Advising on overseas law reform

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In this paper the Right Honourable Mr Justice Richardson discusses the role and possible methods of work of lawyers assigned to law reform tasks outside their home jurisdictions. In particular he relates his comments to his own experience in preparing fiscal and banking legislation for Mauritius, Tonga, and Western Samoa.

I. INTRODUCTION

Academic lawyers are often heavily involved in law reform. The Law School at Victoria is no exception. What has been a significant and unusual feature of law reform work on the part of members of the Faculty over the last twenty years is the extent of the involvement of staff members as advisers to overseas governments and in respect of the development of their constitutions and their laws. Three examples may be given. One is the pioneering work of Dr C. C. Aikman in the development of the constitution of Western Samoa. In that same field Professor Quentin-Baxter was adviser to the New Zealand Government in relation to the constitutional development of Niue. Another is the work of members of the Faculty, especially Professor E. P. Ellinger, in the establishment of the Royal Bank of Tonga and the drafting of commercial legislation for Tonga. The third is the massive undertaking led by Mr A. H. Angelo in Mauritius, in which other members of the Faculty also participated. It has involved three steps. First, the ascertaining and publication of all the statutory laws and regulations in force in Mauritius as a prerequisite to law reform. Secondly, the establishment of a Law Revision Unit and the training in law drafting of junior and medium range officials, not all experienced lawyers. The successful functioning of the Unit goes some way to disproving the conventional wisdom expressed in law drafting circles that law drafting is an arcane science which requires a pool of very experienced draftsmen. Thirdly, the review of all the laws of Mauritius and the preparation and enactment of legislation designed to meet current needs. The work in which I was involved was, by comparison, distinctly limited — in Tonga to the establishment of the

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Bank and in Western Samoa and Mauritius to the review and preparation of new tax legislation. However, it was intensely interesting and in this article I propose to explain why I found it so and how I went about the work.

II. THE OBJECTIVE

All of us are prisoners of our backgrounds. Our social, economic and political values are conditioned by our upbringing and our experiences. No-one sheds his social philosophy on being appointed an adviser to a foreign government. It continues to colour his thinking and his advice. That must be recognised. In his home country his attitudes are likely to be known to others in the field. They will have different views. The balancing of competing views, while difficult enough, is usually possible and obviously desirable. The role of the overseas expert is a more difficult one. At least in the initial stages, he tends to be taken on trust. He tends to be thought of as objective. There may be no other sources of sufficient expertise in the subject in the country. That is usually why he has been invited. So there may be no-one to hold the scales, to put an alternative view of a problem and its solution, to put a brake on any temptation to implement long-held ideas of what legislation in the field should provide. All this makes it particularly necessary that the adviser should be as neutral in his work as he possibly can: that he should present all the alternatives of which he is aware and their pros and cons as objectively as possible, and leave it for the minister or senior officials to decide from the options he has put forward. The objective is to formulate legislation that will, so far as possible, meet the needs of that particular society. And they, the local people, are the proper judges of that.

What I have been discussing is the attitude of the adviser to his assignment. This leads on to the next point, as to how he equips himself to undertake it. An expert working in his own country is able to draw on his experience of his own society. The overseas adviser is under a very great handicap in that respect. If he is not familiar with the society, he can and obviously does read widely about the country and its people. He tries to find out, through reading and through discussion, the nature and extent of the differences between that society and its problems and those with which he is familiar. But time is always limited. He is never able to get as rounded and reliable a picture of the society as he would wish for a full understanding of the setting in which he is working and of the way in which the legislation would work in practice. It is a matter of assessing, so far as he can in the time available:

(1) what are the needs in that country in that area of the law;
(2) the extent to which the existing laws satisfy those needs and the respects in which they are deficient; and
(3) the alternative approaches reasonably available to meet those needs and remedy those deficiencies.

Few of us would quarrel with this proposition even though there may well be different views as to the emphasis to be put on one or other of the considerations. But what of the practice of this theory? An obvious first step in preparation for the assignment is to study the existing legislation and other matters in that field. That needs to be supplemented by information about the country, its people, its economy, its history, its culture, its constitution and its legal system. Thirdly, it is necessary to have available current legislation of a number of countries for the purpose of comparison. In the case of Mauritius it was the tax legislation of

(1) the United Kingdom, only because the existing Mauritius legislation was based on model revenue legislation drafted in the United Kingdom for colonial territories and because the Mauritius legislation to some extent reflected patterns in the United Kingdom legislation;
(2) Australia and New Zealand, because they are still not overly complex and a New Zealand adviser feels reasonably familiar with them and the problems with which they have attempted to deal;
(3) Hong Kong, Singapore, Kenya, Cook Islands and Fiji, because they too are relatively small colonial or ex-colonial societies which might be expected to have somewhat similar problems in some respects and offer some alternatives for consideration.

Then, taking Mauritius as the example, after preliminary discussions with the Minister of Finance and senior officials, and a close consideration of a random selection of departmental files to provide some understanding of the local administration of the tax laws, time was allocated each day for consultation and drafting. Usually about six people and always including the Commissioner and one or two senior officials, supplemented by others depending on the topics being considered, met together. Ordinarily we spent the morning and often the early afternoon in consultation, going through a group of sections in the existing legislation, step by step, discussing the problems that had arisen under the legislation. Alternatives were outlined and discussed. By the end of each session a tentative pattern for the first draft of that portion of the proposed revision had been settled in principle. The late afternoon and evening were spent on drafting and sometimes drafting alternatives for subsequent consideration. As the first draft material started to come through, it was reviewed within the department and thereafter part of the early session of the day was devoted to discussion of the first draft which was then in turn, subject to further re-writing. In my view this process of continuing discussion, provision by provision, first of the existing legislation and then of successive drafts of the new legislation, has advantages over the course which is sometimes followed of having the adviser prepare a complete draft on the basis of a set of general instructions, set in the framework of his assessment of the local scene. The drafts then received consideration by officers in the Crown Law Office and elsewhere as appropriate, and eventually after vetting by the law draftsmen to ensure that the text conformed with local legislative drafting practice and local idiom, an agreed draft was finalised. It was submitted to the Minister of Finance with a detailed memorandum setting out the approach taken and the scheme of the draft legislation, the policy and significant machinery changes reflected in the draft and the reasons for the changes proposed.

Such a revision is government legislation. So it is drafted in accordance with the policies of the government, but formulated to some extent as the result of consideration of options discussed in the process of continuing consultation. The nature and amount of any consultation in relation to draft legislation is, of course, a matter for the government concerned. From the viewpoint of the overseas adviser the wider the consultation process the better. But in some areas — and tax is traditionally one — ministers may not want to have any outside consultation, even in relation to machinery matters, at least until the legislation has been introduced into Parliament. For the government to suggest possible changes for consideration may be thought to give rise to an undesirable uncertainty and to allow too much scope for tax planning and reorganisation in the interim in anticipation of change. And it is very difficult in a field in which there is so much financial advantage to be gained by advance knowledge of what the government is proposing to do, or considering doing, to maintain the confidentiality of informal discussions. On the other hand, there are advantages in ascertaining direct from those immediately affected by the existing legislation how they view problem areas and the feasibility of projected remedies. After all, most tax systems depend to a very substantial extent on the co-operation of the great mass of taxpayers. Their voluntary compliance may well be affected by any widespread concern as to the fairness of the tax system and as to whether it is workable in practice. And in some cases it is more difficult to have a provision changed if it has been exposed to public gaze than when it is in the earlier drafting stages without any form of government commitment to it. Approaches differ. Mauritius adopted the traditional approach in the tax field and introduced the proposed legislation without consultation over the details with interested groups. On the other hand, the Cabinet of Western Samoa gave authority for a series of informal discussions on the draft bills with the accountancy and legal professions and certain business and other community groups. This proved helpful in framing the final drafts for introduction into the Legislative Assembly. Then, following introduction the bills were referred to the Bills Committee. Submissions from the public were sought and the Committee sat for some weeks considering the bills clause by clause and looking at the bills overall. It was a stimulating experience to spend a week before the Bills Committee towards the conclusion of its deliberations discussing the policy considerations and the administration of the new tax system and once again exploring alternatives and at times carrying out further drafting to reflect other approaches under consideration.

Finally, legislation of this kind directly affects very many persons and it is essential to ensure that it is well understood by the departmental officers concerned with its implementation, by accountants and lawyers who will be closely involved on behalf of taxpayers, and by the public generally. So it is necessary to ensure first, that practice manuals are prepared for departmental use and staff training programmes instituted. And secondly, that by means of an intensive education programme, taxpayers and their professional advisers are aware of the detailed scheme of the new legislation, of the changes from the previous legislation and of their rights and responsibilities under the new legislation.

III. SPECIAL PROBLEMS IN DRAFTING TAX LEGISLATION

Tax has the reputation of being a complex subject. But simplicity is not the sole criterion. Fairness, certainty and providing incentives for socially desired effort are some of the other objectives which become more and more important as the burden of tax increases. Where there is little at stake, income tax legislation can be broadly and simply framed. If, for instance, taxes take only one per cent of income, a simple system, even if it operates unevenly over the community, cannot cause great hardship. But where rates run as high as 50 sene in the tala as in Western Samoa and even more so where they are 80 cents in the rupee as in Mauritius, the legislation must go to pains to ensure that the proper burden, no more and no less, is borne by all sections of the community. The other reason is that the tax structure is an essential feature of the management and control of the economy. All this calls for detailed drafting to cover a wide range of circumstances. But it is not possible to anticipate and provide for every distinct situation which calls for separate treatment. The difficulties are compounded by recognition that reluctant taxpayers and astute advisers will seek to order their affairs so as to escape the disadvantages or attract the benefits of the particular provision as will suit their financial purposes. And legislation designed to cover every situation eventually assumes inordinate length and complexity. The course adopted to a greater or lesser extent in many countries is to draft in some detail and then to repose certain discretions in an officer of the revenue and buttress the specific legislation with a variety of anti-avoidance provisions to put a damper on the resourcefulness of taxplanners.

In addition to this general problem, there are special difficulties in designing tax codes in developing countries. One is to strike a balance between the need of the revenue for a comprehensive tax code, capable of fair application to all taxpayers, and the desire of the great mass of taxpayers for a relatively straightforward system which will be reasonably understood. Moreover, it must be workable in practice. There is a limit to the resources available to taxpayers and to the department for tax administration. At the same time, the legislation must be sufficiently sophisticated to ensure that overseas companies and substantial enterprises of the country concerned cannot, through appropriate planning, escape what are considered to be their tax obligations. In short, the tax base must be protected. So it may be considered desirable to introduce a series of provisions to allow the Commissioner to counter tax avoidance arrangements. Where this is done it is not necessarily expected that the Commissioner will have frequent recourse to the provisions. Rather, they are there if they are needed and as a deterrent to taxpayers who might otherwise be inclined to shift income, inflate deductions and in other ways reduce artificially the overall burden of the local tax, while still having command over the additional income whether at home or overseas. Apart from anti-avoidance provisions relating to the reasonableness of remuneration, shares of profits and rents, transfer prices for trading stock and depreciable items and strong agency provisions making the local intermediary accountable where the non-resident, who deals through the intermediary, is not himself readily taxable, the new legislation both in Mauritius and Western Samoa relied on two types of general anti-avoidance provisions. One was an expanded variation of what is now section 99 of the Income Tax Act 1976 (New Zealand) relating to arrangements having the purpose of tax avoidance. The other was an arm's length test applicable not only as under the New Zealand section 22 where the business is controlled or carried on by a non-resident, directly or through a local company, but also where, in the carrying on of any income earning activity, any person controlling that activity by reason of his relationship or otherwise with another person, is not, in the opinion of the Commissioner, at arm's length with that person with respect to any commercial or financial transaction and the income earning activity produces less than the amount of income which in the opinion of the Commissioner might be expected to be derived from that activity. It was considered that the latter provision would be a more straightforward and satisfactory general anti-avoidance provision than the former.

There is a further and in some ways, unexpected consequence of the strengthening of existing anti-avoidance provisions and the enactment of new provisions designed to protect the revenue. It is the effect of the resultant increase in the tax burdens of taxpayers, who previously had much greater scope for tax minimisation. It may affect their ability to pay. It may affect their willingness to comply with the new tax code. It may be a disincentive to productive effort. So far as all that can be gauged, it needs to be weighed. It is a factor that has to be taken into account in considering both the anti-avoidance provisions themselves and the appropriateness of the proposed tax rate structure.

Finally, somewhat similar tax avoidance problems tend to arise in different countries. But this is not always the case. For example, the problems stemming from the use, or in most cases, misuse of trusts which have occasioned concern in New Zealand and to a greater extent in Australia in recent years, did not exist in Mauritius or Western Samoa. In Mauritius this was because the local law does not recognise the concept of trusts and in Western Samoa because the use of inter vivos trusts was not widespread. So it was easy to cut through the potential avoidance problems in Western Samoa by providing for the income of a trust to be taxed at a flat rate equal to the maximum individual rate.

Another special problem in designing a tax code in developing countries is to strike a proper balance in providing the revenue with the machinery necessary for the administration of the tax legislation: between what is desirable in terms of accurate and effective administration and what is reasonably within the resources and capabilities of both the department and the taxpaying community. To put it in somewhat different terms, there are three points any tax adviser has to have in mind when considering the legislative structure of the administration provisions. The first is that the successful operation of a tax system depends on the general willingness of taxpayers to comply and provide correct information as to their income earning activities and to pay their proper taxes as and when required.

The second is that, in order to protect the revenue and to encourage taxpayers to fulfil their responsibility to the state, it is essential that taxpayers be required to keep sufficient records, that the Commissioner be given appropriate powers to obtain all information necessary to enable him to make assessments and that adequate, but fair, sanctions be provided to deal with defaulting taxpayers. But it is worse than useless to enact a set of provisions which, while suitable for one country, do not take into account the circumstances in which tax is administered in the particular country. To arrive at a proper balance is an essentially practical exercise. In many ways the settling of the administrative provisions is far more difficult for the overseas adviser than advising on the structure of the basic tax legislation. And providing a system that meets the needs of the particular society may require special provisions that may seem strange in a New Zealand setting. By way of illustration, the requirement that proper records be kept may require special expression to facilitate checking by the revenue authorities. Thus, in both

Western Samoa and Mauritius the new administration provisions require a taxpayer whose net income from business in a preceding year exceeded a certain figure, to issue written receipts, serially numbered, for every sum received for goods sold or services performed in connection with that business and to retain a duplicate in each case unless the Commissioner has authorised the use of a machine for recording sales. A similar provision was and is in use in Singapore. It is designed to deal with the problems of securing minimum records from small shopkeepers and to allow for easy policing by officers of the department. Again, it is provided in the Mauritius legislation that the Commissioner may require an objector to an assessment to furnish a report by an auditor approved by the Commissioner, the justification being that taxpayers, who fail to provide proper records of their business activities, can hardly be recognised as bona fide objectors to assessment of tax. And under the old Mauritius legislation the making of an objection suspended liability to pay tax which produced a flood of objections each year. This in turn lengthened the time for processing objections to the point of hearing in the courts and encouraged taxpayers to object knowing that they would gain substantially from having the use of the unpaid taxes in the meantime. The easy answer to that administration problem was to introduce the provision, standard in many countries including New Zealand, that the obligation to pay tax is not suspended by objection to an assessment.

The third is that it takes a considerable time to build up a reasonably comprehensive pattern of decisions of the courts and departmental rulings on particular cases arising under a new tax code. Accordingly, it may be desirable to adopt a statutory scheme similar to that of a larger state with which the country has a close connection, and in certain areas to adopt the same statutory language, in this way tapping into an existing pool of expertise. This also makes technical aid in the form of temporary secondment of officers from the larger state to the developing country and the attendance of officials in staff training programmes that much more available. Accordingly, to a certain extent the Western Samoan legislation adopts that approach but there was no such source on which Mauritius could draw. And in any event, care needs to be taken not to introduce alien concepts or language usages inadvertently. This leads on to the comment that the draft legislation should be screened by the law drafting office to ensure that local solecisms are avoided and that local idiom is employed.

IV. THE END RESULT

The new tax codes were enacted in Mauritius in July 1974 and in Western Samoa at the end of that year. The Western Samoan legislation was contained in three statutes, an Income Tax Act containing all the substantive income and deduction and exemption and charging and associated provisions, the Income Tax Administration Act concerned with the machinery provisions including PAYE and provisional tax provisions, and a separate Income Tax Rate Act. It was considered administratively desirable and helpful to taxpayers and their advisers to have these separate but linked statutes. The Income Tax Act contained 69 sections, the Income Tax Administration Act 125 sections and the Income Tax Rate Act 4 sections and a large number of schedules. The number of sections and the total length of the statutes were marginally less than the legislation they replaced, notwithstanding a substantially expanded treatment of some topics, for example, tax avoidance. The Mauritius legislation was contained in one bill of 140 clauses and, although a great deal of material was added, overall it was somewhat shorter than the Income Tax Ordinance 1955 and Amendments. Its 80 pages stand in striking contrast with the 543 pages and the 436 sections of the Income Tax Act 1976 (New Zealand), the difference being explained in part by the absence of the detailed provisions for the administration of a PAYE and provisional tax system (in Western Samoa 40 sections) and by the presence in the New Zealand legislation of a very large number of incentive provisions of one kind or another.

Finally, as a response to those who claim that tax revision, as distinct from the rearrangement of provisions in consolidating legislation, cannot be promised because it is such a time consuming task, it may be noted that the review in Western Samoa extended over some two years and that the new legislation in Mauritius was enacted within six months after the assignment commenced.