

# THE JUDICIARY AND ITS ROLE IN THE TAX REFORM PROCESS

By Justice Graham Hill\*

*Judges do more than just decide controversies. Their decisions prompt the legislature to change the law although often considerable time will elapse before this happens. By deciding controversies they often change the direction the law is taking. The article examines particularly the way the judges mould the tax law and the shifting judicial attitudes to tax avoidance against the question raised by the first report of the Committee on the Review of Business Taxation whether tax legislation should be directed at specific anti-avoidance behaviour or rely on a general anti-avoidance provision.*

## 1. INTRODUCTION

At first sight the idea of a link between the judiciary and tax reform may seem foreign. It is easy to be distracted by the traditional notions of judicial power as involving binding and authoritative decisions of controversies made in the determination of a dispute with power to take action to enforce those decisions.<sup>1</sup> But it is not difficult to adopt a wider perspective.

In deciding controversies in the areas of taxation, as indeed in other areas, there are two particular ways in which the judiciary may become direct or indirect agents of reform.

The first is both obvious and uncontroversial. A decision may itself prompt reform of the law. If it is adverse to the government it will be open to parliament to reverse it. If it is adverse to the citizen a subsequent outcry may precipitate parliamentary action to alleviate the impact. Commissions of inquiry into law reform will ponder the decisions of courts and weigh up the competing policies apparent in, or at least underlying them and, where appropriate, will

suggest reform. One may speak of this as indirect reform, for the courts are not themselves the agents of reform, rather the decisions of the courts act as triggers for reform.

But courts do regularly instigate through their judgments, and indeed always have instigated changes in the law which may be seen as part of a continuing reform process. Judgments may be reversed or decisions may be affirmed, but for different reasons thereby effecting changes in the law.

It is the purpose of this article to examine both these direct and indirect avenues of the reform process involving the judiciary.

There is a third area in which judges have from time to time participated in the reform process – that is by chairing Committees of Inquiry into legislation or proposed legislation. It is somewhat outside the scope of this article but should be, at least, recognised. Ferguson J of the Supreme Court of New South Wales chaired the inquiry into the uniform taxation system which led to the *Income Tax Assessment Act 1936* (Cth) ("ITAA36").<sup>2</sup> Asprey J, also of the Supreme Court

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<sup>1</sup> *Huddart, Parker & Co Pty Ltd v Moorehead* (1909) 8 CLR 330, 357 (per Griffith CJ) and more recently discussed in *Brandy v Human Rights and Equal Opportunity Commission* (1995) 183 CLR 245, 267-269 (per Deane, Dawson, Gaudron and McHugh JJ).

<sup>2</sup> Royal Commission on Taxation (Ferguson Committee) (1934)

of New South Wales, chaired the inquiry which led to a seminal report into the ITAA36.<sup>3</sup>

There is an interesting question whether the participation of the federal judiciary in the legislative process through an administrative inquiry would involve an impermissible incursus into the separation of powers implicit in Chapters I, II and III of the Commonwealth Constitution.<sup>4</sup> No doubt the role would be a role adopted and performed by the judge personally, rather than a role undertaken by the court. But, the issue is whether the role might prejudice the independence of the judiciary and conflict with the proper performance of the judge's judicial function. Or to put it in the words of the Supreme Court of the United States:

The ultimate inquiry remains whether a particular extrajudicial assignment undermines the integrity of the Judicial Branch.<sup>5</sup>

It is interesting to note that the United States Supreme Court continued:<sup>6</sup>

We are somewhat more troubled by [the] argument that the Judiciary's entanglement in the political work of the Commission undermines public confidence in the disinterestedness of the Judicial Branch ... The legitimacy of the Judicial Branch ultimately depends on its reputation for impartiality and non partisanship. That reputation may not be borrowed by the political branches to cloak their work in the neutral colors of judicial action.

No such difficulty would arise with the involvement of the state judiciary.

Ferguson and Asprey JJ were, as noted members of the Supreme Court of New South Wales, part of the state judiciary. In 1936, or for that matter before, there was no federal taxation jurisdiction conferred upon state courts. By the time the Asprey Report came to be published there was. It is easy to conceive the difficulty which could arise if a judge participating in the legislative process were required to sit to consider the legislation, the drafting of which was a matter he or she participated in. There is a similar practical, although not constitutional, difficulty in circumstances where the judge adjudicating a matter had participated as counsel in the legislative process. Perhaps it may be said that participation in drafting may be a poor indicator of understanding parliamentary intention, that being what is to be given effect to, for that is not necessarily the same as the intention of the drafter.

It is convenient to consider briefly indirect reform in the area of taxation before turning to consider the more interesting and controversial area of the direct involvement of the courts in the tax reform process.

### 2. INDIRECT REFORM

Illustrations of the legislature stepping in when courts have found adversely to the government are legion in the taxation area. Often the intervention of the legislature may be specific to the problem addressed by a decision. Less often it may be more general, addressing the approach adopted by the courts, rather than the mere outcome of a case.

An example of a specific intervention is the amendment to the definition of "asset" in s 160A of the ITAA36 to ensure that rights of a non-proprietary kind are assets for capital gains tax

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<sup>3</sup> Taxation Review Committee (Asprey Committee), *Full Report* (1975).

<sup>4</sup> See eg, *R v Kirby; Ex parte Boilermakers Society of Australia* (1956) 94 CLR 254; *Attorney-General (Cth) v R* (1957) 95 CLR 529; *Grollo v Palmer* (1995) 184 CLR 348 and in the United States, *Mistretta v United States* (1989) 488 US 361, 404.

<sup>5</sup> *Mistretta v United States* (1989) 488 US 361, 404.

<sup>6</sup> *Ibid* 407.

purposes, and to s 160M(6) both arising out of the decisions of the Full Federal Court and of the High Court in *Hepples v FC of T*.<sup>7</sup> The amendment, which was made by *Act No 191 of 1992*, was carried over into the rewrite of the capital gains tax provisions, albeit in somewhat different language.

The obvious example of a more general intervention by the legislature is the introduction of the general anti-avoidance provisions of Pt IVA of the ITAA36 to overcome what were thought to be defects in the previous s 260 of the ITAA36 as a result of court decisions. I shall return to that matter later in the article.

It must be said that judges will often call for law reform in taxation as well as other areas. So, for example, in *FC of T v Newton*<sup>8</sup> Kitto J said:

Section 260 is a difficult provision, inherited from earlier legislation, and long overdue for reform by someone who will take the trouble to analyse his ideas and define his intentions with precision before putting pen to paper.

That was in 1957. Although it may be argued that the later shift in judicial interpretation of s 260 may have made the section work more in favour of the revenue than earlier decisions of the High Court may have suggested,<sup>9</sup> it took until 1981 before s 260 was replaced with the rather more logical provisions of Pt IVA. Indeed, historical analysis demonstrates that often tax reform can be a slow and grinding process. Many of the matters in the report of the Asprey Committee into tax reform remained unattended to some ten years after the report, although most were ultimately adopted in some form.

Recently in *Consolidated Press Holdings Ltd v FC of T*<sup>10</sup> I made a more general plea, not merely

for reform in matters of detail, but also in matters of clarity. I said:

... the drafting of the provisions ... is hardly a model of clarity. In my view there is much to be said for the view that it is the duty of Parliament to ensure that legislation designed to extract tax from taxpayers be expressed both in ideas and language that are clear. While it is for the courts to endeavour, where possible, to give effect to the legislative purpose, it should not be expected that the courts will construe legislation to make up for drafting deficiencies which revel in obscurity.

While the reaction of Parliament to a decision which it regards as adverse to the revenue may not always be swift, the reaction becomes almost imperceptible where the decision is one which favours the revenue, but in circumstances which to many taxpayers and their advisers may seem to be outrageous. A recent example which may be cited is the complete lack of legislative recognition to the interpretation given to s 160M(3) of the ITAA36 in *FC of T v Orica*.<sup>11</sup> While the result of the case may be criticised on policy grounds, the reasoning employed in reaching that result was no more than the giving to the words of the statute a literal interpretation. Those who criticise a literalist view of interpretation appear quite silent when it is employed in favour of the revenue. I shall return to the matter of interpretative literalism later. Taxpayers, if they knew of and understood the implications of *Orica*, would have cause to be apprehensive of a tax system which brought about the result that the performance of any executory contract could give rise to a taxable capital gain. It is hard to believe that to have been the parliamentary intention. Although the rewrite of the capital gains tax provisions is in different terms and raises other issues, the parliamentary reaction to *Orica* has been deafening.

<sup>7</sup> 90 ATC 4497 (FFC); (1992) 173 CLR 492 (HC) "*Hepples*"

<sup>8</sup> (1957) 96 CLR 577, 596.

<sup>9</sup> See eg, the decisions of the High Court in the trilogy of cases: *FC of T v Gulland*; *Pincus v FC of T* and *Watson v FC of T* (1985) 160 CLR 55 ("*Gulland, Pincus & Watson*")

<sup>10</sup> 98 ATC 5009, 5018 ("*Consolidated Press*")

<sup>11</sup> 98 ATC 4494 ("*Orica*").

### 3. DIRECT REFORM

The most interesting area for examination is the role of the courts in changing the law. It is a matter which would not have been the subject of discussion in the last century; it certainly is a matter of interest in the present century.

The traditional view in Australia was that the role of the court, at least where matters such as income tax arise under statute, was limited to mere interpretation, whatever that may mean. It was a view originating in the United Kingdom, a land without either a written constitution or any statutory bill of rights where the legislature was said to be supreme. It is a view which is easier to hold in simpler (and perhaps more authoritarian) times. In support of such a view, even today, parliamentarians point out that judges are not elected by the people but in a process that is hardly transparent. Judges are not accountable in the same sense that politicians claim to be in that they submit themselves at regular, or more often than not irregular, short intervals to the vagaries of the ballot box. Under the Australian Constitution, a judge of a court appointed under Chapter III holds office until age seventy and can not be dismissed other than for proven misconduct by a joint vote of both Houses of Parliament.

The criticism that judges now regularly receive in Australia from politicians tends to emerge in areas away from tax. The decision of the High Court<sup>12</sup> that an elected parliamentarian, Mr Cleary, was disqualified from election to the House of Representatives on the basis that he held an office of profit under the Crown (he was at the time on leave without pay from a teaching position), was trenchantly criticised by some politicians in the media as involving an interference by the High Court in the political process, although the criticism would more aptly

have been addressed to the constitutional provision than to the High Court's interpretation of it. Many other examples abound in recent times. The Aboriginal land rights decisions of the High Court<sup>13</sup> have attracted perhaps even more criticism from some sections of the Parliament and the community.

It may be said that the very existence of a written constitution places upon the judiciary an obligation to ensure that legislation enacted by Parliament be within power. When no constraint of Parliament's power existed (as in the United Kingdom), it could more readily be said that challenges to legislation were non-justiciable. But if there are constitutional restraints imposed upon Parliament, then who, other than the judiciary, can ensure that these restraints are observed. The same may be said of challenges to executive decisions. If the executive has limited power by statute, then access to the courts must be available to challenge decisions made outside power. That is part of the role of the rule of law. So there has grown up, both in the United Kingdom and Australia, a large body of administrative law concerned with judicial review of administrative action.

The fact that many administrative decisions may be set aside by judicial review (in the tax area, the Australian Parliament has sought to prevent the federal and state courts from reviewing outside the tax appeal process most taxation decisions)<sup>14</sup> does not endear the courts to the decision makers shown to be wrong. When a ministerial decision is set aside, this may reflect upon the minister who, or whose delegate, made it. One has only to recall the political fallout of the former Minister for Aboriginal Affairs arising from *Tickner v Bropho*.<sup>15</sup>

I feel no need to apologise if courts set aside decisions made by politicians or for that matter

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<sup>12</sup> *Sykes v Cleary (No 2)* (1992) 176 CLR 77.

<sup>13</sup> Especially *Mabo v State of Queensland (No 2)* (1992) 175 CLR 1 ("*Mabo*") and the working out of that decision in *Wik Peoples v State of Queensland* (1996) 187 CLR 1.

<sup>14</sup> See Sch 1, para (e) of the *Administrative Decisions (Judicial Review) Act 1977*

<sup>15</sup> (1993) 40 FCR 183 and see *Chapman v Tickner* (1995) 55 FCR 316.

bureaucrats, even if the politicians are elected representatives. Parliament is entitled, if within constitutional power, to change the law. But until Parliament acts, the law exists to be obeyed.

In an article covering some of the present ground,<sup>16</sup> I wrote of the "two extreme views of the nature of the judicial process": the legalistic view and the judicial law-making view. The legalistic view found, in Australia, expression in many places and in judgments of judges well respected. So, Kitto J said:<sup>17</sup>

... the process to be followed must generally be an inquiry concerning the law as it is and the facts as they are, followed by an application of the law as determined to the facts as determined.

It may be remarked that even this statement is qualified by the word "generally". Were it absolute then the Australian (and state) budgets could be strengthened by abolishing courts altogether at least for cases where facts were agreed and replacing judges with computers, arriving at results in accordance with some mathematical algorithm.

Mason CJ dismissed this legalistic or mathematical approach to the judicial function as being a "fairy tale".<sup>18</sup> He referred to the long history of the common law as being one of "judicial law-making" suggesting that this was unlikely to come to an end. Indeed, the view that the High Court is "activist" may be thought to have become more vocal during his Honour's leadership of that Court.

The next Chief Justice of Australia, Brennan CJ, had his own journey along the road to Damascus. In 1978, in an article his Honour wrote of the judicial process:<sup>19</sup>

The judicial function is essentially syllogistic. The applicable principles – "the law as it is" – provide the major premise; "the facts as they are" provide the minor premise; the judgment follows inexorably by applying "the law as determined to the facts as determined".

That comment may be thought to sit ill with the later decisions which his Honour participated in, the most noteworthy of which can be said to be *Mabo*. It sits oddly too with what his Honour was some 12 years later to write in *O'Toole v Charles David Proprietary Limited*.<sup>20</sup>

Nowadays nobody accepts that judges simply declare the law; everybody knows that, within their area of competence and subject to the legislature, judges make law. Within the proper limits, judges seek to make the law an effective instrument of doing justice according to contemporary standards in contemporary conditions. And so the law is changed by judicial decision, especially by decision of the higher appellate courts. Thereafter, the law is taken to be and to have been in accordance with the principle which informs the new decision: the ratio decidendi. The ratio, which is expressed in or necessarily implied by reasons for judgment to which a majority of the participating judges assent, is the law. It is not merely a judicial opinion as to what the law is; it is a source of law ...

It may be said that the common law, although thought to be but a judicial expression of customary law when originally conceived, always involved courts in making law. This has ebbed and changed over the centuries and in many cases once the law was announced by judges, it became as inflexible as the statutory law for which it substituted. Many factors have come into play in

<sup>16</sup> G Hill J, "What Do We Expect from Judges in Tax Cases?" (1995) 69 *Australian Law Journal* 992.

<sup>17</sup> *R v Trade Practices Tribunal; Ex parte Tasmanian Breweries Pty Ltd* (1970) 123 CLR 361, 374.

<sup>18</sup> Mason CJ in a speech, "The Australian Judiciary in the 1990s", delivered at the Sydney Institute, 15 March 1994.

<sup>19</sup> Brennan CJ, "Limits on the Use of Judges" (1978) 9 *Federal Law Review* 1, 3.

<sup>20</sup> (1991) 171 CLR 232, 267.

Australia which have ensured that the common law remains flexible. They include the declining influence of United Kingdom law brought about both by the fact that appeals to the Privy Council were abolished and the membership of that country in the European Community bringing with it a need for that country to attempt harmonisation with community laws. Australia is perhaps now, more than ever, prepared to look further afield to North America and other common law countries including perhaps Asia. It is not unknown for resort to be had to European decisions and indeed statutory law, as well as international law and treaties by way of analogy, particularly in the area of civil rights.<sup>21</sup> The fact that United Kingdom universities play a diminishing part in the education of the legal elite is a factor too. So too is the fact that the High Court is not adverse to overruling established authority, including its own decisions in limited circumstances.<sup>22</sup>

While the taxation law is, of necessity, statutory, and so it may be argued that changes in the common law fall outside the realm of the present discussion, this is not really so. Taxation law operates against the background of, or is superimposed upon, basic civil law. Changes in civil law will thus impact upon taxation law. One case only need be cited to demonstrate this.

*David Securities Pty Limited v Commonwealth Bank of Australia*<sup>23</sup> concerned a borrower of foreign currency who had paid money under a clause in a mortgage requiring the amount lent to be at a rate of interest which ensured a particular return to the lender, whether or not interest withholding tax was required to be deducted (a so-called "grossing-up clause"). Despite the fact that the clause was void as a result of s 261 of the ITAA36, the High Court held that the borrower could, if the payment was made under a mistake, recover the withholding tax content. Before that case, the generally accepted view was that there

was a distinction to be drawn between money paid on a mistake of fact and money paid on a mistake of law. In the former case the money was recoverable, in the latter it was not. It can be said that the distinction was neither clear as a matter of policy nor as a matter of logical analysis, a factor which no doubt contributed to the High Court quite explicitly changing the common law in Australia.

Obviously there is less room for judges to make law when the issue before them arises in a statutory context. But that is not to say there is no room at all. The rules of statutory interpretation, as at least expounded in modern times in Australia and other common law countries, leave considerable room for creative interpretation.<sup>24</sup>

#### 4. THE SHIFTING PENDULUM OF JUDICIAL ATTITUDES TO TAX AVOIDANCE

At this point it is useful to summarise the way judicial attitudes to tax avoidance in Australia have fluctuated, for in such a summary lies the answer to both the need for legislative reform in that area and, to the extent reform is required, the way that reform should be effected.

At the outset it should be said that there is room for debate as to the meaning of tax avoidance in this context. Apart from the generally accepted distinction between evasion and avoidance, there is a real question whether a taxpayer who avails himself or herself of choices which the Parliament has legislated for is really involved in tax avoidance. If Parliament wishes to encourage an industry by granting a special write-off (primary industry or films are obvious examples), the fact that a taxpayer enters that industry to obtain the write-off may not be tax avoidance in the real sense of the term. There is no real approbation in

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<sup>21</sup> See eg, *Minister for Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR 273.

<sup>22</sup> In the area of income tax, a famous example is to be found in *John v FC of T* (1989) 166 CLR 417 ("*John*").

<sup>23</sup> (1992) 175 CLR 353.

<sup>24</sup> I have discussed the changing rules of statutory interpretation in the context of tax in "A Judicial Perspective on Tax Law Reform" (1998) 72 *Australian Law Journal* 685.

doing so. The judiciary can not deny the write-off. It is for Parliament to negate the concession or apply conditions to it.

So too with family trusts. If Parliament decides that trusts should be taxed differently to companies (and perhaps more favourably), it is hard to criticise a taxpayer who conducts an activity through such a trust. Judges can do nothing about this. It is for Parliament to decide what changes there should be. Multiple trusts are a different problem.

Tax avoidance, as I use this expression, is therefore in the comments that follow intended to convey an activity entered into for the purpose of reducing tax and in ways which might objectively be seen to be inappropriate and antithetical to the legislated taxation scheme.

In the United Kingdom of last century it may be assumed that judges were likely to be wealthy, "public" school educated at Eton or equivalent, followed by an Oxbridge University education and, in consequence of birth, conservative in attitude. Since the greater percentage of the judiciary came from what may be called the "landed class", it is not surprising that some attitude of distaste accompanied the analysis of tax laws in cases which came before them. Some support existed, it is clear, for those who were able to find their way around the minefield which those laws contained.

The best example of such a judicial attitude in the United Kingdom may be found in *IRC v Duke of Westminster*.<sup>25</sup> The question at issue was whether the payments which the Duke made to his gardener in the form of an annuity, but in substance remuneration for services, were deductible to the Duke in the computation of his surtax liability. The majority of their Lordships (Lord Atkin dissenting) found in favour of form. As Lord Russell observed, the issue had to be

determined by reference to the rights and liabilities under the deed which the Duke and his gardener had executed. Lord Russell said,<sup>26</sup> in reply to an argument, that the substance of the transaction was a payment of wages:

This simply means that the true legal position is disregarded, and a different legal right and liability substituted in the place of the legal right and liability which the parties have created. I confess that I view with disfavour the doctrine that in taxation cases the subject is to be taxed if, in accordance with a Court's view of what it considers the substance of the transaction, the Court thinks that the case falls within the contemplation or spirit of the statute. The subject is not taxable by inference or by analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case. As Lord Cairns said many years ago ... "As I understand the principle of all fiscal legislation it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

The judicial attitude expressed in *Westminster's* case was imported into Australia and is manifested in cases decided in the first half of the 20th century. But it must be said that much water has indeed passed under the bridge since Jordan CJ put to one side the question of the desirability or morality of tax avoidance and, after referring to the different views which by then had been expressed in the United Kingdom, said:<sup>27</sup>

No doubt those who, like Viscount Simon, regard it as a patriotic duty to pay the largest

<sup>25</sup> [1936] AC 1 ("*Westminster*")

<sup>26</sup> *Ibid* 24-25.

<sup>27</sup> *Estate of Vicars (decd)* (1944) 45 SR(NSW) 85, 93.

amount of taxes lawfully exactable will so arrange their transactions as to attract a maximum of liability ... and those who, like Lord Macnaghten and Lord Atkinson recognise no such duty, will order their affairs so as to incur liability for no more than is legally necessary.

In fairness it should be conceded that in the United Kingdom in more recent times the *Westminster* doctrine is likewise moribund.<sup>28</sup> The most revolutionary change of approach in that country was the adoption, at least for a time, of the doctrine of "fiscal nullity",<sup>29</sup> still acknowledging on the one hand *Westminster* but, with some rather fuzzy judicial reasoning, authorising courts to set aside steps in tax avoidance arrangements, treating them as null for revenue purposes, although valid for other purposes.

The criticism usually levied on the concentration of form to the exclusion of substance, or the adoption of a too literal approach is reserved in Australia mainly for what is termed the "Barwick High Court", and especially the Chief Justice, Sir Garfield Barwick, himself.

The traditional view is proclaimed in the unauthorised biography "*Barwick*"<sup>30</sup> written while Sir Garfield was still Chief Justice, in which it is said:

Tax was Barwick's only triumph. The tax avoidance industry boomed in Australia in the 1970s as a direct result of the work of the Barwick High Court. Under Barwick's guidance the court approached tax schemes with great precision and learning, dissecting them and taking little interest in their overall

shape and the purposes for which they were put into operation.

Throughout the 1970s there were calls for the drafting of new and tighter tax laws to make it impossible for the court to arrive at the conclusions it had but it is doubtful what legislation might achieve; the loopholes are not in the laws but the minds of the judges who apply them.

I do not wish to defend Barwick CJ; that would be politically incorrect with some. I have elsewhere examined in some detail his record in deciding taxation cases.<sup>31</sup> I need not repeat what I there said. It suffices here to say that a deal of the substance of the criticism of the Barwick High Court lies in its approach to the construction of the general anti-avoidance provision, s 260, as it then was, rather than it being suggested that the court adopted an otherwise anti-revenue approach in taxation cases. There are also the cases of *Curran v FC of T*,<sup>32</sup> *Investment & Merchant Finance Corporation Ltd v FC of T*<sup>33</sup> and *FC of T v Westrad Pty Ltd*<sup>34</sup> which, it must be said, proved to be destructive of the tax base of the time. While the legislature acted after *Curran* and *Westrad* to shore up the dyke, the real vice of these decisions lay not so much in the interpretation of the taxation law, notwithstanding *Curran* was later to be overruled by the High Court in *John v FC of T*<sup>35</sup> to which reference has already been made, but in the proposition that taxpayers could form themselves into partnerships to undertake what appeared to be share trading (although one would doubt if the returns from that activity had any relevance) and then treat private company shares as trading stock so as to obtain a tax advantage.

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<sup>28</sup> In *Cameron v Prendergast* [1940] AC 549, *Westminster* was given but a passing obeisance in finding that the "substance and form" of a transaction was a reward for services.

<sup>29</sup> See eg, *W T Ramsay Ltd v IRC* [1982] AC 300. The doctrine is somewhat easier to apply in the context of capital gains tax in which it originated, than in other contexts.

<sup>30</sup> D Marr, *Barwick* (George Allen & Unwin, 1980) 293.

<sup>31</sup> G Hill J, "Barwick's Legend" (1997) 32 *Taxation in Australia* 150.

<sup>32</sup> (1974) 131 CLR 409 ("*Curran*").

<sup>33</sup> (1971) 125 CLR 249.

<sup>34</sup> (1980) 144 CLR 55 ("*Westrad*").

<sup>35</sup> (1989) 166 CLR 417.

It is clear enough that the High Court could have taken a different road. The same problem, while initially approached in the same way in the United Kingdom, was ultimately resolved in *Thomson v Gurneville Securities Ltd*<sup>36</sup> in that country. It is perhaps unfortunate that that approach was rejected in *FC of T v Patcorp Investments Ltd*<sup>37</sup> by Mason J, in a judgment with which, on appeal, the Full Court agreed. It may be pointed out that Barwick CJ was not a member of the Full Court and that Mason J, as his Honour then was, came later to be regarded as a progressive.

While opinions may differ, I am of the view that the Full Federal Court's decision in *John*<sup>38</sup> which distinguished *Curran* on the basis that the partnership had engaged in the acquisition of shares on which a bonus issue was made outside its business of share trading was a preferable approach to that adopted in the High Court for two reasons. First, the legislature had, by then, in any event, solved the problem by requiring averaging of costs of shares and bonus shares and thereby denying a loss. Second, and more importantly, the approach taken by the High Court was pregnant with difficulties in applying it to legitimate, that is to say non tax avoidance, transactions.

As stated earlier, it is for the "emasculatation" of s 260 for which the Barwick High Court is most rigorously criticised. However, it must be said that it was the judgment of Mason J in *Cridland v FC of T*<sup>39</sup> which can be said to be the high point of the anti-section 260 judgments.

Of the well-known difficulties to which s 260 was thought to be subject the most serious was probably the question of its relationship to other sections of the legislation. It was the Dixon High Court in *WP Keighery Pty Ltd v FC of T*<sup>40</sup> which made it clear that s 260 did not operate to make

void every arrangement to avoid tax. An arrangement, it was said, entered into to take advantage of a particular section of the Act (in that case the concessional treatment then granted to a public company) was not impugned by s 260. In one sense, this was no more than a recognition that when there are specific provisions in the Act granting concessions and there is a general anti-avoidance provision, on the application of ordinary principles of interpretation, the anti-avoidance provision should not be construed so as to render the specific provision nugatory. That ultimately was the explanation and approach adopted by a later and differently constituted High Court in *Gulland, Pincus & Watson* to which reference has already been made, although, perhaps, with some qualification.

There is no doubt that the High Court in the Barwick time built upon Keighery. Perhaps Sir Owen Dixon might have modified his view had he sat on *Mullens Investments Pty Ltd v FC of T*<sup>41</sup> or *Cridland*, perhaps not. There is, however, much to be said for the argument, however heretical it may be to some, that the opprobrium for the spate of s 260 decisions adverse to the revenue should as much be laid at the feet of Dixon CJ as his successor.

Whatever the explanation may be for the judicial attitudes of Barwick CJ, it can not be the same as can be advanced in respect of the United Kingdom judiciary of last century. His Honour came not from the landed class. He was not educated at a private school but at a public school. He went to a state university and as a young man was no stranger to poverty or indeed bankruptcy. Such wealth as he had was acquired not by inheritance but by dint of hard work and a most successful career as the leader of the bar in Australia. He could not really be described as an Anglophile and in part, it may be said, his reaction to s 260 was born of his treatment in the Privy

<sup>36</sup> [1972] AC 661.

<sup>37</sup> (1976) 140 CLR 247.

<sup>38</sup> (1987) 16 FCR 188.

<sup>39</sup> (1977) 140 CLR 330 ("*Cridland*").

<sup>40</sup> (1957) 100 CLR 66 ("*Keighery*").

<sup>41</sup> (1976) 135 CLR 290.

Council as advocate in *Newton v FC of T*<sup>42</sup> on behalf of the taxpayer.

There is, however, much to be said for the view that the High Court of the time was reflecting, to some extent at least, an attitude which prevailed in the community, although whether the High Court itself brought about that attitude, or the attitude coloured the High Court's view may be the subject of debate. It was an entrepreneurial time. Tax rates were much higher than they are now at the upper levels at least and were perhaps seen by many as expropriatory. There is little doubt that the community embarked then upon tax avoidance as if a patriotic duty. At times the press were breathless in praise of those who achieved success in tax avoidance.

Times have changed. Public perceptions towards tax avoidance have too. Despite some suggestions to the contrary judges are no longer white anglo-celtic protestants, educated in private schools and coming from wealthy backgrounds. A majority of the High Court, at least as constituted before recent appointments, was catholic, if religion is thought to matter today. A majority of the Federal Court was educated at state schools. While still predominantly appointed from the bar some judges have been appointed both from the ranks of academics (not among the highest paid) or solicitors. There are still not a significant number of women or persons of ethnic backgrounds in the judiciary but time will probably cure that. It is important, therefore, to consider whether the changing times and changing public attitudes have effected a change in judicial attitudes.

### 5. JUDICIAL ATTITUDES IN THE PAST TWO DECADES

There may be some who believe that judicial attitudes have not changed. Those who do so are either misguided or have some hidden agenda for their belief. On Australian National radio recently

an academic suggested that judges of the Federal Court had reverted to literalistic interpretations reminiscent of the Barwick High Court. He said:

... the Federal Court really does has [sic] to start looking at the paradigm within which it's working, at its formalism, at its pinpricking ...

For goodness sake, what is it now, you know, 20 years on from the Barwick era, in which the decisions of the High Court at that stage were completely discredited because of this. There was a public outrage and now that the fuss has died down, we start to have the Federal Court – to be fair, the High Court has now – has behaved in a much more responsible way, but we now have certainly elements of the Federal Court taking that same formalists Barwick approach and that, in my view, is the real – is the real cause of tax avoidance in Australia.

There is nothing in the flow of judgments emanating from the Federal Court which would support this criticism.

It is obvious to any advocate appearing in Australian courts today and to any student of taxation jurisprudence that Australian judges (and I include the Federal Court in that) display no love of tax avoidance. This is not to say that the Commissioner will always win. For there remains still a need for judicial balance. There remains also the need for the Commissioner to observe the law.

Let me give some illustrations from the past two decades.

In the early 1980s and with the object of preventing a slow down of tax collections arising from tax avoidance schemes the Commissioner

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<sup>42</sup> (1958) 98 CLR 1.

adopted a practice of attempting to collect tax notwithstanding that objections and appeals had not been finalised. In *Clyne v DC of T*<sup>43</sup> Mason ACJ refused Mr Clyne a stay of a tax judgment against him pending an appeal he had lodged with the High Court where objections and appeals on tax assessment remained unfinalised. The stay was refused. Mason ACJ while refusing the stay did express some reservations. His Honour said:<sup>44</sup>

I was informed that it is a somewhat unusual course for the Deputy Commissioner to commence proceedings for recovery in a court relying on a notice of assessment which is under challenge in proceedings under Pt V of the Assessment Act. It is to be hoped that this is so. The institution of proceedings for recovery on a notice of assessment which is challenged in proceedings under Pt V may operate oppressively and unfairly to a taxpayer. Fortunately, and this is conceded by Mr Priestley QC for the Deputy Commissioner, the courts in which recovery is sought have a jurisdiction to stay or adjourn recovery proceedings when the notice of assessment is under challenge in Pt V proceedings, insisting, if it be appropriate, on the taxpayer giving suitable security or a suitable undertaking to meet the exigencies of the situation.

While the courts do have jurisdiction to grant a stay, that jurisdiction has been sparingly exercised when a whiff of tax avoidance is to be found.<sup>45</sup> In the Federal Court French J was moved in *Snow v DFC of T*<sup>46</sup> to come out into the open and say:

Irrespective of the legal merits of the appeal a stay will not usually be granted where the

taxpayer is party to a contrivance to avoid his liability to payment of the tax.

The Commissioner's powers to collect tax, and with that the potentiality for unfairness, have expanded somewhat since the 1980s. Perhaps the most unfortunate decision has been that of the Full Court of the Federal Court holding that once bankrupt a taxpayer has no right to challenge an assessment, whether by objection, administrative appeal or judicial appeal.<sup>47</sup> The potentiality for abuse in the Commissioner obtaining judgment on presentation of the assessment (s 177 of the ITAA36 prevents the Court going behind the assessment), commencing bankruptcy proceedings and making a sequestration order (where even the Court in bankruptcy can not, having regard to s 177, go behind the judgment) and thereby stultifying the objection and appeal process is self-evident. Whether the Commissioner's powers to obtain information are presently inadequate where legal professional privilege is at issue is a matter on which I prefer not to comment.

It is perhaps correct to say that since the 1980s with the advent of Pt IVA, paper tax avoidance schemes have largely been eliminated. So the decisions of the present decade have had less need to consider the sort of schemes that were considered in cases such as *John, FC of T v Creer*<sup>48</sup> and *Fletcher v FC of T*<sup>49</sup> for such cases are now less likely to arise. But they do arise from time to time. A recent example is to be found in *FC of T v Prestige Motors Pty Ltd*<sup>50</sup> where the Full Federal Court unanimously found for the Commissioner in trust-stripping arrangements with no commercial justification. Other cases within my own experience and which can be said to involve blatant, artificial or contrived tax avoidance include *Davis v FC of T*,<sup>51</sup> *Pettigrew v*

<sup>43</sup> (1982) 43 ALR 342.

<sup>44</sup> 44 Ibid 344.

<sup>45</sup> *DFC of T v Mackey* 82 ATC 4571, the high water mark of refusal to stay.

<sup>46</sup> 87 ATC 4078, 4093.

<sup>47</sup> *McCallum v FC of T* 97 ATC 4509.

<sup>48</sup> 86 ATC 4318.

<sup>49</sup> 90 ATC 4559 ("*Fletcher*").

<sup>50</sup> 50 98 ATC 4241.

<sup>51</sup> 51 89 ATC 4377.

*FC of T*,<sup>52</sup> *Traknew Holdings Pty Ltd v FC of T*,<sup>53</sup> *SP Investments Pty Ltd v FC of T*<sup>54</sup> and *Richard Walter Pty Ltd v Commissioner of Taxation*.<sup>55</sup> In each the Commissioner was successful.

Paper schemes have largely been replaced by more sophisticated arrangements devised, or peddled, by merchant bankers against what can at least be described as a commercial background. Privatisation and infrastructure development provide two examples of areas where tax minimisation may be found. The recent decision of the Full Federal Court in *Bellinz Pty Ltd v FC of T*<sup>56</sup> provides both a glimpse into this world and a rejection of the arrangement which was put in place.

I do not pretend that every tax avoidance scheme which comes before the courts is necessarily swept away. So, the taxpayer in *FC of T v Lamesa Holdings BV*<sup>57</sup> succeeded in using the Netherlands/Australia double tax treaty to avoid tax on a profit arising from the sale of shares. Australia's richest man had, at least at first instance, great success in *Consolidated Press* and the related case of *CPH Property Pty Ltd v FC of T*.<sup>58</sup> No-one could doubt having regard to the structure adopted in that case, and the underlying tax havens involved, that tax avoidance was clearly present. Whatever the outcome on appeal there is no doubt that the Commissioner would have at least substantially won at first instance had he performed the assessment process correctly.

The Commissioner has been largely successful too in either the application of, or the interpretation of the general anti-avoidance provisions of Pt IVA. It is true that the Commissioner lost in *FC of T v Peabody*,<sup>59</sup> but that was only because he chose to tax the wrong person who obtained no relevant tax

benefit. The underlying principles laid down by the High Court clearly favoured the Commissioner. In *FC of T v Spotless Services Ltd*<sup>60</sup> the High Court not only found for the Commissioner, but in so doing set an important precedent which will chart the course of Pt IVA into the future. Relevant to the current preoccupation with what are euphemistically referred to as "tax-driven financing" is the express position of the High Court that there is no true dichotomy between schemes which are commercial and those which are tax driven – both can and do fall within Pt IVA.

### **6. WHAT LIMITS, IF ANY, SHOULD THERE BE ON A COURT NEGATING TAX AVOIDANCE?**

The academic to whom reference was earlier made would presumably want every tax avoidance case to be determined for the Commissioner, whatever violence that would do to principle, the system or the rule of law. If he thought enough about it I am sure he would not. There are some dangers which should be stated.

First, there is a real danger in judges deciding cases by reference to their own morality or sense of justice. This is so for no other reason than that views of morality differ from person to person. Second, to adapt a metaphor from another area of law and another time, the outcome of each case would depend upon the size of the Chancellor's foot, rather than the application of some predictable principle.

A most significant characteristic of perceived views of justice is that the law be predictable. Business, lawyers and citizens should be able to see that like cases will be decided in like ways and

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<sup>52</sup> 90 ATC 4124.

<sup>53</sup> 91 ATC 4272.

<sup>54</sup> 93 ATC 4170.

<sup>55</sup> (1996) 67 FCR 243.

<sup>56</sup> 98 ATC 4634.

<sup>57</sup> 97 ATC 4752.

<sup>58</sup> 98 ATC 4983.

<sup>59</sup> (1994) 181 CLR 359.

<sup>60</sup> (1996) 186 CLR 404.

that analogous cases will also be decided in like ways to those with which the analogy is cogent. Commercial activity depends upon the ability to plan. Decisions based upon individual judge's concepts of what constitutes acceptable or unacceptable tax avoidance, or none at all, and views about that, would make decision making, to say the least, difficult. It is obvious enough, in areas outside tax, that some part of the public disquiet concerning the judiciary stems from the perception that certainty has been departed from and in its place there has been substituted some abstract and personal sense of justice.

The outcry against the *Consolidated Press* decisions, concentrating, as it did, on the fact that behind the taxpayer was a high profile wealthy individual raises an important question. We would all decry a system where justice was denied to a person because he or she was poor? Do we want a system which distinguishes between rich and poor in the opposite way? Is a person to be denied justice just because he or she is rich?

Another problem of applying different standards to tax avoidance cases than to other cases in the absence of a general anti-avoidance provision is that the law is likely to pursue somewhat peculiar paths. General principles as to what is taxable income or what are allowable deductions are expressed by the legislature in general terms applicable to all. They can not be given different interpretations depending just on the motivation of taxpayers. The concentration on purpose in *Fletcher* in the context of the general deduction provision may create more problems than it solved on the facts of that case.

## 7. WHAT CAN THE LEGISLATURE DO TO ASSIST THE PROCESS?

If it is accepted that there are limitations on the judiciary in tax avoidance cases or for that matter

in the task of statutory interpretation it does not follow that there is nothing the legislature can do to assist the process.

First, it can enact a general anti-avoidance section so that in most circumstances tax avoidance can be dealt with by the courts not by reference to subjective standards or by distorting general tax law concepts. Largely in Australia this has been achieved by Pt IVA and some amendments made since its enactment in 1981. Despite pessimism of the kind expressed by writers such as Mr Marr, that legislation has been relatively effective, both in preventing tax avoidance and in ensuring the success of the Commissioner in tax avoidance cases where it has been applied. I would agree with the authors of the first report of the Review of Business Taxation, if I understand them correctly, that it would be desirable to rely on a generic anti-avoidance provision than to enact a plethora of specific anti-avoidance provisions.<sup>61</sup>

But there is another problem where a legislative solution can be adopted. Taxation laws often apply fuzzy principles and are expressed in fuzzy language. While ss 15AA and 15AB of the *Acts Interpretation Act 1901* (emphasising both the need for Australian courts to give effect to the legislative purpose and to have resort to extrinsic materials in the process) assist courts in giving effect to Parliamentary intention, neither section can be sufficient on its own. First, it is important for Parliament to express itself in language which is both clear and intelligible. It does not always do so.<sup>62</sup> Second, while it is clear enough law that courts in construing legislation must consider the context in which it is enacted, the legislative history, the mischief if any to which it was addressed and the legislative purpose underlying it, that task often becomes fruitless because no clear legislative policy is evident in what parliament has enacted. Courts may be prepared to overlook legislative slips in cases such as

<sup>61</sup> Review of Business Taxation, *A Strong Foundation* (1998) 87.

<sup>62</sup> The most apt example, unfortunately among many, is to be found in the provisions of s 160M(6) of the ITAA36 considered by the High Court in *Hepples* 91 ATC 4808 of which McHugh J, adopting what I had said in *FC of T v Cooling* 90 ATC 4472, said that it was "drafted with such obscurity that even those used to interpreting the utterances of the Delphic oracle might falter in seeking to elicit a sensible meaning from its terms."

*Cooper Brookes (Wollongong) Pty Ltd v FC of T*,<sup>63</sup> where an analysis of context in the broadest sense shows the literal language which Parliament employed did produce absurdity. But should it be expected that courts be left in a vacuum in endeavouring to interpret what Parliament intended? There is a need for Parliament to spell out what the underlying concepts are upon which the legislation is based. In an ideal world Parliament might draft legislation which is clear and unambiguous. We do not live in an ideal world. The next best solution is for Parliament to make its legislative policy clear — not merely by some brief generalised statement, for the general policy of most legislation is tolerably clear, but by a statement which expresses with clarity and in some greater detail, the design details which underpin the legislation which the courts will be called upon to interpret.

Perhaps this is what the authors of the Review of Business Taxation mean when they say in their recent report:<sup>64</sup>

The rules in the tax law obviously need to be clear, certain in their application, and consistent across applications. Certainty does not require inordinate detail. No matter how much detail is provided in the law, there will be ambiguity. Indeed the more detailed tax law is, the greater the likelihood of ambiguity or mistakes (from a principles perspective) as detail has a tendency to bury principle. Likewise, clarity is often more likely to be achieved by the statement of a principle rather than the elaboration of detail.

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<sup>63</sup> 63 (1981) 147 CLR 297.

<sup>64</sup> 64 Above n 61, 85.

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