TAX UNCERTAINTY

THE HON JUSTICE G T PAGONE*

[Lawyers are taught to appreciate the value of certainty in the law. In the field of taxation, however, the law is often far from certain. This article examines some of the causes of uncertainty within tax law, including the inherent uncertainty of language, the mismatch between the lawyer's tools of statutory interpretation and a tax statute drafted using an economic or accounting understanding of tax concepts, differing judicial constructions of tax statutes, and the intentional uncertainty in the drafting of tax statutes to allow for discretion or to prevent tax avoidance. It is argued that community consultation and bodies such as a specialist tax tribunal may reduce uncertainty and allow the community to make an informed choice as to the desired level of uncertainty within tax law.]

CONTENTS

Whoever hopes a faultless tax to see,
Hopes what ne'er was, or is, or e'er shall be.[1]

I CERTAINTY

At some point in a law course, every law student is taught about the importance of certainty in the law. At some point in a lawyer's career, every lawyer in every area of legal practice comes to appreciate the necessity of certainty in the law. Certainty is the foundation of the lawyer's craft and is, perhaps, the only contribution that makes us useful to clients and society. It is the lawyer's ability

* BA, Dip Ed, LLB (Monash), LLM (Cantab); Justice of the Supreme Court of Victoria; Professorial Fellow, Melbourne Law School, The University of Melbourne. An earlier version of this article was presented by the author as 'Tax Uncertainty' (Speech delivered at the Annual Tax Lecture, The University of Melbourne, 20 August 2009). The style of the author's oral delivery has been preserved.

1 Sir Josiah Stamp, *The Fundamental Principles of Taxation in the Light of Modern Developments: The Newmarch Lectures for 1919* (1929) 198 (referring to M'Culloch's adaptation of Pope), quoted in P J Lanigan, 'Technical Problems Relating to the Objectives and Consequences of Taxation' in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 27, 39.

to predict the application of the law that helps us organise relations between people in their personal affairs, business relations and dealings with government. Without a reliable degree of certainty, contracts would be worthless and ongoing ordinary relations and dealings would be at risk of whim and fancy. Certainty in the law is fundamental to the rule of law, which holds that law 'should be clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable.'[2] It is with that frame of mind that I turn to taxation.

II UNCERTAINTY IN TAX LAW

There is a curious entry, some may say a curiously candid entry, under the heading 'Taxation' in *The Oxford Companion to Law*.[3] The first two and the last two sentences describe taxation as follows:

> Traditionally the principal way in which the ruling classes in organized communities have oppressed, fleeced, and expropriated some of their subjects. It has been known from very early times, and from the earliest times the tax-gatherer has been an object of public fear, hatred, and execration. …
>
> Not the least evil features of the modern tax system are the army of unproductive civil servants concerned with the assessing and collecting of taxes, the enormous volume and constantly changing detail of the chaotic and largely incomprehensible body of verbiage called the law of taxation, the incomprehensible and frequently incorrect assessments, and the utterly irrational nature of the whole topic. In the law of taxation justice has no place at all.[4]

Some may think this an extreme view. Perhaps it is, but it gives us a context in which to evaluate the role of certainty in tax law. Tax falls upon us in the ordinary course of our activities as a compulsory taking[5] from us of something that we, by definition, have earned or owned. How and when that may happen should be clear, predictable and free from whim, caprice or chance. Below, I reflect upon some causes of uncertainty in tax law and whether this uncertainty is desirable or deliberate. In doing so I should make it clear that I hold no hope for certainty in tax law in the future. Ten years ago, the Review of Business Taxation, in *A Tax System Redesigned: More Certain, Equitable and Durable — Report* ('*Ralph Report*'), recommended that reform to the anti-avoidance provisions 'be based around a clear articulation of the underlying policy of a restructured tax law'.[6] A few years before that we lived through the partial and incomplete rewriting of the *Income Tax Assessment Act 1936* (Cth) (commonly known as the '1936 Act') as the result of what was optimistically called the 'Tax

[2] Sarah Joseph and Melissa Castan, *Federal Constitutional Law: A Contemporary View* (2nd ed, 2006) 6, citing Joseph Raz, 'The Rule of Law and Its Virtue' (1977) 93 *Law Quarterly Review* 195, 198–202. See also A V Dicey, *Introduction to the Study of the Law of the Constitution* (10th ed, 1959) ch 4; Butterworths, *Halsbury's Laws of Australia*, vol 4 (at 18 August 2009) 80 Civil and Political Rights, '1 Introduction' [80-25].

[3] David M Walker, *The Oxford Companion to Law* (1980) 1208.

[4] Ibid.

[5] *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276 (Latham CJ).

[6] John Ralph, Rick Allert and Bob Joss, Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable — Report* (1999) 243.

Law Improvement Project'. Forty years ago, at the First National Convention of the Taxation Institute of Australia in May 1969, a Mr R F Hughes wrote:

> Some not very scientific, and probably far from complete, research has disclosed that, in the last eight years in Australia, at least two hundred separate articles in professional or business journals and papers presented at professional conventions or congresses have been concerned with taxation reform in one way or another. One wonders whether, therefore, anything further may usefully be said on this topic, or, if said, whether we will ever see reform.[7]

At the same conference the then Second Commissioner of Taxation, Mr P J Lanigan, began his paper by recalling the four basic canons laid down by Adam Smith in 1776.[8] The second canon was:

> The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.[9]

And yet stubborn uncertainty stubbornly remains. The more things change, as the French adage goes, the more things remain the same.[10] I doubt that we can do much more than gain some small insight into why that may be so.

Uncertainty may in part be an inevitable feature of language. Words are frequently capable of many meanings, some of which were not, or at least may not have been, intended when used in a particular context. One such example may be seen in *Bourne (Inspector of Taxes) v Norwich Crematorium Ltd*[11] in the context of a United Kingdom statute where the tax fell by reference to whether a building or structure was for the 'manufacture of goods or materials or the subjection of goods or materials to any process'.[12] A narrow question raised in that case was whether goods and materials subject to a process included the cremated remains of human bodies. Stamp J said of this:

> In my judgment it would be a distortion of the English language to describe the living or the dead as goods or materials. The argument, of course, goes on inevitably to this: that just as 'goods and maeterials' [sic] is wide enough to embrace, and does embrace, all things animate and inanimate, and so includes the dead human body, so that other words to which a meaning must be given, namely 'subjection' and 'process', are words of the widest import. Parliament cannot, so the argument as I understood it runs, have intended to exclude from the definition a process whereby refuse or waste material is destroyed or consumed by fire and, putting it crudely, for it can only be put crudely, the consumption by fire of the human body is a process. I protest against subjecting

[7] R F Hughes, 'Taxation Reform' in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 143, 143.

[8] Lanigan, above n 1, 27.

[9] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (first published 1776, 1849 ed) 371, quoted in ibid.

[10] Or, as Yogi Berra might have said, 'It's déjà vu all over again': Yogi Berra, *The Yogi Book* (1998) 30.

[11] [1967] 2 All ER 576.

[12] *Income Tax Act 1952*, 15 & 16 Geo 6 & 1 Eliz 2, c 10, s 271(1)(c).

> the English language, and more particularly a simply English phrase, to this kind of process of philology and semasiology. English words derive colour from those which surround them. *Sentences are not mere collections of words to be taken out of the sentence, defined separately by reference to the dictionary or decided cases, and then put back again into the sentence with the meaning which you have assigned to them as separate words, so as to give the sentence or phrase a meaning which as a sentence or phrase it cannot bear without distortion of the English language.* That one must construe a word or phrase in a section of an Act of Parliament with all the assistance one can from decided cases and, if one will, from the dictionary, is not in doubt; but having obtained all that assistance, one must not at the end of the day distort that which has to be construed and give it a meaning which in its context one does not think it can possibly bear. What has to be decided here is whether what is done by the taxpayer, viz, the consumption or destruction by fire of the dead body of the human being, is within the phrase, 'the subjection of goods or materials to any process'. I can only say that, having given the matter the best attention that I can, I conclude that the consumption by fire of the mortal remains of homo sapiens is not the subjection of goods or materials to a process within the definition of 'industrial building or structure' contained in s 271(1)(c) of the *Income Tax Act, 1952*.[13]

To the inherent ambiguity in language one may also add determined obfuscation,[14] nurtured, perhaps, by self-interest or institutional objective.

Another cause of uncertainty may be a mismatch between the underlying objectives expressed in statute and the potentially distorting tools used by lawyers to determine the meaning of the words used and their application. This mismatch may be seen in many contexts of tax law. The reason for the mismatch is essentially that the tools used by the law to discern or apply meaning may not reflect the non-lawyer's intention or meaning when the words were used or adopted. Take for example the distinction between capital and income, upon which our system of taxation so heavily depends. Whether a receipt or an outgoing has the character of capital or income will usually be obvious enough and the legal answer may well accord with the economic or accounting outcome which the statutory words were intended to express. However, that will not always be so, and one reason for this is that the lawyer's tools to determine the characterisation are different from those of an accountant or an economist.

A *Capital and Income: Economic and Accounting Standards versus Legal Analysis*

In this context, the courts have frequently said that what is income and what are allowable as deductions are matters for legal analysis rather than matters for determination by accountants or economists,[15] notwithstanding that the legal

[13] *Bourne (Inspector of Taxes) v Norwich Crematorium Ltd* [1967] 2 All ER 576, 578 (emphasis added).

[14] *Pyneboard Pty Ltd v Trade Practices Commission* (1982) 57 FLR 368, 375 (Northrop, Deane and Fisher JJ).

[15] *Commissioner of Taxes (SA) v The Executor Trustee & Agency Co of South Australia Ltd* (1938) 63 CLR 108, 151–2 (Dixon J) ('*Carden's Case*').

measure adopted in the statute might be thought to have been the expression of the accounting or economic concept by reference to which profit and loss were traditionally determined applying ordinary concepts. An example of the difference in approach may be seen in the decision in *Federal Commissioner of Taxation v McNeil* ('*McNeil*'),[16] which concerned the taxability as 'income' of a receipt by a shareholder of $514 from the sale on her behalf of rights to sell shares in St George Bank. Mrs McNeil had previously held 5450 shares in the Bank from which, over the years, she derived dividends upon which she paid tax in the ordinary way.[17] In January 2001, the Bank announced its intention to buy back about 5 per cent of its issued share capital at a fixed price of $16.50 per share. Mrs McNeil thus came to have 272 rights to require the Bank to buy her shares.[18] These rights were separately listed for trading on the Australian Stock Exchange and, at the time in question, had a value of $1.89 each.[19] Mrs McNeil took no steps to exercise her rights with the consequence, under the transaction documents, that they were transferred to a merchant bank, which sold them back to St George at $2.12 each (for a total of $576.64).[20] Part of that receipt was treated as a capital gain, but the bulk, $514, was treated by the Federal Commissioner of Taxation ('Commissioner') as ordinary income under general principles.[21]

The occasion by which Mrs McNeil came to have the rights was, from the company's point of view, a partial return of capital to its shareholders. Mrs McNeil, as a shareholder and from an accounting and economic point of view, could be seen to be receiving a part of the capital value of her shareholding upon the sale of the sell-back rights. The High Court of Australia, by a 4:1 majority, held otherwise, focusing upon Mrs McNeil's individual receipt of the money and upon a finding that her shareholding remained unchanged as a matter of legal analysis. The law treated the receipt as income, though in economic terms her capital wealth as a shareholder in the Bank before and after the transaction had not changed (except, of course, that it was reduced by reason of the tax she had to pay).

The majority judgment in *McNeil* began its consideration of the issues by recalling that the character of the sell-back rights had to be determined from the point of view of the taxpayer (the recipient) and not from the point of view of the Bank (the payer).[22] Their Honours next reasoned that 'a gain derived from property has the character of income', including a gain to an owner who receives the gain passively.[23] An important inquiry relevant to the ultimate issue was, therefore, whether the gain was derived from property which the taxpayer continued to hold in contrast to a receipt in exchange for a disposal of part of the

16 (2007) 229 CLR 656.
17 Ibid 660 (Gummow ACJ, Hayne, Heydon and Crennan JJ).
18 Ibid.
19 Ibid 661.
20 Ibid 661–2.
21 Ibid 662.
22 Ibid 663.
23 Ibid.

capital. This led their Honours to consider whether the rights enjoyed by Mrs McNeil 'arose and were severed from, and were a product of, her shareholding in [the Bank], which she retained':[24] in short, was the capital severed or did it remain intact? Was the receipt in exchange for what was severed or did it proceed from capital which remained whole? Critical to their Honours' conclusion that the receipt was a product of (and not in exchange for a part of) the capital was their Honours' holding that Mrs McNeil's shareholding in the Bank, as a matter of legal analysis, 'remained untouched'.[25] Callinan J reached the contrary conclusion, placing significance on the impact upon Mrs McNeil as a shareholder when considering, as his Honour said, the 'transaction as a whole'.[26]

The most significant point in the conclusion of the majority judgment was that Mrs McNeil's shareholding in the Bank 'remained untouched'.[27] An accountant or an economist may have analysed the transaction quite differently and may have seen the transaction from Mrs McNeil's point of view as an affair wholly on capital account (as did Callinan J).[28] On such an analysis, Mrs McNeil, as a shareholder, had a number of shares and came to receive part of their value in cash in consequence of her capacity as a shareholder. The number of shares she held before and after her receipt of cash remained the same, but part of the economic value of her investment in those shares was returned to her (in her capacity as a shareholder) without her doing anything and for no other reason than because she was a shareholder. From her point of view, the accounting and economic consequence of the receipt upon the sale of the rights was that her shareholding was, in economic and accounting terms, reduced in value by the amount she received in cash. On that analysis, a portion of *the value* of her shareholding was 'severed' from the worth of the whole of her shareholding and paid to her in cash. That appears to have been the view adopted by Callinan J when his Honour concluded that if one were

> to look only to what [Mrs McNeil] had in her hands, … [s]he was left with a sum of money … representing a contingent entitlement to the capital of [the Bank] reduced by reason of the expenditure of some of [the capital] to buy back its shares. The money that [Mrs McNeil] received was … the result of a reorganisation of the capital of the company which effectively gave shareholders access to a component of [capital] that they would not otherwise have had.[29]

Similar differences between the lawyer's tools and the meaning of taxation concepts for economists and accountants may be seen on the deduction side of

[24] Ibid.
[25] Ibid 664.
[26] Ibid 672.
[27] Ibid 664 (Gummow ACJ, Hayne, Heydon and Crennan JJ).
[28] See ibid 672.
[29] Ibid. For discussion of this case, see David Bloom, 'Taxpayer's Heaven: The *Citylink* Decision — The Opposite of Heaven: The Decision in *McNeil*' (Paper presented at the Taxation Institute of Australia 52nd National Convention, Hobart, 16 March 2007); Justice Richard Edmonds, 'Recent Tax Litigation: A View from the Bench' (2008) 37 *Australian Tax Review* 79, 81.

the distinction between capital and income. Capital losses and outgoings are not usually deductible against income receipts, and the character of a loss or outgoing as being either on revenue account or on capital account can have profound consequences for fiscal outcomes. The legislative amendments and line of litigation involving convertible notes and instruments with a component of deductible outgoings illustrate this.[30]

The cases involving finance companies raising Tier 1 capital[31] through instruments with an obligation to pay an interest component also illustrate the tensions between the lawyer's analysis of tax law and the economic view of transactions. The raising of capital, whether by a financier or any other taxpayer, carries with it a cost: investors buying shares expect a return on their investment and lenders who have lent money similarly require an economic return on the funds advanced. From the point of view of the taxpayer raising funds, there is a cost by reason of the impact of tax whichever way the funds are raised, but the amount of the cost will differ depending upon whether the funds are obtained as loans or as contributions to equity. Similarly, from the point of view of the provider of funds (whether as investor or as lender) there will be an expectation of preserving capital as well as an economic return upon the capital, but there will be a difference in expected risk and return depending upon whether the funds are provided as investor or as lender. The parties regulate their dealings to share or minimise risks and share returns by the type, form and detail of the transactions into which they enter. Transactions differ in the nature of the risk exposure undertaken by the provider of the funds and the degree to which a company is willing to share the rewards of its risks and endeavours with those who have provided the funds that make this possible. How much risk each will take and how much of the reward each may enjoy are part of the economics of the bargain finally made. Embedded (indeed, inevitably embedded) in those dealings, and governing the shape of the transactions and the outcomes agreed to, is the fiscal treatment of different transactions.

These differences may be of interest to accountants and economists, but they are critical to the tax adviser because of the fiscal consequences which flow from the different legal character ascribed to each kind of transaction. The investor risks capital into a corporate venture and generally has no legal right to require repayment of the capital as such. In return for the investment risk, the investor will generally be entitled to share in the fruits of the venture through dividends (that is, through a distribution and division of profits amongst shareholders). The lender, on the other hand, assumes a different risk to that of an investor and will generally have a legal entitlement to require repayment of the moneys lent. However, it will generally be entitled only to a financier's return on capital

[30] See, eg, *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2004) 210 ALR 508 (Federal Court); *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2005) 146 FCR 77 (Full Court).

[31] See generally Australian Prudential Regulation Authority, *Capital Adequacy*, Prudential Standard APS 110, January 2008; Australian Prudential Regulation Authority, *Capital Adequacy: Measurement of Capital*, Prudential Standard APS 111, January 2008, paras 5, 17–22, attachment A.

without reference to the profitability of the use to which the funds have been put. The cost to the person obtaining the funds (whether by share issue or as a borrowing) will be treated either as an affair of capital or as an affair of revenue, with an important consequence for the cost of the funds obtained and for the public revenue. If the cost be on capital account, it will generally not be deductible and, therefore, it will, to that extent, be more expensive than if the outgoing were deductible.

There are many observations in the decided cases which explain why in law the form of a transaction is important and why it may be difficult to rely upon broader notions of substance to determine the fiscal outcomes.[32] On the other hand, a mere interpretation of a transaction by reference to its form may say nothing about its nature. In *Lomax (HM Inspector of Taxes) v Peter Dixon & Son Ltd*, Lord Greene MR observed:

> In many cases … mere interpretation of the contract leads nowhere. If A lends B 100*l* on the terms that B will pay him 110*l* at the expiration of two years, interpretation of the contract tells us that B's obligation is to make this payment. It tells us nothing more.[33]

The 10*l* difference between the payments could be accretion to capital or it could be in the nature of interest return upon the capital. In cases like *Macquarie Finance Ltd v Federal Commissioner of Taxation*[34] and *St George Bank Ltd v Federal Commissioner of Taxation* ('*St George Bank*'),[35] there were considerable fiscal and commercial consequences flowing from a determination of whether the payment of an obligation described as interest was to be seen as on capital account: that is, as a return upon the capital provided rather than as a cost incurred in the derivation of income. One economic consequence of allowing deductibility of the 'interest' component of the payment under a perpetual Tier 1 instrument is that the economic cost to the taxpayer of its capital is reduced by the tax effect of the deduction. Another economic consequence of allowing a deduction is to shift from the shareholders to the public revenue the economic burden of that amount of the cost of capital raising that is effectively part of the economic return to the shareholder/lender for the risking of funds. In other words, an economic consequence of allowing deductions for such payments is that the 'interest' component has the economic effect of becoming similar to a tax deductible dividend by the company making the payment. In *Macquarie Finance Ltd v Federal Commissioner of Taxation*, Hill J, at first instance,[36] and the Full Court of the Federal Court of Australia, on appeal,[37]

32 See, eg, *Australia & New Zealand Savings Bank Ltd v Federal Commissioner of Taxation* (1993) 42 FCR 535, 558–60 (Hill J); *Reuter v Federal Commissioner of Taxation* (1993) 111 ALR 716, 729 (Hill J).

33 [1943] 1 KB 671, 675.

34 *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2004) 210 ALR 508 (Federal Court); *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2005) 146 FCR 77 (Full Court).

35 (2009) 176 FCR 424.

36 See (2004) 210 ALR 508, 522, 525–8.

37 See (2005) 146 FCR 77, 105–8 (French J), 114, 120–1, 123–6 (Hely J), 140–2 (Gyles J).

sought to determine the substance of the transaction by the legal rights created rather than by reference to an economic or accounting analysis. In other words, the outcome of the case was not governed by the broader economic or accounting realities of the transactions, but by the lawyer's tools of analysing and classifying the legal rights between the parties. Even so, recourse to lawyers' tools of analysis will not always guarantee the same reasoning process, as a comparison of the reasoning of the Full Courts in *Macquarie Finance Ltd v Federal Commissioner of Taxation*, on the one hand, and *St George Bank*,[38] on the other, shows.

Some uncertainty also arises from the ordinary development and rearticulation of principles fundamental to tax. The High Court held in *Federal Commissioner of Taxation v Stone* ('*Stone*') that the hallmark of a revenue receipt by an athlete was 'that she had turned her sporting ability to account for money'.[39] The decision was applied by the Federal Court at first instance in *Spriggs v Federal Commissioner of Taxation*[40] and *Riddell v Federal Commissioner of Taxation*[41] to allow deductions.[42] These cases, like *McNeil*,[43] effectively applied the dicta in *Federal Commissioner of Taxation v Montgomery* ('*Montgomery*') that

> income is often (but not always) a product of exploitation of capital; income is often (but not always) recurrent or periodical; receipts from carrying on a business are mostly (but not always) income.[44]

The concept that an income receipt may flow from the exploitation of capital is not novel and lies at the heart of many of the decided cases. What *Stone* highlighted, however, was the importance of the link between a receipt and the exploitation of the capital. It was the exploitation of the capital that made the receipts assessable as income.[45] However, that basal principle, articulated again in *McNeil*, appeared in a different light upon its application in that case.

The critical concept in both *Stone* and *Montgomery* may have been thought to be the emphasis placed by the Court upon the finding of 'use', 'exploitation' or 'bringing to account' of the capital. In *Montgomery*, for example, the Court explained its application of the dicta from *Eisner v Macomber* by saying that 'the

[38] (2009) 176 FCR 424, 441–8 (Perram J); see also at 427 (Emmett J), 427 (Stone J).

[39] (2005) 222 CLR 289, 303 (Gleeson CJ, Gummow, Hayne and Heydon JJ). The submission of the Commissioner was put in the following terms: 'The activities of the taxpayer were commercial arrangements. She was in the business of a professional athlete and turned her undoubted talent to account for money': at 291 (G T Pagone QC) (during argument).

[40] (2007) 68 ATR 740, 752 (Gordon J).

[41] (2007) 68 ATR 757, 766 (Gordon J).

[42] The decisions of Gordon J in both cases were overturned on appeal by a unanimous Full Court (Goldberg, Bennett and Edmonds JJ) in *Federal Commissioner of Taxation v Spriggs* (2008) 170 FCR 135 but were reinstated by a unanimous High Court (French CJ, Gummow, Heydon, Crennan, Kiefel and Bell JJ) in *Spriggs v Federal Commissioner of Taxation* (2009) 239 CLR 1.

[43] (2007) 229 CLR 656, 663–4 (Gummow ACJ, Hayne, Heydon and Crennan JJ).

[44] (1999) 198 CLR 639, 663 (Gaudron, Gummow, Kirby and Hayne JJ).

[45] See *Stone* (2005) 222 CLR 289, 303–5 (Gleeson CJ, Gummow, Hayne and Heydon JJ).

firm used or exploited its capital … to obtain the inducement amounts.'[46] So understood, what mattered was not just that the capital had not been severed but, rather, that the resultant receipt was a product of activity which stamped the receipt with some profit-making purpose. In that regard the decision is illustrative of the dicta in *Federal Commissioner of Taxation v Myer Emporium Ltd*:

> Generally speaking … it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. … The authorities establish that a profit or gain [made in a 'one-off' transaction] will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit.[47]

What *McNeil* may add to that analysis, however, is that the circumstance of the capital having remained intact may be sufficient to provide the finding that the receipt had the character of income without the need to find that the circumstances of the receipt had the characteristics of income earning activity. In *Montgomery* and *Stone* it was the *exploitation* of the (intact) capital that stamped a profit-making purpose upon the receipt but, in *McNeil*, Mrs McNeil had been entirely passive (a circumstance pointed out in the majority judgment as being insufficient to deny a receipt the character of income).[48] Taxpayers, and their professional advisers, may now need to consider many other receipts hitherto not thought to be brought to tax as income when lodging returns. Amounts received, for example, in restraint of trade upon the sale of a business, which many may have thought taxable only as a capital gain (and perhaps only in the extended operation of those provisions) may need to be reconsidered in light of *McNeil*.

Recourse to metaphors also carries its share of uncertainty. One metaphor which has featured prominently at the heart of tax law is the metaphor of trees and fruits in explanation of the difference between capital and income. The metaphor was used by Pitney J in *Eisner v Macomber*,[49] it was accepted in *Montgomery*,[50] and it was endorsed in *McNeil*.[51] In *Berkey v Third Avenue Railway Co*, Cardozo J warned that '[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.'[52] The metaphor may be helpful when the fiscal issue in dispute depends upon

46 (1999) 198 CLR 639, 678 (Gaudron, Gummow, Kirby and Hayne JJ). At 677, their Honours quoted from *Eisner v Macomber*, 252 US 189, 207 (Pitney J for White CJ, McKenna, Holmes, Day, Devanter, Pitney, McReynolds, Brandeis and Clarke JJ) (1920).

47 (1986) 163 CLR 199, 209–10 (Mason ACJ, Wilson, Brennan, Deane and Dawson JJ).

48 (2007) 229 CLR 656, 663 (Gummow ACJ, Hayne, Heydon and Crennan JJ).

49 252 US 189, 206–7 (Pitney J for White CJ, McKenna, Holmes, Day, Devanter, Pitney, McReynolds, Brandeis and Clarke JJ) (1920).

50 (1999) 198 CLR 639, 661–3 (Gaudron, Gummow, Kirby and Hayne JJ).

51 (2007) 229 CLR 656, 663–4 (Gummow ACJ, Hayne, Heydon and Crennan JJ).

52 155 NE 58, 61 (Cardozo J for Hiscock CJ, Cardozo, McLaughlin, Andrews and Lehmann JJ) (NY, 1926). See also Edmonds, above n 29, 81.

whether the receipt is made in return for part of the severed whole (in which case the receipt can more readily be seen as given in exchange for part of the corpus) but is less helpful when the fiscal issue in dispute depends upon the impact which the circumstances of the receipt have upon its character. In the latter case, the fact that the receipt is not given in exchange for a severed portion of the whole may be taken as a given and the focus of enquiry shifts from the nature of its source to the nature of the receiving.

It will not always be clear to taxpayers, or to their advisers who must lodge returns and advise upon transactions, when, or how, a receipt may be said to be severed from an item of capital as its fruit rather than its body. The payment to a shareholder of part of a company's profits should and will, in the ordinary course, be treated as income. Such a payment will ordinarily be a taxable dividend to the recipient and little further enquiry need be undertaken to dispose of any question about assessability. The same answer need not necessarily be reached, as a matter of fiscal policy, where the receipt does not proceed from a pool of taxable profits. Indeed, to treat a payment of a company's corpus as taxable — as ordinary income — in the hands of a shareholder may present several fiscal anomalies. Such a payment, for example, would not receive the benefit of company tax imputation (since no company tax was paid or payable upon the corpus) and may produce unexpected capital gains tax outcomes if the shares are eventually sold (since the receipt will not be treated as a reduction in the cost base).

B *Judicial Construction of Tax Statutes*

Another cause of uncertainty in tax law arises not from the discipline of the law producing an answer different from other disciplines but because within the law there are strongly held, divergent views about the law itself. Countless examples of this may be given but it will be sufficient to remember only the decision in *Hepples v Federal Commissioner of Taxation*[53] to see how this cause of uncertainty may give rise to severe problems in the application of taxing statutes with no countervailing public benefit. The facts and the question involved in the case are easy to convey in general terms, but the legal analysis that produced the ultimate outcome is far more complicated. The question, in general terms, was whether the payment of $40 000 to a former employee in consideration of a restraint upon termination of employment was a deemed disposal for capital gains tax purposes. The resolution of that issue reached the High Court by way of a case stated from the Administrative Appeals Tribunal of Australia ('AAT'). The Tribunal Member (that is, the decision-maker) sought to know whether he should determine that the amount was taxable as a deemed disposal under one or other of two subsections, namely, ss 160M(6) or (7) of the *Income Tax Assessment Act 1936* (Cth).[54] If either was engaged, the receipt would be brought to tax as assessable income through another provision, namely,

[53] (1992) 173 CLR 492.
[54] Ibid 494 (headnote).

s 160ZO. That section, however, was not itself the basis of the liability: either s 160M(6) or s 160M(7) had first to be engaged for s 160ZO to operate.

Four out of the seven Justices of the High Court decided that the payment was not taxable as a disposal under the first of the provisions (s 160M(6)).[55] A different four Justices held that the amount was not taxable as a disposal under the other provision (s 160M(7)).[56] Viewed in that way, there was no majority supporting the proposition that either of the two subsections was engaged, because there was no majority view that there was a deemed disposal. Seen simplistically, the primary decision-maker would have concluded that the amount was not taxable because neither of the two provisions upon which taxability depended were engaged. Unfortunately for the taxpayer, however, there was a majority which concluded that it was taxable. That was because three out of the seven Justices had concluded that it was taxable as a disposal under s 160M(6) and therefore brought to tax through s 160ZO,[57] and a different three Justices out of the seven had concluded that it was taxable as a disposal under s 160M(7) and therefore brought to tax through s 160ZO.[58] In all, four out of seven of their Honours had concluded that, one way or another, the receipt was taxable through s 160ZO. The order made by the Court on appeal declared the majority opinion as to the issue of law, notwithstanding the lack of a majority about the foundation upon which that conclusion was supported.[59] The outcome, jurisprudentially, can be explained, justified and understood (at least by lawyers), although if the decision reflected the reasoning process of the one individual Member of the AAT who had the unfortunate task of deciding the case at first instance (as in a sense it could) it would reveal a deeply troubled and profoundly unstable mind.

The lawyer's rules of statutory construction are, of course, intended in part to remove uncertainties by making the approach to interpretation predictable. Some of these rules are said to be particular to tax and, ironically, in their own way have played their part in producing uncertainty, especially in the field of tax avoidance. In *Anderson v Commissioner of Taxes (Vic)*, Latham CJ adopted with approval[60] a principle stated in *Inland Revenue Commissioners v Duke of Westminster*:

> If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.[61]

[55] Ibid 497–8 (Mason CJ), 515 (Deane J), 527 (Toohey J), 549 (McHugh J).

[56] Ibid 498 (Mason CJ), 508–9 (Brennan J), 516–17 (Deane J), 544 (McHugh J).

[57] Ibid 508–9 (Brennan J), 518 (Dawson J), 528 (Gaudron J).

[58] Ibid 521 (Dawson J), 524 (Toohey J), 528 (Gaudron J).

[59] Ibid 550–3 (Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ). This was a separate, further judgment to which all Justices hearing the matter were party.

[60] (1937) 57 CLR 233, 239.

[61] [1936] AC 1, 24–5 (Lord Russell), quoting *Partington v A-G (UK)* (1869) LR 4 HL 100, 122 (Lord Cairns).

A literal construction and application of taxing provisions may no longer be in vogue[62] and has given way to a reaffirmation that the task of statutory interpretation must be to discern and apply the intention of Parliament.[63] Whether there is logically much difference between these two approaches may be open to doubt; after all, there is no reason to assume that the purpose of Parliament in enacting fiscal legislation was to impose any more than would be imposed by a literal application of a provision. In *Scott v Cawsey*, Isaacs J had said:

> When it is said that penal Acts or fiscal Acts should receive a strict construction I apprehend it amounts to nothing more than this. Where Parliament has in the public interest thought fit in the one case to restrain private action to a limited extent and penalise a contravention of its directions, and in the other to exact from individuals certain contributions to the general revenue, a Court should be specially careful, in the view of the consequences on both sides, to ascertain and enforce the actual commands of the legislature, not weakening them in favour of private persons to the detriment of the public welfare, nor enlarging them as against the individuals towards whom they are directed.[64]

As this passage shows, the overriding requirement of interpreting legislation by giving effect to the intention of the legislature is consistent with the assumption that the legislature saw fit to impose fiscal obligations strictly in accordance with the limited extent to which they are imposed by the words. In *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*, the majority of the Privy Council observed that it was a strong thing to read into an Act of Parliament words which were not there and that it was 'a particularly strong thing to do so when it amounts to modifying, as against the fiscal subject, words which have a plain, natural and ordinary meaning in [the subject's] favour.'[65] Similarly, in *Western Australian Trustee Executor & Agency Co Ltd v Commissioner of State Taxation (WA)* Gibbs J observed that a liability to taxation should not be inferred from ambiguous words if the terms of a taxing Act did 'not reveal a clear intention to do so'.[66]

C *Uncertainty by Design, Discretion and Notions of Anti-Avoidance*

In any event, the lawyer's tools of statutory construction may be a reason for some of the uncertainty in our tax laws. It may be that the drafting of some of the provisions has sought to overcome the effect of rules of construction and that,

62 Sir Anthony Mason, 'Taxation Policy and the Courts' (1990) 2(4) *CCH Journal of Australian Taxation* 40; Justice D Graham Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 *Australian Law Journal* 685; Mark Burton, 'The Rhetoric of Tax Interpretation — Where Talking the Talk Is Not Walking the Walk' (2005) 1(3) *Journal of the Australasian Tax Teachers Association* 1. But see Robert C Allerdice, 'The Swinging Pendulum: Judicial Trends in the Interpretation of Revenue Statutes' (1996) 19 *University of New South Wales Law Journal* 162.

63 *Mills v Meeking* (1990) 169 CLR 214, 234–5 (Dawson J); *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 408 (Brennan CJ, Dawson, Toohey and Gummow JJ); *MLC Ltd v Federal Commissioner of Taxation* (2002) 126 FCR 37, 47–8 (Hill J).

64 (1907) 5 CLR 132, 154–5.

65 (1977) 180 CLR 266, 280 (Lord Simon for Viscount Dilhorne, Lords Simon and Keith).

66 (1980) 147 CLR 119, 126.

perhaps, some uncertainty may have been intended as a design feature in our system of taxation. I do not stop to ask whether this is a good thing but observe that rewards and penalties linked to unpredictable outcomes are an important part of ordinary economic behaviour in ordinary life.[67] There are many instances in tax law of structured uncertainty. There are, for instance, numerous provisions where the liability of a taxpayer is made to depend upon the exercise of a discretion by the Commissioner. The Parliament may constitutionally enact a law with respect to taxation by reference to which the amount of tax payable is made to depend upon the formation by the Commissioner of an opinion about whether the application of some provision is unreasonable, even when the basis of that opinion is in part dependent upon the Commissioner having a discretion to take into account 'such … matters, if any, as he thinks fit'.[68] Delegated legislation, if it is found upon its proper construction to be sufficiently uncertain, may for that reason fall outside the power of delegation (and therefore be invalid),[69] but the duty of a court in relation to Acts of Parliament is to find meaning in the words and apply them no matter how difficult they may be to interpret.[70]

There are many reasons for discretions to be given in tax legislation notwithstanding the desirability of clarity, certainty and predictability.[71] One of them may be to have a tax outcome depend upon commercial, business or economic considerations that non-discretionary rules might not allow. It is not hard to see the echo of economic criteria as the determinants in transfer pricing discretions or in the debt/equity rules. At times — alas, all too frequently — the complexity of drafting is such that 'what seem[ed] obvious at first sight quickly recedes into obscurity.'[72] The consolidation provisions[73] may be one such example, to which one may rapidly add the controlled foreign companies regime,[74] the foreign investment funds regime[75] and other provisions, before the number of additions becomes a flood.

67 See generally Philip D Straffin, 'The Prisoner's Dilemma' in Eric Rasmusen (ed), *Readings in Games and Information* (2001) 5; John von Neumann and Oskar Morgenstern, *Theory of Games and Economic Behaviour* (60th anniversary ed, 2004).

68 As, for example, in *Income Tax Assessment Act 1936* (Cth) s 99A(3)(c), the validity of which was upheld in *Giris Pty Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 365, 373–4 (Barwick CJ), 375–6 (McTiernan J), 378–80 (Kitto J), 381–2 (Menzies J), 384–5 (Windeyer J), 387–9 (Owen J).

69 See *King Gee Clothing Co Pty Ltd v Commonwealth* (1945) 71 CLR 184, 190 (Rich J), 192–3 (Starke J); cf at 194–5 (Dixon J), citing *Kruse v Johnson* [1898] 2 QB 91, 108 (Mathew J); *Cann's Pty Ltd v Commonwealth* (1946) 71 CLR 210, 217, 219–21, 223 (Latham CJ), 224, 226 (Starke J), 234–5 (Williams J); cf at 227–8 (Dixon J); *TAB Ltd v Racing Victoria Ltd* [2009] VSC 338 (Unreported, Davies J, 13 August 2009) [32]–[41].

70 *Brisbane City Council v A-G (Qld) ex rel Isles* (1908) 5 CLR 695, 720 (O'Connor J); Dennis Pearce and Stephen Argument, *Delegated Legislation in Australia* (3rd ed, 2005) 269; D C Pearce and Robert Geddes, *Statutory Interpretation in Australia* (6th ed, 2006) 44–5.

71 G S A Wheatcroft, 'Taxation by Administrative Discretion' in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 1, 5–11. See generally Kenneth Culp Davis, *Discretionary Justice: A Preliminary Inquiry* (1969) ch 1.

72 *Inland Revenue Commissioners v Bew Estates Ltd* [1956] 1 Ch 407, 413 (Roxburgh J).

73 *Income Tax Assessment Act 1997* (Cth) pt 3-90.

74 *Income Tax Assessment Act 1936* (Cth) pt X.

75 *Income Tax Assessment Act 1936* (Cth) pt XI.

Another reason for discretions is that they are a response to what may be thought to be the 'social evil' of tax avoidance.[76] The shape of modern legislation against tax avoidance in Australia may be a reaction against the way we had previously viewed such activities.[77] The provisions directed to preventing tax avoidance — part IVA of the *Income Tax Assessment Act 1936* (Cth) — are steeped in uncertainty, although the uncertainty embedded in these provisions is conceptually problematic. It is problematic because the anti-avoidance provisions are not intended to apply as primary taxing provisions. They are intended to apply, rather, only when the ordinary provisions have failed to achieve the purpose which, somehow, they were intended to achieve but failed to achieve. A moment's reflection will reveal an obvious tension between the application of such provisions and a purposive construction of fiscal legislation: how can taxing provisions fail to achieve their proper and intended purpose if they have been construed and applied according to their purpose?

In other jurisdictions, typically those which do not have a specific anti-avoidance provision, a purposive construction of legislation has been used as the basis for courts attempting to prevent tax avoidance. In the United States decision of *Helvering v Gregory* ('*Gregory*'),[78] Learned Hand J refused to apply a literal reading of a statute which he considered to be contrary to the statutory intention. His Honour said:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. … Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition. … [T]he meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create.[79]

A purposive, or non-literal, construction of taxing statutes may, however, be made more difficult as the statute increases in specificity. In the same passage in *Gregory*, Learned Hand J observed that 'as the articulation of a statute increases, the room for interpretation must contract'.[80]

The courts have also relied upon principles of statutory interpretation in the United Kingdom in developing the doctrine of fiscal nullity to counter tax avoidance. The doctrine, first articulated in *WT Ramsay Ltd v Inland Revenue*

[76] Lanigan, above n 1, 29, 38; see also at 32–3; Ross Parsons, 'Commentary' in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 45, 47.

[77] See Arie Freiberg, 'White-Collar Crime Must Be Seen as "Real" Crime', *The Age* (Melbourne), 23 September 1982, 12.

[78] 69 F 2d 809 (2nd Cir, 1934), affd 293 US 465 (1935).

[79] *Gregory*, 69 F 2d 809, 810–11 (Learned Hand J for Learned Hand, Swan and Augustus N Hand JJ) (2nd Cir, 1934) (citations omitted). See also Marvin A Chirelstein, 'Learned Hand's Contribution to the Law of Tax Avoidance' (1968) 77 *Yale Law Journal* 440, 444–6.

[80] 69 F 2d 809, 810 (Learned Hand J for Learned Hand, Swan and Augustus N Hand JJ) (2nd Cir, 1934).

Commissioners ('*Ramsay*'),[81] was said by Lord Wilberforce to be part of the function of the courts to apply strictly and correctly the legislation enacted by Parliament. In that context, his Lordship said:

> To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process.[82]

The question at issue in *Ramsay* was whether there had been a disposal giving rise to a loss under a taxing statute.[83] The issue of construction was whether the particular transaction came within the intended terms of the statute where the disposal was effected by a series of steps, each of which the parties necessarily intended to be effective according to its terms but the partial legal effect of which had been intentionally cancelled by some other parts of the transaction.[84] The principle adopted in that case was subsequently formulated by Lord Brightman in *Furniss (Inspector of Taxes) v Dawson* in these terms:

> First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end. The composite transaction does, in the instant case; it achieved a sale of the shares in the operating companies by the Dawsons to Wood Bastow. It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax — not 'no business *effect*.' If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.[85]

The importance, and limitations, of the statutory construction at play as the foundation and extent of the principle enunciated have been remarked upon in subsequent cases[86] and by commentators.[87] Nonetheless, whatever its limitations, the foundation for the development of these judicial attempts to prevent tax avoidance has been a purposive construction of tax legislation.

The anti-avoidance provision in Australia, however, must be applied even when a fully purposive construction of the tax legislation has enabled a taxpayer to obtain a tax benefit. In such cases, it is not just that the 'literal' words have failed to apply but, rather, that the words in the statute, when properly construed by reference to the legislative intention, have failed to secure a fiscal objective

81 [1982] AC 300.
82 Ibid 326.
83 Ibid 321 (Lord Wilberforce).
84 Ibid 322–3.
85 [1984] 1 AC 474, 527 (emphasis in original).
86 See especially *Inland Revenue Commissioners v McGuckian* [1997] 3 All ER 817, 824–5 (Lord Steyn), 829–30 (Lord Cooke); *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311, 325–7, 334–5 (Lord Hoffmann).
87 See, eg, Lord Robert Walker, '*Ramsay* 25 Years On: Some Reflections on Tax Avoidance' (2004) 120 *Law Quarterly Review* 412, 416, quoting Robert Stevens, *The English Judges: Their Role in the Changing Constitution* (revised ed, 2005) 24.

which is somehow still supposed to be evident. Part IVA is not expressed as a provision to allow the Commissioner or the courts to impose such tax as either might think fit, or as either might be minded to impose in the exercise of some uncontrolled discretion or notion of fiscal equity. A casual observer might be forgiven, therefore, for being surprised that the application of part IVA may seem neither certain nor predictable and that it can operate after a purposive interpretation of the legislation has permitted a tax benefit to be obtained. The course of judicial consideration of the provisions has demonstrated a marked difference in judicial application of them. In *Federal Commissioner of Taxation v Spotless Services Ltd*, the joint judgment in the High Court adopted a passage from the reasons of the judgment of Cooper J in the Full Court of the Federal Court as the foundation for the opposite conclusion to that which had been reached by his Honour.[88] In *Macquarie Finance Ltd v Federal Commissioner of Taxation*, Hill J, at first instance, concluded that part IVA applied to a transaction but said that he did so 'with some reluctance'.[89] He doubted that the legislature would have regarded the relevant scheme as one involving the application of part IVA when it was enacted in 1981.[90] On appeal, Gyles J had no doubt that part IVA applied,[91] whilst French and Hely JJ were of the opposite view.[92] Similar divergence of views can be seen in many of the other cases in which part IVA has been considered by different judges. In *Hart v Federal Commissioner of Taxation*, at first instance, Gyles J concluded that part IVA applied to the transaction in question[93] but, on appeal, the Full Federal Court unanimously concluded that it did not.[94] On further appeal to the High Court, all five judges concluded that it did.[95] Differences in interpretation of the provisions before the High Court decision in *Hart v Federal Commissioner of Taxation* ('*Hart*') might explain the different outcomes reached in the lower courts and in cases decided before *Hart*, but that cannot explain the different conclusions reached by the judges who have decided *Macquarie Finance Ltd v Federal Commissioner of Taxation*[96] and other cases after *Hart*.

It is a reasonable concern of the casual observer that the differences in application of part IVA reflect a profound uncertainty about whether or how the anti-avoidance provisions apply to the countless number of transactions which are entered into on a daily basis and to the many cases which various members of

[88] (1996) 186 CLR 404, 422–3 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ), quoting *Federal Commissioner of Taxation v Spotless Services Ltd* (1995) 62 FCR 244, 285 (Cooper J).

[89] (2004) 210 ALR 508, 542. Hill J's primary conclusion was that a deduction was not possible in the circumstances of the case: at 528, 530. His Honour reasoned in the alternative that, if a deduction had been available, pt IVA would have applied to the transaction: at 530.

[90] Ibid 542.

[91] See *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2005) 146 FCR 77, 142.

[92] Ibid 108–9 (French J), 139 (Hely J).

[93] (2001) 189 ALR 584, 609.

[94] (2002) 121 FCR 206, 228 (Hill J); see also at 229 (Hely J), 231 (Conti J).

[95] *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 222, 228 (Gleeson CJ and McHugh J), 244–5 (Gummow and Hayne JJ), 262–3 (Callinan J).

[96] (2004) 210 ALR 508, affd (2005) 146 FCR 77.

the Australian Taxation Office, at varying levels of seniority, have to consider. None of the cases which have exhibited such different conclusions had depended for their different views upon different subjective views or discretionary considerations. In each case the judges applied objective criteria to the facts as found. The uncertainty, in short, is embedded in the application of part IVA and acts as a sword of Damocles over the heads of taxpayers each time a taxable event occurs or a taxable transaction is entered into. We have adopted, as the provision of last resort, a provision which may operate at least in part from fear of the unknown (with the full impact of the chilling effect upon commerce and economic activities which that may bring).

The main feature of part IVA to which the uncertainty may be attributed is undoubtedly the conclusion which s 177D requires to be reached for the provisions to apply.[97] The section requires a conclusion to be drawn that the 'dominant purpose' of a person who entered into or carried out the scheme[98] was to obtain a 'tax benefit'.[99] Assuming, therefore, the existence of a tax benefit as a precondition, the enquiry is focused upon the purpose of a person. That purpose is to be ascertained not by reference to any actual intention but, rather, by an objective evaluation of the matters which s 177D(b) permits to be taken into account.[100] To that extent, the analysis is essentially that articulated by the Privy Council in *Newton v Federal Commissioner of Taxation*[101] and accords with the general statements about 'blatant, artificial or contrived' in the Explanatory Memorandum from when the provision was first introduced into Parliament.[102] The difficult issue which remains, however, is that of evaluating the factors permitted by s 177D(b) to be taken into account and determining whether, when those limited factors are taken into account, and excluding the subjective purpose or motive of the taxpayer, the conclusion should be drawn that the dominant purpose of a person was to obtain the tax benefit. The joint judgment of Gummow and Hayne JJ in *Hart* sought to provide guidance in undertaking that task when their Honours said:

> In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or carried out, the deductions 'might reasonably be expected not to have been allowable'. When that is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed. To say, as Hill J did, that 'the manner in which the scheme was formulated and thus entered into or carried out is certainly explicable only by the taxation consequences' assumes that there were other ways in which the borrowing of

97 *Income Tax Assessment Act 1936* (Cth) s 177D.
98 *Income Tax Assessment Act 1936* (Cth) s 177A(5).
99 *Income Tax Assessment Act 1936* (Cth) s 177D(a).
100 *Hart* (2004) 217 CLR 216, 243 (Gummow and Hayne JJ).
101 [1958] AC 450, 465–6 (Lord Denning for Viscount Simonds, Lords Tucker, Keith, Somervell and Denning).
102 Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth) 2.

> moneys for two purposes (one private and the other income producing) might have been effected. And it further assumes that those other ways of borrowing would have had less advantageous taxation consequences.[103]

In this way, their Honours sought to inform the fundamental issue upon which the application of the provision depended by drawing attention to the need to compare what was done with something else in order to determine whether the way in which the transaction was entered into was explicable only by taxation consequences.[104] The problem is that, however helpful and correct that analysis may be, the evaluation and judgement required for the application of the statutory provision still appear to be so broad as to permit widely differing conclusions between apparently reasonable people. As such, it leaves much to be desired as an anti-avoidance provision of last resort after a purposive construction of the primary taxing provisions has not brought an item to tax.

III Possible Institutional Change to Address Tax Uncertainty

Barely ten years ago the *Ralph Report* recommended streamlining the general anti-avoidance rules as a means of reinforcing the integrity and equity in the taxation system.[105] The *Ralph Report* recommended clarification of the anti-avoidance rules to ensure that those rules are 'exercised in a manner consistent with, and supportive of, the tax policy principles embodied in other provisions in the tax law.'[106] One wonders what has happened to those recommendations and why to date they have not been adopted. Part of the recommendations called for an involvement by the Board of Taxation in reviewing the application of the policy framework and processes guiding the implementation of the anti-avoidance provisions. The task envisaged in the *Ralph Report* was that the Board of Taxation would consult with taxpayers on appropriate responses to tax avoidance and monitor the policy guidelines adopted by the ATO in applying the provisions.[107]

There is much to be said for a greater impact by taxpayers in the implementation of tax at this level of administration. The point is not that the Commissioner should not apply the law but, rather, that an institutional view about what constitutes tax avoidance should be informed broadly where there is legitimate room for difference. The *Ralph Report* suggested a relatively modest role for the Board of Taxation in that task but, where there is genuine difference of views about the true legal content of tax avoidance, I would have thought it a strong case for a much greater role to be given to business and other groups with an interest in how the tax avoidance provisions should operate in the Australian economy. Those charged with the administration of tax laws have, as they should

[103] (2004) 217 CLR 216, 243–4.
[104] See ibid.
[105] *Ralph Report*, above n 6, 241–9.
[106] Ibid 241.
[107] Ibid 244–5.

have, an understandable bias towards raising revenue. Their primary task is to apply the law, not to see it weakened or ignored. It is natural and proper for those charged with the administration of tax laws to favour the raising of revenue as a public good and to ensure equity amongst taxpayers. But, where there is room for doubt about what constitutes tax avoidance, the task to be undertaken is not merely that of administration: it is first to form a view about how the uncertainties are to be understood and applied. In that task it is desirable for the decision to be informed by all interests which may bear upon a reasonable, responsible and defensible understanding and application of the law within the limited tolerances of the ambit of uncertainty. It is a mistake to assume that all taxpayers, whether business, corporate or individual, will favour a weak anti-avoidance rule. Taxpayers have much to gain from a level playing field and have a real interest in ensuring that business competition does not favour, and personal wealth is not secured by, unacceptable exploitation of tax law. The Commissioner has adopted an impressive array of measures to ensure taxpayer representation in his decision-making or decision-forming internal bodies and in processes such as the public rulings panel and the general anti-avoidance rule panel. Such measures are to be encouraged and confirm a genuine commitment to informed decision-making; but it is still decision-making by the administration and is no substitute for an independent decision-maker.

One solution that attempted to provide certainty was the enactment of a comprehensive private and public rulings regime.[108] There are a number of weaknesses in this regime. First, the strength of rulings depends upon the precision of the facts upon which they are based. Secondly, obtaining rulings depends upon the decisions of the Commissioner, whose statutory tasks and administrative duties may weigh against rulings favourable to taxpayers in cases of genuine doubt. Thirdly, the rulings are difficult to apply to the anti-avoidance provisions, where much may depend upon how a scheme is carried out after any ruling is obtained.[109] In part, therefore, a solution designed to provide certainty brings with it its own baggage of uncertainty.

An alternative solution to reduce uncertainty might be the creation of a specialist tribunal charged primarily with the development of consistent, clear and predictable rules concerning tax law. Whether there should be a separate Australian tax court was an issue upon which Justice Michael Kirby delivered a paper just over two years ago in Sydney. The paper bore the title 'Hubris Contained: Why a Separate Australian Tax Court Should Be Rejected'.[110] 'Hubris', I think, is not a friendly word; at least not as used by his Honour. It is defined as 'arrogant pride or presumption' and, in relation to Greek tragedy at any rate, as 'excessive pride towards or defiance of the Gods, leading to

[108] *Taxation Administration Act 1953* (Cth) sch 1 pt 5-5.

[109] *Bellinz v Federal Commissioner of Taxation* (1998) 84 FCR 154, 170 (Hill, Sundberg and Goldberg JJ).

[110] Justice Michael Kirby, 'Hubris Contained: Why a Separate Tax Court Should Be Rejected' (Speech delivered at the Challis Taxation Discussion Group, Sydney, 3 August 2007) <http://www.hcourt.gov.au/speeches/kirbyj/kirbyj_3aug07.pdf>.

nemesis.'[111] With that definition, and in the light of the title adopted by his Honour, I enter upon this debate with grave trepidation and fear of nemesis. Perhaps I should seek some protection by saying that I am not generally in favour of specialist courts. Most of the arguments identified by his Honour against specialist courts[112] are ones which I generally embrace. However, I think it a little unfair to assume that the argument in favour of a specialist tax tribunal, whether a court or otherwise, is evidence of 'hubris'. One can readily accept that the law should be developed by the general courts of law informed by the general application of the law and not by the potentially distorted prism which may come from specialisation in a narrow field of practice. For this purpose I will assume, although I think it wrong in fact, that taxation practitioners do not have as good a grasp of the general law as some other practitioners (indeed, for my part, I am hard pressed to think of any class of legal practitioner other than tax lawyers likely to have a greater need to grasp as broad a range of laws upon which tax law will apply). The point, rather, is that a specialist tax tribunal at first instance might usefully develop principles and practices informed by an understanding of fiscal consequences. Consistency and uniformity may then be achieved with greater certainty and predictability, but always, of course, subject to the review on appeal by the courts of law which are charged with the task of declaring and applying the law. The Taxation Boards of Review used to fulfil some such role without evident 'hubris'. The expertise and experience their members brought to tax decisions was considerable but, over time, was largely diluted by an overriding imperative for administrative decisions of the AAT to be made by a broader group of decision-makers than the accountants, economists, former tax officials and occasional lawyer who had typically been appointed to the Boards of Review. It seems to me that tax law and practice would gain much from decision-makers bringing their expertise and experience of economic, accounting and business realities when deciding tax cases, within the bounds permitted by the law. The community would also have greater confidence in that level of decision-making, especially in relation to the application of discretionary considerations, including the uncertainties inherent in the anti-avoidance provisions.

IV Conclusion

Some uncertainty may be inevitable, but some is not. Certainty and uncertainty each come at a cost to the community, and our focus should be on what we gain and what we lose when we enact laws with deliberate uncertainties. We should look hard at who gains, and how much may be lost, from the uncertainty of the application of taxing laws and seriously question in whose interest uncertainty can be maintained. William Pitt is quoted as saying that 'where law ends, tyranny begins',[113] and there are many other variations on that theme. Discretions in law,

111 R E Allen (ed), *The Concise Oxford Dictionary of Current Speech* (8th ed, 1990) 574.
112 Kirby, above n 110, 9–23.
113 United Kingdom, *Cobbett's Parliamentary History of England*, House of Lords, 9 January 1770, vol 16, 665 (William Pitt, Earl of Chatham). See also Davis, above n 71, 3.

including tax law, may be necessary, but they should be structured, confined, reviewable[114] and above all predictable. Laws tend towards tyranny when they are not predictable. The Explanatory Memorandum accompanying the Bill which introduced part IVA said that the

> test for application of the new provisions is intended to have the effect that arrangements of a normal business or family kind, including those of a tax planning nature, will be beyond the scope of Part IVA.[115]

However, the lack of predictability of the provisions impacts upon, and potentially distorts, ordinary business or family dealing. In the end, we may decide that it suits us as a community for business transactions and other dealings to be undertaken with an overarching uncertainty about fiscal outcomes. We should be reluctant to accept that, however, without intending that to be so.

[114] Davis, above n 71, chs 3–5.
[115] Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth) 3.