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Income Tax - Discipline or Review?

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INTRODUCTION

A government needs money to be able to operate and usually raises a significant proportion of this finance by taxing those who live and earn income within its boundaries. This paper addresses aspects of the question why one government, the Australian government, should choose income tax as the major vehicle for raising revenue. Drawing on the work of the French historian and philosopher Michel Foucault it is suggested the income taxing system provides a way of disciplining and monitoring the population, primarily to encourage the voluntary payment of income tax but also allowing each citizen to become known.

SOVEREIGNTY

In terms of western society, before the seventeenth century, power lay with the sovereign and obedience with the subject. Power was not concerned with details. In feudal societies power functioned essentially through signs and levies, rituals, ceremonies and so forth, and levies in the form of taxes, pillages, hunting, war, etc. [Foucault, 1980, p.125]

People were subject to the sovereign and were required to do/pay what the sovereign required. Individuals were subjects of sovereignty, to be ordered at will. Each individual knew his/her place in the scheme of things where aristocratic honour, cosmic order and orthodox religious order were stressed. [Taylor, 1986, p.69]. The old order of power depended on the idea of public space, and of a public authority which essentially manifested itself in this space, which overawed us with its majesty and regulated the subject to a less visible status... [Taylor, p.74].

A change appeared to take place during the seventeenth and eighteenth centuries when a new form of power began to manifest itself through social production and service [Foucault, 1980, p.125]. New mechanisms of power emerged during the classical age. These mechanisms of power were endowed with very specific procedural techniques. Power became one of disciplinary domination, which concentrated on human bodies and their operations. [Merquior, 1985, p.113].

The economic take-off of Western Europe began with the techniques that made possible the accumulation of capital; methods for the accumulation of men made possible a political take-off, as the traditional, ritual, costly, violent forms of power were superseded by a subtle, calculated technology of subjection.

The two processes are interdependent: economic expansion provided the means of sustaining and using the increase in population while the disciplinary techniques accelerated the accumulation of capital. The process by which the bourgeoisie became the politically dominant class in the eighteenth century was masked by the establishment of a coded, formally egalitarian constitution, supported by a system of representative government. [Sheridan, 1980, p.157]

There was a dark underside to this 'enlightenment' and this was represented by an evergrowing network of disciplinary mechanisms. [Sheridan, p.157].

These mechanisms of power were not compatible with the old relations of sovereignty. Disciplinary power came to be exercised over bodies through a system of surveillance through a network of material coercions which allowed an increase in the utility of the subjected body. [Smart, 1985, p.80].
Disciplinary power based upon a system of surveillance has become the basis of Australian society and the old idea of sovereignty has given way to this new technology of control, the object of control being the individual. Control is exercised by society itself rather than by a sovereign.

The old economy of power
... was costly in several senses: because directly it cost a great deal to the Treasury; because the system of corrupt offices and farmed out taxes weighed indirectly, but very heavily, on the population; because the resistance it encountered forced it into a cycle of perpetual reinforcement; because it proceeded essentially by levying (levying on money or products by royal seigniorial, ecclesiastical taxation; levying on men or time by corvees of press-ganging, by locking up or banishing vagabonds). The development of the discipline marks the appearance of elementary techniques belonging to a quite different economy: mechanisms of power which, instead of proceeding by deduction, are integrated into the productive efficiency of the apparatuses from within into the growth of this efficiency and into the use of what it produces. [Foucault 1979, p.219].

According to Michel Foucault, modern society, from the nineteenth century until today, has been characterised by, on the one hand, an organisation based on public right, the social body and the ability of each citizen to delegate rights to society; on the other hand it is characterised by a closely linked grid of disciplinary coercions, the purpose of which is to assume the cohesion of the social body. [Foucault, 1980, p.106].

The powers of modern society are exercised through, on the basis of, and by virtue of, this very heterogeneity between public right of sovereignty and a polymorphous disciplining mechanism. [Foucault, 1980, p.106]

DISCIPLINING SOCIETY

There has been a shift so that now the means of social control is concerned with the disciplining of the person rather than punishing the body. Power, as theorised by Foucault, is seen as something positive and not as repression or suppression. Foucault talks of power as...
... a set of practices which could be specified and which positively produced ways of behaving and free dispositions in human subjects: indeed the most pervasive power is that which makes its subjects co-operate and commune in their subjection to it. [Hoskin & Macve, 1986, p.106]

The foregoing implies that social control is achieved through the discipline of individuals, encouraging individuals to co-operate, to be both the instruments and objects of this exercise of power. This power is modest, suspicious and calculating rather than 'omnipotent or excessive' [Sheridan, p.152]. It is important to now consider some of the techniques of this discipline that can persuade individuals to willingly co-operate in their own subjection and to ensure that they pay the correct amount of tax at the correct time with minimum cost to the revenue.

The success of disciplinary power derives no doubt from the use of simple instruments; hierarchical observation, normalising judgements and their combination in the procedure that is specific to it, the examination. [Foucault, 1979, p.170].

This paper is concerned with whether the income taxing system as exists in Australia fits into the framework of disciplinary mechanisms as proposed by Foucault.
INCOME TAX - THE AUSTRALIAN EXPERIENCE

Income tax, in Australia, has a relatively recent history, being introduced, firstly by South Australia in 1884 to help overcome a financial crises at the time, then by the other states within two decades. The Commonwealth Government first levied income tax in 1914 as a 'temporary measure'. The Commonwealth Government assumed full responsibility for income tax in 1942, when the states surrendered their income taxing rights. Over the ninety or so years that it has been levied, income tax has grown in importance as a means of raising revenue while taxes levied on goods, wealth and property have declined and in a number of cases have disappeared altogether.

Taxation by its very nature is coercive.
For the ordinary citizen, the power to tax is the most familiar manifestation of the government's power to coerce. This power to tax involves the power to impose on individuals and private institutions more generally, charges that can only be met by a transfer to government of economic resources, or financial claims to such resources - charges that carry with them effective powers of enforcement under the very definition of the taxing power. [Brennan & Buchanan, 1980, p.8]

Most other countries in the world tend to rely more on property and goods taxes than does Australia.

LEGAL POSITION

... government derives its powers from the ultimate consent of those who are governed ... [Brennan & Buchanan, p.1]

The requirements for assessing income tax, in Australia, are laid down by the Income Tax Assessment Act (1936 as amended). Briefly, the Act requires the calculation of taxable income by the subtraction from gross income of allowable deductions. It should be noted that the Act does not define 'gross income', although it is often quite prescriptive as to what constitutes an allowable deduction. Not all expenses of a business are allowable in the calculation of taxable income, for example the cost of entertaining clients is not allowable. The term 'taxable income' as required for tax purposes is often very different from the accounting concept of profit. Often the taxpayer is required to make two calculations, firstly accounting profit then taxable income.

The Act imposes upon the taxpayer the requirement that a return detailing gross income and allowable deductions be submitted annually for assessment of tax, providing a number of penalties should the taxpayer fail to do so. In its original concept the Act was relatively simple. However, the passage of time and tinkering by successive governments in an attempt to stop tax avoidance and evasion, as well as to further their own policies, has produced a very complex set of rules. So complex and diverse are the provisions of the Act, that the average taxpayer is intimidated and overawed. So much so that large numbers feel that they need professional help to navigate their way through the treacherous shoals presented by the Act.

Other taxes imposed by governments involve relatively few actual taxpayers - for example, sales tax involves only those who wholesale goods, payroll taxes only those who pay wages and so they are confined to a small section of the community. On the other hand, income taxes involve the whole community, and so a very large administrative machinery has been developed to supervise and assess large numbers of taxpayers. For example, in 1989/90 there were 10,789,000 income tax returns
lodged, in comparison for the same period there were 82,613 sales tax remitters [Comm. Taxation, 1990, p.137-144].

Most agree that there is a need for a mix of different types of taxes, and this is the case in Australia to some degree. Those who support income tax as the principal source of government revenues do so on two grounds:

1. That income tax is the best tax to further a government's expenditure aims and in particular, the aim of redistributing income. Just how much income should be distributed is of course much argued and is the subject of political choice.

2. That income tax is a fairer tax in terms of the ability to pay, which they say should be the underlying cannon in the selection of a tax base. While income tax has many drawbacks its perceived fundamental quality of fairness is its greatest advantage. [Cooper, et al, p.21].

Historical development has determined that income tax is the best choice, in terms of equity, in raising revenue for governmental expenditure, in Australia. While consumption may or may not be a better taxing base, income tax has developed to be the predominant tax in Australia.

The income tax system as it exists in Australia depends on the willing co-operation of taxpayers, in the following sections it is proposed to examine the mechanisms that are in place to encourage the willing compliance of Australian taxpayers.

**HIERARCHICAL OBSERVATION**

The time has long passed when armed soldiers arrived to collect tribute for the king. Our tax system depends upon taxpayers voluntarily providing information as to their income and then paying the tax owing. Early attempts to introduce income tax foundered upon this very point. It appears that a significant number of taxpayers were unwilling to provide this vital information.

The days of overt force in the taxing sphere have long gone, yet the need to encourage taxpayers to comply with tax laws is still there. The problem for tax administrators is to develop systems and arrangements to ensure the willing compliance of the taxpayer. Tax laws require people to do things, to keep records and to submit returns of income. Most Australian adults are required to perform these duties yet there is no social or economic reward to encourage them to do so [Speed, 1988, p.597]. The problem for the tax authorities is how to provide this 'encouragement' to ensure accurate returns of income are provided when required.

Information is forwarded to the Tax Office by taxpayers. The fact that the information provided will be used in a way which will affect the circumstances of the provider may be an incentive for some to misreport. Failure to report or misreporting income can be of great economic benefit to an individual taxpayer. Of course the resultant tax evaded is a loss to the revenue which is not to be encouraged [Trengrove, 1985, p.86].

The major forms of non-compliance with the tax laws involve:-

- failure to submit returns - the belief being among taxpayers that if the Tax Office does not know about them then they do not have to pay tax.
- under-reporting income - this is probably the most significant form of evasion and often takes the form of 'forgetting' about items of income or receiving
income under a variety of names so that there appears to be a number of taxpayers instead of only one.

- overstating deductions - deductions are claimed for items of expense that were never incurred or for more than was incurred.

Probably one of the major factors in a taxpayer not complying with the law is the knowledge held by the taxpayer that the possibility of detection is remote. The Income Tax Assessment Act carries some fairly harsh penalties for non-compliance with its provisions but these are not sufficient if the taxpayer believes that there is a low probability of evasion being detected. The problem is how to lead the taxpayer to the conclusion that the probability of detection is much higher than he thinks and to the belief that tax evasion is for him problematic.

The Review of Systems for Dealing with Fraud on the Commonwealth [1987], at page 52 notes,

Criminological research shows, however, that widespread knowledge of a substantial probability of detection (followed by some adverse consequences) carries an infinitely greater deterrent weight than the threat of even the harshest penalties in circumstances where detection is rare.

This section is concerned with the techniques used to know about a taxpayer's affairs and the way that knowledge of the taxpayer's affairs is 'known' by the authorities is communicated to taxpayers. Most taxing authorities agree that information is the key to ensuring greater compliance. While not ideal from his point of view, the information systems employed by the Taxation Commissioner are in a state of evolution and growing sophistication. The affairs of a taxpayer are no longer in his or her private domain, the surveillance activities of the Commissioner of Taxation are able to intrude into the very heart of this dominion.

The paradigm of the surveillance sanction is the Orwellian world of Nineteen Eighty Four in which every individual is constantly watched, or rather has no way of knowing whether he or she is being watched or not. Those who believe they are being watched will modify their behaviour to conform with what they believe the watcher wants. [Freiberg, 1990, p.20]

Taxpayers have always been watched to some degree, but the sheer weight of information made collation and knowledge formation difficult. The computer revolution has made extensive mass surveillance of individuals a very real probability. Data matching and cross checking can be performed quickly and economically for each taxpayer so that the activities of each, in relation to income tax matters, can be closely monitored. The purpose of monitoring is to ensure the taxpayer fulfils his or her obligations and pays the appropriate amount of tax. Some examples of this monitoring will be discussed later.

STATUTORY POWERS

The Commissioner of Taxation and his officers appear to have more information gathering powers than even the police. Access powers are provided by the Income Tax Assessment Act in several places, the most important being Section 263 and Section 261.

Section 263(1) states:
The Commissioner, or any officer authorized by him in that behalf, shall at all times have full and free access to all buildings, places, books, documents and other papers for any of the purposes of this Act, and for that purpose may make extracts from or copies of any such books, documents or papers.

This section gives full access to information. There is no requirement that there be a search warrant. There is no requirement of notification of an intended visit. There is no requirement that there be a dispute between the Commissioner and the taxpayer. There is no requirement that the Commissioner needs to know beforehand what he is looking for. The section does not confine the search to documents relating to the person whose premises are being searched but can include information concerning others. The implication for accountants is that their premises may be searched and documents relating to a client copied without the client being aware of what was taking place.

The section provides two small comforts, firstly the seeking of information must be for "any of the purposes" of the Act, the courts have construed this strictly disallowing acts of idle curiosity. Secondly, documents cannot be removed, however S263(3) requires the occupier of the premises raided to provide reasonable assistance which includes the use of a photocopier if one is available; often the Tax officials bring their own portable photocopiers. The situation is unclear in relation to information stored on computers. However, the occupier of the premises would be required to provide assistance to enable the computer data to be examined.

One of the most dramatic uses of this power was highlighted in what is known as the Citibank case, which occurred in 1988. Thirty seven tax officers, including a locksmith, arrived unannounced at the Citibank premises for the purpose of making and removing copies of documents relating to a tax avoidance scheme. In fact most of the documents copied related to other tax matters. The copying was completed before Citibank could seek court orders. Citibank in fact took action alleging that the tax officers had exceeded their authority in copying documents protected by legal privilege. The Court found for Citibank, but the documents had been copied. [O'Connor, 1988, p.277]

Section 263 is complemented by Section 264 which states in subsection (1)

The Commissioner may by notice in writing require any person, whether a taxpayer or not, including any officer employed in or in connexion with any department of a Government or a public authority-
(a) to furnish him with such information as he may require; and
(b) to attend and give evidence before him or before any officer authorized by him in that behalf concerning his or any other person's income or assessment, and may require him to produce all books, documents and other papers whatever in his custody or under his control relating thereto.

The term 'information' is not defined in the Act and is taken to have its ordinary meaning. This Section is perhaps more civilized than Section 263, but nevertheless it allows the Commissioner to obtain whatever information he wants, provided of course that it is limited to information required for purposes of the Income Tax Assessment Act. S264 cannot be used to gain access to documents covered by legal professional privilege, all other documents are accessible. The Commissioner or his officers can go on 'fishing expeditions' to discover the existence of information he thinks he should know about...

.... the Commissioner can require information from the taxpayer which will enable him to determine which documents, books or papers he can require to be produced. [Skinner & Nethercott, 1990, p.887]
These two Sections are primarily in connection with tax audits, in the investigation of single taxpayers or groups of taxpayers. Both Sections allow information to be obtained without the taxpayer being aware at the time of the type or quantity of information being obtained. Section 264 requires notification but Section 263 does not. It is possible for tax inspectors to turn up on a doorstep and demand access to information with no advance warning. Apparently this is by no means a rare occurrence. Cases have been reported of inspectors arriving at cleaning companies demanding lists of employees, at transport companies seeking employee details, at metal fabrication firms wanting details of overtime payments and at banks seeking to have safety deposit boxes opened - all without warning.

In late 1989 the Commissioner of Taxation released guide-lines as to the manner and circumstances in which he will exercise his power to seek access to documents held by external accountants and their clients. The guide-lines place documents into three categories:

1. **Source Documents** such as the traditional accounting records, audit files and tax working papers - access to these is reserved without restriction.
2. **Non-Source Documents** such as advice papers and statements of opinion - the Commissioner will not seek access unless there is a suspicion of fraud or the source documents have been destroyed or cannot be located.
3. **Restricted Source Documents** such as advice papers concerning transaction structuring - access to these papers is as for non-source documents. [Deutsch, et al, 1991, p.1012]

These guide-lines provide little comfort for accountants. The Commissioner of Taxation ultimately has access to any and all information they hold concerning their clients' tax affairs.

Other Sections of the Act require the reporting of payments by employers and financial institutions, they will be referred to later. However Sections 263 and 264 provide the opportunity for the taxing authority to know intimately details of an individual taxpayer's affairs.

**INFORMAL SURVEILLANCE SYSTEMS**

The Australian Tax Office is staffed by individuals, who for the most part take their jobs very seriously and it has long been rumoured that these officers sometimes use unorthodox methods to obtain information about taxpayers or people who should be taxpayers. Quoting from an article in the "Good Weekend" of 29 July, 1989, published with the Sydney Morning Herald, the Butterworths Weekly Tax Bulletin [No. 40, 22-8-89, pp.687-688] lists a number of these unorthodox sources of information which include:

- getting lists of taxi drivers from taxi companies.
- following intuition.
- watching the neighbourhood, acquaintances, businesses, for signs of unusual activity.
- checking the social pages of the newspapers for people who may not be registered as taxpayers.
- information from the Department of Motor Transport - who owns what cars.
- luxury car dealers.
- credit card providers.
- club membership lists.
- insurance companies
- those taking overseas trips.
- banks.
- local councils.
Apparently the above sources of information are used to find out about people, whether they are taxpayers and whether the income they report is in accordance with their lifestyle. This informal surveillance is unobtrusive yet widespread.

Often, too, interesting pieces of information about recalcitrant taxpayers will flow to the tax authorities from members of the community. This apparently well-established flow of information from informers often comes from disgruntled family members. The investigation of a promoter of tax avoidance schemes featured in *Briggs v. D.F.C.T.* (1987) 87 ATC 4278 was assisted by an anonymous telephone call. [Cooper, et al, p.1071]

As noted above, the Family Court appears to be an excellent source of information in relation to tax matters. At a time of often great animosity, details of financial arrangements are often used as bargaining weapons. [Cooper, et al, p.1071] Other matters before the courts can also yield information which is of interest to the Commissioner of Taxation.

**FORMAL SURVEILLANCE SYSTEMS**

For many years the Commissioner of Taxation has received reports from a number of sources concerning the affairs of taxpayers. For example, employers are required to report the wages they pay to employees. Banks, large corporations and financial institutions have been required to report interest and dividend payments. The purpose of these reports was to provide a check of the validity of information disclosed in tax returns. The matching process was long and tedious. However, most tax agents would concede that from time to time, clients were called upon to explain why a certain amount of interest or a dividend did not appear in their tax return, often from some years previously.

**The Return**

Section 161 of the Income Tax Assessment Act requires each person to submit each year, a return giving details of the income, profits or gains of a capital nature, derived during the year, and also details of any deductions, losses or rebates claimed by the person. The Section gives power to the Commissioner to exempt people from submitting a return – usually those whose income falls below a certain level.

The return contains personal details of the taxpayer such as name, address, date of birth, occupation, marital status, dependants as well as details of the taxpayer's income and deductions. The return is the primary income source for the Tax Office.

Section 161(1) requires each taxpayer to sign his/her return declaring that the information contained within is true (taxpayers such as companies act through a human agent). Under the full assessment system an assessor then examines the information provided with a view to its apparent reasonableness and compliance with the rules. This is not the case with the self-assessment system which is in the process of being implemented.

**Reports**

As mentioned previously the Commissioner of Taxation receives details of interest and dividend payments from companies and financial institutions. This information is
now supplied on computer tape which makes less difficult the verification and matching of information supplied by the taxpayer.

Employers are required by the Act to deduct tax from payments to employees. This tax must of course be forwarded to the Tax Office. As well each year, employers must inform the Tax Office of the wages paid, to whom they were paid and the tax deducted.

Similarly, the Prescribed Payments Scheme, a scheme designed to stop widespread tax avoidance in certain industries by requiring tax instalments to be deducted from intra-industry payments, has a reporting requirement. Payers are required to notify the Tax Office of all payments under the scheme. This reporting requirement is extended to householders who employ a member of the building industry to do work worth more than $10 000. The householder is not required to make any deduction but is required to notify the authorities of payments made. A further surveillance measure is that local councils are required to notify the Tax Office of building approvals. Action can be taken against those who fail this reporting duty.

A More Formalised System

Some years ago there arose calls for a national identity system to combat perceived offences caused by problems of identifying individuals. It was claimed that some people using a number of bogus identities were avoiding the payment of their full measure of income tax, while others were able to claim unemployment benefits while maintaining employment under another name. The "Australia Card" was proposed as the solution to these problems, problems which could not apparently be solved by existing law enforcement techniques. The Australia Card was to be a national identity system and was to be the vehicle for an extensive mass surveillance system. The proposal was introduced into Parliament and became the subject of a double dissolution. After its re-election the government modified the Australia Card proposals to produce what has become known as the Tax File Number System in 1988. [Cooper, et al, p.53]

The Tax File Number System

Not as comprehensive as the proposed Australia Card, yet in practice likely to become far more wide reaching, the Tax File Number System (TFN) is now in the process of implementation. The TFN will be a vehicle for accumulating, more easily than hitherto, information concerning, in the first instance, taxpayers and later on a much wider section of the community.

The TFN system represents a further attempt to increase the efficiency of the A.T.O.'s income matching procedures, by facilitating accurate identification of persons receiving employment, interest and other income, thus making it more difficult for people to receive income under false names, in second jobs ("moonlighting"), or otherwise abuse the system. [Woellner, et al, p.212]

Sections 202-202G of the Income Tax Assessment Act govern the TFN system. These sections set out the requirement to be able to prove identity when applying for a TFN. They also require the TFN to be quoted by individuals to employers and financial institutions. These institutions are required to report to the Tax Office listing payments made and the associated TFN.

It needs to be pointed out that certain people, such as those under 16 and pensioners, are exempt from the TFN system (unless they earn enough income to pay tax). The
obligation to quote a TFN is not compulsory; however failure to do so will require the paying institution to deduct tax at the highest personal marginal rate of tax. By requiring the linking of the major sources of income of the majority of citizens with the TFN the gaze of the Tax Office can be more comprehensive. Especially as there is a requirement that information be submitted in computer readable form to allow the speedy comparison of data for all taxpayers and not just a few selected at random.

Due to the community's concern with privacy there are very strict guide-lines as to who should have access to TFNs and their security. Information obtained by the Tax Office is confidential to that organisation except in a few specified instances.

The Data Matching Programme

The use of the TFN system has been recently extended to include other areas within its surveillance net. The Data Matching Program (Assistance and Tax) Bill, 1990 became law in December 1990. The purpose of this law is to provide for wide-ranging data-matching between the Australian Tax Office and the Departments of Social Security, Veteran's Affairs, Community Services and Health, and Employment Education and Training.

The government hopes that data-matching will enable it to virtually eliminate a major cause of taxation and social security fraud. A cross-check and match will be made of TFN, income and family structure. It is hoped that the program will indicate those who have provided inconsistent information to one or more government departments and to highlight information disclosed to another government agency and not to the Tax Office.

There are strict guide-lines as to when this matching of data can take place. The frequency of matching is restricted to nine times in any one year. The data to be matched must be transferred physically and not by an on-line computer connection; at the end of three months the information not followed up must be destroyed. [Butterworths Weekly Tax Bulletin, No. 56, 1990, para 845]

The machinery is now in place for gathering knowledge about individuals in a wider sphere than purely tax matters. Yet the expansion of surveillance activity is under the guise of the income tax system.

Cash Transaction Reporting

A further extension of the surveillance net can be found in the Cash Transaction Reports Act of 1988. The purpose of this legislation, as stated in Section 4, is to facilitate the administration of the taxation laws by providing the Commissioner of Taxation with details of large cash transactions conducted through defined 'dealers'.

The Act has been introduced progressively. Among other things the Act has made the holding of a bank account in a false name an offence. As well there are extensive requirements as to proof of identity for those wishing to open a bank account.

Cash dealers such as banks, building societies, credit unions, T.A.B.'s, casinos and bookmakers must report all transactions they suspect of being involved in tax evasion or other breaches of the law. In addition they must report cash transactions of $10 000 or more, or $5000 or more involving foreign currency. The information received is to be made available to the Australian Taxation Office as well as Customs and Federal and State law enforcement bodies.
It is expected that the cash transaction reporting legislation, being a 'high-visibility' innovation, will make all those dealing with cash dealers aware of the fact of surveillance. As well, it is expected to yield useful and relatively high-quality information about a range of significant financial transactions. [Woellner & Burns, 1989, p.173] Not only will information be obtained about wrongdoers but it will also be obtained about people, going about their lawful business, who like to deal in large amounts of cash.

PUBLICITY

For a surveillance system to be effective as a disciplinary force the watched must be aware of being watched. The TFN system and the Cash Transaction Report system have been publicised widely. Each employee and each holder of a bank account, each recipient of interest or dividend income, has been made aware of the need to make known their tax file number. This has taken place through TV and newspaper advertisements and literature made available through the financial institutions.

Each taxpayer is made aware each year, of the requirement to submit a tax return and give the details required by that form. In addition, from time to time, press releases by the Commissioner of Taxation or his officers, mention specific areas of activity which, at the time, are of prime interest to the Tax Office; also of course, indicating that the watchers are watching. For example the Sydney Morning Herald of 25/2/91 carried a report of a speech to the Queensland branch of the Institute of Chartered Accountants by the Commissioner of Taxation, Mr Boucher. He warned that hairdressers, doctors, engineers, miners, cleaners and teachers have been targeted for special investigation during the coming year a clear statement that a special gaze has been turned on people in those occupations but no indication of which individuals are being watched. Statements carrying a similar message appear with regularity, reminding taxpayers that the gaze of the Commissioner has not been turned off. The frequency of these press statements seems to increase as the time for lodgement of returns approaches.

SUMMARY

One of the keys to developing a compliant, docile taxpayer is surveillance. The knowledge of being under surveillance, especially if the subject believes that the chance of detection is not a remote possibility, is often enough to ensure willing cooperation. The systems our society has devised to watch its taxpaying members are not complete or all-encompassing but they are growing in complexity and sophistication. This has been aided by the development of high speed computers that can deal with large amounts of information very quickly. Bank accounts and sources of income have been linked through the TFN, the machinery is in place for all information held by government on its citizens to be collated and developed into a comprehensive file on every member of society. Thankfully we do still have some safeguards for our privacy guaranteed by legislation, but there could come a time when these safeguards are dispensed with, and the surveillance systems established with a view to ensuring people pay their tax could become all encompassing.

While we are not yet at the stage of 'womb to tomb' dossiers on individuals ... The faceless gaze of government has the power to transform the whole social body into a 'field of perception'.

... the movement to employ privacy sanctions seems inexorable, given the availability of technology. Unlike the physical sanctions which are highly visible, obstrusive and rigid, this form of power is 'a lighter, more rapid and more effective' form of coercion. [Freiberg, p 22]
Finally, in the moves to introduce the Australia Card or similar devices, one can observe the transition of punishment from the physical to the mental, from the body to the mind. We are not quite yet in a Panoptic society, but the pressure is growing. [Freiberg, p.24]

NORMALIZING POWER

A second instrument of disciplinary power is that of normalizing judgement. [Smart, p.86]

In a sense, the power of normalization imposes homogeneity; but it individualizes by making it possible to measure gaps, to determine levels, to fix specialities and to render the differences useful by fitting them one to another. [Foucault, 1979, p.184]

The income tax laws impose their own procedures and methods of accounting on individual taxpayers. Discipline comes from the requirement of homogeneity of presentation and conformity with the rules of behaviour laid down by the legislation. Sanctions are imposed for failure to conform.

In this section it is proposed to examine some of the techniques of 'dressage' or ways of doing things required by the tax system.

TAX ACCOUNTING

One of the purposes of the Income Tax Assessment Act is to lay down procedures for the calculation of taxable income, allowing tax to be assessed at the appropriate rate. Taxable income is the result of subtracting allowable deductions from assessable income. On the surface it is a relatively simple calculation, but in practice not necessarily so. There is not one accounting regime in relation to tax but many. These regimes vary according to the category of taxpayer as well as the nature of the taxpayer's income and outgoings. [Cooper, et al, p.542]

The Act makes gross income assessable yet nowhere defines this concept. Allowable deductions are defined as being deductions allowable under the Act. To add to the confusion, the Act deems as income certain receipts which by any definition are not income. As well, certain items of expense, which should be allowed to reduce net income are not allowable deductions. So, an individual must include in his or her taxable income calculations amounts which represent capital gains yet exclude items such as cost of travelling to work and entertainment expenses which are costs related to the earning of the individual's income.

The Year

Tax is levied on income derived during the twelve month period beginning on 1 July. There is provision for a substituted period of twelve months provided some fairly stringent criteria are met. No matter how inappropriate, taxable income must be calculated in relation to the tax year. No matter how the income cycle for a particular taxpayer operates, for the vast majority the period to be considered is 1 July to 30 June. In the case of company taxpayers tax is levied on the income of the preceding year; for all others the year of income and the year of tax are the same.

For a taxpayer embarking on a long term-project, profits might not be realized for a number of years, yet the taxpayer must calculate income for each year. Tax regulations take no account of the variation in income flows experienced by a number
of taxpayers, with the minor exception that a very limited group of taxpayers (mainly primary producers) are allowed to have tax assessed on an average income basis.

**Basis of Accounting**

Income must be computed for a fixed accounting period according to the method which best reflects the nature of the income flow. The only two methods allowed are:

1. cash basis.
2. accruals basis.

The cash basis of accounting treats income as being derived when it is actually received. This has been deemed the most appropriate tax accounting method for individuals who receive income from sources such as employment, dividends and interest.

For those involved in trading activities the accruals method of accounting has been deemed the most appropriate. Income is recognised when the right to receive it comes into being.

Allowable deductions for both methods are recognised when they are incurred (S51(1)), which is not necessarily when the expenses are paid.

The Act refers to income becoming assessable when it is derived. The most appropriate basis of calculation of income for an individual taxpayer will centre around the point at which income can be considered to be derived. This question of timing has largely been determined by the legislation, cases and practice for most taxpayers and the question of which accounting basis to use is not problematic. Income calculated according to these prescriptions is not necessarily the same as that calculated by the usual accounting methods.

**RECORD KEEPING**

The Act requires that records be kept. Every taxpayer who carries on 'a business must keep records that record explain all transactions and other acts engaged in by the person that are relevant for any purpose of this Act' [S262A(i)]. Section 262A(2)

States

The records to be kept under subsection (i) include:

(a) Any documents that are relevant for the purpose of ascertaining the person's income and expenditure and

(b) Documents containing particulars of any election, estimate, determination or calculation made by the person under this Act and, in the case of an estimate, showing the basis on which and method by which the estimate, determination or calculation was made.

Section 262A(3) requires that the records be kept in English or readily convertible into English and that they be kept so as to enable liability to be readily ascertained. Section 262A(4) requires the records to be kept for five years or such other period as the commissioner determines.

So then for a taxpayer who is carrying on a business the tax system requires:

1. That records be kept.
2. That the records be easily convertible into English if they are not already so.
3. That the records be kept for five years.
Failure to keep records can result in a fairly substantial fine. Taxpayers must keep records even though they may not wish to. Other sections are as prescriptive in requiring records to be kept to maintain details of capital gains, fringe benefits and work related expenses. This latter item will be discussed below.

The record-keeping requirements of the Act impose additional accounting responsibilities upon most businesses. The tax rules and accounting rules maintain a degree of similarity but are aimed at different ends. Accounting rules as described by accounting standards are designed to allow the establishment of a subjective true and fair view. Standards need to be flexible as they are concerned with presenting a dynamic image of an entity. On the other hand the tax rules need to be certain to allow the calculation of the tax burden. [Westworth, 1985, p.243]. The tax rules require, in many instances, calculation of items of income and expenditure which are different to calculations required by the accounting rules. The tax laws impose ways of calculating items such as depreciation, of dealing with lease expenditure, of deeming certain capital items to be income or expenditure which are at variance with conventional accounting practice.

**SUBSTANTIATION OF WORK RELATED EXPENSES**

Probably one of the best examples of behaviour imposed by the tax laws is the requirement that work-related expenses being claimed by individuals as deductions must be substantiated. The substantiation rules are very specific and must be complied with to the letter, otherwise the deduction will not be allowed. The substantiation rules are onerous and enforce a strict discipline on taxpayers. The end result appears to be that many taxpayers do not claim deductions they would otherwise be entitled to because they are unable to comply with the substantiation requirements.

The substantiation rules are found in Sections 82KT - 82KZBB, of the Income Tax Assessment Act. They lay down very strict requirements for the substantiation of items of work-related expenditure. Standards are set down for receipts, which evidence transactions, and for information which must be kept in relation to the use of motor vehicles. These standards must be strictly adhered to.

The workings of these draconian rules are perhaps best illustrated by the example of the first case to come before the Administrative Appeals Tribunal, on the subject of substantiation. The case reported as AAT Case 5501 20 ATR (20 November 1989) has become known as the Evangelist's case and was discussed at paragraph 29, Butterworths Weekly Tax Bulletin, 23-1-90, -

The taxpayer, who was a minister of religion, was required to supply documentary evidence to substantiate certain items claimed by him as deductions. Mr Roach (Senior member of the AAT) made an initial finding that the taxpayer was a completely honest person and that all the expenses would have been allowable under S51 if the substantiation provisions were not in force.

Among other things -

The AAT disallowed a claim for the cost of enrolling in an educational course despite the fact that the taxpayer had produced a cheque butt that recorded the date and amount of the cheque for the payment of the fees, the identity of the conference organisers and the nature of the payment as conference fees. The amount was not allowed because the cheque butt had not been signed by the taxpayer.
The taxpayer did not have a receipt for this amount so he tendered the cheque butt as a diary entry. However to be acceptable as a diary entry, a signature is required for each entry. As no signature was on the cheque butt it failed as a diary record of expenditure.

The taxpayer maintained a meticulous record of his use of his motor vehicle for work related journeys. However he failed to sign each entry in his car log book and according to the substantiation rules was denied a deduction even though the AAT was satisfied that he had in fact made the journeys and incurred the expenditure claimed. Even though the entries in the cheque book and the log book were in the taxpayer's own handwriting they were not regarded as having been signed for the purposes of the substantiation rules.

Senior member of the AAT, Mr Roach said in connection with the case:

The substantiation provisions have been enacted in terms which emphasise form above substance and which tend to concentrate the attention of those required to enforce the rules on questions of form and to distract attention from the more basic question as to whether what is represented on the forms is true, in the sense of being both honestly stated and accurate. Under such circumstances it is likely that the only person at risk of being disadvantaged by the 'substantiation provisions' will be the honest. [Dymond, 1991, p.541]

Calls were made to soften the effect of the substantiation provisions but the government remained resolute that they stand. The result was that people are paying more tax than they should because they have lost receipts or because the evidence of transactions they have does not measure up fully to the requirements of the Act.

On the other hand, many claims that were spurious are no longer made because the person desirous of making a claim for a fictitious item of expenditure feels intimidated by the substantiation requirements. Many tax agents would agree that the days of taxpayers claiming for work clothes they have not purchased, or for "whatever the limit is" have now gone.

These rules seem to be somewhat excessive in their effect. Not only are the dishonest disciplined but also the honest, in many cases to their disadvantage.

**IMPOSED CALCULATION**

Amongst its provisions the Income Tax Assessment Act has rules for deeming amounts income, which under normal accounting procedures are not income and for not allowing as deductions against income, items which accounting practice requires to be offset against income; also for making deductions, items which usual accounting practice would not use to reduce income.

**Deemed Income**

In 1985 the Income Tax Assessment Act was amended to include capital gains in the calculation of assessable income. Taxpayers must now give details of any capital gains they have made during the year. The calculation of the gain makes allowance for the effect of inflation. The amount of the gain is also influenced by the nature of the asset sold. For example gains on motor cars are specifically excluded whereas some types of personal assets are included if their value is greater than $100, but others are not taken into account unless their value is greater than $5000. Capital losses are taken into consideration too, but only as an offset against capital gains.
Receipts of items other than cash are regarded to be income if they are in connection with employment or the taxpayer's business. The receipt of shares by an employee, the receipt of a holiday by a soft drink salesman, the consumption of stock by the owner of a delicatessen are all regarded by the Tax Act as being income even though these items would not be recorded by conventional methods of bookkeeping.

An interesting example of normalization is in relation to fringe benefits. Fringe benefits are extra benefits given by an employer to an employee; for example a company car, a house, school fees paid, cheap loans and free or reduced airline travel. In the past these items were deemed income. The amount of income was the value to the taxpayer. Most taxpayers claimed that the fringe benefits were really of no value at all to them. Company cars were a disadvantage because they had to be cleaned and garaged, and employer-provided accommodation was of little value because it was too close to the job or was not what the employee would have chosen.

To overcome these practices and to increase tax revenue on items that those who did not receive them certainly regarded as items of income and thus taxable, the government enacted the Fringe Benefits Tax Assessment Act, 1983. This Act makes the employer liable for a tax assessed on the fringe benefits provided to employees. The provider of the benefit is thus taxed on the benefit provided.

Comprehensive rules are given for the calculation of the taxable value of the benefits provided, tax being levied at the highest personal tax rate. By imposing its rules on the providers the taxing authority was able to recover tax that was being avoided by individuals taking advantage of the somewhat loose wording of the Income Tax Assessment Act.

Exempt Income

Some types of income, albeit shrinking in variety, are exempted from the tax calculation altogether. Section 23 of the Act provides a list of different types of income that are recognised as being exempt income. For example, income from service in the Army Reserve; income earned while working overseas; income earned while serving as the Governor General of Australia or maintenance paid to an estranged spouse are all items of income that are exempt from tax.

Expenses Deemed Non-Deductions

Section 51(1) of the Income Tax Assessment Act specifically denies a deduction, from income, for items of a private nature. For example, the cost of childcare while a parent works, and the cost of travel to and from work, are regarded to be expenses of a private nature and are thus not deductible. Nor are items of a capital nature deductible - except when the Act deems particular items of such expenditure to be deductions.

However, items that a prudent accountant would offset against income such as provision for sick leave, provision for annual leave, provision for long service leave or provision for bad debts are specifically excluded from being allowable deductions from assessable income. The reason for this is that the provisions so made have not been incurred.

Some items of expense, which in the past have been allowed as deductions, are now not allowed; for example, entertainment expenses and club memberships. These may be absolutely essential for the earning of the taxpayer's income yet Sections 51AB and 51AE operate to deny a deduction.
Many other sections, too numerous to list here, operate to disallow items of expenditure, usually in specific circumstances. Generally this disallowance has arisen from expenditure having been involved in tax avoidance schemes.

Non-Income-Related Expenditure Deemed Deductions

In several instances the Income Tax Assessment Act deems items of expenditure, which would normally be considered capital expenditure, to be deductions from income. For example, primary producers can deduct the cost of dams and irrigation facilities as well as the cost of extending telephone lines and the cost of certain types of fences.

Depreciation, of course, is allowed as a deduction, for the purposes of calculating taxable income, but only at the rates prescribed by the tax regulations. These rates vary from time to time in accordance with the current government policy. The Act only allows two methods of calculating depreciation, viz. straight line and reducing balance methods. The reducing balance rate is simply one and one half times the flat rate. On occasions, the Act has only permitted the straight line method of calculation.

What Income?

The Income Tax Assessment Act makes the gross income of the taxpayer assessable. It does not, however, contain a definition of 'income' as such, although, definitions of 'income from personal exertion' and 'income from property' are given. Section 25 makes gross income assessable and Section 26 includes specific items in assessable income.

There has been much litigation and judicial interpretation of the term 'gross income'. There does not appear to be any problem with specific items as defined by the Act but the general catch-all phrase of 'gross income' is open to interpretation.

What is the taxpayer to do when in doubt about whether a receipt is income or not? One course of action is to apply to the Commissioner of Taxation for a ruling under S169A. In asking the Commissioner for his opinion on the nature of the transaction the taxpayer becomes subject to the Commissioner's supposed greater knowledge. The Commissioner will abide by his rulings, thus protecting the taxpayer from penalty when conforming to a ruling which turns out to be a wrong interpretation.

Sometimes 'gross' income means 'net' income. For example, a partner must include in his/her gross income his/her share of the net income of the partnership. A non-taxable entity such as a partnership or a trust must calculate its net income, which is then passed to a taxpayer for inclusion in gross income.

RELEVANCE OF ACCOUNTING PRINCIPLES

It is usual for accounting purposes to treat as assets in the balance sheet, items of expenditure that will give rise to benefits in the future. It is also usual, as mentioned earlier, to bring to account as items of expense, provisions for expenditure when no liability has arisen but it is substantially likely that a liability will arise in the future. These procedures are involved in the 'matching' of income against expenditure process. The revenue of a period is charged with the expenses associated with obtaining it.

For tax purposes there is no matching principle. A deduction is only obtained when a loss or outgoing is incurred. The outgoing may not necessarily be related to the
income of the period. Thus the accounting treatment of an item of expenditure is not necessarily the same as the tax treatment.

It would appear that accounting principles are of more relevance in determining income than expenses but they are not the sole determinant of whether an amount is income for tax purposes. Nor, it seems, are the accounting treatments adopted by a particular taxpayer necessarily relevant when deciding whether an amount constitutes income. Woellner [p.941] quotes Lord Gorell in Edinburgh Life Assurance Co. v Lord Advocate (1909) 5 T.C. 472...

... the rights of the Crown [do not] depend upon the book-keeping of the company; ... nor do I think the liabilities of the company can be made to depend upon the system of accounts.

The accounting treatment will not necessarily render an item income for tax purposes. Similarly, an amount treated as income for tax purposes will not necessarily be income for accounting purposes.

RELEVANCE OF ACCOUNTING STANDARDS

Companies are required to conform to the companies code, which provides that the accounting practices of companies must be in accordance with approved accounting standards.

The Australian Accounting Standards, as promulgated by the Accounting Standards Review Board, and its successors, together with the professional accounting bodies, do not set out any single objective. There is a presumption that the adoption of the standards will lead companies to produce less subjective, more reliable reports for shareholders and other interested parties. The reports produced in accordance with the standards are general purpose reports.

It would appear that the accounting standard setting process has divided the measurement of profit into two categories:

1. Those with legally oriented objectives, e.g., restricting dividends to be paid only from profits - here certainty of calculation is the main aim.

2. Those where the objective is to provide information which assists in controlling the performance of a company and the making of judgements about its past successes and future potential. Here judgements and guesses can be important.

Generally the measurement of income and expenses, calculated in conformity with the accounting standards is too subjective to comply with the requirements of the tax rules.

Accounting reports are prepared for many reasons. The balance sheet, the profit and loss, together with the required statutory reports are for the purpose of informing shareholders of the current financial position of the company in historical terms. The accounting standards are designed to help achieve this end and to protect capital from unwarranted dividend distributions. [Fayle, 1990, pp.27-28]

... company accounting, conforming with the AAS and Schedule 7, includes many subjective judgements of a predictive nature, the results of deliberations about such fundamental issues as whether a transaction results in a capital or revenue outcome, the costing of capital outgoings to current activities in the form of amortisation, depletion or depreciation allowances, whether caution requires profits to be reduced
by crystallising future liabilities which may be associated with the current financial period's business activities (e.g., provisions) whether prudence dictates that receipts/income recognition should be deferred to a later period (e.g., unearned income), whether revenue items are better classified as capital having regard to the peculiar circumstances of the entity e.g., expenditure producing future benefits), and so on. [Fayle, p.28]

The Income Tax Assessment Act provides little room for the imprecision implied by the estimation process permitted by company law. It is not that accounts produced in accordance with the Companies Code are unreliable. It is that the Income Tax Assessment Act is a different set of rules. Unlike the situation in the U.S.A. or the U.K. where the profit is the starting point in the calculation of taxable income, Australian tax calculation begins with the concept of assessable income. The rules provided by the tax regulations must be followed in order to calculate taxable income. Accounting reports prepared in accordance with the standards provide little by way of essential detail to enable conformity with the requirements of the tax rules. [Fayle, pp.28-42]

Fayle [p.29] quotes the judges in **Arthur Murray (NSW) Pty Limited v F.C.T. 14 ATD 98** at p 100 when they were considering the notion of derivation of receipts:

... a judicial decision as to whether an amount received but not yet earned or an amount earned but not yet received is income must depend upon the judicial understanding of the meaning which the word conveys to those whose concern it is to observe the distinctions it implies. What ultimately matters is the concept; book-keeping methods are but evidence of the concept.

As a final word about the conflict between accounting practices and the tax rules, Mr Boucher, the Commissioner of Taxation, when discussing adjustments made by tax auditors to the assessable income of companies said:

Just another word about the types of adjustments we make when auditing companies ... they are for things like capital improvements incorrectly classified as repairs, incorrectly claimed investment allowances or wrongly written off bad debts. Timing differences, deferral of income and valuation of trading stock also account for a large proportion of the adjustments. [Boucher, 1987, p.320]

**SUMMARY**

The preparation and submission of returns and accounts could be viewed as technology that brings the financial conduct of individuals and organisation within the gaze of the Tax Office. [Preston, 1989, p.395]

The chief function of the disciplinary power is to 'train' rather than to select and to levy; or no doubt to train in order to levy and select all the more. [Foucault, 1979, p.170]

Taxpayers are subject to training by being required to present their financial affairs in the form laid down by the legislation. Taxpayers are required to conform to common concepts of income and deductions, not their own conception of these ideas.

The disciplining of taxpayers is not complete. If it were there would be no litigation, no discussion of alternative treatments and all taxpayers would act as one. The requirements of accounting for tax purposes are becoming more refined and restrictive. It is suggested that the accounting requirements, imposed by the tax rules,
discussed in this section are part of the disciplinary technology which aims to produce willing and compliant taxpayers.

THE EXAMINATION

The third instrument of discipline, the examination, combines the techniques of hierarchical observation and normalizing judgement, to effect a 'normalizing gaze' through which individuals may be classified and judged. [Smart, p.86]

The examination, according to Foucault, locates individuals within a field of visibility, where they are subjected to a mechanism of objectification and thus become subject to the exercise of power. Such visibility or potential visibility constitutes an important technique in the exercise of discipline. A second feature of the examination is that particular aspects of the observed individual are recorded in reports and files, and organised into general registers. Such techniques and methods of documentation aid the description and analysis of individuals and groups. It aids, as well, the identification and classification of attributes and differences between people, which commonly occur in a population.

Thirdly the examination renders each individual a 'case'. This occurs through the constitution of a field of visibility and the collation of documentary records. Thus the individual becomes known and recorded. [Smart, p.86]

The case . . . is the individual as he may be described, judged, measured, compared with others, in his very individuality; and is also the individual who has to be trained or corrected, classified, normalized, excluded, etc. [Foucault, 1979, p.191]

In the taxing process the stage of assessment becomes the examination. It is the time when details of each individual taxpayer are written in files. Each individual taxpayer becomes a 'case'. Each individual taxpayer becomes an object for knowledge and a site for the exercise of power. The process of assessment and perhaps increasingly, audit, exposes the affairs of the taxpayer to the full scrutiny of the Taxation Office. The fact of this scrutiny has a disciplinary influence on the behaviour of the taxpayer.

It is proposed to examine the assessment process, and the audit process, in an attempt to evaluate its influence on taxpayers and implications for the accounting profession, who after all are intimately involved with assisting taxpayers as they attempt to deal with the complexity of the tax laws.

ASSESSMENT

Assessment is defined in Section 6(1) of the Income Tax Assessment Act to mean the ascertainment of the taxable income and the tax payable thereon.

The assessment process is in a state of change in Australia. The Taxation Office is moving from a situation where all tax returns were individually assessed to a position where each taxpayer self-assesses. The former position, i.e. where each return was individually assessed will now be discussed.

Full Assessment

The assessment procedure of some years ago took the following form:
Self-Assessment

In 1984 the Australian Taxation Office established a task force to review the lodgement of returns and assessing procedures. The taskforce found that:

- The first moves towards self-assessment occurred during the 1986-87 financial year, when taxpayers' returns were no longer subjected to technical scrutiny. Arithmetic was checked but that was all. Information included by the taxpayer was taken at face value. Tax payable was, and still is in most cases, calculated by the Taxation Office.
- The burden of assessing was shifted from the Taxation Office to the taxpayer.
- The cost of assessing returns was greater than any gain to the revenue from adjustments that were made by assessors;
- The fact that the return would be assessed, apparently, often had little deterrent effect in achieving compliance with the tax laws;
- Assessing could not effectively respond to an increasing trend by taxpayers to engage in costly litigation over what the Taxation Office perceived to be questionable claims; and
- The assessing system was considered to be not cost effective. [Thomas, 1990, p.1]

This mode of assessment was highly labour intensive, repetitive, and for the assessor, boring. However, from the point of view of the taxpayer, this examination of his/her affairs by the assessor usually meant, in the absence of fraud, an end to the matter. Once the taxpayer accepted the assessment the matter was closed and it was highly unlikely that the taxpayer would be concerned with that particular assessment again. For the taxpayer then, there was a certainty after the assessment process, that the examination for that year was complete. A period of three years was allowed when the taxpayer could ask for an amendment to correct an error, or a period of six years when the Taxation Commissioner could amend an error (or an indefinite period in the case of fraud). For the majority, assessment was the conclusion of the process.

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- The fact that the return would be assessed, apparently, often had little deterrent effect in achieving compliance with the tax laws;
- Assessing could not effectively respond to an increasing trend by taxpayers to engage in costly litigation over what the Taxation Office perceived to be questionable claims; and
- The assessing system was considered to be not cost effective. [Thomas, 1990, p.1]

It was quite a common practice, at the time, for taxpayers, to include a 'sacrificial deduction' in their returns, designed to distract the assessor's attention from other claims which may have been questionable. As well, because the appeal process only cost a nominal amount ($2), taxpayers were very ready to take action when they disagreed with the Commissioner's assessment.

Given the forementioned problems, in 1986, the government decided to move towards a system of self-assessment.

**Self-Assessment**

The first moves towards self-assessment occurred during the 1986-87 financial year, when taxpayers' returns were no longer subjected to technical scrutiny. Arithmetic was checked but that was all. Information included by the taxpayer was taken at face value. Tax payable was, and still is in most cases, calculated by the Taxation Office. The burden of assessing was shifted from the Taxation Office to the taxpayer.
In 1989-90 full self-assessment was introduced for companies and superannuation funds. This means that corporate taxpayers calculate not only their own taxable income but also the tax payable. Payment is to be forwarded with the return. The return is deemed by amended provisions of the Act, to be an assessment. Again the information provided is taken at face value, initially at any rate.

In a statement released in December, 1990, the Treasurer, Mr Keating, has foreshadowed the extension of the full self-assessment system to all taxpayers. Under this proposed system, all taxpayers will be responsible for ascertaining their taxable income and tax liability.

The site of examination of taxpayers is splitting into two parts. On the one hand the individual taxpayer is responsible for ensuring his/her own compliance to the regulations. On the other hand, increased post-assessment activity with substantial penalties for non-compliance, will become more prevalent. Staff of the Taxation Office, freed from assessing duties have become available to carry out post assessment checks, increasingly supplemented by information available through the data matching programme.

In reality information fed into the Taxation Office's computer system by banks, and other financial institutions, as well as employers is easily matched with information provided by taxpayers. Increasingly too, taxpayers' returns are lodged electronically by tax agents using computers and taking part in the Electronic Lodgement System. Computers will be able automatically examine a return for inconsistent information and signal the need for further investigation. In a sense then examination takes place on the entry of the data on each taxpayer into the computer system.

It is proposed that the full self-assessment system be self-regulatory with the taxpayer being required to prepare and maintain adequate records, to ascertain the taxable income and tax liability and to make information available to the Taxation Office on request. It is a system which depends on the taxpayer voluntarily complying with the regulations.

Mr Keating said at page 22 of the Consultative Document on Self-Assessment [1990] -

For voluntary compliance to work, the Tax Office must maintain public confidence in the integrity of the system. The Tax Office needs to encourage voluntary compliance through taxpayer service and a rigorous, firm and efficient approach to enforcement. One element of that approach is the application of penalties and, where appropriate, prosecution action for non-compliance with the law. Taxpayers are expected to observe due diligence in fulfilling their income tax obligations. This responsibility has greater significance in a full self-assessment environment, and taxpayers need to have a clear understanding of the circumstances in which penalties for non-compliance are applicable and those in which only interest is imposed.

Under self-assessment, then, a fuller examination will come when a post-assessment check takes place. However taxpayers are unaware when such a check will occur. This expectation in itself imposes a discipline upon the taxpayer to comply.

A large number of tax returns, both corporate and individual, are prepared by accountants acting as registered tax agents. Self-assessment poses a number of unique problems for these accountants, who now must take on, albeit unwillingly, something of the role of the Taxation Commissioner towards their clients. The editorial in Taxation in Australia [Nov. 1990] at page 443 noted -
. . . practitioners must now attempt to prepare returns according to how they think the Commissioner would interpret the law. Any disagreement with the interpretation will not come to light until an ATO audit and taxpayers could be penalised for unwittingly taking a position that was at variance with the Commissioner.

Quoting the Taxation Institute of Australia’s Chairman of the National Technical Committee, Allan Blaikie, at page 446, the editorial continued -

Self-assessment increases the level of responsibility on agents in preparing returns and verifying the information provided. They have to have a greater understanding of their clients’ businesses and make sure they get the return right. There is no longer any room for the ambit claim.

To some extent, the agent rather than the Tax Office becomes the enforcer.

Under self-assessment, a taxpayer can decide to supply the information for a return on the back of an envelope - but he needs to be made aware that failure to keep all the data from which the calculations are made could result in an enormous cost in an audit.

The Act has been changed to allow the Taxation Commissioner four years in which to amend a return. This compares to the former situation where the Commissioner had three years to amend a return where full disclosure had been made or six years where there had not been full disclosure but there had not been fraud. The honest taxpayer has now an extra year of uncertainty, while the risk period for dishonest taxpayers has been reduced by two years. This seems to be somewhat discriminatory.

The problem, as many practitioners see it, is that there is too much uncertainty in the tax rules coupled with wide ranging discretions available to the Commissioner. Presumably these objections can be overcome with a simplification of the law.

Taxpayers can reduce the penalty risk exposure by rigorously complying with the law, applying for a S169A ruling when in doubt and lodging a return without claiming a disputed amount then lodging an objection to their own assessment [Spence, 1990, p.9]. The taxpayer, the subject, becomes part of the examination process, the results of the examination are recorded in computer files and further examined by being collated with information from other sources.

**Default Assessments**

For taxpayers who do not furnish a tax return and whom the Commissioner of Taxation has reason to believe have a taxable income, or where the taxation authorities are not satisfied with a return, or where they are satisfied a person has made a default in furnishing a return, the Commissioner has power to make a default assessment. Section 167 of the Income Tax Assessment Act states -

> . . . the Commissioner may make an assessment of the amount upon which in his judgement income tax ought to be levied, and that amount shall be the taxable income of that person ...

Often a default assessment is the result of an investigation. The Commissioner is enjoined not to act capriciously or dishonestly in making such an assessment, but he is allowed to use techniques in the calculation of taxable income that may involve what he believes to be a fair estimate of what the taxpayer’s taxable income should be. The onus of proof in default assessments lies with the taxpayer.

In case V12 [88 ATC 784] Mr McMahon observed that where (as would often be the case) the true facts of the situation lie uniquely
within the taxpayer's knowledge, the taxpayer bears a heavy burden in proving the assessment is incorrect ... [Woellner, et al, p.134]

Default assessments are an interesting example of where the Commissioner of Taxation uses his knowledge to force an examination upon a taxpayer, together with penalties for the default. The knowledge that the Commissioner has the power to take such action is also used to discipline taxpayers who may be thinking of not taking part in the assessment process.

**AUDIT**

The quid pro quo of the introduction of self-assessment has of course, been the introduction of audits on a scale never before seen. [Thomas, 1990, p.4]

Before the introduction of the self-assessment scheme audits were apparently a fairly haphazard affair. Self-assessment has allowed the Taxation Office to transfer a large amount of resources to the audit section. The process of audit offers taxpayers a more rigorous form of examination than they have hitherto been subjected. Of course, not all taxpayers will be subjected to audit in any one year, but taxpayers are not to know in advance whether they will be one of those selected and they must take this probability into account.

The Commissioner of Taxation in his 1989-90 Annual Report, when discussing the Taxpayer Audit Program said its purposes were . . .

To monitor, on behalf of the ATO, compliance with the tax laws through systematic measures across all taxpayer groups.

To promote voluntary compliance through a program which is seen to be soundly balanced between taxpayer groups and which, within each group, detects and brings to account those who do not pay the correct amount of tax. [p.41]

Audit takes place at three levels. It is instructive to look at each of these types of audit to gain some insight into their effectiveness.

**Primary Audit**

The primary audit section is responsible for the following activities, dealing mainly with individual taxpayers.

(a) **Internal Checks.** These deal with the cross checking of information from different sources to check the veracity of the tax returns submitted. Computers are used extensively in this process, and of course will be used even more extensively now that tax file numbers are linked with many sources of income for taxpayers. According to the Commissioner of Taxation's 1989-90 Annual Report [p.155] in 1989-90, 62,932 cases were examined and 62.6% of those cases required an increase in taxable income. This contrasts with the previous year when 95,662 cases were examined and 94% required adjustment. The decline in the number of cases requiring adjustment may indicate an increase in taxpayer willingness to comply, although the numbers are too small to draw any meaningful conclusions.

(b) **Desk Audits.** Desk audits are conducted by way of interview at the Taxation Office, where the taxpayer is questioned by the auditor. The purpose of a desk audit is to check the returns of salary and wage earners, those with property income and small businesses. The most common areas for checking include: undisclosed income; car and travel expenses; deductions for work expenses; and gifts to charities.
The desk audit approach relies very heavily on the taxpayer being prepared to discuss his/her affairs. [Woellner, et al, p.119]

The Commissioner of Taxation reports [p.154] that in 1989-90, 17,980 desk audits were conducted with 63.5% requiring adjustment.

The desk audit is essentially the inquisition of the taxpayer selected after an assessment has been issued, sometimes several years after the assessment has been issued. [Cooper, et al, p.1075]

Obviously taxpayers do not view desk audits in the same light as the Commissioner of Taxation. The taxpayer is at considerable disadvantage, being unaware of the information the audit is designed to elicit; is in unfamiliar and possibly intimidating surroundings being questioned about events which transpired in previous years. Usually, too, the auditor has other information available, such as bank records, of which the taxpayer is unaware and the auditor is in a position of power over the taxpayer. It is instructive to consider some of the complaints made to the Ombudsman in relation to desk audits.

* Auditors harass taxpayers by asking questions about one item in several different ways, apparently to obtain contradiction;
* penalties are imposed harshly for alleged non-cooperation;
* auditors threaten to extend the audit to induce the taxpayer to accept the Australian Taxation Office's adjustments;
* the audit has been conducted inefficiently and has caused excessive disruption to the taxpayer's normal work or business;
* auditors have asked "personal" questions about a taxpayer's tax affairs; and
* auditors have threatened to audit other parties who have allegedly lent money to the taxpayer. [Cooper, et al, p.1075]

It would appear from the foregoing that desk audits are not the clinical affairs suggested by the Commissioner's Report. How the views of the taxpayer have been coloured by being caught evading tax by a substantial omission of income is open to question. Likewise, the attitude of the auditor may change according to what is revealed in the process of the interview.

The statistics revealed by the Commissioner say nothing of the nature of the adjustments made. It is wrong to assume all of the adjustments were the result of an intentional omission of income. Many omissions could be unintentional or due to a different opinion as to the nature of the transaction.

(c) Substantiation Audits. These audits are usually carried out by mail and require the taxpayer to forward documentary evidence in substantiation of claims made for deductions.

(d) Inspections. Inspections involve inspectors checking the PAYE records of employers.

Business Audit

Business audits are carried out in the field and cover individuals, partnerships, trusts, companies and fringe benefit matters. The auditors visit the taxpayer seeking voluntary compliance with their requests or using S 263 powers, to interview the taxpayer and inspect records. These field audits are intended to be reasonably close but comparatively quick "spot checks" of key or suspicious items. Business audits are
commonly concerned with items such as bad debts, repairs, trading stock and international transactions.

The Commissioner reports [p.156] that in 1989-90, 6,366 entities were subject to business audit and 71.5% of those had adjustments made to their taxable income. Again, the nature of the adjustments was not discussed.

**Complex Audits**

Complex audits are concerned with the "Large Case" programme, where teams of auditors closely and regularly audit the tax affairs of very large corporate groups, entities with international affiliations and "illegals". The complex audit section is also responsible for the "Limited Entity" programme where large businesses, which have been selected from industries with a low compliance rating, are audited. [Woellner, et al, p.121]

Complex audits are very comprehensive, and in each case take up to two years. It has been reported that substantial accretions to revenue have resulted from this programme. However the reports do not indicate the reasons for these adjustments. What proportion is the result of intentional evasion is not indicated.

**TARGETING**

Apparently audits are not conducted on a purely random basis. The Taxation Office uses a number of techniques to "trigger" an audit campaign. These techniques include :-

1) **Computer Targeting**

   (a) "Score" System - This system identifies variations over time, in a particular taxpayer's profitability, compared to others in similar businesses in the same industry. Unusual variations can initiate an audit. This system is relatively unsophisticated and is being replaced.

   (b) Taxpayer Information Profile System (TIPS) - This system provides for computer storage of relevant information on a person's tax profile (e.g., external indications of wealth) and it is designed to assist auditors with the selection of cases. TIPS highlights aspects of a person's affairs that may want probing, from the point of view of the Taxation Office. [Woellner, et al, p.122]

2) **Project Work** Project based audits are designed to estimate compliance within a particular industry. The procedure is to select a statistically representative sample of companies or individuals and to conduct audits of their tax affairs. This allows auditors to estimate the level of compliance in that industry as a whole. If it is low then a more widespread audit is carried out. The Commissioner of Taxation usually indicates in advance which industries will be subject to a project audit. This has been alluded to in an earlier section.

3) **Information from Other Sources** The Taxation Office's normal information-gathering processes, both formal and informal, may indicate taxpayers to be given the attention of an audit.

Several points for consideration emerge from the foregoing. In the eyes of the Taxation Office, audit activity is considered to be successful and cost effective. The targeting techniques they have developed seem to point to taxpayers whose declared
income provides scope for adjustment. The targeting activity is expected to become more precise as the Tax File Number system becomes fully operational. From the point of view of the taxpayer though uncertainty is increased. The probability of an audit is very real for most taxpayers, a fact that encourages taxpayers to ensure that their affairs are in order.

**COMPLIANCE**


. . . the timely filing and reporting of required tax information, the correct (assessment) of income taxes owed, and the timely payment of these taxes without enforcement action.

The whole thrust of the technologies of discipline used by the taxing authorities are to encourage compliance with the rules. The stated desire is for taxpayers to comply voluntarily without coercion. However, the very technologies established to oversee this provide a coercive force to discipline the taxpayer. Failure to comply renders the taxpayer liable to sanctions in the form of penalties, increased tax and interest thereon.

Nicholls, an Assistant Deputy Commissioner of Taxation, in Perth, wrote . . .

Our primary consideration has now got to be to conduct our operations in a way which maximises voluntary compliance to the law. Quite clearly what we have to do is to concentrate on shifting people from the involuntary compliance group to the voluntary compliance group.

In writing about audits he goes on to say that one of the purposes is to . . .

Obtain a "multiplier" effect - that is we want our actions and our results to influence the thinking and approach of a much wider range of people than just those who have been audited. The aim is to "encourage" people to join the voluntary compliance group . ..

[Nicholls, 1990, p.742]

This "encouragement" appears to take the form of some fairly draconian measures.

**SUMMARY**

The examination is the third step in turning the subject into an object of knowledge. The aim is to turn the individual into a willing and compliant taxpayer. The purpose of the examination into a 'case' is that he/she may be compared and judged. Failure on the part of the individual to conform to the standards of the examination incurs sanctions in the form of penalties. The severity of the penalty varies according to the "wrongness" of the deed.

In income tax matters the individual taxpayer becomes a 'case' at the time of assessment. This is the time when the taxpayer's affairs are documented and judged. With self-assessment it is the taxpayer documenting his/her own affairs with the recording in files taking place in the Taxation Office's computer system. The audit process provides a further threat of an additional examination. For many taxpayers the threat of such additional examination is enough to ensure that they willingly comply.
CONCLUSION

Discipline, as a technology of power, functions in society by unceasing surveillance and documentation of individuals so that the affairs and behaviour of each individual become known and measurable. Thus the individual becomes a subject to be observed and reported upon. Just as in the use of the panopticon, permanent visibility induces in the subject a consciousness of being watched and a desire to conform to what society has decided to be 'normal' behaviour.

He who is subjected to a field of visibility, and who knows it, assumes responsibility for the constraints of power; he makes them play spontaneously upon himself; he inscribes in himself the power relation in which he simultaneously plays both rates; he becomes the principle of his own subjection. [Foucault, 1979, pp.202-3].

In Australian society, cohesion is derived not from some outside force but from the disciplinary forces acting within the society. That is not to say that there is no resistance to these forces - of course there is - but by and large, most members of the society willingly take part in its life. That which ensures this social cohesion is a set of disciplinary coercions.

In reality, the disciplines have their own discourse. They engender... apparatuses of knowledge (Savoir) and a multiplicity of new domains of understanding. They are extraordinarily inventive, participants in the order of these knowledge - producing apparatuses.

The discourse of discipline has nothing in common with that of law, rule or sovereign will.

The code to define is not that of law but that of normalization. [Foucault, 1979, p.106].

This paper has been concerned with the question of why income tax was so central in the revenue raising processes of Australian society in the late twentieth century. Income tax has come to predominate in the taxing sphere only during the last 100 years, yet governments have been raising revenue for several thousand years.

From a historical perspective, rulers and governments used whatever expedients were available to raise revenue. They were not particularly concerned with their subjects' views of how the revenue was raised, nor were they concerned with avoiding overt coercion. The need for finance was there and the rulers took whatever action they thought was necessary to fulfil that need. Lacking administrative machinery and coping with corrupt officials, collecting revenue, so essential for the purposes of government, was a difficult task.

In the course of time the nature of society, and more particularly Western society, changed. Governments became representative, with citizens having a voice in the running of the state. However, democracy brings with it new responsibilities and new ways of dealing with the affairs of society. Citizens are no longer servants to obey the whims of a ruler. Instead they become masters in the sense that they choose governments, but still remain servants in the sense that they remain subject to the rules of the society in which they live. People who live in democracies, such as Australia, are not oppressed but are totally implicated in the laws and regulations of that society. It has taken considerable time for society to evolve to this point.

Democratic society holds together through a multitude of 'disciplines' which constitute an entire normalizing technology. The purpose of the 'disciplines' is to produce a docile, obedient individual. The 'disciplines' operate by making each individual 'known' so that those individuals who refuse to conform to the 'normal' can then be subject to correction. [Hughes, 1991, p.29] The idea of the disciplining
society and the techniques relating to the application of discipline were elucidated by Michel Foucault.

It is suggested that the income tax system, in Australia, is part of the disciplinary process. Income tax came into being, in Australia, about the time when a fully democratic society was being established and it has become more prominent as taxes on wealth and property have been reduced.

Michel Foucault pointed out that modern society is characterised by a closely linked grid of disciplinary coercions which aims to ensure the cohesion of the social body. The exercise of disciplinary power is dependant on the use of techniques of observation, normalizing judgements and their combination in the examination. By this process each member of society becomes 'known'.

Other countries have other ways of knowing and classifying their citizens. In Australia, too, each citizen is subject to a number of 'disciplines'. It is suggested that the income tax system is one of the more widespread and far reaching disciplinary technologies in the grid of disciplinary coercions.

The income tax system imposes its own technologies to make each taxpayer 'knowable' and to ensure a willing compliance with the rules imposed by the system.

Obviously governments need revenue in order to fulfil society's wishes. However revenue can be obtained from many sources. Taxes on goods such as sales tax or taxes on goods and services such as value added tax, have the potential to provide the necessary funding for government. However, even though such taxes are in fact paid by the entire community the number from whom the government collects the tax is relatively small. On the other hand the number of payers of income tax is a significant proportion of the entire population.

The surveillance systems associated with income tax in Australia are in the process of being extended and can provide a detailed view of the affairs of those who come under notice. These surveillance systems and their potential were discussed at length.

The income tax system imposes its own way of doing things, its own dressage. It imposes a set of rules for its own accounting, an area which involves the accounting profession to a high degree.

Finally the affairs of each taxpayer are recorded and examined in the assessment and audit processes. Those found not conforming are then subjected to corrective action in the form of fines and penalties.

The requirement for revenue does not necessarily come before discipline in modern Australian society, but one necessarily leads to the other: revenue to discipline; discipline to revenue. The whole system is based on the willing compliance of people to pay their tax and the disciplinary techniques designed to ensure that they do so.

The answer to the question "Income Tax - revenue or discipline?" must be Income Tax - revenue and discipline!
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