Tax and the Rule of Law

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Abstract

The rule of law is a wide-ranging concept. This presentation focuses on its significance for the administration of the Australian Tax System.

In particular, I want to explore whether, in circumstances where there is a change in the interpretation of particular tax laws or a long-standing administrative practice, can we be certain that the Commissioner of Taxation exercises his extensive powers within a framework which is consistent with the rule of law and the fair treatment of taxpayers?

I will be exploring how the Commissioner currently uses his power of general administration, the private and public ruling system and the statutory remedial power to manage such situations. This exploration will also encompass how similar situations are managed in other jurisdictions.

As we will find, none of these mechanisms is entirely satisfactory in ensuring that taxpayers are always treated fairly and with due consideration.

The solution, I believe, is to be found in a new statutory protection for taxpayers who rely on the stated positions of the Commissioner of Taxation and established administrative practices. This, in my view, is the only way to ensure sufficient protection for taxpayers, whilst, at the same time, preserving the rule of law and enhancing public confidence in the tax system.

Introduction

The rule of law is the fundamental principle upon which law-making and governing are founded. It is the cornerstone of civilized society. Put most simply, it protects us from tyranny.

Central to the rule of law is the premise that the power of the executive government is exercised according to an independent justice system. That power must be restricted to the bounds set down by the law, and must rest with a democratically elected body which is ultimately answerable to the people at elections.

Today, that seems a trite summary but it has not always been so. Wars have been fought, governments toppled and monarchs executed over the rule of law generally, and the power to tax in particular.

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The tax system ogles every corner of our society – scrutinising how we live, how we work and how we trade. It cannot be avoided, meaning just about all of us, at some stage of our lives, will interact with tax law and the tax system.

This is why the rule of law is fundamental to the development and administration of our tax laws. Without it, taxpayers could be subject to arbitrary exaction by the government. Taxation would be little more than state-sanctioned theft on a grand scale.

Fortunately, we do not find ourselves in that position in Australia. But extreme potential consequences should never be far from our minds as a backdrop for policy development and administering the tax system.

Upholding the rule of law in the taxation context means that:

(a) taxation must be according to law;

(b) the law must be available and clear to taxpayers; and

(c) the Crown should deal fairly with its subjects.

To that end, we have a number of well entrenched principles. Since 1689, the *Bill of Rights* has provided:

> That levying Money for or to the Use of the Crowne by pretence of Prerogative without Grant of Parlyament… is Illegall[1]

The High Court has also expressed the clear view that taxation is not a prerogative power and that the Crown cannot impose tax without the authority of Parliament.[2]

That said, the reality is that assessment, collection and administration of the tax system must necessarily be undertaken by an officer of the executive government, that is, the Commissioner of Taxation ("**Commissioner**").

It is the Commissioner's duty to ensure the correct amount of tax is paid by each taxpayer "not a penny more, not a penny less".[3] The sheer scale of that task means that the Commissioner must have many powers, sometimes frighteningly invasive powers, and many subordinates to facilitate the task of obtaining information and/or bringing compliance action against taxpayers.

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[1] *Bill of Rights 1688*, 1 Wm & M sess 2, c 2.
[2] *Cth v Colonial Combing, Spinning and Weaving Co Ltd* (1922) 31 CLR 421, 433-434, 444 (Isaacs J), 460 (Starke J).
[3] *Lighthouse Philatelics Pty Ltd v FCT* (1991) 32 FCR 148, 155 (Lockhart, Burchett and Hill JJ).

Even before compliance and recovery work can begin, the Commissioner must form a view about how the tax law operates and applies to particular taxpayers, and effectively and consistently inform taxpayers of that view.

Theoretically, as an officer of the executive, this should be a straightforward process: the Commissioner should merely execute the commands of Parliament as they are set down in the relevant legislation. That would be taxation according to law.

However, in practice, as the tax legislation becomes more voluminous and complex, and with taxpayers' affairs becoming more sophisticated, it increasingly falls on the Commissioner, at least in the first instance, to decide if and how the law applies, sometimes with only minimal guidance from the legislation.

In this environment, it becomes vitally important that taxpayers understand their obligations and have confidence in both the Commissioner and the system more broadly. The only way to instil that confidence is for the Commissioner, by which I really mean tax officers at all levels, to deal with taxpayers fairly and consistently.

This is especially important where the Commissioner has long adopted a particular interpretation of the law or approach to an issue which may be debatable or not clearly required by the law.

For example, the Commissioner has never sought to apply s 99B of the 1936 Act[4] to resident trusts that have never accumulated foreign income. Although this seems consistent with the purpose of the provision, it is not clear either on a literal reading of the statute or the relevant case law that s 99B is confined in that way.[5] Nor is there a public ruling, although there are a few private rulings which directly support that view.

The Commissioner could, if so inclined, change his mind tomorrow and, subject to the time limits imposed by s 170 of the 1936 Act, commence issuing amended assessments on the basis of a literal reading of s 99B.[6] This would be a major reversal and many taxpayers could find themselves adversely impacted by the Commissioner's change of position.

Those taxpayers might have otherwise been fully compliant and quite legitimately adopted an interpretation which not only appears to be consistent with the law, but is also consistent with the Commissioner's position over many years. Even so, they would have no protection if the

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[4] *Income Tax Assessment Act 1936* (Cth) ("**1936 Act"**).

[5] In *Traknew Holdings Pty Ltd v FCT* (1991) 21 ATR 1478, 1492, Hill J said application to a resident trust "presents difficulty" but did not need to decide "whether the extreme width of s 99B and associated sections require it to be read down having regard to the obvious legislative purpose in enacting it".

[6] I should explain that I am using the pronoun "his" for simplicity's sake because the incumbent Commissioner and all of his predecessors are male, recognising and celebrating the fact that future occupants of the role may well be women.

Commissioner suddenly shifted his approach and their only recourse would be long and expensive litigation under Part IVC.[7]

Would that inspire confidence in the Commissioner or the tax system? Would it be just?

So we have a tension: does the requirement that taxation be in accordance with the law also mean that the taxpayer has no protection from changes by the executive government?[8] Is there protection if a decision of a court either overturns an earlier precedent or interprets the law in a way that differs from the Commissioner's long standing interpretation, established without any binding authority?

Strict adherence to the law, newly articulated by the Court or re-interpreted by the Commissioner, with retrospective effect, would lead to taxpayers being punished for following the Commissioner's established approach at the time. Short of time travel, what can even the most conscientious taxpayers do to protect themselves?

Within the confines of the Commissioner's duty to collect the right amount of tax under the legislation, there must be room for the Commissioner to act concessionally in these kinds of circumstances. Circumstances where concerns of clarity, confidence, equity and fairness (which in themselves contribute to upholding the rule of law) demand an approach not strictly in accordance with the letter of the law.

In practical terms, it is possible that this objective can be achieved in three ways:

(a) the power of general administration, specifically the allocation of compliance resources;

(b) a system of rulings; and

(c) a statutorily sanctioned remedial power.

As I will explain, each of these options goes some way to relieving the problem but, until there is a legislative protection for taxpayers who reasonably rely on the Commissioner's practice, the proper balance cannot be struck.

And let me make it quite clear that the observations I am making here should not be interpreted as criticism of either the Commissioner or the Tax Office, who have no choice but to operate within the paradigm delivered to them by legislators and the courts.

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[7] *Taxation Administration Act 1953* (Cth) Pt IVC ("**Administration Act"**).
[8] See, eg, TR 2022/D1; PCG 2022/D1; TA 2022/1, which raise precisely this question.

Powers of General Administration

The Commissioner has the responsibility for administering tax laws.[9]

The general administration power authorises the Commissioner to take action incidental to, or consequential upon, other express powers, such as:

(a) the power to audit taxpayers at random;[10]

(b) the power to settle or compromise proceedings;[11] and

(c) the power to decide whether to allocate limited compliance resources to an issue.[12]

This power has been used pragmatically and generally leads to better outcomes for the tax system and Australian taxpayers as a whole.

For example, in 2014, I was heavily involved in the formulation and implementation of an initiative called Project Do It, whereby the Commissioner gave taxpayers the opportunity to voluntarily disclose offshore interests that had not previously been declared. The Commissioner decided not to apply resources to the issue of fraud or evasion and, consequently, confined reassessments to the four-year period.[13] Although the Commissioner could not guarantee that taxpayers would not face criminal prosecution, the program was supported by AUSTRAC and the Director of Public Prosecutions. In practice, the likelihood of any prosecution was minimal.

Taxpayers were given protection in exchange for normalising their overseas arrangements. By the end of the project, some $6.7 billion[14] of previously undisclosed assets were brought within the Australian tax net.

This was a pragmatic and efficient use of the power to compromise,[15] which certainly benefitted the tax system as a whole, but also meant greater peace of mind for individual taxpayers who had made use of the protections on offer. Many of them had historical overseas assets that they were afraid to disclose lest the Commissioner initiate prosecutions and seek to tax decades of overseas income.

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[9] *Income Tax Assessment Act 1936* (Cth) s 8; *Superannuation Guarantee (Administration) Act 1992* (Cth) s 43; *Excise Act 1901* (Cth) s 7; *Fringe Benefits Tax Assessment Act 1986* (Cth) s 3; *Taxation Administration Act 1953* (Cth) sch 1 s 356-5.
[10] See, eg, *Industrial Equity Ltd v DCT* (1990) 170 CLR 649; *Knuckey v FCT* (1998) 87 FCR 187.
[11] See, eg, *Grofam Pty Ltd v FCT* (1997) 36 ATR 493.
[12] *Public Governance, Performance and Accountability Act 2013* (Cth) s 15; *Financial Management and Accountability Act 1997* (Cth) s 44 later repealed by *Public Governance, Performance and Accountability (Consequential and Transitional Provisions) Act 2014* (Cth); *Macquarie Bank Ltd v FCT* (2013) 215 FCR 403, [70]-[71] (Edmonds J). See, PSLA 2009/4. See also, *R v IRC; Ex parte National Federation of Self-Employed and Small Business Ltd* [1982] AC 617, 651 (Lord Scarman).
[13] *Income Tax Assessment Act 1936* (Cth) s 170(1).
[14] 'Statement on Reporting Project DO IT', *Australian Taxation Office* (Web Page, 18 September 2018) <www.ato.gov.au/Media-centre/Corrections-and-clarifications/Statement-on-reporting-on-Project-DO-IT/>.
[15] See, *Bosanac v FCT* [2018] FCA 946, [4] (Steward J).

It provided a fine example of the Commissioner deciding not to allocate resources to a particular issue where that approach was viewed as being beneficial to tax administration.

In determining whether to go down this path, the Commissioner has stated, both publicly and privately, that the decision is "not simply a narrow cost-benefit analysis" of expected revenue against cost of collection, but takes "into account the broader health of the tax system, and especially the public confidence in tax administration" which might otherwise be undermined by a decision to pursue the law strictly.[16]

That is wise policy. The limited resources of the Commissioner should be used to strengthen the system as a whole to be in the long-term national interest, not merely to collect revenue today.

The approach is often used where the Commissioner has previously adopted one interpretation of the law and later changed the interpretation so that the Tax Office will only apply resources to enforcing the new interpretation prospectively.

But it doesn't entirely solve our dilemma. In such cases, the Commissioner will refrain from initiating audits on those issues in periods before his change of view. However, if the Commissioner is asked to rule on the issue, or it arises in another context (such as an audit around something else), he considers himself bound to apply his "new" view of the law. It is a limited concession and purely administrative.

Compare that to the legislative protection in s 170B of the 1936 Act. This provision protects positions taken in anticipation of certain amendments that were announced between 2006 and 2012 but did not eventuate following the change of government in late 2013.[17]

At that time, the legislative backlog meant that a number of measures had been announced in budgets and elsewhere but not enacted. Anticipating that changes would be effective from the time of announcement, many taxpayers had taken positions off the back of those announcements. When the new government decided not to pursue the changes, they were left exposed.

Section 170B was enacted shortly after and prevents the Commissioner from amending an assessment in a less favourable way in respect of announced changes. It also "switches off" the machinery allowing the Commissioner to recover administrative overpayments. This is a good example of statutory protection for taxpayers faced with a change in position, albeit a policy position rather than an interpretation of the law.

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[16] Chris Jordan, 'Reinventing the ATO' (Speech, The Tax Institute 29th National Convention, Hobart, 27 March 2014). See also PSLA 2011/27.
[17] For the list of announced amendments see *Income Tax Assessment Act 1936* (Cth) s 170B(8).

In the absence of such a statutory protection, the Commissioner recognises that the general administration power "cannot be used to remedy defects or omissions in the law".[18]

So much was apparent from the decision in *Macquarie Bank Ltd v Federal Commissioner of Taxation*[19] where the Court rejected a contention that the so-called "U-turns" practice statement, PSLA 2011/27, prevented the Commissioner from applying his changed view of the law retrospectively.

In light of that decision, there remain significant questions about whether a taxpayer who has followed an interpretation previously accepted by the Commissioner is protected when those issues come to the attention of the Tax Office after the change of interpretation in the context of an audit, even an audit on other issues. Is the Commissioner not duty-bound to make an assessment in accordance with the current interpretation of the law? Can a decision about resource allocation really absolve the Commissioner of that duty?

Although useful, resource allocation decisions are not the solution that taxpayers need.

There is a statutory protection from penalties if taxpayers apply the law consistently with an administrative practice.[20] But taxpayers can still find themselves with amended assessments for substantial sums, even where they have always sought to adhere to the law in line with the Commissioner's then view of it.

Australia is not alone in having a general administration power that stops short of a discretionary power to grant relief. In the United Kingdom, the notion that the general administration power provides for a "dispensing power" has been clearly rejected.[21]

In *Vestey v IRC*, the Inland Revenue Commissioners contended that a provision of the UK tax legislation deemed all beneficiaries of certain non-resident discretionary trusts to be assessable on all the income of the trust. The Commissioners could use their dispensing powers to determine the appropriate amount assessable to each beneficiary, provided the total amount assessed did not exceed the total trust income. The House of Lords found for the taxpayers, with Lord Edmund-Davies concluding that:

> So remarkable are [the consequences of the commissioners' contentions], and so disturbing are the unconstitutional devices now resorted to by the Inland Revenue Commissioners, that I am forced to the conclusion that the interests, not only of the

[18] See, PSLA 2009/4.
[19] (2013) 215 FCR 403; appeal dismissed in *Macquarie Bank Ltd v FCT* [2013] FCAFC 119.
[20] *Taxation Administration Act 1953* (Cth) sch 1 s 284-224. See similar protection in the US: IRC §§ 6404(f) and 6664(c) (2019).
[21] *Vestey v IRC* [1980] AC 1148, 1185 (Viscount Dilhorne), 1193-1195 (Lord Edmund-Davies); *R v IRC ex parte Wilkinson* [2005] 1 WLR 1718, [20]-[23] (Lord Hoffman).

> respondents but of the public at large alike, demand that the claim of the executive in this matter be challenged and rejected.[22]

In the court below, Walton J was scathing of the commissioners' claim to a dispensing power:

> In one case the Crown can remit one-third, in another one-half, and in yet another case the whole, of the tax properly payable, at its own sweet will and pleasure. If this is indeed so, we are back to the days of the Star Chamber. Again, I want to make it crystal clear that nobody is suggesting that the Crown has, or indeed ever would, so utilise the powers which it claims to bring about unjust results; or really, of course, which is not necessarily the same thing, results which it thought to be unjust. The root of the evil is that it claims that it has, in fact, the right to do so.[23]

Even so, for many years the revenue authorities in the UK allowed certain "extra-statutory concessions", which it published. These gave more favourable treatment to taxpayers than was provided for under the law.[24]

The practice attracted mixed judicial comment over the years, some from the same judge in different cases. In 1968, in *IRC v Bates*, Lord Upjohn said:

> …the Commissioners of Inland Revenue, realising the monstrous result of giving effect to the true construction of the section, have in fact worked out what they consider to be an equitable way of operating it which seems to them to result in a fair system of taxation. I am quite unable to understand upon what principle they can properly do so and, like Lord Reid, I hope this matter may receive some consideration in the proper place.[25]

Yet, in the very next year, his Lordship observed that:

> This practice is very old, works great justice between the Crown and the subject and I trust will never be disturbed.[26]

The balance of opinion was critical and Lord Justice Scott in *Absalom v Talbot* captures the nub of the issue, which is equally applicable in Australia:

> No judicial countenance can or ought to be given in matters of taxation to any system of extra-legal concessions. Amongst other reasons, it exposes revenue officials to temptation,

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[22] *Vestey v IRC* [1980] AC 1148, 1196-1197. In the result, their Lordships held that it was the transferor of property to the non-resident trust that was liable to tax under s 412 of the *Income Tax Act 1952* and not the beneficiaries of the trust. As none of the assessed taxpayers were settlors of the trust, or otherwise persons transferring property to the trust, all succeeded in challenging the assessments.

[23] *IRC v Vestey* [1979] Ch 198, 204. This passage was quoted with approval in *Vestey v IRC* [1980] AC 1148, 1194 (Lord Edmund-Davies).

[24] Although the revenue could refuse to apply the concession when it was used for tax avoidance: *R v Reading; ex parte Fulford-Dobson* [1987] QB 978.

[25] *IRC v Bates* [1968] AC 483, 516.

[26] *IRC v Korner* [1969] 1 WLR 554, 558.

> which is wrong, even in the case of a service like the Inland Revenue, characterised by a wonderfully high sense of honour. The fact that such extralegal concessions have to be made to avoid unjust hardships is conclusive that there is something wrong with the legislation.[27]

Following the House of Lords' decision in *Wilkinson*[28] in 2005, the practice of issuing extra-statutory concessions was curtailed. HMRC undertook a review of the concessions, and those exceeding the bounds of the discretion outlined in *Wilkinson* were either legislated or withdrawn entirely.[29]

The experience in the UK demonstrates the problems with granting concessionary treatment outside the authority of the legislation, and beyond scope of the general power to compromise a dispute. It would be neither appropriate nor wise for Australia to attempt to follow that approach.

That said, some of the difficulty in the UK is relieved by the doctrine of "legitimate expectation". The doctrine stems from a tax decision, Re Preston[30], regarding an agreement to settle a dispute and acts much like an estoppel. In that case, Lord Scarman said:

> …judicial review should in principle be available where the conduct of the commissioners in initiating such action [under Part XVII of the *Income and Corporation Taxes Act 1970*] would have been equivalent, had they not been a public authority, to a breach of contract or a breach of a representation giving rise to an estoppel. Such a decision could be an abuse of power: whether it was or not and whether in the circumstances the court would in its discretion intervene would, of course, be questions for the court to decide.[31]

It is now a substantive protection that can be used against public authorities generally.

In the UK, this doctrine of legitimate expectation can be used against the revenue authority in the case of both published guidance and established practice. As Lord Wilson described it, to establish a legitimate expectation in the case of a revenue practice, the taxpayer must have:

> …evidence that the practice was so unambiguous, so widespread, so well-established and so well-recognised as to carry within it a commitment to a group of taxpayers including themselves of treatment in accordance with it.[32]

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[27] *Absalom v Talbot* [1943] 1 All ER 589, 598.
[28] *R v IRC ex parte Wilkinson* [2005] 1 WLR 1718.
[29] See, Her Majesty's Revenue & Customs, 'Withdrawal of Extra Statutory Concessions' (Technical Note and Call for Evidence, 2 October 2014).
[30] *Re Preston* [1985] AC 835. See also, Matthew Groves, 'Substantive Legitimate Expectations in Australian Administrative Law' (2008) 32 *Melbourne University Law Review* 470, 475-477.
[31] *Re Preston* [1985] AC 835, 852.
[32] *R (Davies) v Revenue and Customs Commissioners; R (Gains-Cooper) v Revenue and Customs Commissioners* [2011] 1 WLR 2625, [49] (Lord Wilson JSC).

In Australia, however, "legitimate expectation" is approached very differently. It is found in administrative law and does not offer substantive protection, instead being associated with the requirements of natural justice.[33] Given the specific regime in Part IVC for objections, reviews and appeals, and the exclusion of most tax decisions from the ordinary paths for judicial review,[34] the doctrine has no application in tax disputes in Australia.

In the United States, the general administrative power within the Internal Revenue Code has a broader application. Section 7805(a) of the Internal Revenue Code permits the Treasury to:

> …prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.[35]

This provision is said to support Treasury's "longstanding administrative authority to grant transition relief when implementing new legislation".[36] Often this involves relief from complying with procedural requirements. However, sometimes the provision has been used in direct contradiction to legislation that is expressed to be retrospective.[37] Whilst this generates some concern about the bounds of authority assigned to the Treasury, a power to grant relief, where it is not contrary to the intention of the legislature, is a valuable addition to the more general power of administration.

However, the breadth of the rulemaking power in s 7805 has also been used against taxpayers. It allows the revenue authority to issue what we would regard in Australia as regulations or subordinate legislation, with statutory force.

But, unlike Australia, where regulation-making power is usually confined to a narrow field (such as the correct approved form or a list of exceptions to a rule in the principal legislation), the US Treasury issues regulations explaining its interpretation of the tax law. Following the US Supreme Court's decision in *Chevron USA Inc v National Resources Defense Council Inc*,[38] regulations issued by an administrative body are followed by US courts unless they are "arbitrary, capricious or manifestly contrary to the statute".[39] That applies equally to Treasury regulations in the tax context.[40]

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[33] See generally, *Kioa v West* (1985) 159 CLR 550; *Attorney-General (NSW) v Quin* (1990) 170 CLR 1; *Minister of Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR 273; *Re Minister for Immigration, Multicultural and Indigenous Affairs ex parte Lam* (2003) 214 CLR 1; *Minister for Immigration and Border Protection v WZARH* (2015) 256 CLR 326.
[34] *Administrative Decisions (Judicial Review) Act 1977* (Cth) sch 1 (e)-(gb).
[35] IRC § 7805(a) (2019).
[36] Letter from Mark J Mazur, Assistant Secretary of the Department of the Treasury, to Fred Upton, Chairman of the Committee on Energy and Commerce, 9 July 2013 <https://perma.cc/6Z3L-Z4B9>.
[37] See, Airport and Airway Extension Act Pt IV (signed 5 August 2011) and Treasury Department, Notice 2011-69 cited in letter from Mark J Mazur, Assistant Secretary of the Department of the Treasury, to Fred Upton, Chairman of the Committee on Energy and Commerce, 9 July 2013 <https://perma.cc/6Z3L-Z4B9>.
[38] 467 US 837 (1984).
[39] Ibid 844.
[40] *Mayo Foundation for Medical Education & Research v United States* 562 US 44 (2011).

The result is that the revenue authority in the United States can promulgate its view of the law, which the courts must follow, even if its construction is not the court's preferred one.[41] In some cases, this has been used to affect the outcome of litigation on foot with so-called "fighting" regulations.

A stark example, pre-dating *Chevron*, is *Helvering v RJ Reynolds Tobacco Co*[42] in 1939. In that case, a corporation sold its own stock. At the time, the relevant Treasury regulation provided that no gain or loss was realised from such a sale. However, while the taxpayer's case was pending, the regulations were amended making those sales taxable and the revenue authority sought to rely on the amended regulations. Fortunately, the Court held that the taxpayer could only be assessed on the regulations as they stood at the time.

Post-*Chevron*, the approach seems to have shifted. In *Mayo Foundation for Medical Education & Research v United States*, regulations were made after the revenue authority lost a previous case against the same party. The Court extended *Chevron* deference to tax regulations[43] and said, "we have found it immaterial to our analysis that a 'regulation was prompted by litigation'".[44]

These cases demonstrate the danger of *carte blanche* delegated authority to the revenue authority and indicates that any power to grant relief on a change of interpretation given to the Commissioner in Australia must only be capable of exercise for the taxpayer's benefit.

Ruling Regime

So, let's move on now to the power of rulings.

Where a particular interpretation or practice has been adopted in the past, estoppel (or an administrative law remedy to the same effect) is not available against the Commissioner.[45] In *FCT v Wade*, Kitto J was emphatic:

> If the £2,016 formed part of the taxpayer's assessable income by reason of s 26(j), as I think it did, its inclusion in his assessable income in the course of making the assessment was right, whether or not the commissioner referred to s 26(j), and even though he described the amount inaccurately. No conduct on the part of the commissioner could operate as an estoppel against the operation of the Act[46]

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[41] *Chevron USA Inc v National Resources Defense Council Inc* 467 US 837, 843 (1984).
[42] 306 US 110 (1939).
[43] Before *Mayo*, other tax-specific authority had been preferred and the application of *Chevron* to tax cases was uncertain: see Leandra Lederman, 'The Fight Over "Fighting Regs" and Judicial Deference in Tax Litigation' (2012) 92 *Boston University Law Review* 643.
[44] *Mayo Foundation for Medical Education & Research v United States* 562 US 44, 55 (2011).
[45] *FCT v Wade* (1951) 84 CLR 105, 117 (Kitto J); *Bellinz v FCT* (1998) 84 FCR 154, 164 (Hill, Sundberg and Goldberg JJ).
[46] *FCT v Wade* (1951) 84 CLR 105, 117.

The public ruling system provides a degree of relief from this problem, but it is necessarily limited to issues of sufficient importance that a ruling is made.

For nearly 10 years before the enactment of Pt IVAAA of the Administration Act in 1992, there was an informal system of public rulings without statutory authority.[47] Similarly, taxpayers could obtain individual private rulings stating how the Commissioner would apply the law to them, although that practice had limited grounding in the legislation.[48] Those systems were reasonably effective and the Commissioner was known to honour his rulings.[49] Taxpayers had confidence that they would be treated fairly if they followed the Commissioner's rulings, even though these informal private and public rulings were not legally binding.

Since 1992 there have been formalised public and private ruling structures supported by legislation.[50] They are binding on the Commissioner where the ruling (public or private) applies to the taxpayer and they rely on the ruling by acting in accordance with it, whether or not the taxpayer knew of the ruling at the time.[51] However, a taxpayer can still take advantage of the law in a way that is inconsistent with a ruling if it is more favourable to the taxpayer.[52]

The ruling system was, and is, an important mechanism for providing certainty to taxpayers and a valuable means of dealing with issues as they arise without having to resort to knee-jerk legislative fixes, which risk unintended consequences or, alternatively, drawn-out legislative reform.

Whilst the Australian ruling system is not unique in the world, it is broad-based and well developed. In France, for example, the revenue authority has thousands of pages of published "doctrine" which acts much like a public ruling and, since 1959, has prevented the revenue authority from reassessing taxpayers who comply with the doctrine.[53] However, the private ruling system in France only caters for a narrow list of issues,[54] and private rulings are generally not published, even in anonymised form.

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[47] See *Bellinz v FCT* (1998) 84 FCR 154, 163-168 (Hill, Sundberg and Goldberg JJ); Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Income Taxation Rulings* (Parliamentary Paper No 217/1987, 5 November 1987) [1.2]-[1.3].

[48] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Income Taxation Rulings* (Parliamentary Paper No 217/1987, 5 November 1987) [1.13].

[49] Ibid [2.21]; Mark Leibler, submission to Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Income Taxation Rulings* (1 July 1987) 3.

[50] *Taxation Administration Act 1953* (Cth) sch 1 divs 357, 358 and 359. The ruling provisions were originally inserted by the *Taxation Laws Amendment (Self Assessment) Act 1992* (Cth) and contained in *Taxation Administration Act 1953* (Cth) pts IVAAA and IVAA.

[51] *Taxation Administration Act 1953* (Cth) sch 1 s 357-60.

[52] Ibid sch 1 s 357-70.

[53] Law of 28 December 1959, No 1472, art 100; Tax Procedures Act art L.80A.

[54] See, Christophe Grandcolas, 'The Delicate Balance between Revenue Authority Discretions and the Rule of Law in France' in C Evans, J Freedman and R Krever (eds) *The Delicate Balance: Tax, Discretion and the Rule of Law* (2011) 2.1.

They also have a third category: private rulings selected for publication. Since 2009, these have also been binding on the revenue authority.[55] Binding rulings can only be withdrawn prospectively and apply even when they are subsequently held to be wrong in the courts.[56] This alleviates many of the issues around a change of interpretation, at least where doctrine or a ruling has been issued. As in Australia, although binding on the revenue authority, rulings represent the authority's interpretation and a taxpayer can take a different position if they disagree with a ruling.[57]

As I have said previously,[58] in the case of complex commercial transactions dealing with uncertain areas of the law, the only real way of achieving certainty in Australia is to obtain an early ruling. In that way, the Commissioner essentially acts as lawmaker.

If the taxpayer disagrees with the Commissioner's position, they must accept it or resort to protracted and expensive litigation. Of course, many taxpayers decide not to, or simply cannot afford to, pursue that avenue.

From a whole-of-system point of view, approaching the Commissioner for a private ruling for every potentially contentious transaction is not the most efficient way of giving certainty to taxpayers. And the Tax Office would likely be overwhelmed by private ruling applications if every taxpayer sought a ruling whenever they were uncertain. At the same time, the tax law is so extensive that the Commissioner cannot reasonably be expected to have detailed public rulings on every area.

Despite the value of rulings, particularly public rulings, there is a temptation to deal with issues quickly through a ruling or some other form of non-legally binding guidance at the expense of a proper process of considered legislative reform. The result is that deficient legislation is left untouched, and a complex web of rulings or administrative guidance is spun around it. It is a lazy, timid way to avoid the real issue. Even if rulings or administrative guidance are seen as only a temporary fix, when a long legislative reform agenda competes for parliamentary time, a temporary fix can easily become a permanent ersatz solution.

One recent example which could well have fallen into that category is the Commissioner's current interpretation of the non-arm's length income rules as they relate to outgoings incurred by superannuation funds. In Law Companion Ruling LCR 2021/2, the Commissioner states that outgoings incurred at less than arm's length rates that are not referrable to any one asset taint all

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[55] Tax Procedures Act art L.80B.

[56] Christophe Grandcolas, 'The Delicate Balance between Revenue Authority Discretions and the Rule of Law in France' in C Evans, J Freedman and R Krever (eds) *The Delicate Balance: Tax, Discretion and the Rule of Law* (2011) 2.2.2.4 and 3; Emmanuel de Crouy-Chanel and Alexandre Maitrot de la Motte, Separation of Powers in Tax Law (EATLP Congress, Santiago de Compostela, 4-6 June 2009) 2.5.4.5.

[57] Emmanuel de Crouy-Chanel and Alexandre Maitrot de la Motte, Separation of Powers in Tax Law (EATLP Congress, Santiago de Compostela, 4-6 June 2009) 2.5.4.5, 2.5.5.3.

[58] See, eg, Mark Leibler, 'The Politics of Tax Administration' (1990) 19 *Australian Tax Review* 9.

the fund's income as non-arm's length income to be taxed at the top rate. The ruling recognises concerns over the severity of such an outcome:

> …the Commissioner is alive to concerns that a finding that general fund expenses are non-arm's length is likely to have a very significant tax impact on the complying superannuation fund, even where the relevant expenses are immaterial.[59]

In the case of large APRA-regulated superannuation funds, the Commissioner's solution to these concerns is to only apply compliance resources to reviewing documentation that evidences appropriate internal controls and that reasonable steps were taken in determining an arm's length expenditure amount, but not to determining whether an arm's length amount was *actually incurred*.[60] No doubt this is a commendable attempt to relieve the most onerous and inequitable results stemming from the Commissioner's interpretation. However, if that interpretation is correct, this is clearly a problem that can only be resolved by legislative reform. Indeed, only recently, after a year of political advocacy by the professional bodies led by the Tax Institute, the government committed to developing legislation to fix this issue.[61]

The issue of change of interpretation and retrospectivity is particularly acute in the case of public rulings. Although rulings are usually stated to apply before and after the date of the ruling, in these cases the Commissioner will often take a position to not commit resources to the issue for periods before the change of view.

However, many practitioners will be familiar with the approach in TR 2010/3 and PSLA 2010/4 in the context of Division 7A and the extended meaning of "loan"[62] being applied to unpaid present entitlements ("**UPEs**") from trusts, but only for UPEs arising after 16 December 2009.[63] Before that date, the Commissioner had publicly taken the position that UPEs were not loans within the meaning of the provisions, although not in a binding ruling.[64] The approach to the new ruling went one step further than not applying compliance resources. Rather than publishing the new view, applicable before and after the date of the ruling, with a policy not to apply compliance resources to UPEs arising before that date, the ruling explicitly stated that it applied only prospectively on this issue.[65]

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[59] LCR 2021/2, [91].
[60] Ibid [92].
[61] Senator Jane Hume, 'Government to Ensure Non-Arm's Length Expense Provisions Operate as Intended' (Media Release, 22 March 2022).
[62] See, *Income Tax Assessment Act 1936* (Cth) s 109D.
[63] TR 2010/3, [28]-[30]. See also PSLA 2010/4.
[64] See, TR 2010/3, [29].
[65] Ibid [28].

The ruling, together with PSLA 2010/4,[66] purports to do precisely what *Macquarie* decided the Commissioner cannot do: apply a view of the law that the Commissioner thinks is wrong, based merely on timing.[67]

Where there was an old ruling expressing the old view, taxpayers were protected by the binding nature of that old ruling. However, where there is no ruling, just an understood practice, the taxpayer is left with no assurances other than the resource allocation decision. As we have seen, that is not satisfactory.

In the United States, the IRS also publishes revenue rulings, distinct from the regulations discussed earlier, which are similar to public rulings in Australia. But unlike here, whilst they are not binding on courts in the same way as Treasury regulations, US courts afford a degree of deference to rulings when they are called upon to interpret the tax legislation.[68] The persuasiveness of a ruling:

> …will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.[69]

There is a statutory presumption that rulings are retrospective.[70] However, the IRS can determine the extent of any retrospectivity and its policy is not to make rulings retrospective if it would be harmful to taxpayers. That said, it could change its policy at any time or make an exception in a particularly important case.

It has done precisely that in a number of cases where it has issued rulings during litigation in an attempt to influence the outcome. Fortunately, US courts seem to have resisted those attempts and, because rulings are given less deference than regulations, have been able to give the ruling little weight.[71]

There are also cases where, in the absence of a binding judicial decision or clearly preferable interpretation of the legislation, the IRS has been held to its rulings at the time of a tax event, even though there was no ruling precisely on point and even though the IRS later issued a contrary ruling. In that way, the deference given to rulings by the courts holds the revenue authority to its stated position.

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[66] PSLA 2010/4, [13]. Interestingly, the Commissioner proposes to again change his approach to administering the Division 7A provisions as they relate to sub-trusts: see TD 2022/D1.
[67] *Macquarie Bank Ltd v FCT* [2013] FCAFC 119, [10]-[11]; *Macquarie Bank Ltd v FCT* (2013) 215 FCR 403, [81]-[82].
[68] See *United States v Mead Corp* 533 US 218 (2001) applying *Skidmore v Swift & Co* 323 US 134 (1944). See, eg, *Bogue v Internal Revenue Commissioner* 102 TCM 41 (2011).
[69] *Skidmore v Swift & Co* 323 US 134, 140 (1944).
[70] IRC § 7805(b)(8) (2019).
[71] See, eg, *AMP Inc v United States* 185 F 3d 1333 (1999); *Tandy Corp v Internal Revenue Commissioner* 92 TC 1165 (1989); *Fribourg Navigation Co v Internal Revenue Commissioner* 383 US 272 (1966).

In *Silco Inc v United States*,[72] the Court had to decide whether a taxpayer who purchased shares on the New York Stock Exchange between their record date and the date for payment of the dividend was entitled to that dividend and consequential refunds. The Court said (emphasis added):

> Since no court has interpreted the effect of Treas. Reg. § 1.61–9(c) on transactions occurring after the corporate record date and before a stock exchange's postponed ex-dividend date, this court should apply the interpretation followed by the IRS **on the date of the purchase in question**.
>
> ….
>
> The facts behind these two rulings [on issue at that date] are not identical to those in the case at bar. They do, however, **provide the only insight available** to a taxpayer at the time of the Silco transaction as to the conceptual approach the IRS would use… **Although a ruling published after this transaction is contrary**, [the contemporary rulings] suggested to buyers at the time of Silco's purchase that the IRS would adhere to an economic reality theory.[73]

However, the weight of authority in the United States, as here, still appears to be that, apart from blatant cases of issuing rulings to affect ongoing litigation, the revenue authority can retrospectively change its view of the law, even where taxpayers have relied on its previous view to their detriment.[74]

Of course, a degree of caution should be exercised when comparing the Australian and US ruling systems. Australian rulings are binding in a different way. They bind the Commissioner and, whatever the true state of the law, the Commissioner must apply the law in accordance with his rulings. Presumably, once it is clear a ruling is wrong, public rulings will be withdrawn and private rulings will no longer be issued in those terms. By way of contrast, in the US, rulings (and regulations) influence the positions taken by the courts. They shape the law in a fashion that is unfamiliar in Australia.

Remedial Power

The remaining solution to the problem I'm canvassing is for federal Parliament to delegate remedial powers to the Commissioner for situations where gaps in the law are exposed, or where the letter

[72] 779 F 2d 282 (1986).
[73] Ibid 286-287.
[74] *Dixon v United States* 381 US 68, 73 (1965). See also *Vons Companies Inc v United States* 51 Fed Cl 1, [4] (2001).

of the law applies to the detriment of taxpayers in a way that is inconsistent with Parliament's purpose. This might include cases where there has been a change of interpretation or practice.

One argument against any remedial power is that Parliament can always amend the legislation.[75] But the reality is that the process of legislative amendment and reform moves more slowly than one would wish and the consequences of amendment are not always anticipated, particularly with such complex and interdependent tax legislation.

The current remedial power in Div 370 of Schedule 1 to the Administration Act is the culmination of a long process of discussion and official review.[76] It is intended to:

> …increase certainty in the administration of taxation laws by reducing the regulatory burden on entities that arise from unforeseen or unintended consequences in the application of taxation laws which cannot otherwise be addressed by the Commissioner exercising his or her general powers of administration…[77]

The current power allows the Commissioner to alter the law by legislative instrument where:

(a) the modification is not inconsistent with the intended purpose of the provision;

(b) the Commissioner considers the modification reasonable, having regard to that purpose and the costs of complying with the law; and

(c) the Commissioner has been advised by Treasury or the Finance Department that the modification would have only a negligible impact on the Budget.[78]

Parliamentary oversight is maintained because Parliament can disallow a legislative instrument within 15 sitting days of it being tabled in each House[79] and there are restrictions on when and to whom the instrument applies.[80]

However, the remedial power has been used on only five occasions.[81]

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[75] See, eg, *IRC v Frere* [1965] AC 402, 429 (Viscount Radcliffe).
[76] Tax Design Review Panel, 'An "Extra-statutory Concession" Power for the Commissioner of Taxation?' (Discussion Paper, 12 May 2009). The measure was finally announced on 12 May 2015 as part of the Budget.
[77] Explanatory Memorandum, Tax and Superannuation Laws Amendment (2016 Budget Measures No 2) Bill 2016 (Cth) [1.22].
[78] *Taxation Administration Act 1953* (Cth) sch 1 s 370-5(1).
[79] *Legislation Act 2003* (Cth) s 42.
[80] *Taxation Administration Act 1953* (Cth) sch 1 s 370-5(4)-(5).
[81] They cover the following issues:

(a) entitlements to credits from foreign resident capital gains withholding occurring in a different year to the CGT event (October 2017);
(b) treatment of depreciating assets where small business rollover relief is available (May 2018);
(c) release of a deceased's protected information to the tax agent or solicitors for the executors of the deceased estate (May 2020);
(d) reliance on certain certificates for the GST-free supply of cars for the disabled (December 2020); and
(e) arrangements for the Seasonal Labour Mobility Program (May 2021).

See, 'When the Commissioner's Remedial Power Has Been Used', *Australian Taxation Office* (Web Page, 21 May 2021) <www.ato.gov.au/General/ATO-advice-and-guidance/Commissioner-s-remedial-power/When-the-Commissioner-s-remedial-power-has-been-used/>.

Again, whilst this power is useful, it relies on a lengthy process of review and consultation and, in practice, has only been used to deal with minor matters.

Conclusion: A New Tool

So, having explored three options to give taxpayers more certainty and found each of them wanting, where do we land on this?

The conclusion I have reached is that the more fundamental issues which arise from a change in position on the part of the Commissioner, and the danger arising from action against taxpayers which is inconsistent with the objectives of clarity, consistency and fairness, can only be dealt with by broader protections grounded in legislation.

In order to protect the rule of law, and strike the necessary balance between collecting tax according to the letter of the law and the broader objectives underpinning a coherent tax system, taxpayers who reasonably rely on the practice of the Commissioner, in good faith, should be protected if the Commissioner changes course at a later date.

Taxpayers would have to prove an administrative practice, but this could be easily done where Tax Office publications existed or where the relevant administrative practice was well established. One should expect that the statute would not set the bar to establishing an existing practice at an unreasonable level.

In such cases, it is necessary for continued clarity, confidence and trust in the tax system – ultimately for the rule of law – that taxpayers be relieved from tax shortfalls, penalties and interest.

By providing protection in legislation there can be no question of the Commissioner exceeding his remit, unlike the so-called “dispensing power” once advocated for in the United Kingdom or the extra-statutory concessions there. The provision could draw on existing learning in the UK regarding “legitimate expectation” and the protection against penalties for relying on administrative practice that already exists in s 284-224 of Schedule 1 to the Administration Act.

The legislative protection could be framed in similar terms, such as:

(1) If you or your agent treated a taxation law as applying in a particular way in an income year, and that way agreed with:

(a) advice given to you or your agent by or on behalf of the Commissioner;

(b) general administrative practice under that law; or

(c) a statement in a publication approved in writing by the Commissioner

the Commissioner must treat that law as applying in that way in that income year.

(2) Despite subsection (1), the Commissioner must apply a taxation law in a way that is consistent with his view of the law if:

(a) you get a more favourable result by doing so; and

(b) you request the Commissioner to do so.

(3) Subsection (1) does not apply to an income year if, before the first day of that income year, the Commissioner:

(a) states that he will not apply the taxation law in that particular way:

(i) in writing addressed to you, which is received by you before that day; or

(ii) by issuing a ruling under Division 358; or

(b) publicises a change of general administrative practice referred to in paragraph (1)(b); or

(c) withdraws a statement referred to in paragraph (1)(c)

provided that you have not been unfairly or unreasonably prejudiced in respect of arrangements entered into before the Commissioner acts in the manner described in this subsection or, in the case of subparagraph (a)(i), before you receive written notice.

The purpose of the proviso to subsection (3) is to ensure that taxpayers are protected if they enter into an arrangement which has consequences for future tax years. For example, a taxpayer may incur capital expenditure in one year which, consistently with the Commissioner's practice at that time, entitles the taxpayer to equal deductions over five years under s 40-880 of the *Income Tax Assessment Act 1997* (Cth). If, before the start of the second or later year, the Commissioner's practice changes, the taxpayer should still be able to rely on the Commissioner's practice at the time it incurred the relevant expenditure.

Without a legislative protection along the lines set out above, despite the Commissioner's power to allocate resources, issue rulings or provide minor relief by legislative instrument, taxpayers would be at the mercy of the Tax Office which could, perhaps even must, immediately issue assessments according to their current, albeit new, interpretation of the law, no matter the care taken by those taxpayers. This serves no purpose to our society and is antithetical to the rule of law. Whilst, for a time, the revenue take might be increased, the erosion of confidence and trust in the tax system would ultimately lead to a serious reduction in the willingness of taxpayers to voluntarily comply with their taxation obligations.