

Managing



Disputes

- An Australian Perspective-

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(Part I)

Outline and Scope

Attendees at a paper on the topic of “Managing Tax Disputes” could be forgiven for thinking that this paper will be free of the issues of definition and scope that normally arise in tax discussion groups. Unfortunately, that is not the case.

In particular, the question arises as to what comprises a tax dispute or, perhaps more precisely, when that dispute commences. In my experience, the view is often taken that the dispute arises, at the earliest, when an unfavourable assessment issues or perhaps even later when the decision to disallow the objection against it is notified.

In the sense that the latter of those two points is the first time at which lawyers need to be involved (and then only if a decision is taken to appeal against the objection decision to the Federal Court),¹ the view can be adopted that a tax dispute starts then.

So to view the matter is to adopt an approach analogous to commercial litigation, when the problems only start once a commercial relationship has broken down.

In the world of taxation, particularly where what is involved is the taking of a position in an Income Tax

Return (“return”) or Business Activity Statement (“BAS”) which it is understood may be contested by the

ATO, that may be an unwise approach. The outcome of a tax dispute, and in particular the level of penalties if a taxpayer is unsuccessful in an objection, can easily be influenced by the manner in which issues such as requests for information are handled. Moreover, the obligation of those dealing with the ATO to be accurate in statements made to it means that an imprecise approach to the provision of information can have significantly adverse consequences.

For this reason, it seems to me appropriate to consider the management of a tax dispute as encompassing all aspects of dealing with the ATO and its legal representatives from the time it is apprehended that there may be a contest as to the appropriate taxation treatment of a particular transaction. In some cases at least that may be even before lodgment of the relevant return or BAS.

For that reason I propose to deal with the topic under four subheadings, namely:

- Pre-litigation Strategies and Obligations
- The Litigation Choice – Declaratory Proceedings or Part IVC
- Part IVC proceedings – section 14ZZO, *Rio Tinto* and the Model Litigant
- Post-Assessment *Corporations Act* responsibilities

Pre-litigation Strategies and Obligations

Recent cases like *R v Pearce*,² and in other jurisdictions *R v Charlton*³ and the prosecution of Arthur Anderson in the United States, have emphasised the very different atmosphere in which tax disputes can nowadays be conducted.

Tax professionals have been used to a litigious world in which, for the most part, there is little dispute about what actually occurred. What has more likely been in dispute is how the law applies to the underlying facts – either the general law, upon which the taxation law operates, or the taxation law itself. Rarely, in such a context, in former days was the evidence of the tax professional or the taxpayer the subject of serious challenge as to what actually occurred. Where there is such a challenge, it was usually associated with the issue of whether or not a tax motivation existed for particular conduct where the case for the taxpayer concerns deductibility under s 8-1 and/or anti-avoidance rules.

Increasingly, factual issues are contested in tax cases. That is particularly so if criminal law is involved.

The criminal law is essentially concerned with facts. The majority of criminal cases are not concerned about what the law really means, but

rather whether or not the accused has in fact committed the act in question, or, if that be not in dispute, whether the act was committed with the intention necessary to make it criminal. Criminal lawyers (particularly prosecutors) are trained not to argue nice points of law (although they do from time to time arise), but rather to establish, by way of evidence, that the version of events being given by the accused should not be accepted by the jury.

Legislatures all over the world have acted, as they see it, to protect their respective jurisdictions' tax bases from inappropriate techniques of tax reduction. The most familiar of these are General Anti-Avoidance Rules, but in addition there are various attribution rules so that taxpayers can be made liable to tax in respect of income that they do not beneficially own (as, for example, controlled foreign corporation provisions in those jurisdictions which maintain the whole of the world as the territorial base) and, increasingly, prescriptive rules which require transactions of various types to be dealt with in ways which may be inconsistent with Generally Accepted Accounting Practice.

The result, particularly in Europe, the United States and Australia, is the bewildering maze of legislation which well merits the criticism of it by Learned Hand J.⁴

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power; if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that

net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a certain passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness. Much of the law is now as difficult to fathom, and more and more of it is likely to be so; for there is little doubt that we are entering a period of increasingly detailed regulation and it will be the duty of judges to thread the path—for path there is—through these fantastic labyrinths.

Given that these observations were made in 1947, one might wonder whether perhaps the final conclusion reached was overly optimistic in the light of subsequent developments. Be that as it may, it is the daily task of the tax adviser to meet clients' needs against a background of some complexity.

The other significant change has been the move in many countries towards a system where the responsibility for determining tax liability falls in the first instance not on the relevant Revenue Authority, but on the individual taxpayer. Gone are the days when a taxpayer can make a full disclosure of the transactions entered into, leave it to the Revenue Authority to adopt a view of the liability, and escape any suggestion of inappropriate conduct. Whilst in most jurisdictions the counterpart of abolition of the assessment process has been the adoption of binding ruling systems, these bring their own problems.

In that environment, there will from time to time be pressure on tax professionals to come to see their role as Professor Graetz has asserted it to have become:⁵

The tax bar, the accounting profession, and other tax-return preparers no longer hold the view—if they ever did—that filing a tax return should represent each

taxpayer's best efforts at determining the actual tax due. Instead, they treat tax returns as an 'opening bid,' where every issue is resolved in favor of paying less taxes on the assumption that the taxpayer will not be audited or that, if audited, the IRS agent will either overlook or compromise on the issue.

This characterisation is perhaps a little unfair, given that in circumstances of genuine doubt, a taxpayer who does not claim a particular tax position will never have the opportunity to have the matter resolved in his or her favour.

There may well be proper cases in which in circumstances of genuine doubt, or even an "on balance" view that an amount should be treated in a particular way for tax purposes, the possibility that the revenue or, on appeal, the Courts may adopt a different position warrants non-application of one's own view of the law. Indeed, the legislative structure in the context of self-assessment systems, involving as it does concepts such as (limited) safe harbour for reasonably arguable positions, and increasing levels of penalty for error depending upon whether what is involved is lack of reasonable care, recklessness or intentional disregard for the law, necessarily recognises that positions of this type may be taken and identifies with clarity the levels of risk involved.

Nonetheless, it remains the position that a taxpayer in a self-assessment system has the responsibility to assess his or her liability to taxation.

The United States Supreme Court in *United States v Arthur Young & Company*⁶ observed that:

Our complex and comprehensive system of federal taxation, relying as it does on self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities.

The jurat at the foot of the Australian individual tax return reflects the requirements of sections 284-10, 284-75(1), 388-50(1)(b), 388-60, 388-65, 388-70, and 388-75 of the Taxation Administration Act 1953. It says (taking the 2000/1 return as a model):

I declare that:

- *all the information I have given in this tax return, including any attachments, is true and correct*
- *I have shown all my income—including net capital gains—for tax purposes for 2000-01*

IMPORTANT

The tax law imposes heavy penalties for giving false or misleading information.

Likewise, the jurat at the foot of the Company Tax Return says:

I declare that the information in this tax return is true and correct.

As Tony Molloy QC has noted,⁷ the words are “Is” true: not “disputably, possibly, by some stretch of the imagination, may be” arguably true.

By subsection 8J(11) of the Taxation Administration Act 1953:

“Where a person omits from a return ... of income derived by the person ... during a period, any assessable income derived by the person ... during the period, the person shall ... be taken to have made a statement in the return to the effect that the person ... did not derive the assessable income during the period.”

Failure to respect these obligations not only may be an offence in itself, but may constitute evidence of a dishonest intent which might support a charge of conspiracy to defraud the Revenue. The prosecution case against one of the accused, Cunningham, in the case of *R. v. Charlton* mentioned

above included evidence that he had not believed the answers that one of the taxpayers had prepared in response to the Revenue's questions. Yet Cunningham proceeded to submit the answers to the Revenue, and then followed up with letters that were “aggressive” and that claimed that the Revenue was attempting to browbeat the client. The Court of Appeal could find no fault with the trial judge's directions that it was open to the jury to find that Cunningham had acted to conceal the truth from the Revenue.

In a similar vein in *R v Pearce*,⁸ Malcolm CJ noted:⁹

On 2 September, Pearce sent a copy of a fax he intended to send to the ATO to Wharton for his approval. It contained, to the knowledge of both Pearce and Wharton, a number of inaccurate and false statements. In particular, the assertion that “the lender has advised us that actual funds were physically passed to the Franchiser by virtue of the direction to pay and that the loan funds remain under the control of the franchiser”. It was further asserted that no round-robin of cheques occurred and that the lender and indemnifier were non-associated third parties. On 3 September, Wharton approved the letter to the ATO with some minor modifications. Pearce sent the letter dated 3 September 1998 to the ATO.

Malcolm CJ concluded in these terms:¹⁰

In the present case, it was clear from the material provided to prospective franchisees that it was intended to represent to them that the \$39,500 would be received by the franchisor and that of that amount, \$38,000 would be expended in the provision of the services to be provided in the period of 13 months after the expenditure had been incurred. It was also clear that the representations made were both false and intended to

cause the franchisees to claim the \$38,000 as deductible expenditure against their income in the year ended 30 June 1998. As a matter of fact, to the knowledge of the appellants, while the loan agreements themselves were not shams, there was not to be any genuine transfer of funds, but only a “round-robin” calculated only to provide an artificial basis for the participants to claim a deduction in the amount of \$38,000. This was intended by the appellants to enable each franchisee to fund the amount invested from the taxation refund which was obtained from the ATO. (emphasis added)

Further, in my opinion, the Crown case and the evidence was such that the only inference which could properly be drawn in the light of all the evidence was that each of the elements of the charge of conspiracy had been proved beyond reasonable doubt. It follows from this conclusion that, had the true facts been known to the ATO or the Commissioner of Taxation, the deductibility of the claimed deductions would have been questioned or challenged by the Commissioner with the result that the deductibility of the relevant expenditure would also have been challenged.

If sloppy, inexact or inaccurate answers in dealings with the revenue authorities can provide a basis for criminal charges, it is hardly a matter for surprise that they also have the capacity either to diminish the credibility of the factual case put by a taxpayer, or to support a conclusion of lack of reasonable care, recklessness or intentional disregard of the law.¹¹ It is unfortunate in this context that the Australian Taxation Office (“ATO”) encourages “informal” discussion of issues with taxpayers and their accounting advisers in which answers may be given without the precision which would

be employed by a lawyer, and subsequently relies upon any clarification or change of position based on more comprehensive analysis of the position as evidence of dishonesty or professional misconduct.¹² Its apparent practice of refusing to supply transcripts or copies of recorded conversations in this context, even when requested under Freedom of Information legislation, is also hardly reassuring.

Hence my earlier comments that these processes should be regarded as forming part of the dispute and attended to with the same level of care and precision as the later parts of it. Put another way, the starting point in a tax dispute is the filing position taken by a taxpayer.

The Litigation Choice – Declaratory Proceedings or Part IVC

Recent cases highlight the availability (and on some views at least the utility) of resolving disputed indirect tax issues by proceedings in State Supreme Courts¹³ or the Federal Court¹⁴ for declarations about tax liabilities. The ATO has recognized the utility of such proceedings in an indirect tax context in *Sales Tax Ruling* ST 2454:

10. The question arises, however, as to how section 67 of Assessment Act (No.1) interacts with the declaratory jurisdiction of the Supreme Courts of the States and Territories and of the Federal Court. As sales tax imposition can strike at the heart of a taxpayer's business, there is often a need for disputes about sales tax liability to be resolved promptly. Sales tax assessments are still the exception rather than the rule and as the new special assessment procedure in section 25AA is optional and can be time-consuming, declaratory relief is seen in some circumstances as a prompt remedy available to persons in

addition to the statutory procedures set out in Assessment Act (No.1). Reliance on section 67 in declaratory proceedings to conclusively prove the matters set out in any document referred to in that section could frustrate the effective conduct of such proceedings. Accordingly, such action should not be taken in these types of declaratory actions.

Disputes in General

11. Notwithstanding the availability of declaratory relief, it is clear that Parliament intended that the new objection and appeal procedure should be the main remedy available to dispute sales tax liability. The question then arises as to what should be the Commissioner's policy when declaratory proceedings have been commenced and at the same time a decision on an objection has been referred to either the Tribunal or the Federal Court under section 42C of Assessment Act (No.1), both proceedings seeking to resolve the same issues. The guiding objective is that any action should seek the quickest resolution of the issues in dispute, by whatever means. In some circumstances, this may be achieved by seeking to join both proceedings in one forum. In other circumstances, it may be achieved by accelerating one proceeding and seeking, as a matter of discretion, to have the other proceeding stayed or dismissed. In determining which action should be taken, care should be exercised to ensure that all issues in dispute will be dealt with in the *litigation*.

12. The following examples provide guidance on suggested courses of action:

a) If declaratory proceedings are commenced in the High Court, an application could be made to the Court under sub-section 44(1) of the Judiciary Act 1903 to remit the matter

to the Federal Court. Then, if the objection decision is before the Federal Court, an application could be made to that Court to have both proceedings heard together. A similar joinder could be achieved where declaratory proceedings have been remitted to the Federal Court and the objection decision is before the Tribunal for review. An application could be made to the Tribunal under sub-section 45(1) of the Tribunal Act to refer questions of law (being those questions to be resolved in the declaratory proceedings) to the Federal Court.

b) Where declaratory proceedings are commenced in the Supreme Court of a State or Territory, use could be made of the national cross-vesting of jurisdiction scheme. (The cross-vesting scheme became operative as from 1 July 1988.) Depending on which of the declaratory proceedings or cross-vesting scheme became operative as from 1 July 1988.) Depending on which of the declaratory proceedings the objection proceedings in the Federal Court is more advanced, an application could be made to transfer the less advanced proceedings to the other Court so that they can be heard together. Under section 4 of the Jurisdiction of Courts (Cross-Vesting) Act 1987 (Cth), and equivalent provisions in each State and the Northern Territory, so far as sales tax matters are concerned, Supreme Courts are vested with the jurisdiction of the Federal Court, and the Federal Court (by sub-section 4(3) of the Cth Act) is given the same jurisdiction as the Supreme Courts have, once a matter is transferred under section 5 of the Cth Act to the Federal Court. Section 5 permits a Court to transfer proceedings to another Court in which related proceedings are pending if it considers that it is more appropriate for the proceedings to be determined by the other Court. It is acknowledged

that transfer of sales tax matters will not be achieved in all cases. The ability of the Commissioner and taxpayers to make effective use of the scheme in this regard partly depends on the approach Courts take on what is more appropriate in particular circumstances. It is noted that no appeal lies from any decision about whether to transfer (section 13) and that section 11 deems any steps taken in the transferor Court to be steps taken in the transferee Court.

c) If one of the proceedings is far more advanced than the other, and provided that all the issues in dispute are covered by those proceedings, then an application could be made to the Court hearing the other proceeding for a stay or a dismissal on the basis that the first action will determine the issues in dispute more expeditiously. However, in the light of recent High Court authority, the Commissioner would need to show, in seeking a stay, that continuation of the other proceedings would be oppressive, vexatious or otherwise an abuse of process and that a stay would not cause injustice to the applicant. It may be difficult to satisfy this burden save in exceptional circumstances.

d) Where the declaratory proceedings and objection proceedings cover different issues, though may be in relation to the same

facts, both proceedings should be allowed to run their normal course. Adjustments may have to be made to the running of the less advanced proceedings when the decision in the more advanced proceedings is handed down.

13. Where declaratory proceedings have been commenced and the assessment and review procedure has not yet reached either the Tribunal or the Federal Court, the objective still remains to ensure a quick resolution of the issues in dispute. Accordingly, while the Commissioner does not wish to see any delay in the reference of requests made under section 41 of Assessment Act (No.1) or in the determination of any objections, there is an obvious benefit in concentrating resources on the litigation of the declaratory proceedings. Where assessment action is contemplated when declaratory proceedings have commenced, such action should be put on hold unless a taxpayer has specifically requested the issue of an assessment under section 25AA.

And, more recently, in the annexure to GSTD 2004/1 such procedures appear to have been regarded by the ATO as the equivalent of Part IVC proceedings:

4. The circumstances are that all the following requirements are satisfied:

(a)(i) under Part IVC of the Taxation Administration Act 1953 you have applied to the Tribunal for review of an objection

decision or appealed against an objection decision to a Court, and in making the objection decision the Commissioner decided that you have not made a creditable acquisition, and the grounds of the objection include that you have made a creditable acquisition and are entitled to an input tax credit; or

(ii) you have sought declaratory orders from a Court that you have made a creditable acquisition and are entitled to an input tax credit; or

(iii) you or the Commissioner has appealed against a decision of the Tribunal or Court that resulted from a proceeding covered by clause 4(a)(i) or appealed against a decision of the Court that resulted from a proceeding covered by clause 4(a)(ii); and

(b) the Court or Tribunal has found that you have made a creditable acquisition and are entitled to an input tax credit. (emphasis added)

In considering the utility of proceedings for declaratory relief in a GST context it is useful to consider how, otherwise, a dispute may be resolved. For most taxpayers other than ultimate consumers, payment of GST on inputs presents few problems so long as the corresponding input tax credits can be accessed. And collection of the tax from the ultimately consumer presents few difficulties for them.

GST is a multilevel value-added tax intended to be paid by ultimate consumers, not by enterprises. It is critical to the economic integrity of the tax that inter-enterprise transactions do not generate net tax liabilities – the tax paid by the supplier is balanced by the input tax credit payable by the revenue,¹⁵ subject only to timing differences arising due to different tax periods for the taxpayers concerned or different bases of tax (one taxpayer being on a cash basis and the other on an accruals basis).



For this reason there is a duality about every transaction on which GST is payable – except where the ultimate recipient of the taxable supply is not an enterprise which is registered or required to be registered, the taxable supply by the supplier is a creditable acquisition by the acquirer.¹⁶ Indeed, subsequent dealings by one of the parties can change the tax consequence for the other, as with bad debt writeoffs.¹⁷ In the GST context, therefore, the commercial realities that led the Full Court of Victoria to hold¹⁸ that an end lessee (a person other than a taxpayer) had standing to challenge legal views of the Commissioner as to the classification of goods which led to sales tax assessments which were as a matter of reality passed on the end lessee become legal realities for the third party. They are not merely subsidiary matters forming part of the process of making an assessment.

The absence of symmetrical treatment of taxpayers involved in the same transaction which is a feature of income tax jurisprudence¹⁹ has no application in a GST context. It is both relevant and necessary to examine the tax treatment of all aspects of the transaction – both how it affects the parties to each component (external symmetry) and how it affects the enterprise in all its ramifications (internal symmetry) - to reach the correct conclusion as to the way in which it is treated for the purposes of GST.

In countries with a more developed Value Added Tax jurisprudence than Australia, the term encompassing both these concepts is “neutrality”. It was explained thus by Ward LJ in the Court of Appeal in *Commissioners of Customs & Excise v Plantiflor Ltd*²⁰

The result contended for by the Commissioners before us would be

equally surprising and wrong. One tests it in this way. As set out in Article 2 of First Directive, VAT is a tax on consumption exactly proportional to the price of goods and services. The tax is paid by the ultimate consumer. As *Elida Gibbs Limited -v- The Customs and Excise Commissioners* [1996] STC 1387 confirms in paragraph 31, the position of taxable persons must be neutral the principle of neutrality is offended if:-

"The tax authorities would receive by VAT a sum greater than actually paid by the final consumer, at the expense of the taxable person."

These observations reflect the decision of the European Court of Justice in *Elida Gibbs Limited -v- The Customs and Excise Commissioners*.²¹

General considerations

18 Before replying to these questions, it is appropriate to describe briefly the basic principle of the VAT system and how it operates.

19 The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.

20 Thus, in Case 89/81 *Staatssecretaris van Financiën v Hong Kong Trade* [1982] ECR 1277, paragraph 6, the Court held that it was apparent from the First Directive (Council Directive 67/227/EEC of 11 April 1967 on the harmonization of the legislation of the Member States concerning turnover tax (OJ, English Special Edition 1967, p. 16) that one of the principles on which the VAT system was based was neutrality,

in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain.

21 That basic principle clarifies the role and obligations of taxable persons within the machinery established for the collection of VAT.

22 It is not, in fact, the taxable persons who themselves bear the burden of VAT. The sole requirement imposed on them, when they take part in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved, is that, at each stage of the process, they collect the tax on behalf of the tax authorities and account for it to them.

23 In order to guarantee complete neutrality of the machinery as far as taxable persons are concerned, the Sixth Directive provides, in Title XI, for a system of deductions designed to ensure that the taxable person is not improperly charged VAT. As the Court held in its judgment in Case 15/81 *Schul v Inspecteur der Invoerrechten en Accijnzen* [1982] ECR 1409, paragraph 10, a basic feature of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of VAT borne directly by the cost of the various price components of the goods and services. The procedure for deduction is so arranged that only taxable persons are authorized to deduct from the VAT for which they are liable the VAT which the goods and services have already borne.

24 It follows that, having regard in each case to the machinery of the VAT system, its operation and the role of the intermediaries, the tax authorities may not in any circumstances charge an amount exceeding the tax paid by the final consumer.

These observations apply equally to the design of the Australian GST as appears from the Explanatory Memorandum Executive Summary. The opportunity to resolve a dispute as to liability in a way which binds all interested parties would seem to make declaratory relief a particularly appropriate procedure where the issue is the application of the GST to complicated transactions.

Notwithstanding the eminently sensible observations in the Ruling set out above and the foregoing considerations, as the litigation in *Platypus Leasing Pty Ltd v. Federal Commissioner of Taxation (No 3)*²² demonstrates, the ATO's co-operation in facilitating declaratory proceedings will not always be forthcoming and the conclusion of Gzell J²³ that Supreme Courts²⁴ lack jurisdiction to make a declaration once an assessment issues and is tendered provides the ATO with a ready means available to it to frustrate the exercise of such jurisdiction.

If the ATO is not inclined to frustration, declaratory relief will usually be the simpler method of resolving the dispute. But if the ATO's co-operation cannot be taken for granted, the question remains whether an application for declaratory relief will serve a useful purpose.

The ATO may take considerable time in carrying out an investigation, while increasing the pressure on the various parties. It may have made its intended position quite clear, although without precision as to the reasoning relied upon. It may have shown enthusiasm for obtaining the taxpayer's legal opinions if it can. It may also suggest that the Commissioner's Accountant's Concession will not be applied in the hope, presumably, that there will be some correspondence that gives it more insight.

Eventually, but potentially after a long interval, the ATO may issue

assessments to most, if not all, the entities involved in an arrangement, which will take inconsistent positions: in a GST context, denying the various input tax credits but leaving GST payable on all taxable supplies, or, in an income tax context including the same income in the assessable incomes of more than one person. Inconsistent alternative assessments, if *bona fide*, are allowed at law. The ATO's modus operandi is often also to impose penalties at the greatest level possible, with a view to placing pressure on taxpayers to settle. For example, it attempted, in *Prebble v FCT*,²⁵ to support an assessment to penalties at 75% of the tax assessed on the basis that the taxpayer, who had sought legal advice, had intentionally disregarded the law. That contention was rejected summarily by the Court.

More recently, the ATO has asserted that a taxpayer, who seeks legal advice as to its tax position which suggests that, despite the (favourable) advice there is always a risk that the ATO will disagree, is reckless and subject to 50% penalties if it does not disclose its circumstances to the ATO. This approach should also be rejected by the courts but, until it is, the ATO can be expected to assess on such a basis. Also, in the minds of some practitioners there is a suspicion that the ATO has never accepted in an assessment that any view of the law other than its own is "reasonably arguable". So it does not apply the provisions that reduce, or eliminate, penalties on that basis.

The taxpayers may well intend to object to these assessments. Although the grounds of objection must be comprehensive, and reasons for the objections detailed, the taxpayers need not disclose their legal advice to the ATO. The ATO can be expected to ask for the legal advice, purportedly to assist it in deciding the objections, but the taxpayers are not obliged to provide it or to set out their opinion

on how the tax law operates; that is the ATO's function. The ATO's deliberations cannot go on indefinitely, because the taxpayers have the power after 60 days to require the ATO to make a decision after a further 60 days.²⁶ The ATO can also issue further notices requiring provision of information in order to assist it in deciding the objections.²⁷

Ultimately the ATO's unfavourable objection decisions should proceed to the Federal Court. The ATO is obliged to state its contentions in detail within a short time of the proceedings being instituted.²⁸ The taxpayer will usually also be required to do so. The taxpayers must give their evidence by affidavit, which will be provided to the ATO prior to the hearing.

Seeking a declaration involves a somewhat different process if the facts in the case are largely uncontroversial (apart from anti-avoidance issues which could not be the subject of the declaration). The parties would settle questions upon which the court is asked to declare the law, which declarations will bind the taxpayers and the ATO. The taxpayers would have to provide evidence, which would be to prove how and when the transactions occurred. In this regard the various documents often speak for themselves. Although occasionally the parties agree a statement of relevant facts for the court in such matters, and the ATO is under an obligation as a model litigant not to dispute uncontroversial matters, it is open to the ATO to refuse to agree anything. It is open to the taxpayers to lodge a notice requiring facts to be admitted. If the ATO refuses, and the facts are proved, then the ATO might be ordered to pay the taxpayers' costs of proving those facts. Contentions by the ATO that it stands in a different position to other litigants in this regard have not been accepted by the Courts.

might be ordered to pay the taxpayers' costs of proving those facts.²⁹ Contentions by the ATO that it stands in a different position to other litigants in this regard have not been accepted by the Courts.³⁰

Seeking a declaration may have a number of advantages in appropriate circumstances:

- It gets the taxpayer on the front foot, rather than sitting by and waiting for the ATO to proceed with the matter at its own pace;
- There would be a much earlier resolution of the issues, a matter of some significance in the context of a corporate taxpayer for the reasons discussed below; and
- It precludes the ATO relying upon delay as a tactic.

Should the ATO seek to pre-empt such proceedings, it can issue assessments and/or (in a GST context) Division 165 declarations for the relevant periods against the taxpayers. The ATO will then rely on section 177 of the *Income Tax Assessment Act 1936* or, in a GST context, section 59 of the *Taxation Administration Act 1953*.

Whilst it may be possible for the ATO to stall the declaratory proceedings by issuing assessments and/or declarations promptly, and the advantages of such proceedings would not arise in such a case, at least the taxpayer will have assessments and/or declarations that can be attacked under Part IVC. This is itself an advantage, if one concern of the taxpayer is the delay in resolving the matter with the ATO.

There are a number of potential disadvantages that have to be considered.

First, the institution of, and preparation for, declaratory proceedings will give rise to additional costs to the taxpayer (compared with proceeding with

Part IVC proceedings alone). Even though much the same preparation will be involved, these additional costs would not be insignificant. Of course they would be reduced to some extent if the taxpayer is successful, but likewise increased if unsuccessful.

Second, assuming the declaratory proceedings occur, the ATO may have an opportunity to cross-examine the taxpayer's witnesses. This evidence could then be used by it in the later Part IVC proceedings.

Third, the taxpayers will be subject to the usual disclosure rules, which would include, if requested by the ATO, disclosing documents which may otherwise be the subject of the Accountant's Concession claim. This disadvantage is probably illusory, for the ATO will probably indicate that it thinks there are "extraordinary circumstances" warranting a lifting of the self-imposed sanction on accounting advice. So, at any time, the ATO can determine that it wants access to those documents.

The decision will often be finely balanced.

As mentioned above, in *Platypus Leasing Pty Ltd v. Federal Commissioner of Taxation (No 3)* the ATO argued that there was no jurisdiction both before the assessment issued, and after. It succeeded on the latter proposition. In relation to the former, it argued in a strikeout application that the somewhat stringent requirements for striking out the plaintiff's claim were met on the basis that

- (a) the Plaintiffs' summons and consequent proceedings disclosed no reasonable cause of action in that:
 - (i) they were premature and hypothetical;
 - (ii) they may not involve a federal

- matter under the Constitution;
- (iii) they were frivolous or vexatious;
- (iv) there was no reasonable prospect that the Court would make the declarations sought in the Summons on discretionary grounds; and
- (b) the Plaintiffs' summons and consequent proceedings constituted an abuse of process of the Court as being instituted for an ulterior purpose, namely the inhibition of the exercise by the Defendant of his statutory responsibilities.

In relation to these issues, Gzell J observed:

The fate of the matter argument

55 In light of the tender of the signed copies of the notices of assessment and declaration, for the reasons expressed below, it is unnecessary for me to express an opinion on the Commissioner's argument that the proceedings raised no matter.

56 It was not contended by the Commissioner that proceedings in a State court seeking declaratory relief with respect to liability under A New Tax System (Good and Services Tax) Act 1999 (Cth) will never raise a matter. On the contrary, he submitted that such proceedings are appropriate in some instances.

57 There is a long history of declaratory proceedings against the Commissioner in disputes arising under the former sales tax legislation. Indeed, the Commissioner issued Sales Tax Ruling ST 2454 expressing his approval of such proceedings in appropriate cases. Their utility in resolving disputes with the Commissioner prior to the issue of a notice of assessment is demonstrated by *Oil Basins Ltd v The Commonwealth* (1993) 178 CLR 643 in which Dawson J held that the fact that the Commissioner had not made up his mind whether or not to

issue an assessment did not deprive the court of jurisdiction for want of a proper contradictor.

58 In his final submissions, counsel for the Commissioner submitted that it was “theoretically possible” that a case with a factual controversy could be the subject of declaratory relief by a State court. It was submitted that appropriate cases for this form of relief were those where not factual controversy existed. I doubt that is a valid distinction or that the grant of jurisdiction under the Judiciary Act 1903 (Cth), s 39(2) is so circumscribed. However, that is a matter for another day.

Utility of the declaratory proceedings

59 International Lease Finance and its associated companies pointed to

the utility and the convenience of proceeding to a hearing on the merits in this court. There is obvious force in those arguments in light of the material that has already been filed in these proceedings, the allotment of a hearing date and the delay that will inevitably be occasioned by the procedures in the Taxation Administration Act 1953 (Cth), Pt IVC.

60 Nevertheless, signed notices of assessment and a declaration have now been tendered in this court and the effect of that tender must be analysed.

Gzell J did not need to deal with the abuse of process issue, as the taxpayers made it clear that they did not seek to obtain any forensic advantage flowing from limitations which might otherwise arise on the

use by the ATO of its compulsive powers³¹ and, to make that clear, consented to an order authorizing completion of the audit he was conducting. In a similar vein, an adjournment of the Plaintiffs’ summons was granted so that the ATO could, with reasonable expedition, complete the audit. The prospect of such proceedings being used to interfere inappropriately with the due conduct by the ATO of its statutory functions is accordingly remote.

On appeal, the only member of the Court (Handley JA) to consider the matter in any detail made it clear that in his view the challenge to jurisdiction in a pre-assessment context was bound to fail.

FOOTNOTES

1. That is because a corporate taxpayer must be represented by a lawyer unless the court grants leave otherwise.
2. [2005] WASCA 74 (Malcolm CJ, Murray and Steytler JJ, 15 April 2005)
3. [1996] STC 1417, 1433
4. **Thomas Walter Swan**, 57 Yale LJ (1947) 167, 169:
5. **The US Income Tax: What it is, How it Got That Way, and Where We Go From Here** (1999) page 51
6. 465 US 805, 815-816 (1984)
7. A P Molloy QC: **Restrictions on the Role of International Tax Advisers** (2004) World Tax Conference papers
8. [2005] WASCA 74 (Malcolm CJ, Murray and Steytler JJ, 15 April 2005)
9. at para [50]
10. at paras [153] and [163]
11. see, e.g., *Harts Australia Ltd v Federal Commissioner of Taxation* 2001 ATC 4,572, *Weyers v Federal Commissioner of Taxation* (2006) Federal Court (Dowsett J) [2006] FCA 818
12. see, e.g., the transcript of cross-examination of the Applicant’s witnesses in *Di Lorenzo Ceramics Pty Ltd v Federal Commissioner of Taxation* (2006) Federal Court (Lindgren J) (decision reserved)
13. e.g. *TAB Limited v Federal Commissioner of Taxation* 2005 ATC 4,512
14. e.g. *Marana Holdings Pty Ltd v Federal Commissioner of Taxation* 2004 ATC 4,256, 5,068
15. Explanatory Memorandum Chapter 1 – Executive Summary
16. GST Act, paragraph 11-5(b). A less common example is the unavailability of the margin scheme method of accounting for real estate transaction where the acquisition resulted in a taxable supply by the vendor who was not himself using the margin scheme (GST Act subsection 75-5(2))
17. GST Act subsection 21-15(c)
18. *Federal Commissioner of Taxation v Biga Nominees Pty Ltd* [1988] 1,006 at pp1,015-6
19. *G P International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at p. 136; *Federal Commissioner of Taxation v Rowe* (1997) 187 CLR 266 at pp 279-280 (Brennan CJ, Dawson, Toohey and McHugh JJ) and pp 291-2 (Gaudron, Gummow and Kirby JJ)
20. [2000] EWCA Civ 26 (3 February 2000). The actual decision was reversed on other grounds by the House of Lords [2002] UKHL 33
21. *Elida Gibbs Ltd v Commissioners of Customs and Excise*. [1996] EUECJ C-317/94 (24 October 1996)
22. [2005] NSWSC 388 (17 May 2005)
23. upheld on appeal at . See also the decision of the House of Lords in comparable circumstances in *Autologic Holdings plc v Inland Revenue Commissioners* [2005] 3 WLR 339
24. and, seemingly, by parity of reasoning, the Federal Court
25. [2002] FCA 1434.
26. *Taxation Administration Act* 1953 section 14ZYA
27. *ibid.* para 14ZYA(1)(b)
28. *Federal Court Rules* O.52B r.5(a)(v)
29. *Federal Court Rules* O.18 r.2 and O.62 r.25 and 25 and corresponding provisions in the Rules of the State and Territory Supreme Courts
30. see, e.g., *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* [2004] FCA 1299
31. see, in the context of section 155 of the *Trade Practices Act* 1974, *Brambles Holdings Ltd v Trade Practices Commission* (1980) ATPR 40-179

Author’s Profile

Mr David Rusell QC was called to the Bar in 1977, having been admitted as a solicitor in 1974. Admitted to practice in New South Wales, Queensland, Victoria, the Northern Territory, the Australian Capital Territory and Papua New Guinea, David took silk in 1986 and holds that office in all the above jurisdictions except Papua New Guinea.