

AN OLD METHODOLOGY IN A NEW WORLD: A COMMENT ON OUR CURRENT SYSTEM OF JUDICIAL DECISION MAKING IN TAX CASES

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The traditional approach to resolving tax disputes adopted by the judiciary is to look to the words of the legislation to identify parliament's intention. However this approach is founded on the fallacy that words have a 'correct' meaning which is there for the judiciary to discover. In fact, language is inherently imprecise and, typically, in difficult tax cases the determination of how the legislation was meant to apply to the facts of the particular case is at best a guess. Yet, as if in fear of a great lie being discovered, the judiciary will seek to clothe their guess with respectability by employing rhetorical devices designed to persuade the reader that they have identified the undeniable truth. However, ultimately, such a subterfuge does not do justice to the parties to the litigation nor establish an effective precedent. These cases fail a cost-benefit analysis. They indicate that a new approach is needed that is prepared to acknowledge the inherent uncertainty of language and to seek to establish a precedent by reference to the underlying policy objectives of the legislation. This will require mechanisms to assist the courts to identify the relevant policy considerations and to ensure that justice is done in the case at hand.

I INTRODUCTION

A definition of insanity is doing the same thing but expecting a different result.

Such is an apt description of our belief that the uncertainty in the tax law can be resolved through the traditional system of litigation and judicial rulings. The taxation community keenly awaits the next High Court decision that will resolve a difficult area of tax law, but it never comes. Each High Court decision is met with disappointment, critical disclaim and the identification of further grey areas and difficulties. Yet we sprout the creed that we require a further High Court decision to clarify the issues.

Why is this so? Burton has presented a cogent, albeit controversial, explanation.¹ He explained that the idea that judicial decisions are 'correct' is a fallacy. This arises from the misplaced belief that in tax law disputes there is one undeniable truth that the judiciary is charged with finding and thought to be capable of identifying. Rather, he suggested that judges are, after all, only human and their views on tax issues are only as 'correct' as those of anyone else, or at least those of anyone with considerable intellect and tax learning. Thus judicial decisions are simply justifications of one person's view. However, with a view to convincing us that their decisions are 'correct,' judges adopt certain rhetorical devices. For example, they might refer to common sense, various rules of interpretation, past precedent and fairness.

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¹ Mark Burton, 'The Rhetoric of Tax Interpretation: Where Talking the Talk Is Not Walking the Walk' (Paper presented at the Australasian Tax Teachers' Association Conference, Wellington, 26-28 January 2005). Sir Neil MacCormick has previously expressed similar views but now sees the circumstances in which judges make the law, as distinct from deducing it from interpretational practice, as less common: see Neil MacCormick, *Rhetoric and the Rule of Law* (2005).

So the 'correct' judicial decision is really the one that sounds the most convincing in the sense of appealing to rhetorical devices. At least this is the case for lower court judges who must be able to convince appeal judges. Of course, ultimately the 'correct' decision will be that of the majority at the highest level to which the case is appealed, although even their decisions are subject to the caveat that if they are not sufficiently convincing they may be subsequently rejected or, more deferentially, distinguished by a court of equal standing.

Burton's thesis rests on the notion that there is no single correct view of the underlying tax legislation which the judiciary is considering. This is because legislation is a product of words and language is an imperfect and imprecise mechanism for describing intention. If Burton's thesis is an accurate description of what judges really do and how tax disputes are resolved, then what are the implications? The author has previously argued that faced with this new reality we need to change the way in which we resolve and settle tax disputes to recognise the fallacy of the belief that the answer can always be found in the words of Parliament.² I have attempted to illustrate, by reference to cases dealing with the general anti-avoidance rule in Part IVA of the *Income Tax Assessment Act 1936* ('ITAA36'), that the traditional approach adopted by the judiciary simply creates another level of complexity and uncertainty. Furthermore, the methodology employed tends toward futile attempts to divine the 'correct' meaning of legislation thereby failing to address what would be a much more worthy consideration, namely, what is best for the economic and social well-being of the country.

My argument is that the traditional approach to attempting to find the answer from the words used by Parliament results in a technical analysis of semantics and minutiae. Burton would add that in an effort to make each decision sound correct the judiciary utilise a plethora of often competing rhetorical devices that result in inconsistency.

I suggest that the current approach needs to be abandoned and there should be recognition of the fact that legislation is inherently uncertain and that the cost of this uncertainty needs to be appropriately shared by the community. To this end I have identified eight strategies that should be adopted.

- 1 **Legislative purposive rule.** As a starting point, there should be an express mandate in the tax legislation requiring the courts to interpret the legislation to give effect to its underlying purpose and to read words into a provision if necessary to further its purpose. Whilst the purposive approach is not without its limitations, this might restrict the use of competing rhetorical devices by the judiciary and see most cases resolved in a way that Parliament would presumably have considered to be in the best interests of the country.³
- 2 **Purposive legislation and objects clauses.** To assist the judiciary to ascertain the purpose of legislation, a drafting methodology that abandons detailed legislation in favour of statements of broader principle and the use of objects clauses should be adopted. However, it is acknowledged that due to the inherent uncertainty of language the debate over how best to draft tax legislation is of secondary significance. At least less detailed legislation is less likely to obscure the underlying purpose.

² Justin Dabner, 'There Are Too Many Witchdoctors in Our Tax Courts: Is There a Better Way?' (Paper presented at the Australasian Tax Teachers' Association Conference, Wellington, 26-28 January 2005).

³ But see below n 36 and n 38 on the competing theories behind the legislative process.

- 3 **Unfettered reference to extrinsic material.** Abandoning the rule that Parliament's purpose is to be found solely in the words of a provision would permit the judiciary to refer to whatever extrinsic material is considered useful and give it the appropriate weight.
- 4 **Substance over form.** Substance should dominate as the inquiry before the courts must be as to the manner in which Parliament intended a given economic result to be managed.
- 5 **Indeterminable purpose — Adopt the best policy solution.** Where the purpose(s) of the legislation is obscure or it does not assist in resolving the issue at hand, the judiciary should undertake a policy analysis and openly decide the matter by reference to the preferred policy outcome.
- 6 **Expanded discretion in quantifying liability.** Given the imperfections of language, innocent taxpayers may have been positively misled by the legislation, especially where a court has adopted a broad purposive approach or policy analysis. Therefore, the judiciary should be provided with an expanded discretion to quantify liability by taking into account the clarity by which tax policy has been expressed and the taxpayer's conduct. This could extend from simply refraining from entering a costs order through to negative penalties or discounts off the tax liability. Furthermore, a fund should be established to compensate taxpayers who have incurred expense arising from their interpretation of what has been held by a court or the tax policy committee (see point seven below) to be misleading legislation but whose cases did not proceed to litigation. In this way the inherent costs arising from the imprecision of language could be borne by the community generally rather than by individual taxpayers.
- 7 **Tax policy committee.** A tax policy committee should be established with representatives from relevant stakeholders such as the Australian Taxation Office ('ATO'), the Treasury, the Australian Council of Social Service, business and the profession. The Committee's primary role would be to enunciate the perceived policy behind tax legislation, or a desirable policy direction where the existing policy is unclear, and to monitor whether tax rulings reflect this policy. Applications could be made to the Committee by a taxpayer (following an adverse decision on a ruling application by the ATO). The deliberations of the Committee would not be binding on courts but would provide highly persuasive evidence of either the existing or desirable policy position and, therefore, would be unlikely to be contested.⁴
- 8 **A 'norm campaign' to change community values.** There is evidence to suggest that taxpayer perceptions of unfairness, excessive taxation and regulation are determinants that contribute to avoidance of their obligations under the tax system.⁵ In order to improve the

⁴ The ATO GAAR Panel is heading in this direction: ATO, *Law Administration Practice Statement PS LA 2005/24* (2005). This has been discussed in a paper by the (former) Federal Commissioner of Taxation: Michael Carmody 'Corporate Governance and Its Role in Tax' (Paper presented at the Taxation Institute National Convention 'Tax Unmasked', Perth, 17 March 2005).

⁵ See Valerie Braithwaite, 'Perceptions of Who's Not Paying Their Fair Share' (Working Paper No 54, Centre for Tax System Integrity, Australian National University, Canberra, 2004); G Richardson, 'An Exploratory Cross-cultural Study of Tax Fairness Perceptions and Tax Compliance Behaviour in Australia and Hong Kong' (2005) 31 *International Tax Journal* 11 and M Richardson and A J Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137, 148, 177-84. As recent research indicates, the relationship between personal ethics and perceived social norms on the one hand and tax compliance on the other is complicated: M Wenzel, *Motivation or Rationalization? Casual Relations between Ethics, Norms and Tax Compliance* (2005) Centre for Tax System Integrity, Australian National University <<http://ctsi.anu.edu.au/publications/taxpubs/Wenzel.JEP2.pdf>> at 6 June 2006.

public perception of the tax system a campaign should be instituted to persuade taxpayers that they have both a legal and moral obligation to pay tax in pursuit of the Government's (now more transparent) socio-economic objectives. This campaign would emphasise the moral obligation to contribute to the cost of public resources as well as the legal sanctions for failing to comply. It might also encourage whistle-blowing and seek to render those who are non-compliant, especially non-compliant corporations, public pariahs. In contrast, in support of good citizenship the campaign might (with their consent) publicise the names of the highest tax paying corporations and individuals. One consequence of this campaign might be added pressure on tax advisers to bring a broader, even moral, dimension to the provision of their tax advice.⁶

Ultimately, I suggest that we are in denial if we believe that the current system of tax dispute resolution can ever deliver more clarity and certainty. Our reluctance to change is costing us dearly. The community is not receiving good value for its expenditure on the judiciary and tax court structure. This article further discusses the inadequacies of the current judicial tax dispute resolution system and elaborates on the proposed reforms above. It will be demonstrated that the reforms are not as radical, as they may appear as there is already some precedent in mandates expressed in other areas of economic law for a more policy orientated approach by the judiciary.

II THE TRADITIONAL APPROACH TO JUDICIAL DECISIONMAKING IN TAX CASES FAILS CONTEMPORARY NEEDS

The universal approach of common law tax judges is to seek to resolve a case by identifying the 'true' or 'correct' meaning of the legislation: that is, to identify the intention of Parliament from the words used in the statute.⁷

My thesis is that typically tax disputes arise because it is simply impossible to determine what Parliament intended from its words. We often observe Parliament respond to a judicial decision it does not like by enacting further legislation, that is, more words. But typically this simply generates new issues for resolution and again the judiciary becomes involved. The result is that we see the growth of legislation spiralling out of control and judicial decisions generating more uncertainty and complexity. The administration of, and compliance with, the system becomes a massive burden. Ultimately the public loses confidence in it and there are continual demands for reform.

A *An Illustration: FCT v Hart*⁸

A perfect illustration of this is the High Court's most recent pronouncement on the general anti-avoidance provisions of Part IVA of the *ITAA36* in *Hart*. In his speech at the launch of the

⁶ McBarnett suggests that tackling tax avoidance through general principle drafting, a substance over form approach and purposive interpretation by the judiciary and the implementation of a GAAR will just lead to creative compliance, which is a problem not a solution. She argues the need to change the attitudes of taxpayers and taxpayer advisers toward taxation so that it is seen as a positive contribution, not a negative imposition: D McBarnett, 'When Compliance Is Not the Solution but the Problem: From Changes in Law to Changes in Attitude' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Tax Evasion* (2003).

⁷ See, for example, Gary Heilbronn et al, *Introducing the Law* (5th ed, 1996) at 137 and following.

⁸ (2004) 217 CLR 216 ('*Hart*').

publication *Global Challenges in Tax Administration*,⁹ Sir Anthony Mason referred to the adherence of Australian courts to a narrow conception of judicial power and the failure to creatively interpret statutes. It is not surprising to the author that he thereafter made specific reference to the decision in *Hart* as not having done much to lessen the conflicts and tensions that exist within the tax laws. The facts were that the taxpayers took out a wealth optimiser split loan product to enable them to purchase a home and retain their former residence as an investment property. The product was structured such that in the early years of the loan all repayments were directed towards paying off the home loan while allowing the interest on the investment property loan to be capitalised. Interest was then imposed on the capitalised portion. In essence, the progressive shift of the loan balance from the residential side of the account to the investment side permitted interest on the loan funds used to purchase the Harts' home to be claimed as a tax deduction.

The High Court held, overruling a unanimous Full Federal Court, that the tax benefit associated with the loan was subject to Part IVA. According to the transcript, a key reason for leave to appeal to the High Court being granted was to clarify the operation of the definition of 'scheme' for the purposes of Part IVA.¹⁰ In fact, the decision has done anything but provide clarity. The pivotal decision of Callinan J is open to competing interpretations. One interpretation would see the Commissioner's powers under Part IVA expanded, while the alternative interpretation would merely reinforce the status quo that has prevailed since the first High Court decision on Part IVA in *FCT v Peabody*.¹¹

The uncertainty which the High Court decision created is illustrated by Hill J's subsequent attempt to make sense of it in *Macquarie Finance Ltd v FCT*¹². His Honour clearly had great difficulty identifying a precedent on the meaning of 'scheme' from the High Court decision. Fortunately for his Honour, the facts permitted him to avoid having to reach a decided view on the scope of the scheme. Ultimately, whilst concluding with reluctance that Part IVA (as interpreted in *Hart*) applied, his Honour expressed doubt as to whether this would have been Parliament's intention when Part IVA was enacted.¹³

⁹ Sir Anthony Mason, 'Global Challenges in Tax Administration Launch' (Speech delivered at the *Global Challenges in Tax Administration* Launch, Sydney, 18 August 2005).

¹⁰ See the transcript of the special leave application: *Commissioner of Taxation v Hart* S279/2002 11 April 2003 (especially the submissions of Shaw QC for the Commissioner at page 4).

¹¹ (1994) 181 CLR 359. For a discussion of the possible interpretation of the decision in *Hart* see Mark Burton and Justin Dabner, 'Hart — The Death of Tax Planning?' *CCH Tax Week* Issue 24, 24 June 2004; P Donovan, 'The Aftermath of Hart's Case — A Case for Reform of Part IVA?' (2004) 39 *Taxation in Australia* 253; Dominic Carbone and John Tretola, 'Does Hart's Case Change the Application of Part IVA?' (Paper presented at the Australasian Tax Teachers' Association Conference, Wellington, 26-28 January 2005); Michael D'Ascenzo, 'Part IVA: Post Hart' (2004) 7 *Journal of Australian Taxation* 357.

¹² [2004] FCA 1170.

¹³ On appeal a majority of the Full Federal Court disagreed with Hill J on the application of Part IVA to the facts whilst expressly endorsing his Honour's summary of the relevant law: *Macquarie Finance Ltd v Commissioner of Taxation* [2005] FCAFC 205. Hill J elaborated on his view as to how *Hart* may have significantly expanded the application of Part IVA in 'The Incremental Expansion of Part IVA' (2005) 40 *Taxation in Australia* 23. See also Justin Dabner, 'So Just What Did Hart Decide: *Macquarie Finance*' *CCH Tax Week*, Issue 45, 18 November 2004; M Cashmere, 'Part IVA after Hart' (2004) 33 *Australian Tax Review* 131; P Donovan, 'The Aftermath of Hart's Case — A Case for Reform of Part IVA?' (2004) 39 *Taxation in Australia* 253. It must be acknowledged that the ATO does not share the view of his Honour and most other commentators that the decision does not clarify but confuse: Michael D'Ascenzo, 'Part IVA: Post Hart' (2004) 7 *Journal of Australian Taxation* 357. However, a comparison of the conclusions in that article with conclusions drawn by others would not support the ATO's position. For example, on the critical issue whether the case rejects the view that a scheme needs to stand on its

The decisions at all levels in the *Hart* litigation were classic tax judgments in the sense that the focus of the judges was to identify the true application of Part IVA through consideration of its language. Thus the decisions degenerated into a debate over semantics and minutiae, the main focus of which was the definition of the word 'scheme'. On one argument, if the ATO could select a narrow scheme of, say, the borrowing on its own, then it might be easier to conclude that the dominant purpose of the scheme was to secure a tax benefit. On the other hand, a requirement to identify within the scheme commercial motivations for the borrowing might lead to a different conclusion. Thus argument centred on what scheme the Commissioner could select and whether the facts selected had to 'stand on their own feet' and not be 'robbed of all practical meaning'.¹⁴

Alternatively, it may not matter now exactly what the test is for determining the relevant scheme, as the scheme (whatever it is) must be viewed in the context of the surrounding circumstances in any event.¹⁵ Of course, this begs the question as to what are the relevant surrounding circumstances and how they are weighted. The relaxation of the 'scheme' requirement places even greater importance on the application of s 177D of the *ITAA36* (factors to consider in identifying the dominant purpose) in striking an appropriate application of the Part. Arguably the approach adopted by the courts to date in distilling a dominant purpose from these factors has essentially been a 'smell test' rather than a scientific approach. The approach generally has been to make a conclusion 'on balance' from a consideration of these factors.¹⁶ Although the Commissioner has, following his success in *Hart*, undertaken to apply Part IVA in a 'practical' way¹⁷ it is possible that the next High Court case concerning Part IVA will have to consider this very issue.

In support of the positions taken by the judges in *Hart*, we can see that the judges rely on many tried and tested rhetorical devices.¹⁸ Thus, Gummow and Hayne JJ suggest that a test they disavow is 'far from clear' and where it was used before it was 'used in a very different context'.¹⁹ In any event there is no basis for the introduction of a 'judicial gloss' into the *ITAA36*.²⁰ Furthermore, at one stage Callinan J employs a literal interpretation in his judgment.²¹ Nowhere in any of the judgments is there any attempt to examine the issue under consideration from a policy perspective.

own feet, contrast the views of D'Ascenzo with those expressed in the otherwise supportive analysis of the case by Dominic Carbone and John Tretola, 'Does *Hart's* Case Change the Application of Part IVA?' (Paper presented at the Australasian Tax Teachers' Conference, Wellington 26-28 January 2005), 15-18. Thus, even those rare supporters of the case are unable to agree on what it decided.

¹⁴ See, eg, (2004) 217 CLR 216, 235-241, Gummow and Hayne JJ.

¹⁵ See the discussion by Hill J in *Macquarie Finance Ltd v FCT* [2004] FCA 1170, (especially from paragraph 110) and the judgment of Gummow and Hayne JJ in *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 241-5.

¹⁶ *FCT v Sleight* 2004 ATC 4477, 4492, Hill J.

¹⁷ Michael Carmody, 'Corporate Governance and Its Role in Tax' (Paper presented at the Taxation Institute National Convention 'Tax Unmasked', Perth, 17 March 2005).

¹⁸ Referred to by Mark Burton, 'The Rhetoric of Tax Interpretation: Where Talking the Talk Is Not Walking the Walk' (Paper presented at the Australasian Tax Teachers' Association Conference, Wellington, 26-28 January 2005).

¹⁹ (2004) 217 CLR 216, 237 - 238.

²⁰ *Ibid.*

²¹ *Ibid* 259-60.

B A Cost Benefit Analysis of Hart

In this section, I seek to analyse whether the community received good value for the resources allocated to *Hart's* case. First, was justice achieved between the parties, namely the taxpayers and the ATO? It must be appreciated that the amount of deductions at issue in the case was only around \$800.²² The Harts subsequently made public comment to the effect that they did not have tax considerations predominately in mind when they took out the loan.²³ That is, there was no evidence of serious malfeasance and the tax revenue in question was minimal.

Secondly, did *Hart* create a valuable precedent to aid the future interpretation of the tax laws? It is notable that no cost orders were sought by the ATO which saw the case as a test case.²⁴ Certainly the taxation of split loan products was resolved in favour of the ATO. However, the basis of the special leave application being upheld was that the High Court wished to establish a precedent clarifying Part IVA. The preponderance of both academic and judicial analysis to date considers that it is difficult to determine what the case stands for; on one view, it may be a considerable departure from previous learning and possibly Parliament's intention when the legislation was enacted.²⁵

These could be considered to be marginal returns to the community in terms of revenue, justice, or the establishment of clear precedent. Given this, it is appropriate to reflect on how much the decision cost and whether these funds could have been more effectively employed elsewhere. It is very difficult to calculate the cost of the case without access to the financial records of the various parties involved. The table on the following page is a legal academic's attempt to approximate what the cost might have been, subject to some very coarse assumptions. This rough estimate is sufficient for current purposes to support the proposition that the attempt to resolve through the court system as to how Part IVA is meant to apply is a very costly process. The resolution of its application to one type of transaction, namely the split loan product, has cost the parties involved around \$1.2 million and we remain no wiser as to its application generally.

The opportunity to create the split loan product under consideration in *Hart* only came about because of uncertainty as to how the tax laws apply, especially the application of Part IVA. Therefore, the Table on the following pages includes the costs of generating the product and a proxy for the costs of its subsequent marketing, sale and implementation.²⁶ Added to these expenses are the ATO's costs in reaching a position on the product and the costs of the subsequent dispute with the taxpayer. The Table attempts to identify the cost for each group of relevant stakeholders, namely the financial community (including the taxpayer), the ATO and the public court system.

²² See F Buffini, 'Loan Was Not a Rort', *The Australian Financial Review* (Sydney), 28 May 2004 at 4.

²³ *Ibid.*

²⁴ It is widely believed that the ATO's focus in litigating the case to the High Court was to obtain a precedent that might override the Full Federal Court decision in *Eastern Nitrogen v FCT* 2001 ATC 4164 which had upheld the tax effectiveness of sale and lease back financing arrangements. The High Court had refused leave to appeal on the Part IVA point in *Eastern Nitrogen* on the basis that there was no error of law at issue, *Commissioner of Taxation v Eastern Nitrogen Ltd* B28/2001 (15 February 2002). The ATO was concerned that this had been interpreted as an endorsement of the approach and decision of the Full Federal Court in that case.

²⁵ In particular see Hill J in *Macquarie Finance Limited v FCT* [2004] FCA 1170 at paragraph 120.

²⁶ This takes into account expenses such as printing of brochures, advertising generally, training sales staff, establishing relevant accounts and maintaining records.

There are likely to have been many more indirect costs which would be difficult to quantify (and unnecessary for the purposes of this rough approximation). For example, there would have been many other taxpayers who purchased the split loan or a similar product (maybe after obtaining advice) and who may have either been the subject of a dispute with the ATO or who subsequently voluntarily amended their relevant assessments. Both taxpayers and the ATO would have incurred financial, accounting and legal expenses and possibly interest and penalties. There would have been considerable professional (and, indeed, academic) time devoted to understanding the product and its tax implications at the various stages of its life; from generation, to ATO ruling, to the various court decisions. These costs can all be related back to the product's initial creation, conceived from the uncertainty in the way our tax laws have been and are interpreted.

Set out here are some assumptions used in preparing the Table.

- 1 The relevant hourly rates adopted are those reflecting the likely cost to the relevant stakeholder. So, for example, in the case of public court costs the rate for the judiciary is their likely employment cost rather than any charge out rate based on opportunity costs.
- 2 The financial communities' internal hourly rate is assumed to be an average of \$100 per hour, with legal and tax advisers and junior counsel at \$400 per hour and senior counsel at \$600 per hour.
- 3 The ATO's internal hourly rate is also assumed at \$100 per hour with their legal and advisers at \$400 per hour and counsel at \$600 per hour.
- 4 The hourly employment rate for the judiciary is assumed at \$200 per hour.
- 5 Fixed and variable court costs include court staff such as security, judges' associates, transcribers, bailiffs and the cost of the infrastructure. This is assumed at \$1000 per hour. Given the inclusion of these amounts application and appeal fees payable by the parties have not been included.
- 6 The decisions record that the hearing took two days, the Full Federal Court appeal one day and it is assumed that the High Court appeal took a further day. Given preparation time, ten hour days are assumed.

It is argued that even if the assumptions used in preparing the Table are inaccurate in many respects, the Table nevertheless illustrates that the legal process by which the application of Part IVA to split loan products was resolved is likely to have been very costly. As with the interest at issue, the cost of uncertainty in the application of Part IVA continues to compound — even after resolution of the case itself and the closing down of the split loan scheme. The cost of the High Court's failure to provide a clear precedent on the application of Part IVA *generally* continues to resonate as hours of professional, academic and judicial time are spent on attempting to distil some sense from the case and identify its implications. Some might argue that this uncertainty helps to discourage tax avoiders. However it might also discourage economically desirable activity as even the Commissioner acknowledges that businesses thrive on certainty.²⁷ Economic impact statements now typically accompany tax reform proposals and tax bills. It may be a worthwhile exercise for such statements to be drawn up in relation to tax cases so that we, as a community, can start to focus on their true costs and benefits.

²⁷ Michael Carmody, 'Corporate Governance and Its Role in Tax' (Paper presented at the Taxation Institute National Convention 'Tax Unmasked', Perth, 17 March 2005).

Table: What did the decision in *Hart* cost?

Activity	Time (hours)			Cost (\$)			Total
	Taxpayer/ Financial Sector	ATO	Courts	Taxpayer/ Financial Sector	ATO	Courts	
Product Development (In-house/External Advisers)	500/ 200			50,000 80,000			130,000
Marketing, Sale & Implementation	3,000			300,000			300,000
Ruling by ATO		500			5,000		5,000
First Objections & Advice	10			4,000			4,000
Amended Assessment		50			5,000		5,000
Second Objections & Advice	10			4,000			4,000
Reconsideration by ATO		50			5,000		5,000
Referral to Federal Court	10			4,000			4,000
Pre-trial Activities	10	10		4,000	4,000		8,000
Preparation for Trial	25	25		10,000	10,000		20,000
Solicitors at First Instance	20	20		8,000	8,000		16,000
Counsel at First Instance	1 SC x 20 2 JC x 20	1 QC x 20 1 JC x 20		12,000 16,000	12,000 8,000		48,000
Judge at First Instance			20			4,000	4,000
Fixed/Variable Court Costs			20			20,000	20,000
Writing Judgment			100			20,000	20,000
Review by ATO and Taxpayer	10	10		4,000	4,000		8,000
Full Federal Court Appeal Application	10			4,000			4,000
Review by ATO		10			4,000		4,000
Preparation for Full Federal Court	25	25	30	10,000	10,000	6,000	26,000
Solicitors on Full Federal Court Appeal	10	10		4,000	4,000		8,000

Activity	Time (hours)			Cost (\$)			
	Taxpayer / Financial Sector	ATO	Courts	Taxpayer/ Financial Sector	ATO	Courts	Total
Counsel on Full Federal Court Appeal	1 SC x 10	1 QC x 10 1 JC x 10		6,000	6,000 4,000		16,000
Three Judges on Full Federal Court Appeal			30			6,000	6,000
Fixed/Variable Court Costs			10				10,000
Writing Judgments (One principal judgment at 100 hours and two additional judgments at 25 hours)			150			300,0 00	300,000
Review by ATO and Taxpayer	10	10		4,000	4,000		8,000
Leave Application		10			4,000		4,000
Review and Preparation Solicitors on	10 1	10 1		4,000 400	4,000 400		8,000 800
Application (Assume 1 hour)							
Counsel on Application (Assume 1 hour)	1 SC x 1 1 JC x 1	1 QC x 1 1 JC x 1		600 400	600 400		2,000
Judges on Application (2 x 30 minutes)			1			200	200
Fixed/Variable Court Costs			1				1,000
Preparation for High Court	25	25	50	10,000	10,000	10,00 0	30,000
Solicitors on High Court Appeal	10	10		4,000	4,000		8,000
Counsel on High Court Appeal	1 SC x 10 1 JC x 10	2 QC x 10 1 JC x 10		6,000 4,000	12,000 4,000		26,000
Five Judges on Appeal Fixed/Variable Court Costs			50 10				10,000 10,000
Writing Judgments (3 at 100 hours each)			300				60,000
Implementation of Decision		10			1,000		1,000
Analysis of Implications for Split Loan Products	100	100		10,000	10,000		20,000
					Total		1,164,000

My proposition is that there must be a way to generate a better return for the community from the investment in tax cases. Cases that focus on semantics and minutiae will inevitably be a futile investment. Unfortunately, with occasional exceptions, the judicial mindset is to focus on the words rather than any bigger picture. It is as if the words present a comfort zone which permit wider issues, such as economic well-being and social equity, to be avoided.

Perhaps it is unfair to solely blame the judiciary, as the tax advisory profession is all too ready to hide behind literal interpretations of the law in order to avoid considerations of what might be socially acceptable and ethical behaviour. Legal academics continue to teach the study of law in a traditional way with only limited reference to normative issues.²⁸

III THE ALTERNATIVE IS NOT SO RADICAL

The alternative approach I have proposed is really not so radical. It acknowledges that there will be cases where it is impossible to ascertain how Parliament intended the transaction to be taxed and any attempt to determine Parliament's intention from the words would be mere speculation. Furthermore, any attempt to justify the decision reached would be merely an exercise in rhetoric that might be readily rejected in subsequent cases. The result is a determination lacking precedential value and generating further uncertainty.

A Better Approach

The better approach in such cases would be to concede that Parliament's intention is unclear and to apply an overriding principle to the decision, namely, what is best for the country. The judiciary would then state the law by reference to the underlying principles of our taxation system which might be articulated as first, raising revenue for the government; second, achieving social equity; and third, advancing the country's economic well-being.

The opposing parties to a case could then lead evidence and address arguments to support their preferred interpretation of the law with reference to these principles. Ultimately the judiciary would be required to make a value-laden decision but it would be made with express reference to the values that the judges are advancing. Should these be inconsistent with the preferred policies of the government, then the government would be in a position to pass amending legislation with the benefit of a record of expert testimony and the insight of the judiciary on the relevant policy considerations.

Some might argue that such an approach encourages judicial activism and erodes parliamentary sovereignty. It must be appreciated that by virtue of its ability to enact amending legislation Parliament has the ultimate power, at least prospectively. There are already illustrations of such quasi-legislative authority being invested in administrators and, therefore, ultimately quasi-judicial and judicial bodies by provisions contained in other economic legislation. For example, ss 665A, 669, 673, 741 and 1075A of the *Corporations Act 2001* (Cth) permit the Australian Securities Investment Commission ('ASIC') and, ultimately, the courts to override express legislation to give a better effect to the policy behind takeovers and fundraising provisions.²⁹ In

²⁸ Grbich takes the view that tax academics need to be more critical of tax judgments and tax lawyers need to be better tooled: Yuri Grbich, 'New modalities in tax decision-making: applying European experience to Australia' (2004) 2 *eJournal of Tax Research* 125.

²⁹ See also Part VII of the *Trade Practices Act 1974* (Cth), especially s 88, which empowers the Australian Competition and Consumer Commission to authorise arrangements that would otherwise be anti-competitive and in breach of the Act. In exercising this power, the Commission is to weigh up how the public interest is best served.

the context of the voluntary administration provisions, s 447A of the *Corporations Act* empowers the courts to make orders about how the provisions are to apply to a particular company with the only limit being the aim to further the objects of the provisions. By virtue of these provisions, ASIC and the courts are given a very broad discretion and a mandate to ensure that the rights of parties affected by their decisions in such cases are protected. Furthermore, this legislation contains object clauses.³⁰ In some cases there are well-documented non-legislative pronouncements on the policy behind the legislation, another element of the current proposal.³¹

B *Limitations of Parliamentary Sovereignty*

In any event, it may be time to question the limits of the notion of parliamentary sovereignty, at least in the context of the relationship between Parliament and the courts. The notion that Parliament is the sovereign law making was adopted into Australia from the United Kingdom, where the principle had evolved over centuries of struggle between Parliament and the Crown. Initially there was little to distinguish between a judgment and a statute and it can be argued that the acceptance of the superiority of Parliament over the judiciary was simply an historical accident.³² Parliament's dominance over the judiciary is certainly less developed in non-common law countries.³³

The notion of parliamentary sovereignty, including its sovereignty over the courts, was articulated by the famous constitutional lawyer A V Dicey in the late 19th century.³⁴ He explained it as Parliament having the right to make laws and no other person or body having the right to override the legislation of Parliament. Thus it is that with the stroke of a pen Parliament can override centuries of judge-made law.

It is not my purpose to attempt to argue against the doctrine that Parliament should be sovereign over the judiciary. Rather, I wish to highlight that there was no oracle from high that mandated this outcome: the hierarchical relationship simply evolved.³⁵ There may be good reason for this in our system of democracy with Parliaments elected by the people and the judiciary merely appointed by the Executive. However this assumes that parliamentarians serve a higher purpose than judges. The public choice theory of the legislative process suggests that politicians act for self-interested purposes — that is to be re-elected. It might be argued that (non-elected) judges are less likely to be influenced by self-interest and so potentially are more representative. Of course, they may still harbour ambitions (for example, to be appointed to the High Court or as a Governor or Governor-General) and seek further power, prestige and influence which might dictate their leanings.³⁶ What I am proposing here is not a realignment of the hierarchy but simply the recognition that where the legislation is ambiguous or silent then the

³⁰ See, eg, ss 602 (takeovers) and 435A (voluntary administration) *Corporations Act 2001* (Cth).

³¹ Such as the Eggleston Committee principles in the context of takeovers: Commonwealth, *Second Interim Report to the Standing Committee of Attorneys-General: Disclosure of Substantial Shareholdings and Takeovers*, Parl Paper No 43 (1969) 6.

³² See, eg, Gary Heilbronn et al, *Introducing the Law* (5th ed, 1996) especially 35-38.

³³ In these jurisdictions, the balance of power is probably closer to a partnership, see Grbich, above n 28.

³⁴ A V Dicey, *Introduction to the Law of the Constitution* (9th ed, 1950), especially 60-1.

³⁵ The sovereignty of Parliament over the judiciary probably evolved because in the history of the legal system the dispensing of justice was a role initially undertaken by the Monarch which was subsequently delegated to the courts.

³⁶ See Richard A Posner, *Overcoming Law* (1995) 118; contrast R B Korobkin and T S Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 *California Law Review* 1051.

judiciary should make law by reference to an express policy analysis, rather than pretend to divine Parliament's intention from the words of the legislation. Parliament remains empowered to subsequently overrule the judiciary with amending legislation.

C *Making Policy-based Decisions*

It would also be naïve not to appreciate that in many cases judges do, in fact, decide cases by reference to underlying economic and social values, either consciously or sub-consciously. Few are prepared to articulate exactly what they are doing but rather they appear constrained to veil their decision behind the orthodoxy that they are really just identifying Parliament's intention from the words of the Statute. The proposed approach would liberate the judiciary to be open and frank as to the basis for a decision and, indeed, encourage some self-reflection. Such transparency can only further our pursuit of a just and consistent legal system that complements our economic and social agenda.

There are also those who might suggest that deciding cases on principles of public finance is no less problematic than using traditional legal reasoning with all its flaws. This writer is no apologist for economics, however I argue that the express reference to underlying economic and social policies by judges is a step in the direction of more transparent decisions and proceeds from a more acceptable basis, namely, what is best for the country rather than what is the best guess at what the words of the legislation mean. Everyday the government makes decisions for the country based on public finance theory. Certainly, there is still room for political decisions to be made based on a hidden agenda justified by reference to some doubtful public finance equation but at least one layer of subterfuge is removed.³⁷ In other words, whilst public finance theory is no magic bullet it is, in the writer's opinion, an improvement on the current system.

This is, indeed, the path eloquently advocated by Yuri Grbich as long ago as 1980.³⁸ Whilst Grbich took the view then that the current model of judicial decision making in tax cases was clearly inadequate and that there was no need to demonstrate this,³⁹ I am not so convinced that this is well appreciated. Hence my discussion of *Hart* here.

Grbich proposed a model where judges articulated the social and economic values behind their decisions. Whilst this model was based on welfare economics he acknowledged the limitations of economic theory but suggested that at least it put the values at play in sharper focus even if it was not a complete solution. A primary device to be used to rationalise decisions was the Pareto optimality principle, namely a decision might be preferred where it improved the condition of those who gained by more than those who lost.⁴⁰ Similarities with the writer's more simplistic

³⁷ There are two main theories seeking to explain the legislative process, namely public interest theory (that legislation is enacted with the public interest in mind) and public choice theory (that legislation is enacted with politicians' and others' self-interest in mind). For an overview of these see W Eskridge, P Frickey and E Garrett, *Legislation and Statutory Interpretation* (2000). For a critical appraisal of the public interest theory and one strand of public choice theory in the context of the US income tax see D Shaviro, 'Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s' (1990) 139 *University of Pennsylvania Law Review* 1.

³⁸ Yuri Grbich, 'Is Economics Any Use To Tax Lawyers' (1980) 12 *Melbourne University Law Review* 340.

³⁹ *Ibid* 354. Grbich states that "[t]he old closed rule model is so tattered that it threatens to undermine the credibility of legal dispute mechanisms."

⁴⁰ This was not to deny a role for distributional preferences and other justice reasons in rationalising decisions but these were to be expressly acknowledged: *ibid*, 345-6.

'what is best for the country' criterion are clear. Grbich accepted that his new model would require lawyers to be better tooled up to engage in economic analysis.⁴¹

Twenty four years later, Grbich derives support for a judicial decision making model focused on public policy imperatives from the European experience. This time he calls on Australian tax teachers to contribute to the development of a culture of accountability by judges by being prepared to criticise the judiciary in how they deal with policy and principles when making decisions. Furthermore, principles and legal philosophy should be at the heart of the teaching of taxation law.⁴² After criticising 'sterile definitional debates' in tax decisions, he suggests that a more principled approach would 'prevent fundamental principles from being submerged in a self-justifying spiral of mindless technical analysis feeding on itself.'⁴³ And later he describes the result of the current methodology as 'barren verbal analysis and technical minutiae wag[g]ing the policy dog.' In his view 'we must not suffer the hijacking of core policy decisions by low-level debates about words in a vacuum or the exercise of judicial discretion hidden behind a jungle of complexity.'⁴⁴

The judgments in *Hart* unfortunately provide the perfect illustration of what Grbich is speaking about.

IV CONCLUSION

My analysis of the costs and benefits of the *Hart* case illustrates that the resolution of tax disputes imposes a huge cost on the community. I argue that we are not are we obtaining value for our investment.

The application of traditional legal reasoning to the interpretation of obscure tax legislation does not pass a cost-benefit analysis. This reasoning seeks to identify Parliament's intention from the words of the legislation. However, typically in difficult cases Parliament's intention can not be discerned and the judges' best guess results in recourse to doubtful rhetorical devices in an effort to justify the conclusion reached. Slavish adherence to the fallacy that the 'correct' meaning of the legislation is there to be ultimately divined by the judiciary can lead to sub-optimum outcomes and precedents that do not provide the community with any certainty. This failure of the system is then destined to repeat itself.

In such cases, I recommend that courts embrace an approach that acknowledges the inherent uncertainty of language and seeks to establish a precedent based on desirable policy objectives. This would necessitate mechanisms to assist the courts in identifying the various policy objectives behind the legislation and some protections to ensure that justice is done between the parties in the case at hand. Some image marketing of the tax system to address negative public perceptions and encourage a consideration of wider socio-economic factors by taxpayers and advisers alike might also be desirable.

In the absence of a new approach the tax system will continue in its trajectory towards greater complexity and uncertainty. Ultimately it will become the subject of public condemnation and ridicule, the first signs of which, we may already be witnessing.

⁴¹ Ibid 349.

⁴² Grbich, above n 28, especially 152 – 154.

⁴³ Ibid 143.

⁴⁴ Ibid 153. Here, Grbich also suggests the need to strengthen other delegated tax decision-making institutions, including an agenda setting and implementation capacity which spans political and bureaucratic decision-making. This has a correlation with the author's proposal for the establishment of a tax policy committee.