomic effects, with increases in productivity and improved national competitiveness.

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FURTHER IMPROVING OUR UNDERSTANDING OF THE TAX AWARENESS, TAX LITERACY AND TAX MORALE OF YOUNG ADULTS

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Abstract

Developed countries have, for some years, been introducing policies that focus more on the individual's responsibility to engage with taxpaying obligations. At the same time, they have provided less state support and assistance except where taxpayers are motivated to self-serve online. This paper argues that, given this change of approach to compliance, a greater focus on tax education is needed, particularly amongst younger people as they prepare to engage with the tax system beyond consumption taxation payment, and in order to build a platform for compliance improvement efforts in the future that is better suited to this greater focus on the individual's responsibility for compliance. As such, it is also necessary to ascertain the most effective way in which to educate young people about the tax system. This paper seeks to contribute to this. It presents quantitative research into socio-demographic influences and the impact that tax tuition may have on young adults' tax morale. The results of a two-staged survey show that gender, tax tuition, and employment experience significantly influence tax morale. The study contributes to the literature on tax morale and tax literacy by showing, through regression analysis, that the effect of tax tuition on tax morale is negatively influenced by employment experience.

Keywords: Tax Morale, Tax Literacy, Tax Education, Work Experience.

1. INTRODUCTION AND CONTEXT

In a 2015 report, the Organisation for Co-operation and Development (OECD) and the International and Ibero-American Foundation for Administration and Public Policies (FIIAPP) recognise that global society is "witnessing a transformation of state-citizen relations and a cultural shift in tax administrations themselves" (OECD & FIIAPP, 2015, p. 17). Alexander and Balavac-Orlic (2022) note that, "resources directed at improving taxpayer education and facilitating a greater appreciation for individual contributions" to nations are deemed to be cost-beneficial in improving taxpayer compliance, particularly cost-effective voluntary compliance (p. 3; see also Loo et al., 2005). They add that "tax authorities, once reliant on a culture of fear (e.g., fear of being caught and penalized), recognize citizens as allies, rather than mere 'obligation holders'" (p. 3; see also Aberbach & Christensen, 2007; Gangl et al., 2015). They state that "that said, culture shifts are slow" and, in many countries, it will take time for "the public perception of tax authorities" to shift from that of organisations involved in "coercion and repression" to that of organisations focussed on partnership, co-production, and alliance (p. 3; see also Alford, 2009; Currie, Tuck & Morrell, 2015; OECD & FIIAPP, 2015).

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The underlying objective of taxpayer education (i.e. educating taxpayers in all matters related to the assessment, compliance, and understanding of tax collection and administration) is to "foster attitudes of commitment to the common good, emphasising the social value of tax and its link to public expenditures" (OECD & FIIAPP, 2015, p. 17). A common aspect of recent taxpayer education initiatives in various countries is to highlight the detrimental impact of tax evasion and aggressive tax avoidance. Taxpayer education is most often achieved by the combined development of tax awareness (knowledge of tax principles, of how taxes operate and are charged, and how payment is enforced) and tax literacy (the ability to apply knowledge to comply with the principles and operational rules of a tax system) (OECD & FIIAPP, 2015).

In her discussion on external factors influencing internal motivations, Kornhauser (2007) states that "education can strengthen norms that are positively correlated with tax compliance such as honesty, morality, national pride, concern for others, and fairness" (p. 619).

The OECD and FIIAPP (2015) undertook a global survey of various tax education programmes and initiatives, and found that many countries specifically target school children and/or university students, the objective being to improve young adults' tax literacy before they transition into the labour market. In 2019, the OECD followed this up with a report that provided further details about the principles that underpin tax education programmes in developing countries. One of the policy considerations for individuals centres on the provision of support for tax education programmes (OECD, 2019).

In the United Kingdom, tax education forms part of national curricula within the compulsory financial education programmes that must be provided by all state-maintained secondary schools. However, the impact of general financial education programmes, including taxation education programmes, and of education and materials produced and supported by HM Revenue & Customs (HMRC), is still poorly understood, particularly with regard to their longer term impact on behaviours. A recent survey conducted by Deloitte LLP (2019) found generally low levels of very basic tax knowledge in the United Kingdom. Furthermore, the researchers found tax knowledge to be robustly and positively associated with perceptions of fairness in the tax system and willingness to pay more tax (tax morale) (Deloitte, 2019).

Most people receive very little directed tax education following the formal education that they receive in school (unless they seek to become professionally qualified in related fields of work). Taxpayers are largely left to self-educate as needed, with limited support from HMRC other than via its website and some increasingly limited face-to-face and telephone services. Alternatively, they have to buy access to others' knowledge where this can be afforded and is available (Deloitte, 2019).

General tax awareness within the United Kingdom is further hindered by the very nature of the tax system itself (Lymer, 2015). The majority of U.K. residents, who are typically employed and/or hold modest savings and investments, do not need to file self-assessment tax returns given the personal and investment exemptions, and the precision of Pay As You Earn (P.A.Y.E.) withholding on their earnings. As such, their direct engagement with income taxation is, at best, limited. Furthermore, as a result of rising personal allowance levels—a fourfold increase has been implemented since 1990/1991, when the level was £3,005, to the current level of £12,570 (Finance Act, 2021)—increasing numbers of people don't have to pay income taxation at all. From a peak of 32.5 million income taxpayers in 2007/2008, 800,000 fewer people—particularly women and those under the age of 65—were expected to pay income tax in 2020/21 (HMRC, 2022). Furthermore, it seems that many do not think of Value

Added Tax (VAT) and other indirect taxes as "true" taxes, but instead view them simply as part of the cost of purchases made (Gemmell et al., 2003) so, if they do not pay income tax, they rarely feel that their purchasing behaviour makes them taxpayers.

Conversely, it behoves the self-employed to be tax aware from the outset of the formation of their businesses. The digital economy is facilitating the move to more adjunct work and self-employment (De Stefano, 2015). According to the Office for National Statistics (ONS), the number of self-employed workers in the United Kingdom has increased by approximately 40% since the turn of the century (see https://www.ons.gov.uk/). With an increasing number of individuals engaging in trade in lieu of employment, tax education will play an increasingly important role in their personal and professional development. Furthermore, *Making Tax Digital*, the United Kingdom's HMRC-led programme to move most business-related tax interactions with the government into a digitally mediated form in the near future, commenced in earnest for all VAT-registered businesses in 2019. This means that self-employed people will need higher levels of tax education than was previously the case in order to interact with the tax authorities more routinely (on a month-by-month basis).

On the basis outlined above, it is becoming more of an imperative to raise young people's levels of financial and tax literacy before they leave school and higher education. Beyond this point, there are limited opportunities for the collective development of a core understanding, and an awareness of, tax systems and taxpayer obligations. It is from such understanding and awareness that the desired behaviours of voluntary compliance are likely to naturally develop, and through which the development of greater levels of tax citizenship capability can evolve. These will provide the context for an improved public debate about the evolution of tax systems for the national good.

This paper contributes to the growing literature on the nature and form of effective taxpayer education, particularly amongst young people, by making an original contribution in relation to the moderating influence of initial experiences of work on tax literacy and tax morale. We report findings from an empirical study, conducted in the United Kingdom and funded by the Chartered Institute of Taxation (CIOT), in which we considered the financial and tax literacy of 377 young adults from two U.K. universities, the socio-demographic influences on their tax morale, and their perceptions of tax administration and compliance.

The remainder of this paper is structured as follows. Section two outlines the context for the research, and discusses relevant professional and academic literature in order to extend the motivation for this work. Section three provides details of the quantitative research methodology used in this study. The fourth section summarises the findings of the quantitative research. Finally, conclusions, policy recommendations, and suggestions for further research and outreach are offered in section five.

2. REVIEW OF THE LITERATURE

This section reviews existent literature outlining our current understanding of why tax education is needed and what impact it may have on tax morale, with a particular focus on young adults as they are the subject of this paper.

2.1. Consideration for Tax Education at the Genesis of Tax Morale Research

The existence of a role for suitable taxpayer education to aid the building of a compliant taxpayer community was evident from the earliest of formal studies into tax compliance. Allingham and Sandmo (1972) established:

> the benchmark economic model of tax evasion. . . in which self-interested taxpayers decide how much income to report to the tax authority by trading off the benefits of evasion (lower tax payments) against the costs of evasion (the possibility of being caught and punished). (Luttmer & Singhal, 2014, p. 149)

Luttmer and Singhal (2014) note that this model "is a straightforward application of the Becker (1968) model of crime to the tax-evasion context: risk-averse individuals weigh the utility benefits and costs of evasion to optimize their compliance behaviour" (p. 151). Therefore, under this model, tax education could be deemed to be necessary in order to enable taxpayers to suitably determine their trade-off decisions, aiding their understanding of the full implications of the decisions to avoid tax payments that they may otherwise make. While this was a path-breaking model when introduced, it has since been widely criticised for only providing a limited view of the motivations for individual tax compliance (see, for example, Alm, 1991; Alm et al., 1992; Barone & Mocetti, 2011; Brink & Porcano, 2016; Frey & Feld, 2002; McKerchar et al., 2013; Torgler, 2007; Torgler et al., 2010).

Alm (1991) provided a survey of early theoretical and experimental research into taxpayer compliance. He recognised that the underlying expected utility theory in which taxpayers "pay taxes because they fear detection and punishment. . . cannot explain all compliance behaviour" (p. 577). He found relatively high compliance in spite of the very small possibility of audit and the fractional penalties on unpaid tax liabilities, surmising that enforcement activities alone could not explain taxpayer reporting. The other factors recognised by the author that may be influencing taxpayer compliance include valued government expenditures and social norms. These other compliance-motivating factors have collectively been titled "tax morale" in later literature. Tax morale is defined as the intrinsic motivations for individuals to pay taxes (see, for example, Alm & Torgler, 2006; Frey & Torgler, 2007; McKerchar et al., 2013; Onu et al., 2019). Alm (1991) concluded with a call for "an exploration of alternative theories of behavior under uncertainty" with regard to taxpayer compliance that pay greater attention to these other tax morale factors (p. 591). The role of effective taxpayer education would, therefore, need to be revisited in order to address these apparently wider motivations for compliant behaviours. Tax morale literature is, therefore, expanding.

2.2. How to Measure Tax Morale

Torgler (2002) notes that "the question about tax morale has more to do with why people do not cheat rather than why they do" (p. 658). This explains why tax compliance attitudes are often used as proxies for measuring tax morale in the literature. At the most basic level, tax compliance is the full payment of all tax obligations (James & Alley , 2009) so, by extension, tax non-compliance occurs if tax obligations are not met in their entirety.

According to Torgler (2003), evasion is an indication of a lack of intrinsic motivation to pay tax (i.e. low tax morale. The "measure of tax morale may consist of a single question as to the degree to which tax evasion is justified or not" (Lewis, 2009, p. 432), a series of questions that provides a more robust analysis through indexation or factor analysis, or "more complex

assessments of the perceived fairness of tax systems and the perceived legitimacy of governments" (Lewis, 2009, p. 432).

As noted by Alexander and Balavac-Orlic (2022), prior researchers (see, for example, Alm & Torgler, 2006; McGee & Tyler, 2006; Torgler, 2003; Torgler & Schneider, 2007) have used World Values Survey (WVS) and European Values Study (EVS) data when examining tax morale's key determinants. In order to measure tax morale, empirical literature often refers to the following question from the WVS and the EVS: "Please tell me for the following statement whether you think it can always be justified, never be justified, or something in between. Cheating on taxes if you have the chance (10 – never, 1 – always)."

McGee (2006) established a comprehensive set of 18 questions representing 15 historical and three contemporary issues, and the three points of view found in tax evasion ethics literature: (1) duties to pay the state, (2) an anarchist view, and (3) evasion (ethical and unethical, under particular circumstances). McGee recognised that, as the vast amount of literature considered tax evasion from a public finance perspective, his contribution would be to focus on the ethics of tax evasion. He conducted a number of surveys using these 18 questions in various countries, involving university academics (McGee, 2006) and university students (McGee et al., 2005; McGee & Bernal, 2006; McGee & Tusan, 2008), and citizenry (McGee & Tyler, 2006). Many of these questions have been used, with some modifications, in subsequent surveys by other researchers, including Torgler (2007), and Wong and Lo (2015).

The tax morale literature is now extensive. Alexander and Balavac-Orlic (2022) note that:

> Torgler et al. (2010) provided a review of the early literature (1960 through 2000) which considered various theoretical considerations, including an altruistic approach (e.g. Chung, 1976), the Kantian morality approach (e.g. Laffont, 1975; Sugden, 1984), and social customs (e.g. Akerlof, 1980; Gordon, 1989; Myles & Naylor, 1966; Naylor, 1989). (p. 3)

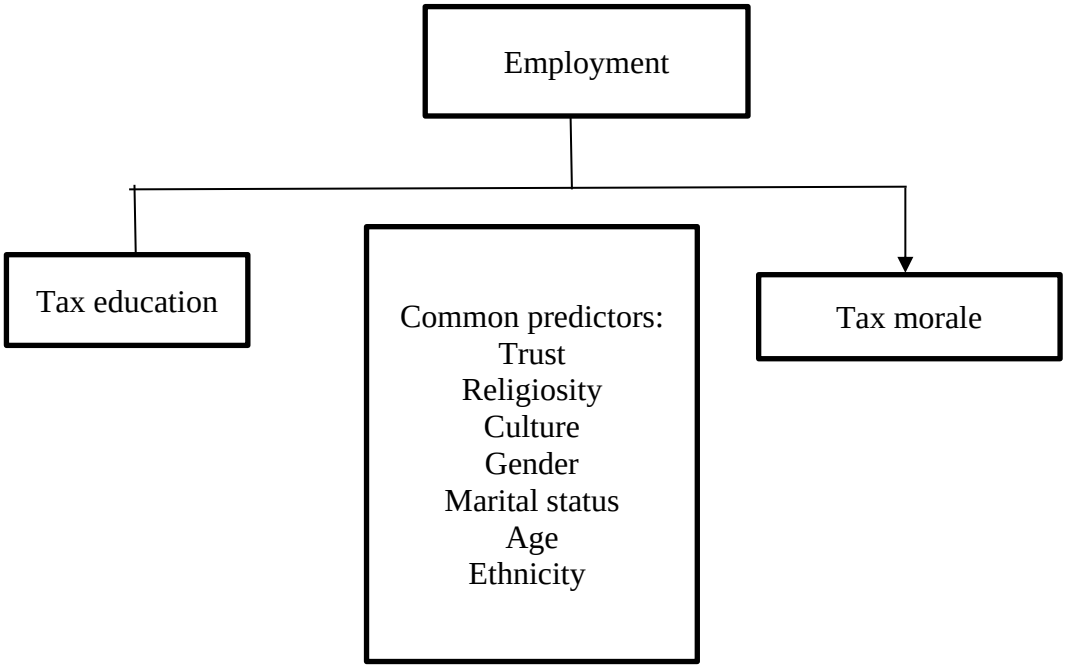
They add that:

> Kornhauser (2007) provided a review of the next wave of literature (2000 through 2007), which further developed the theories and concepts established in the earlier literature. Her review considered tax morale research in three major areas: cognitive and affective processes (e.g., Cullis, et al., 2006; Hansen, 2003; Kahan and Braman, 2005), social norms and personal values/norms (e.g., Fehr and Fischbacher, 2004; Kolstad, 2007; Mazar and Ariely, 2006), and demographic factors (e.g., Hasseldine and Hite, 2003; McGee and Tyler, 2006; Torgler, 2003, 2006). (Alexander & Balavac-Orlic, 2022, p. 3)

The body of literature has grown significantly since the publication of Torgler's seminal work in the 1990s. This is summarised by a systematic review of literature on tax morale provided by Horodnic (2018). This article made use of an institutionalist lens to detail the determinants (excluding socio-economic characteristics) of tax morale in the literature, which is characterised as belonging to either formal institutions—such as authorities—or informal institutions—such as social norms (Alexander & Balavac-Orlic, 2022). A key conclusion of Horodonic's (2018) analysis was that trust has been found, across a range of research in this domain, to be "the most salient factor, especially with regard to horizontal (peer) and vertical (authorities) trust" (Alexander & Balavac-Orlic, 2022, p. 3).

The figure below provides a visual illustration of the estimates and relationships that we aim to explore.

Figure 1: Estimates and Relationships of Tax Morale Explored in this Research



Source: Authors' illustration.

According to Alexander and Balavac-Orlic (2022), evolving tax compliance literature has concentrated on identifying tax morale determinants and has explored various forms of TRUST and equity, as well as RELIGIOSITY, and CULTURE (p. 3). The relationship between tax morale and socio-demographic and economic factors (e.g. age, GENDER, MARITAL STATUS, EDUCATION, income, etc.) is also often examined (Rodriguez-Justicia & Theilen, 2018).

Torgler and Murphy (2004), among others, have found that TRUST in government supports tax morale. In their research into the framing effects of tax morale statements in such surveys, Alexander and Balavac-Orlic (2022) found that while more trust in government results in higher tax morale, the effect is significant only when the framing of the statement or question is negative.

With regard to GENDER, many have considered how tax morale may differ and studies have consistently found that women display higher levels of tax morale to men (see, for example, Alexander & Balavac-Orlic, 2022; Alm & Torgler, 2006; D'Attoma et al., 2020; Doerrenberg & Peichl, 2013).[5]

[5] See Horodnic (2018) for a systematic review of the literature.

AGE is another common variable in the tax morale literature, with older people displaying higher levels of tax morale (see, for example, Alm & Torgler, 2006; Doerrenberg & Peichl, 2013; Torgler & Murphy, 2004).

When MARITAL STATUS has been considered in the research, studies have shown that married people have higher tax morale than single people (see, for example, Alm & Torgler, 2006; Doerrenberg & Peichl, 2013; Torgler & Murphy, 2004). However, McKerchar et al. (2013) did not find the effect to be statistically significant.

RELIGIOSITY has been found to be a significant determinant of tax morale by several researchers (see, for example, Alm & Torgler, 2006; Doerrenberg & Peichl, 2013; Torgler & Murphy, 2004). Conversely, it has made no difference according to Torgler (2006) and McKerchar et al. (2013). It has been observed that a more secular perspective might be taken in future research in order to suitably review the connections and differences between religiosity and personal integrity (McKerchar et al., 2013).

CULTURE has been found to have an impact on tax morale, with differences detected within and between countries (see, for example, Alm & Torgler, 2006; Brink & Porcano, 2016; D'Attoma et al., 2020; Doerrenberg & Peichl, 2013; Torgler & Murphy, 2004).

Some studies find that INCOME has a positive effect on tax morale (Konrad & Qari, 2012) while others report that it has a negative effect (Alm & Torgler, 2006: Doerrenberg & Peichl, 2013). The estimated effect of EDUCATION on tax morale is similarly ambiguous (for a review, see Rodriguez-Justicia and Theilen, 2018). The following sections focus on the literature on these two variables of interest.

In sum, as Alexander and Balavac-Orlic (2022) note, earlier studies have found that those more likely to have lower tax morale are younger people, men, the unemployed, and those in low-income or undeclared employment. They add that Horodnic (2018) and others suggest these groups could be targets for "policy measures related to awareness campaigns" and/or for "suitable tax education to seek to address their otherwise suboptimal tax compliance behavior from the perspective of the wider society" (p. 4).

2.3. Tax Education in Recent Tax Morale Research

Education has been considered as a potential influencing factor in many studies on tax morale, but mostly in the form of levels of formal education and not in terms of tax-specific education. General education, as a common control variable, has yielded mixed results in previous research. Some argue that improved education (both tax specific and other general education levels) enhances tax compliance. It is purported that better-educated individuals have a greater understanding of tax law and fiscal connections (e.g. state-provided benefits and services funded by tax revenues) and, therefore, are more tax-compliant (Lewis, 1982; Lewis et al., 2009; Torgler, 2007). The counterargument is that better-educated individuals have a greater awareness of possible government waste and the added advantage of understanding opportunities for evasion and avoidance (Torgler, 2007). Given these two alternate perspectives on education, due consideration should be given to the empirical evidence of its effects on tax morale and tax compliance.

In the works of Torgler (2003), McGee and Tyler (2006), Cullis et al. (2006), Lewis et al. (2009) and others, the education variable was general in nature (e.g. school, university, or

postgraduate studies). Relatively few have considered the impact of tax-specific tuition on tax morale. The exceptional studies were conducted by Erikson and Fallan (1996), Kasipillai et al., (2003), Goksu and Sahpaz (2015), Wong and Lo (2015), and Kurniawan (2020). These quasi-experimental and/or survey-based studies are reflected in Table 1 and the five studies in which tax-specific education was considered are briefly discussed below.

Eriksen and Fallan (1996) conducted a quasi-experiment that pre- and post-tested two groups of students from a Norwegian university on their tax knowledge and attitudes towards taxation. The experimental group of students (n=194) engaged in a tax law elective between pre- and post-testing while the control group did not. The tax law elective was considered the stimulus in the experimental group. The authors found that the experimental group of students who engaged in the tax law elective improved their tax knowledge significantly and changed their attitudes to tax evasion, whereas no such changes were observed in the control group. Thus, they concluded that such tuition had positive effects.

Kasipillai et al. (2003) undertook a survey study of Malaysian university students, looking at the degree to which taking a formal tax education course as part of their university studies produced a self-reported change in tax compliance intention levels. Having applied surveys before and after tax tuition, they find that while both sexes reported higher compliance intentions, females were more significantly affected by having received formal tax education in this particular instance.

Goksu and Sahpaz (2015) surveyed undergraduate students at two universities, one in Turkey and one in Spain. Their survey consisted of ten questions about tax morale and 12 questions about the students' perceptions of their respective countries' tax systems. The research only considered the differences between the two universities without controlling for any other factors (e.g. age, gender, work experience, etc). They simply speculated that the differences between the cohorts were attributable to social-culture structure, religious beliefs, and economic or political factors. The authors examined responses to specific questions, exploring correlations through Spearman Coefficient testing inferring that tax tuition had a positive effect on tax compliance attitudes.

Wong and Lo (2015) considered how tax compliance might be improved through tax tuition. They surveyed undergraduate and postgraduate students enrolled in a Hong Kong university between 2008 and 2010 on one of three tax courses: general tax education (n=53) or a technical tax course (n=68) at the undergraduate level and an identical tax-technical course (n=80) offered at the postgraduate level. The students were asked to complete the survey at the beginning and the end of their courses to explore how the acquired tax knowledge had impacted their tax compliance decisions (tax morale). The questionnaire had three sections: (1) tax compliance scenarios, (2) perceptions of the Hong Kong tax system, and (3) 16 statements about ethical attitudes to tax compliance. The methodology applied included factor analyses of the 16 tax morale questions based on the characteristics of the tax systems and the consequences of tax evasion, as well as the framing of the statements in which there was (or was not) an excuse for tax evasion. Wong and Lo (2015) concluded that general tax tuition (i.e. education about a broad range of topics, theories, and principles) was sufficient to improve the undergraduate students' sales tax compliance decisions, and technical tax tuition improved the postgraduate students' income tax and sales tax compliance decisions. However, there was no significant relationship between the technical tax tuition and tax compliance decisions made at the undergraduate level for either sales tax or income tax. The authors surmised that the "contents of a tax course and the educational levels of a program influence taxpayers' tax

Table 1: A Selection of Studies from 1996 to 2020 Including Education Variables to Explain Tax Morale

Reference	Dependent Variable	Education as an Independent or Control Variable	Sample and Econometrics	Source of Data	Findings
General Education					
Torgler (2003)	**Tax morale:** responses to ten statements about tax evasion and to the World Value Survey (WVS) question on tax morale.	The respondents were asked to confirm the highest level of education that they had attained.	Quasi-experiment: surveys of 644 university students and staff from an institution in Costa Rica and 1196 from Switzerland. Ordered Probit.	Own survey.	Education has a positive impact on tax compliance.
McGee and Tyler (2006)	**Tax morale:** responses to 18 statements about tax evasion and to the WVS question on tax morale.	The respondents were asked to confirm the highest level of education that they had attained.	Data extracted from 33 countries participating in a larger study on human beliefs and values. Mann-Whitney U Test.	Human beliefs and values survey.	Education has a negative impact on tax compliance.
Cullis et al. (2006)	**Tax compliance:** declarations of income given four differing scenarios of detection and penalty rates.	Participants were pursuing degrees in psychology or economics and inferences were drawn on the influence that degree choice has on tax compliance.	Survey of 539 U.K. university students enrolled on psychology or economics **c**ourses. Factor analysis.	Own survey.	Tax compliance is influenced by individual differences (gender and the degree of study).
Lewis et al. (2009)	**Tax compliance:** Declarations of income given four differing scenarios of detection and penalty rates.	Participants were pursuing degrees in psychology or economics and inferences were drawn on the influence that degree choice has on tax compliance.	Survey of 505 students enrolled on psychology or economics courses at two Italian universities. Factor analysis.	Survey produced by Cullis et al. (2006) - slightly modified.	Tax compliance is influenced by individual differences (gender and the degree of study).
Alexander and Balavac-Orlic (2022)	**Tax morale:** Responses to seven statements on tax evasion; positively or negatively framed.	The respondents were asked to confirm the highest level of education that they had attained.	Survey of 630 U.S. and U.K. public and private sector employees. Factor analysis	Selected statements taken from McGee (2006) - slightly modified.	Higher levels of financial and tax literacy increase tax morale and moderate the effect of fairness when negatively framed.

Tax-Specific Education					
Eriksen and Fallan (1996)	**Tax knowledge:** responses to tax compliance questions (i.e. taxable income, allowances, and tax liabilities). **Tax attitudes:** questions relevant to others' evasion, self-evasion, other illegalities, and understanding of tax system fairness.	**Tax tuition** was the stimulus in the experiment group.	Quasi-experiment. Pre/post surveys of university students. 149 students were tested before tax tuition and 123 students were tested afterwards. Factor analysis.	Own survey.	Specific tax knowledge improves tax ethics and perceived fairness.
Kasipillai et al. (2003)	**Tax compliance:** behavioural responses to scenarios relating to personal tax compliance.	**Tax tuition** was a pre-condition for the survey and inferences were drawn about the self-perceived influence of tax education on personal tax compliance attitude. This study suffered from the lack of a control group.	Quasi-experiment. Pre/post surveys of university students. 553 students were tested before tax tuition and 551 students were tested afterwards. Descriptive statistics.	Own survey.	Tax education has a positive influence on personal tax compliance and gender differences are not a factor in attitudes.
Goksu and Sahpaz (2015)	**Tax morale:** responses to statements of tax evasion. **Tax compliance:** responses to statements on tax compliance and administration.	**Tax tuition** was a pre-condition for the survey and inferences were then drawn about self-perceptions of the impact that tax education had on tax compliance. This study suffered from the lack of a control group.	Survey of 459 Turkish and Spanish students in two universities who had received tax tuition. Spearman correlation.	Own survey.	Tax education in university has a positive effect on the level of tax morale.
Wong and Lo (2015)	**Tax compliance:** responses to compliance in given scenarios. **Perceptions of country's tax system:** responses to statements about tax administration matters. **Tax morale:** responses to statements about tax evasion.	**Tax tuition** was a pre-condition for the survey and inferences were drawn about the influence of general or technical tax education on tax compliance attitudes, controlling for perceptions of the tax system and tax morale. Information was about **work experience** was collected, but it was not considered in the econometrics.	Quasi-experiment. Pre/post surveys of university students. 205 students were tested before tax tuition and 205 students were tested afterwards. Factor analysis.	Own survey, including selected statements about evasion from McGee (2006) in order to determine tax morale.	General tax tuition positively influenced tax compliance of undergraduates with regard to VAT but not to income tax. Technical tax technical tuition positively influenced tax compliance amongst postgraduates with regard to both VAT and income tax.

Kurniawan (2020)	**Tax compliance:** responses to query from lecturers, "are they are compliant or not?". **Tax education:** survey of students on three courses in which a tax module is required. **Tax knowledge**: responses to theoretical and practical tax queries in the survey (not provided).	**Tax education** delivered by (mostly) non-tax-specialist lecturers in one module common to students studying accounting, business administration, or managerial accounting undergraduate courses at a vocational state university in Indonesia. Information about **work experience** was collected, but it was not considered in the econometrics.	Mixed methods surveys of 100 vocational state university students, followed by an interview with two students, two lecturers and one tax official. Descriptive statistics, determination coefficient testing, and path analysis and Sobel testing.	Own survey (not provided).	Tax education had a significant (positive) effect on tax compliance among the surveyed undergraduates. The indirect effect of tax education though tax knowledge also significantly influenced tax compliance.

compliance behaviors in distinct ways" (Wong & Lo, 2015, p. 21). The control variables were gender, age and, for the postgraduate cohort only, work experience.

In a mixed-methods study by Kurniawan (2020), the influence of tax education and tax knowledge on individual tax compliance was considered. They surveyed 100 undergraduate students enrolled on three courses in an Indonesian vocational state university after they had completed a module in taxation.[6] Qualitative data was also collected from five interviews (two with students, two with tax lecturers, and one with a governmental tax employee). Kurniawan (2020), while recognising the weakness inherent in asking individuals directly about their intentions to comply in the future, concluded that tax education had a significant effect on tax compliance. While information regarding the length of work experience was collected from the survey respondents, it was not considered in the descriptive statistics or regressions.

2.4. Work Experience in Tax Morale Research Involving Young People

Given the suggested importance of the younger, poorer demographic for policy measures in targeting awareness campaigns and tax education (see Horodnic, 2018), we also considered the impact of tax tuition undertaken by university students in this research. However, rather than just providing another country's set of descriptive statistics from which correlations may be deduced, we have performed some regressions to explore the possibility that WORK EXPERIENCE has a moderating influence on tax literacy and tax morale. Our hypothesis is underpinned by the pedagogical theory of enhancing learning through work experience. Whilst studying the experiences of U.S. school children, Hoffman (2015) purports that work experience gives the individual the power to exert themselves as more of a citizen in this world, beyond the role that they play in the family. We hypothesise that work experience instils a greater appreciation for taxation which, in turn, would positively impact tax morale. The potential moderating effect of work experience on the relationship between tax tuition and the tax morale of university students has not, to our knowledge, been considered in prior literature. As the sample populations in most of the earlier research transcend generations, the employment status variable has also been general in nature (e.g. unemployment, self-employment, part-time employment, full-time employment, retirement, etc.).

[6] The survey questions were not provided by the author in this paper.

With regard to the five research studies conducted into the tax morale of university students noted above, only Wong and Lo (2015) and Kurniawan (2020) included work experience as a control variable. However, neither offered any further consideration of this characteristic within the presentation of their results. In related literature, Chen and Volpe (1998) considered work experience as an independent variable in their study of financial literacy involving circa 1,800 U.S. college students, finding it to be significant.

Our study contributes to the literature specifically on tax morale and tax literacy by considering the moderating effect of work experience. In the next section, we outline how this literature informed the research methodology that we adopted in our work.

3. DATA AND METHODOLOGY

3.1. Data

This paper is based on quantitative research undertaken in the academic year 2016/2017. The research[7] undertaken examined the inter-relationships between tax literacy and tax morale amongst young people attending university. Following the examples of Eriksen and Fallan (1996) and Wong and Lo (2015), it was conducted through a series of surveys administered before and after curricula-based tax tuition.

A total number of 377 surveys were completed by young people in two universities in the autumn and spring semesters during the 2016/2017 academic year. The students surveyed were enrolled on various courses (i.e. accounting, business, and non-business courses). The control groups (i.e. business and non-business cohorts) did not receive any tax tuition in their respective courses, whereas the experimental groups (i.e. the accounting cohorts) received tax tuition during the academic year. The surveys were conducted at the beginning and the end of the academic year, before and after the delivery of the tax tuition relevant to the experimental group.

More than half (59.42%) of the students surveyed were from accounting cohorts and received formal tax tuition in their second year during the spring term. The other students surveyed were fairly evenly split between business majors (19.63%) and non-business majors (20.95%). The latter two groups of students comprised the control group as they did not receive any formal tax tuition as part of their courses. Most of the students (250) were surveyed in the spring. Of the 127 students surveyed in the autumn (before receiving tax tuition), 97 were surveyed again in the spring (after receiving tax tuition). As the surveys were performed anonymously and independently of each other, the researchers are unable to identify the exact number of students that were surveyed twice, although the overlap will have been significant (Alexander et al., 2019).

The literature outlined in the previous section provided the basis on which the surveys were created. The survey questions were largely drawn from prior studies where some validation had therefore occurred and were used to create a survey instrument for delivery.[8]

As it has been recognised that obtaining responses to multiple questions on tax compliance/morale improves the validity of the measure (Frey & Torgler, 2007; Torgler et al.,

[7] This work was funded by the CIOT.
[8] Further details of how this survey was constructed and applied can be found in Alexander et al. (2019).

2010), we chose to base the initial part of our survey on a selection of statements from prior validated research. These included 11 of the 18 statements in McGee's (2006) survey and seven other statements posed in Wong and Lo's (2015) survey.[9]

We made slight moderations to the terminology. Where the statements in the works of McGee (2006) and Wong and Lo (2015) referred to "tax evasion", we chose to use "underpaying taxes". Where the statements of McGee (2006) and Wong and Lo (2015) referred to an action that is "not unethical", we chose to use the term "justifiable", which is consistent with the terminology used in the WVS and EVS. The framing of our statements was intentionally softened to allow students to consider their responses without the impediment of the illegality of the action (evasion) or the social stigma of unethical behaviour.

The next subsection (3.2) summarises the descriptive and univariant statistics. We present our model in section 3.3 and its estimated results in section four, and discuss the implications of these results further in the fifth and concluding section.

3.2. Descriptive and Univariate Statistics

In terms of socio-demographic characteristics, just over half of the surveyed students were female (51.72%) and aged between 18 and 20 years of age (52.91%). Most were single (92.59%), white (74.87%), and U.K. citizens (87.17%). Of the students surveyed, 44.15% were employed and 28.18% reported that they had completed an income tax return at some point prior to completing the survey.

The respondents were asked to indicate their levels of agreement or disagreement with eighteen statements, in which underpaying taxes may be arguably more or less justified, by ticking boxes from one to seven, where one equals *strongly agrees* and seven equals *strongly disagrees*. Since the responses are Likert-type items, the recommended descriptive statistics were median and mode. In addition to the median and mode, we also report the average value and standard deviation. We base our discussion on the modal value (i.e. the most frequent answer) as the value of the median answers is similar across all statements. The statements together with the respective ranks and scores are reflected in Table 2.

Most of the respondents somewhat agree with statements that cheating is justifiable when most of the money collected is wasted and when the system is unfair. These are the statements that correspond to the lowest modal values in Table 2. The tax morale of the respondents is found to be highest when presented with statements that underpaying tax is justified when: it means that if they pay less, others will have to pay more; tax rates are low; and the tax system is simple. These are the statements that correspond to the highest median and modal values in Table 2.

A review of the literature (e.g. Alm & Torgler, 2006; Daude et al., 2013; Doerrenberg & Peichl, 2013; Frey & Torgler, 2007) shows that tax morale varies among different groups with different socio-demographic and socio-economic characteristics, such as gender, age, education, and employment. This research focusses on the relationships of tax tuition and work experience to the tax morale of young people, given the recognised importance of this demography to policymakers.

[9] The seven statements posed by McGee that we chose not to replicate in our survey concerned matters beyond the scope of this research. These included matters of extreme prejudice: corrupt politicians, financing unjust wars, and racial discrimination.

We use the Wilcoxon-Mann-Whitney[10] test to see if there are any statistically significant differences between the underlying distributions of the tax morale scores between the different genders, the employed[11]/never employed, cohorts with/without tax tuition, and autumn/spring cohorts with tax tuition (performed in the latter case to provide some confirmation of results over a longitudinal basis, as well as to enable us to explore a pre- and post- tax tuition comparison). Table 3 summarises the findings.

Gender differences

The majority of the statements exploring respondents' tax morale show statistically significant differences between female and male students, with female students intimating higher tax morale (i.e. higher mean scores) in all cases where these differences were significant. This is consistent with the literature (Alm & Torgler, 2006; Daude et al., 2013; Frey & Torgler, 2007). The seven statements where no statistically significant differences are detected include three of the four questions with the highest mean scores noted above (i.e. the majority agree that the tax system is not simple, that it is arguably more unfair than fair, and that the rates are not too low).

On average, females tend to report higher levels of tax morale (Table 3). There is a statistically significant difference by gender in the responses to statements about the way in which collected money is spent (whether cheating is justifiable when the money is spent wisely or is wasted, and when it is spent on worthy projects or projects that do or don't benefit respondents etc.). Female respondents also appear to be less concerned with the actions of others, as they find less justification for cheating even if everyone is doing it, or if it means that if they pay less, others will have to pay more. Furthermore, women tend to disagree more with statements claiming that cheating is justified when the penalties and risk of being caught are low, and when the tax system is unfair.

However, the responses to most statements related to the characteristics of tax system itself (whether cheating is justifiable when the tax system is fair, when the tax system is simple/complex, or when the tax rates are low) do not significantly differ by gender.

Tax taught v non-tax taught cohorts

A key focus of our study was whether undertaking tax tuition as a university course influenced the opinions of our respondents. As Table 3 shows, only three of the eighteen statements are answered significantly differently between those who had completed at least one tax course and those who had not had any tax tuition.

Specifically, students enrolled on tax tuition courses claim more justification to underpay taxes (i.e. cheat) when they consider the tax system to be unfair or when money is spent on projects that they morally disprove of.

In this study, the tax tuition cohort members appear to have lower tax morale than the non-tax tuition cohort members. This is even the case when the students were asked their opinions on underpaying when the tax money is being spent on projects from which they directly benefit.

[10] A nonparametric test for checking the equality of means on two independent samples (e.g. male vs. female).
[11] Respondents were coded as "employed" for this purpose if they had ever been involved in any employment, even if only for a short duration.

Table 2: Combined Scores on Tax Morale of Students Before Any Tax Tuition
(1 = strongly agrees; 7 = strongly disagrees)

Rank	**Statement:** *Please tell me for each of the following statements whether you think underpaying taxes is justifiable if…*	**Mean Scores**	**S.D.**	**Median**	**Mode**
6	… most of the money collected is spent wisely.	4.11	1.76	4	3
9	… a large portion of the money collected is spent on projects that do benefit me.	4.32	1.65	4	4
4	... a large portion of the money collected is spent on worthy projects.	4	1.68	4	4
17	… tax rates are low.	4.83	1.63	5	6
15	... it means that if I pay less, others will have to pay more.	4.80	1.63	5	6
3	… the tax system is unfair.	3.91	1.74	4	3
2	… the tax system is complex.	3.81	1.83	4	4
7	… the risk of being caught is high.	4.2	1.79	4	4
13	… the penalty for underpayment is low.	4.59	1.65	4.5	4
5	... a large portion of the money collected is wasted.	4.13	1.81	4	3
8	… a large portion of the money collected is spent on projects that do not benefit me.	4.29	1.67	4	4
10	… a large portion of the money collected is spent on projects that I morally disapprove of.	4.39	1.56	4	4
14	... the risk of being caught is low.	4.72	1.54	5	4
12	… the penalty for underpayment is high.	4.54	1.54	4	4
1	… tax rates are too high.	3.82	1.66	4	4
11	… everyone is doing it.	4.43	1.67	4	4
16	… the tax system is fair.	4.9	1.55	5	4
18	… the tax system is simple.	5.21	1.45	5	6

Table 3: Tax Morale by Different Subgroups of the Surveyed Students

	Gender		**Age**		**Cohort**		**Tax tuition**		**Employment**		**Tax return completed**	
Statement: *Please tell me for each of the following statements whether you think underpaying taxes is justifiable if…*	**Male Mean (median)**	**Female Mean (median)**	**18-20 Mean (median)**	**Over 20 Mean (median)**	**Without tax tuition Mean (median)**	**With (pre-) tax tuition Mean (median)**	**Pre-tuition Mean (median)**	**Post-tuition Mean (median)**	**Yes Mean (median)**	**No Mean (median)**	**Yes Mean (median)**	**No Mean (median)**
… most of the money collected is spent wisely.	3.93 (4)	4.24* (4)	4.16 (4)	4.03 (4)	4.29 (4)	3.93 (4)	3.93 (4)	4.05 (4)	4.18 *** (4)	3.31 (3)	4.12 (4)	4.08 (4)
… a large portion of the money collected is spent on projects that do benefit me.	4.06 (4)	4.45** 4	4.29 (4)	4.23 (4)	4.68 (5)	4.08** (4)	4.08 (4)	4.11 (4)	4.33** (4)	3.66 (3)	4.20 (4)	4.26 (4)
... a large portion of the money collected is spent on worthy projects.	3.97 (4)	4.06 (4)	4.11 (4)	3.92 (4)	4.11 (4)	3.94 (4)	3.94 (4)	4.08 (4)	4.08** (4)	3.46 (3)	3.89 (5)	4.07 (5)
… tax rates are low.	4.86 (5)	4.89 (5)	4.78 (5)	4.95 (5)	4.93 (5)	4.84 (5)	4.84 (5)	4.97 (5)	4.94** (5)	4.12 (4)	5.01 (5)	4.79 (5)
... it means that if I pay less, others will have to pay more.	4.56 (5)	5.05*** (5)	4.85 (5)	4.76 (5)	4.9 (5)	4.62 (5)	4.62 (5)	4.84 (5)	4.87** (5)	4.2 (4)	4.67 (5)	4.85 (5)

… the tax system is unfair.	3.56 (3)	4.14*** (4)	3.95 (4)	3.77 (4)	4.26 (4.5)	3.78* (4)	3.78 (4)	3.75 (4)	3.83 (4)	4.18 (4)	3.64 (4)	3.94 (4)
… the tax system is complex.	3.74 (4)	3.89 (4)	3.95 (4)	3.68 (1)	3.93 (4)	3.84 (4)	3.84 (4)	3.86 (4)	3.81 (4)	3.97 (4)	3.54 (4)	3.94 (4)
… the risk of being caught is high.	4.05 (4)	4.32 (4)	4.32 (4)	4.05 (4)	4.47 (4)	4.11 (4)	4.11 (4)	4.17 (4)	4.25 (4)	3.61 (4)	3.83 (4)	4.32 (4)
… the penalty for underpayment is low.	4.33 (4)	4.84*** (5)	4.54 (4)	4.66 (5)	4.65 (4)	4.47 (4.5)	4.47 (4.5)	4.61 (5)	4.65*** (5)	4 (4)	4.65 (5)	4.58 (4)
... a large portion of the money collected is wasted.	3.61 (3)	4.45*** (4)	4.18 (4)	3.89 (4)	4.46 (5)	4.09 (4)	4.09 (4)	3.82 (4)	4.04 (4)	4.12 (4)	4.13 (4)	3.79 (3.5)
… a large portion of the money collected is spent on projects that do not benefit me.	4.03 (4)	4.48*** (4)	4.33 (4)	4.18 (4)	4.46 (5)	4.3 (4)	4.3 (4)	4.18 (4)	4.28 (4)	4.09 (4)	4 (4)	4.34 (4)
… a large portion of the money collected is spent on projects that I morally disapprove of.	4.02 (4)	4.56*** (4)	4.57 (4)	4.12 (4)	4.7 (5)	4.32** (4)	4.32 (4)	4.02 (4)	4.34 (4)	3.94 (4)	4.21 (4)	4.34 (4)
... the risk of being caught is low.	4.4 (4)	4.66*** (4)	4.56 (4)	4.75 (5)	4.93 (5)	4.57 (5)	4.57 (5)	4.45 (4)	4.66 (5)	4.51 (4)	4.63 (5)	4.65 (5)
… the penalty for underpayment is high.	4.4 (4)	4.66 (4)	4.62 (4)	4.44 (4)	4.59 (4)	4.61 (4)	4.61 (4)	4.52 (4.5)	4.58* (4)	4.06 (4)	4.26 (4)	4.61 (5)

… tax rates are too high.	3.56 (3)	4.05*** (4)	3.92 (4)	3.69 (4)	4.13 (4)	3.85 (4)	3.85 (4)	3.7 (4)	3.83 (4)	3.67 (3)	3.7 (4)	3.86 (4)
… everyone is doing it.	4.23 (4)	4.61** (4)	4.31 (4)	4.57 (4.5)	4.69 (5)	4.34 (4)	4.34 (4)	4.44 (4)	4.47 (4)	4.06 (4)	4.38 (4)	4.47)4)
… the tax system is fair.	4.68 (5)	4.94 (5)	4.81 (5)	4.83 (5)	4.98 (5)	4.71 (5)	4.71 (5)	4.58 (4)	4.9*** (5)	3.97 (4)	4.75 (5)	4.85 (5)
… the tax system is simple.	4.99 (5)	5.24 (6)	5.11 (5)	5.14 (5)	5.36 (6)	5.11 (5)	5.11 (5)	4.86 (5)	5.19** (6)	4.48 (4)	5.14 (5)	5.12 (6)

***p<0.01

**p<0.05;

*p<0.10.

Pre/post tax tuition differences

The answers derived from the cohorts after receiving tax tuition do not differ statistically from those of the pre/no-tax tuition cohorts. This intimates that the level of tax morale has not measurably improved (or decreased) as a result of improved tax literacy. This is contrary to the results presented by Eriksen and Fallan (1996), Goksu and Sahpaz (2015) and Wong and Lo (2015).

Employment experience

The responses to nine of the eighteen statements about tax morale show statistically significant differences, with higher levels of tax morale found in respondents without employment experience. The statements in which these differences are detected are the questions that are positively framed (i.e. the money collected is spent wisely and the tax system is fair etc.) and the differences are detected regardless of whether the penalties are high or low.

Employment effects on opinions about the structure and nature of the United Kingdom's tax system

As researchers, we were particularly intrigued by the employment-related results in our univariate analysis—these potentially imply that having some employment experience is correlated to lower tax morale in comparable groups of similarly aged young adults who were, at the time of the study, in full-time education. While our chosen quantitative research methodology could not, in itself, indicate whether this was a causal relationship (or the direction in which this may have been causal), we wanted to explore this further to better understand what may be driving this correlation.

To explore further the specific relationship between employment and tax morale that the univariate results produced, we undertook further analysis. In addition to the 18 questions asked of our respondents in respect of their opinions about when underpaying of taxes might be justified, the students were also asked to consider three directed statements about the structure and nature of the United Kingdom's individual personal tax system (i.e. the part of the tax system that is the most directly related to taxes paid on employment). They were asked to grade

the extent to which they agreed or disagreed that (1) the system was fair, (2) the system was simple, and (3) the rates of tax are low, again using a 7-point Likert scale.

We then tested whether an average response to these three statements significantly differs according to employment status. In so doing, we sought to explore whether employment experience would be positively/negatively associated with higher tax morale. We were specifically seeking to confirm and delve more deeply into the apparent failure of the univariate analysis to confirm this hypothesis in half of the survey's 18 statements. The univariate results from this analysis are presented in Table 4.

With p-values of much lower than 10% in each case, as reflected in the above table, statistically significant differences were found when there was consideration for students' work experience in each of these questions. In each case those who had had at least some employment experience were shown to be more likely[12] to believe that the tax system was unfair or complex, and that tax rates were not low than comparable cohorts who had no employment experience. Again, we recognise that this research approach does not give us the confirmation of causality required in order to enable us to say whether the employment experience itself actually created these results.

Table 4: Personal Perspectives on U.K. Tax Administration

Statements Regarding the U.K. Tax System	**Status**	**Mean**	**Standard Deviation**	**Median**	**p-value**
The tax system is fair	Employed	4.02	1.45	4	0.0022
	Never employed	3.18	0.98	3	
The tax system is simple	Employed	4.24	1.46	4	0.0374
	Never employed	3.69	1.24	4	
The tax rates are low	Employed	4.71	1.29	5	0.0009
	Never employed	4.03	0.95	4	

3.3. Model

In addition to carrying out the univariate analysis, we wanted to try to infer a causal relationship that may exist between tax morale and its constitute determinants. Our review of prior literature identified various potential determinants for this examination. In this study, we are particularly interested in the effect of tax education on tax morale and, moreover, whether that effect is conditional on the students' work experience (as proxied by employment). When the effect of one independent variable on the dependent variable depends on the value of the other independent variable, the line of causation is known as a "moderated causal relationship". On

[12] The means are higher, and the differences were statistically significant with $p<0.1$ in all cases and below $p<0.01$ in two of the three cases.

this basis, we undertook testing in which employment was hypothesised to moderate the relationship between education and tax morale. Moderated relationships are captured by introducing interaction terms between independent variables in the model.[13] To do this, we have sought to examine the interaction between tax education and employment using the model below (utilising multivariate modelling).

$$Tax\ morale_i = \beta_0 + \beta_1 Tax\ Eductation_{\ i} + \beta_2 Employment_i + \beta_3 (Tax\ Education_i * Employment_i) + \beta_4 Age_i + \beta_5 Female_i + \beta_6 UK_i + \beta_7 Marital\ status_i + \beta_8 White_i + \beta_9 Religiosity_i + \beta_{10} Trust_{UK} gov_i + \varepsilon_{i,t} \quad (1)$$

The dependent variable ($Tax\ morale_i$) is calculated as a composite index from a factor analysis on the eighteen questions assessing tax morale, as adopted from McGee (2006) and Wong and Lo (2015), outlined above. According to the results of both Kaiser-Meyer-Olkin and scree tests, all the indicators were loaded on one distinct factor with factor loadings of more than 0.6, and this factor can therefore be said to represent a composite index measuring the tax morale of the respondents.[14]

The first set of independent variables are the main variables of interest: $Tax\ Education_i$ representing an indicator of received tax tuition; $Employment_i$ as a binary variable indicating whether or not the student is currently and/or has previously been employed; and their interaction ($Tax\ Education_i * Employment_i$). In this case, the coefficient $on\ tax\ education$ (β_1) reflects the effect of tax tuition when the employment is zero (i.e. the student has never been employed) and the sum $\beta_1 + \beta_3 * (Employment_i)$ reflects the effect of tax tuition on students that are either currently employed or have been employed at some point in the past (i.e. employment is equal to 1). Similarly, the coefficient of employment (β_2) captures the effect of employment on tax morale when students did not receive tax education (tax education=0). Furthermore, the model includes the socio-demographic characteristics of the respondents as controls: age, gender, citizenship, marital status, and ethnicity.[15] Finally, we also control for societal factors and personal beliefs, such as a respondent's trust in government and/or their religiosity.[16]

4. ESTIMATED RESULTS

The estimated results of our multivariate analysis (1) are summarised in Table 5.

A composite index measurement of the level of tax morale is estimated using the ordinary least square (OLS) method[17] (Column 1 in Table 5). Diagnostic tests for OLS (tests for correct functional form, heteroscedasticity, normality, and multicollinearity) show that our model is

[13] The interaction is introduced in the model as multiplicative term between moderated variables.
[14] For a more detailed explanation of the execution of the factor analysis, see Alexander and Balavac-Orlic (2022).
[15] Age is measured as the respondent's age. Gender, ethnicity, and citizenship are included as dummy variables (= 1 if a respondent is female, from the United Kingdom, and white, respectively; zero otherwise), while marital status is included as categorical variable with the categories married and separated/divorced/widowed in comparison to single (the reference group).
[16] Respondents were asked to indicate personal trust in the government of the United Kingdom on a scale from 1 (very untrustworthy) to 10 (very trustworthy). The variable (government trust) is included in the model as a dummy variable, taking a value of 1 if the answer is greater than 5, and zero otherwise. Religiosity is measured as a dummy variable, taking a value of 1 if the respondent considers themselves to be religious and zero otherwise.
[17] The OLS estimation method is used.

well-specified. We have also controlled for the sensitivity of our findings by measuring the tax morale with separate 7-point Likert scale questions. Given the ordinal nature of these variables, an ordered logit estimation method has also been utilised (Columns 2-6 in Table 4). Since both the OLS and ordered logit estimates are very similar, only the OLS estimates (Column 1 in Table 5) will be discussed below.

Therefore, to explore whether or not the influence of tax tuition on tax morale is dependent on a student's employment history, we estimate the interaction between the two variables (Course_taxtution_spr#Employment). As the results in Table 5 show, the interaction is statistically significant in all specifications ($p<0.1$). This shows that the effect of tax tuition on tax morale is conditional on the individual's employment experience. The coefficient for tax-course-enrolment (Course_taxtution_spr#) measures the influence of enrolment on tax morale only for students *without* an employment history (i.e. when Employment=0). The effect of tax tuition on tax morale for students *with* employment history (i.e. when Employment=1) is then considered by estimating the coefficient of the interaction term. The estimated coefficient of tax-course-enrolment is positive, revealing that tuition increases the tax morale of students without employment histories ($\beta = 0.925$, $p < 0.1$). However, a negative coefficient on the interaction term shows that the effect of tax-course-enrolment diminishes for students with current or previous employment ($\beta = -0.949$, $p < 0.1$).

Our empirical findings indicate that the impact of tax tuition on tax morale might be better understood if the employment history of a student is considered jointly with tax tuition. These results may suggest that young people will not fully appreciate taxation in theory until they personally engage with the income tax system. As such, first-hand experience of the tax system (as an income tax payer, not just a VAT payer) and tax tuition taken together may produce a negative compliance outcome that tax tuition alone does not produce.

Rodriguez-Justicia and Theilen (2018) find that education levels have a positive influence on tax morale when the participant is a net beneficiary of the system and are negatively associated when the participant pays in more than they get out of it. Therefore, it is interesting to note that when our student participants enter the world of work and pay income taxes, we may observe that they behave as net contributors do. Referring to Feld and Frey (2002), Rodriguez-Justicia and Theilen (2018) suggest that each individual has a "psychological contract" with the state, where some personal benefits are realised from taxation (p. 20). Therefore, net beneficiaries may have higher tax morale (i.e. motivation for tax compliance).

The findings for the effects of the control variables in our study are in line with findings in the literature. Female residents of the United Kingdom and white respondents report higher levels of tax morale than their male, non-U.K.-resident and non-white counterparts—i.e. consistent with Alm and Torgler (2006), Frey and Torgler (2007), and Daude et al. (2013). Age and marital status do not have statistically significant influences, as was expected with this sample given the minor variations in respect of these variables.

5. CONCLUSIONS

The research described in this paper sought to explore the linkages between tax education and tax morale, specifically targeting young adults in the process of completing higher education and (in many cases, albeit not all) joining the workforce on a more full-time basis. This is a domain and subject group that several prior studies have explored, perhaps not unsurprisingly given the critical life change that this move creates, from primarily being substantially engaged

with education to primarily being a member of the workforce. As such, many of these individuals are likely to be about to become income tax payers, potentially for the first time. However, previous studies have not looked at whether or not prior employment and income tax paying experience has an effect on the way in which tax education influences tax morale.

Table 5: Estimated Results of Model (1)

VARIABLES	(1) OLS TM_total	(2) Ordered logit Spent wisely	(3) Ordered logit Project benefited	(4) Ordered logit Worthy projects	(5) Ordered logit Others pay more	(6) Ordered logit Project not benefited
Age	-0.142	-0.283	-0.123	-0.366	-0.08256	-0.120
	(0.209)	(0.220)	(0.232)	(0.234)	(0.219)	(0.245)
Over 25	-0.099	0.219	0.419	0.339	-0.44118	-0.996
	(0.407)	(0.483)	(0.525)	(0.438)	(0.454)	(0.660)
Female	0.571***	0.291	0.349*	0.111	0.55109***	0.513***
	(0.177)	(0.190)	(0.193)	(0.192)	(0.199)	(0.190)
U.K.	0.612***	0.709***	0.979***	0.724***	0.74585**	0.131
	(0.225)	(0.247)	(0.307)	(0.279)	(0.320)	(0.271)
Marital status						
Married	-0.074	0.24288	0.47273	0.28453	0.01855	0.28597
	(0.468)	(0.571)	(0.769)	(0.702)	(0.504)	(0.534)
Other (Separated, Widowed, Divorced)	0.072	0.68396	0.81523	-1.49331	0.79964	0.61801
	(0.824)	(1.079)	(1.528)	(0.974)	(0.576)	(1.440)
White	0.389**	0.21829	0.13872	0.13938	0.02117	0.50617**
	(0.197)	(0.242)	(0.264)	(0.242)	(0.267)	(0.257)
Religious	-0.125	-0.42787	-0.45404*	-0.42648*	-0.23797	0.33919
	(0.215)	(0.261)	(0.247)	(0.235)	(0.277)	(0.268)
Trust_UKgov	-0.316*	-0.30089	-0.36763*	-0.26247	-0.27089	-0.04708
	(0.178)	(0.197)	(0.198)	(0.196)	(0.198)	(0.205)
Course_taxtution_spr	0.925*	2.27246***	1.56996***	2.02686***	1.36284**	1.10018**
	(0.513)	(0.601)	(0.557)	(0.630)	(0.663)	(0.554)

Employment	0.354	1.41370***	0.84986**	1.04896**	0.87788**	0.55566
	(0.367)	(0.452)	(0.369)	(0.460)	(0.407)	(0.416)
Course_taxtution_spr#Employment	-0.949*	-2.2601***	-1.717***	-1.795***	-1.284*	-1.219**
	(0.535)	(0.625)	(0.592)	(0.654)	(0.701)	(0.567)
Constant	4.788***					
	(0.412)					
Observations	312	364	365	362	355	357
R-squared	0.12					

The results of this research show that gender, employment experience, and tax tuition all influence tax morale. Consistent with the literature, female respondents tend to have higher tax morale (i.e. are, on average, more willing to pay taxes due) than the male respondents. Respondents with employment experience tend to have a higher level of tax morale than those without employment experience. There is a general perception that the United Kingdom's individual tax system is fair, but that it is complex and the rates are too high. This perception is particularly strong for those in employment.

The research further shows that students who receive higher levels of tax tuition have higher levels of tax literacy. However, the researchers were unable to conclude whether enhanced tax awareness/literacy gained via tax tuition results in enhanced tax morale. Further research into the causation between tax awareness/literacy and tax morale would be necessary in order to draw such inferences.

The moderating effect of work experience on tax tuition to tax morale of university students has, to our knowledge, yet to be considered in the literature. Following the initial part of our research, we were intrigued by the employment-related results in our univariate analysis which potentially implied that having some employment experience appears to correlate with lower tax morale in comparable groups of similarly aged young adults in full-time education. As we were unable to establish whether this was a causal relationship (or the direction in which this may have been causal), we undertook further research using multivariate analysis in order to explore and better understand what may be driving the correlation.

The findings from this research, as reflected in Table 5, are that students who receive tax education and have employment experience have reduced levels of tax morale. Our research shows that the impact of tax tuition on tax morale is influenced by work experience, suggesting that young people will not fully appreciate taxation in theory until they have personally engaged with the income tax system. Our findings are consistent with those of Rodriguez-Justicia and Theilen (2018), who found education to have a negative impact on tax morale for net contributors to the system. This is an area that warrants further research as it poses interesting challenges for those engaged in tax education if it is creating these unexpected effects on tax morale in some of those who they are seeking to teach.

This research is subject to a number of limitations. First, the data has been extracted from relatively small cohorts of students from two universities within the United Kingdom and the

conclusions may not, therefore, be generalisable even to other students of a similar age. Second, tax morale and tax compliance behaviour have been measured using subjective survey ratings. This raises reliability concerns as these findings could be prone to measurement error. Furthermore, previous studies question the validity of survey instruments due to limited numbers of constructs. We partly address this concern by including a sizable number of constructs.

The results from this research suggest that there is more that could be done to develop taxpayer education. Taxpayer compliance and morale may be positively influenced by widely disseminating foundational tax education early, and then reinforcing and further developing knowledge at later life stages. However, the potential for this to decrease, rather than increase, voluntary compliance is a conundrum that is reflected in this study (as elsewhere) and is a concern that further research may seek to address.

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REVIEW OF RECENT LITERATURE

Felix Wilson[1], *Lynne Oats*[2]

The following is a selection of recently published papers that caught our eye, in no particular order, from a diverse range of publications. JOTA welcomes suggestions for papers for review and offers to assist in compiling future reviews.

TAX MORALE & ATTITUDES

Matthaei, E., Chan, H. F., Schmidt, C., & Torgler, B. (2023). Relative trust and tax morale. *Economic and Political Studies, 11*(3), 400–418.

In this paper, the authors draw on data for 44 European countries from the Integrated Value Survey, which integrates the World Value Survey and the European Value Survey, in order to explore the importance of trust in international institutions—in particular, the European Union (EU) and the United Nations—for tax morale. They find that trust in national government appears to be the main factor in driving tax morale, although there are differences depending on national context. The literature review section of the paper is instructive as to the various understandings of the relationship between trust in national institutions and trust in international institutions, and the development of the research questions investigated in the paper is clearly explained. The measurement of tax morale is based on the response to the single survey question of whether tax cheating is justifiable. The authors find that in the EU and low trust countries, increasing trust in international institutions can help to foster tax morale. In non-EU countries and high trust countries, high levels of tax morale are particularly associated with high levels of trust in government, and higher levels of trust in international institutions can crowd out tax morale, which underscores the importance of creating trust between citizens and the state.

Oliva, M., Tomasena J. M., & Anglada-Pujol, O. (2023). "Kids, these YouTubers are stealing from you": Influencers and online discussion about taxes. *Information, Communication & Society*.

This case study uncovers a tension between debates and conceptions about media ecologies, inequality, welfare, fairness, and generational differences in attitude. The paper reveals these strains through the thematic analysis of public discourse about tax avoidance in Spain, with the case focussing on the public move by Spain's most popular YouTuber, El Rubius, to Andorra with the aim of paying lower taxes. The authors collect data from 30 videos posted by YouTubers, traditional media clips reposted to YouTube, and their respective comment sections. Their analysis exposes a polarised argument, with traditional media forming a moral dispute, and with YouTubers highlighting the burden of taxation and a perception of inefficient and corrupt government. The aim of the study is to explore how taxes are defined, how YouTubers and their audiences are portrayed, and the resulting identification that these stories offer. The literature review section outlines current research on "taxation imaginaries" and "austerity culture", with the research looking at how naming and shaming strategies were applied in this case, the case's impact on tax imaginaries, as well as the role of tax morale, and providing an outline of the current discussion surrounding social media celebrities. This

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research finds that traditional media outlets emphasise the elements of reciprocity, equality, and solidarity, although naming and shaming here is seen as counterproductive, having little effect on their reputation with audiences identifying with the shamed YouTubers. This resulted in legacy media being called out as manipulative, and the younger generation seeing definitions of taxation and the welfare state as outdated and oppressive.

TAX COMPLIANCE

Yong, S., & Fukofuka, P. (2022). Accounting, tax compliance and New Zealand indigenous entrepreneurs: A Bourdieusian perspective. *Accounting Auditing & Accountability Journal, 36*(5), 1350–1378.

This study explores how New Zealand's indigenous (Māori) entrepreneurs use accountants for tax compliance practices, as well as the resulting interactions between these entrepreneurs, their accountants, and the tax authority (the Inland Revenue Department [IRD]). The authors explore 34 qualitative interviews combined with a government documentary review, basing their analysis on Bourdieu's concepts of field, capital, and habitus. This allows for a closer inspection of compliance practices and the power relations between the various actors in the tax field. The authors first discuss the historical relationships developed between Māori people and the state, as well as Māori entrepreneurship, before examining tax compliance literature and Bourdieu's framework. In-depth, semi-structured interviews are undertaken with entrepreneurs, accountants, business experts, and key informants in order to triangulate the narratives of Māori entrepreneurs and uncover the effects of habitus on actions. By analysing the results through Bourdieu's framework, the authors are able to conclude that accountants and the IRD hold positions of power, disadvantaging Māori entrepreneurs as a result of underlying western ideology and a lack of awareness regarding its effect. Accounting for tax reporting does not allow for contextual and social factors to be considered as part of the tax compliance policy debate and is at odds with Māori culture and collectivism.

Barrett, J. M. (2023). Is a duty to pay tax inherent in affirmations of human rights? *Washington and Lee Journal of Civil Rights and Social Justice, 29*(3), Article 3.

This article seeks to understand whether or not the vaguely stated duties presented in the United Nation's Universal Declaration of Human Rights (UDHR), 1948, suggest that there is a duty to pay tax in a way that is comparable with the explicit manner in which such duty is included in the American Declaration of the Rights and Duties of Man, 1948. Through answering this question, the article aims to develop links between welfare rights and duties and the duty to pay tax. This is achieved through consideration of the negotiations that led to the formulation of article 29(1) of the UDHR in order to understand why Anglophone countries do not have an express duty in human rights doctrine to pay tax. Overall, the paper argues that a duty to pay tax may be inferred through the protection and promotion of all rights thus requiring government expenditure. The author outlines the origins and development of welfare rights as universal human rights by close investigation of landmark recognitions of welfare rights (such as the Constitution of Mexico, 1917, and the International Labour Organization, which was founded in 1919). The author presents a discussion about how the development of article 29(1) uses the American Declaration of the Rights and Duties of Man, 1948, as a precursor and comparator, yet only includes a broadly worded mention of duties in the context of human rights, suggesting that the duty to pay tax may be present in human rights doctrine. The author finds that a duty to pay tax is consistent with the presence of human and welfare rights.

INTERNATIONAL TAX COOPERATION AND COMPETITION

Cui, W. (2022). New puzzles in international tax agreements. *Tax Law Review, 75*(2), 201–270.

Cui asks a fundamental question—what are countries cooperating in the international sphere to achieve? He radically suggests that "the answers offered by the proponents of the new international tax agreement are alarmingly ad hoc, misleading, and incoherent" (p. 204).

To frame the discussion, Cui identifies puzzles in three OECD narratives. The first of these is that global business now mainly takes place remotely, yet there is little evidence of this outside of specific sectors and countries, calling into question the idea that global agreement is essential to international reform. The second is that international agreement is necessary in order to appease the United States of America, but the possibility of one country violating global trade agreements is a "highly unusual justification for global cooperation" (p. 204). The third is that a global minimum tax will resolve the problem of tax competition, yet the gains from cooperation remain unclear.

He then takes a close look at whether past scholarship, in particular within economics, has identified a rationale or rationales for cooperation in international corporate income taxation and concludes that it has not. He notes that "in international taxation, the question of what global welfare gain can be achieved through international cooperation is basically unanswered—obviously unsatisfactory 'folk theories' continue to occupy this void" (p. 206). He notes that there are unacknowledged gaps in understanding about common normative assumptions and how international tax rules have worked which have been exacerbated by the isolation of tax law from other areas of law, e.g. trade law. Indeed, he states that a "fundamental reconceptualization of the subject matter of international taxation may be needed for understanding the true past and future grounds for international cooperation" (p. 208).

Cui identifies three rationales for reforming international tax. The first is mode substitution in services (scale without mass). Yet trade statistics cast doubt on the premise that there has been a massive shift to Mode 1 from Mode 3 trade in services. While the growing volume of Mode 1 trade may justify action, it still does not provide grounds for a "prompt and radical overhaul" (p. 214). Similarly, the case for dealing with an increase in Mode 1 trade within corporate income tax is itself weak. In terms of the temporal dimension, the need for speed necessitating more multilateral agreements is also questionable given the reception given to the OECD's *Multilateral Convention to Implement Tax Treaty Related to Measures to Prevent Base Erosion and Profit Sharing* (2020) by practitioners and the added complexity (therefore cost) that it entails.

The second rationale is the prevention of trade wars, exemplified by the United States Trade Representative investigations under Section 301 of the 1974 Trade Act into several DSTs on the basis that they discriminated against U.S. technology companies. In 2021, because of the potential for "trade wars" (p. 216), the OECD agreed that digital services taxes (DSTs) should not be used. Yet, as Cui notes, "a rationale for global tax agreement based on DST induced-trade tensons…emerges only if the United States is assumed to be 'retaliating' against almost the entire world" (pp. 219-220). He also points out that there are unanswered questions about the compatibility of s301 tariffs and World Trade Organization rules.

In terms of the global minimum tax, Cui notes that a requirement to adopt a minimum corporate income tax (CIT) rate is absent from the Two Pillar Solution, which was endorsed by the G20 in July 2021. Both the income inclusion rule and the undertaxed payments rules deal with income lightly taxed elsewhere. The link to tax competition is tenuous at best. In terms of Pillar 1, Cui states that "the smaller the scope of application of the newly created taxing rights, the clearer it is that the *main* outcome… is the prohibition of DSTs" (p. 231).

Cui makes the cogent point that "*it is not clear why maintaining a minimum CIT rate across all countries is good for the world*" (p. 235). Indeed, there are arguments for abolishing CIT altogether. He highlights two unquestioned assumptions in international tax scholarship. The first is that the main subject of international taxation is capital mobility and the second is that CIT is immutable. He concludes that "the new international tax agreements of 2021 seek to weld the world to these outdated assumptions" (p. 269).

Devereux, M., & Vella, J. (2023). The impact of the global minimum tax on tax competition. *World Tax Journal, 15*(3), 323–378.

In this paper, the researchers look at the impact of the Pillar Two Global Anti-Base Erosion (GloBE) rules on corporate tax competition. To do this, they explore the two main objectives of the GloBE rules, addressing issues with profit shifting and tax competition. They locate two different meanings of tax competition in the Inclusive Framework (IF) documentation with recent IF documentation using the first, ensuring that multinationals pay a minimum level of tax. Despite this, OECD officials and politicians still discuss it in terms of bringing a stop to the harmful race to the bottom. As a result, the paper goes on to see which of these forms of tax competition the GloBE rules address.

Furthermore, the authors also discuss the top-up tax calculation, focussing on substance-based income exclusion and the qualified domestic minimum top-up tax. They look at the effects that these different approaches have on tax competition and, more broadly, whether the GloBE rules will be successful in creating a tax floor. The authors then test the impact of several factors, including the interactions between controlled foreign company rules and the GloBE rules on their previous conclusions, finding only small changes. Finally, the authors consider an alternative and more straightforward design for the top-up tax. Overall, they conclude that the impact of the GloBE rules will be significant, although not straightforward.

THE TAX PROFESSION

Killian, S., O'Regan, V., & O'Regan, P. (2023) "Uncomfortable territory": Personal and organisational values in the tax profession. *Accounting Forum, 47*(1), 1–23.

In this paper, the authors zoom in on the personal ethical and spiritual values of individual tax professionals, against the backdrop of a shift in perception of their role from technical service providers to an elite group doing work that damages society. The study draws on a large global survey of tax professionals together with a follow-up set of 68 semi-structured interviews. Much of the previous research on ethics in the tax profession is experimental, based on hypothetical scenarios, but this study takes a mixed methods approach and adapts Rest's (1986) model to tease out "the recognition by tax experts of the ethical dimensions in their work" (p. 5). The authors examine the salience of personal values in light of age, career stage, and organisational context.

The findings of the study yield new insights into tensions between personal and organisational ethics. Spiritual values are strongest among those practitioners working in very small firms, those who are still in the process of obtaining their professional qualifications, and those within domestic (non-international) organisations. Perhaps unsurprisingly, the salience of spiritual and religious values is found to be lowest in large international firms, indicating a "surrender of personal values to the corporate culture" (p. 19), possibly overriding professional ethics training among early career stage practitioners.

OFFSHORE TAX EVASION

Leenders, W., Lejour, A., Rabaté, S., & van 't Reit, M. (2023). Offshore tax evasion and wealth inequality: Evidence from a tax amnesty in the Netherlands. *Journal of Public Economics, 217,* 104785.

The authors analyse datasets of Dutch tax evaders in order to map the distribution of evasion and the implications for how wealth inequality is measured. Hidden wealth poses difficulties for the measurement of wealth inequality. Researchers who have investigated various data leaks and the outcomes of tax amnesties have generally confirmed that tax evasion is concentrated among the wealthy, but the use of tax administration data may fail to capture hidden wealth and income. This study finds that the concentration of tax evasion at the top of the wealth distribution, i.e. the super-rich, is lower than found in previous literature. Rather, there is substantial evasion among the "merely rich", which is at least in part attributable to cross-border evasion opportunities in neighbouring countries. The radical option of tax migration is easier for the super-rich. In relation to the tax amnesty, the authors observe a strong sensitivity to changes in the penalty rate, i.e. institutional and geographical factors have explanatory roles to play.

Fernando G. A., & Mandel, A. (2022). The network structure of global tax evasion evidence from the Panama papers. *Journal of Economic Behavior & Organization, 197,* 660–684.

In this paper, the authors use the Panama Papers to explore the dynamics of tax evasion. They draw on network theory to model links between jurisdictions in what they describe as a "global network of tax evasion" (p. 660). The authors identify structural features consistent with complex networks and are able to identify tax havens that should receive priority attention from policymakers. The authors also identify optimal deterrence strategies.

GLOBAL GOVERNANCE

Killian, S., O'Regan, P., Lynch, R., Laheen, M., & Karavidas, D. (2022). Regulating havens: The role of hard and soft governance of tax experts in conditions of secrecy and low regulation. *Regulation & Governance, 16*(3), 722–737.

The focus of the authors in this paper is the regulation of tax experts and the need to better understand how the relative influence of hard and soft governance varies by jurisdiction. The field study drawn upon to analyse this consists of an international survey that elicited the perceptions of tax experts of the influence of regulation and governance on their day-to-day work. The authors find that influences on work are reported to be stronger for tax experts in countries with high financial secrecy, irrespective of conditions of economic freedom. Workplace ethos is reported to be significantly more influential for tax experts in high-risk

jurisdictions. Economic freedom and financial secrecy are found to "foster very different governance landscapes" (p. 734) and, ultimately, these differences lead to a need for different governance levers. This is an important reminder that the blind adoption of "best practice" regulation and governance mechanisms is generally not a good idea.

Oei, S-Y. (2023). World tax policy in the world tax polity? An event history analysis of OECD/G20 BEPS inclusive framework membership. *The Yale Journal of International Law, 47*(2), 199–246.

Although the Base Erosion and Profits Shifting (BEPS) project and Inclusive Framework (IF) have received criticism for failing to prioritise the interests of developing countries, many countries have still agreed to join. As a result, this paper asks how these developing countries came to join despite the burdens, clear limitations, and questionable benefits of the projects. The author applies event history regression methods and world polity theory to better understand the decisions made by these countries and, therefore, the growth of the new global tax consensus.

World polity theory describes how norms spread across the world, giving rise to shared culture shaped by international organisations and non-governmental organisations. To better understand the application of world polity theory, the underlying mechanisms and processes by which global tax norms have been adopted need to be understood. The author investigates three pathways—normative, mimetic, and coercive—to see where these have driven countries to become members of the BEPS IF. Overall, this article finds that international organisations like the OECD can work with other powerful actors to exert pressure on the international tax landscape in order to generate norms that shape global tax institutions and domestic tax regimes.

TRANSFER PRICING

Ormeño-Pérez, R., & Oats, L. (2022) Implementing problematic tax regulation: Hysteresis and bureaucratic revolutionaries within tax administrations. *British Accounting Review, 55*(3), Article 101147.

This paper takes a historical look at the design and implementation of the first transfer pricing rule in Chile in 1997, its amendment in 2002, and its repeal in 2012. The authors draw on a series of semi-structured interviews to gather behind the scenes insights into how the rule was designed, and the ensuing difficulties resulting from inadequate drafting. The rule was designed to be consistent with the then OECD transfer pricing guidelines, but with modifications to accommodate deficiencies in administrative capabilities. The paper illustrates the unexpected difficulties that emerge when tax rules are adapted from external sources without due deference to their fit within the institutional competencies and resource constraints, thereby providing a cautionary tale for jurisdictions seeking to implement OECD-mandated rules.

Greil, S., Overesch, M., Rohlfing-Bastian, A., Schreiber, U., & Sureth-Sloane, C. (2023). Towards an amended arm's length principle: Tackling complexity and implementing destination rules in transfer pricing. *Intertax, 51*(4), 272-289.

The authors of this paper argue for an extensive revision of the arm's length principle (ALP) to improve fairness in the allocation of MNE profits to jurisdictions where customers reside. They rehearse the arguments for the diminution of support for the single entity principle,

including increasing tax complexity. To tackle complexity, the authors propose the reduction of functional and other analyses, alongside the standardisation of margins, remaining within the bilateral structure to minimise disruption. The second aspect of the authors' concerns is the implementation of destination rules, which they argue can be incorporated into a reinterpreted ALP in keeping with the aspirations of Pillar One, Amount A. With these modifications, the authors do not seek to create a new normative concept, but rather to improve the current bilateral rules.

Akhand, Z., & Mawani, A. (2023) Arm's length principle vs. formulary apportionment in BEPS Action 13: Stakeholders' perspectives. *Accounting in Europe, 20*(2), 225–243.

This study examines 133 comment letters submitted to the OECD in relation to transfer pricing documentation in response to a discussion draft published in January 2014. The authors seek to understand differences in opinion between stakeholders about the longstanding tension between the arm's length principle and formulary apportionment. The authors used qualitative data analysis software to manage the coding process, which featured five main categories. Concerns about a prospective shift to formulary apportionment were higher among European commenters than those from North America, possibly reflecting their starting position of lower levels of disclosure. The authors further argue that comments from that opposed the new documentation regime may be indicative of implicit lobbying and that such firms prefer complex rules that result in lower taxes for their clients.

INFORMATION REPORTING

Blank, J. D., & Glogower, A. (2023). The tax information gap at the top. *Iowa Law Review, 108*(4), 1597–1651.

In this article, the authors theorise about why the U.S. tax information reporting regime treats extremely high earners differently from other taxpayers. Their discussion emphasises that the U.S. tax information reporting regime can be considered as two-tiered where less scrutiny is applied to the very top cases than to most cases. Consequently, this presents greater opportunities for avoidance or evasion, therefore disproportionality benefiting certain groups. As a result, the authors highlight several issues with the current regime. They argue that an overreliance on the activity-based approach allows high-end taxpayers the scope to earn income in ways that fall outside of the law framework of specified activities where tax information reporting is obligatory, introducing the concept of actor-based information reporting rules. To address these weaknesses, the paper first evaluates the Biden administration's recent bank information reporting scheme, which is an attempt to expand the types of transaction that must be reported to the Internal Revenue Service. This is followed by two proposals that introduce a model for first-party information reporting and a hybrid system. This considers both first-party and third-party information reporting along with their challenges and describes the benefits of making use of both types of reporting. This paper is relevant to tax scholars, policymakers, and tax officials.

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