ALTA 2012

University of Sydney

1-4 July 2012

Revenue Law Interest Group

"Penalties for taking a tax position that is not 'reasonably arguable' - the beat goes on."

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June 2012

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Background:

The "Reasonably Arguable Position" ("RHP") provisions were introduced in the *Taxation Laws Amendment (Assessment) Act 1992* in sections 222C and 226K, and have created areas of uncertainty from the outset. I explored some of these issues in an earlier paper[1], but 7 years later, some are no clearer – indeed, some new puzzles have arisen in the interim.

By way of background, it will be recalled that in the Second Reading speech to the 1992 Bill in the House of Representatives, the Minister assisting the Treasurer, the Honourable Peter Baldwin MP stated (so far as relevant) that:

> "The key features of the new penalty provisions are:
>
> - all taxpayers will be required to exercise reasonable care in conducting their tax affairs….
> - Taxpayers with large claims (generally $10,000 tax or more) will, *in addition*, be required to ensure that the positions they adopt are reasonably arguable…
>
> ... Following experience in the United States, the Government considers it appropriate that a more rigorous standard apply where the item at issue is very large (e.g., generally more than $10,000 in tax). Where the interpretation of the law for such large items is in issue, we expect taxpayers to exercise more care. That is the taxpayer must have a reasonably arguable position on the matter...
>
> The crux of the standard is that taxpayers should not take positions at law which, at the time taken, are not about as arguable as an alternative position. All said and done, the standard is about analysing the law and its application to the facts. If there is a strong argument to support the taxpayer's position, that may be enough. However the Government does not want taxpayer to take positions which are not defensible or which do not have reasonable prospects of success" (emphasis added).

The Explanatory Memorandum, in turn, indicated that to be "reasonably arguable":

> "... The position must involve a clearly contentious area of law, that is, one where the relevant law is unsettled, or where, although the principles of law are settled, there is a serious question about the application of those principles to the circumstances of the particular case"[2].

[1] Woellner, R "Avoiding a bum RAP", (2005) 8/3 The Tax Specialist, 166.
[2] Quoted by Hill J in *Walstern Pty Ltd v FC of T* 2003 ATC 5076, at 5094.

Sections 284-75(2) and 284-90 (Table item 4) of the *Taxation Administration Act 1953 (Cth)* currently impose an administrative penalty where:

(1) a taxpayer[3] or their agent[4] makes a statement to the Commissioner or to an entity that is exercising powers or performing functions under income tax law[5]; and
(2) in that statement, they treated an income tax law as applying to a matter or identical matters in a particular way that was "not reasonably arguable";
(3) "having regard to relevant authorities";
(4) "it would be concluded", that "what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect"; and
(5) as a result the taxpayer has a shortfall amount[6], all or part of which resulted from the taxpayer's statement and which is greater than the threshold amount[7].

Relevant "authorities" are defined *inclusively* in s 284-15(3) as:

(a) a "taxation law"[8];
(b) material covered by subsec 15AB(1) of the *Acts Interpretation Act 1901* (Cth);
(c) a decision of a court (whether or not an Australian court), or the (Australian) AAT or a Board of Review; or
(d) a public ruling.

Where these preconditions are met, section 284-90 items 4-6 impose a penalty of "25% of [the] shortfall amount or part".

[3] Similar penalties apply to trusts and partnerships (with the threshold doubled) under Table items 5 and 6 of section 284-90.
[4] See sec 284-25 of the *Tax Administration Act 1953* (Cth), which states that "This Division applies to a statement made by [the taxpayer's] agent as if it had been made by [the taxpayer]".
[5] Because the RAP provisions only apply to the *interpretation* of "income tax laws", they do not apply to the existence of primary facts such as whether the taxpayer is in business, nor do they *directly* cover the FBT or GST: see Jorgensen, R "Penalties & reasonably arguable positions", (April 2011) 45(9) Taxation in Australia, 550 at 556.
[6] A "shortfall amount" for these purposes is defined in the Table in sect 284-80(1), item 3, as a tax-related liability which "is less than it would be if the statement did not treat an income tax law as applying in a way that was not reasonably arguable": i.e. the taxpayer has a lower tax-related liability than their correct ta liability.
[7] The threshold amount under s 284-90(1) Table item 4 is the greater of $10,000 or 1% of the income tax payable by the taxpayer for the income year, calculated on the basis of the income tax return for that year; and $20,000 or 2% for a partnership or trust: s 284-90(1)(Table items 5, 6.
[8] A "taxation law" is defined in sec 995-1 paras (a)-(c) of the *ITAA 97* as an Act of which the Commissioner has the general administration (including a part of a Act to the extent to which the Commissioner has the general administration of the Act); or legislative instruments made under such an Act or part; or the *Tax Agents Services Act* 2009, or regulations made under that Act. There is accordingly a "mismatch" between the (narrower) scope of the provisions in s 284-09(1) Table items 4-6 (in relation to income tax laws) which calculate the quantum of penalty, and the scope of the (wider) "relevant" authorities (in relation to any tax laws) which are the criteria for determining whether a position is reasonably arguable (i.e., whether a penalty can be imposed).

Key issues in relation to RAPs:

The terms of the "reasonably arguable position" provisions are deceptively simple, and they (and their *ITAA 1936* predecessors[9]) have been in the Act for around 20 years. Nevertheless, the correct interpretation of some key elements remain unsettled.

What is generally regarded as the correct approach to the reasonably arguable position ("RAP") provisions was articulated by Hill J in 2003 in *Walstern Pty Ltd v FC of T*[10], where his Honour set out seven principles relating to the interpretation of the RAP provisions, which provide a useful framework for discussion of the issues in this Paper. The principles identified by Hill J were:

Principle 1: The test to be applied is objective, not subjective.

This point is made clear by the use of the words "it would be concluded" in the section.

Not only to the words of the section make it clear that the test is objective, but they set the bar quite high, as the test is not stated to be whether it "could be concluded" or "might reasonably be concluded", but rather the stricter test of it *would be concluded"*, which requires a higher degree of certainty.

One problem that the objective test in s 284-75(2) creates is that, unlike the test for "reasonable care", there is no "allowance" for taxpayers who are not legally or commercially sophisticated – all taxpayers are judged by the same objective criteria[11].

That said, the objectivity of the test in ss 284-75(2) and 284-90(1) is somewhat illusory, because while the test is objective in character, the use of the words "about as likely" require a subjective judgment of what level is adequate to satisfy the test (and may partly explain some of the divergences in judicial approach which are discussed below. The equivalent USA provisions, on which the Australian provisions were based, at one stage imposed a quasi-numerical test of at least a 1 in 3 probability of success, though this is hardly more quantifiable or objective[12].

Points 2-3: the person considering application of penalty must first determine what the taxpayer's argument is, bearing in mind that they will already have formed the view that the taxpayer's argument is wrong (otherwise the issue of penalty would not have arisen).

[9] The RAP provisions were first introduced in 1992 as secs 222C and 226K of the *Income Tax Assessment Act 1936* (Cth).
[10] 2003 ATC 5076 - approved by Sackville J in *Pridecraft Pty Ltd v FC of T; FC of T v Spotlight Stores Pty Ltd* 2005 ATC 4001, at 4023, and by implication by Stone and Allsop J in *Cameron Brae Pty Ltd v FC of T* 2007 ATC 4936, at 4952.
[11] See Woellner, "Avoiding a bum RAP" at 173.
[12] Sec 6694(a) of the *IRC*; see Woellner, "Avoiding a bum RAP", at 167.

4. The decision maker must then refer to the relevant "authorities" in order to apply the statutory test.

As noted above, the relevant "authorities" are defined in the Act as *including* not only "taxation laws", "extrinsic materials" and public rulings, but also court decisions (whether or not it is an Australian court), and decisions of the (Australian) AAT or one of the former Boards of Review.

The distinction between courts world-wide and only Australian tribunals is interesting and, if it impliedly excludes non-Australian tribunals, may produce unusual and undesirable results.

The question of what other materials may constitute "authorities" for the purpose of applying the RAP test is important, because only an "authority" can be taken into account in determining whether or not the taxpayer has established a RAP. The Explanatory Memorandum to the 1992 Act indicated that:

> "the list [of the authorities] is not intended to be exhaustive, and a wider range of authorities may be taken into account in weighing up the merits of the competing arguments. For example, authorities relating to other areas of the law (e.g., contract law) may provide support for a particular treatment of an item. Taxation rulings issued by the Commissioner prior to the new arrangements introduced by this Bill may also be considered...
>
> *An opinion expressed by an accountant, lawyer or other advisor is not an authority*. However, the authorities used to support or reach the views expressed by the advisor, including a well reasoned construction of the relevant statutory provisions may support a position taken by a taxpayer" (emphasis added)[13].

Similarly, while reaffirming that private sector advice would not be an authority, the ATO stated in MT 2008/2 that:

> " 50. Other authorities could also include statements in texts recognised by professionals as being authoritative about how the law operates, particularly in cases where there are few authorities on the correct treatment of a matter apart from the legislation itself. The relative weight to be given to each authority would depend on the circumstances ... ".

The Explanatory Memorandum, then, clearly contemplated that advice provided by legal, accounting or other *private sector* advisers would not be an "authority" for RAP purposes – though ironically, they can "accredit" academic writings as authorities.

This dichotomy may seem unusual to some, and subsequently, in *Walstern Pty Ltd*, Hill J commented (obiter) that:

> "112. It is true that opinions of Counsel are not referred to in the definition of 'authority'. On the other hand it may be said that the definition is included or if so the records of the opinions of counsel is not necessarily ruled out by the definition. It is unnecessary in the present case to decide this question, although I am inclined to think that the opinion of

[13] Compare *MT 2008//2,* para 51.

eminent counsel practising in the field… if directed at the actual facts of the case, may well fall within the definition"[14].

It is difficult to argue against the logic and fairness of this approach, and indeed judges in some cases have expanded the concept of "relevant authority[15].

While academics no doubt will revel in the stature accorded to them (by their non-authoritative practitioner cousins) as "authorities", the differential treatment of eminent practitioners seems difficult to justify. Perhaps a better approach would be to treat eminent practitioners in the same way as eminent text-writers – i.e. to treat both as "authorities", and weigh the persuasiveness of the opinion in the same way as other authorities, including the extent to which the opinion addresses the specific fact situation, the extent to which conclusions are backed by reasoned analysis, and so on.

It must currently be disconcerting for eminent counsel appointed as judges to find that overnight they have assumed the mantle of "authorities", where just 24 hours previously they were humble purveyors of information and accreditors of academic authorities.

Weighing the authorities:

The Revised Explanatory Memorandum to the *A New Tax System (Tax Administration) Bill (No.2) 2000* (Cth), para 1.28 stated that the "relevance of an authority is a matter to be weighed against other authorities, including the applicable statutory provisions and the facts of the case". Similarly, the ATO in *MT 2008/2* para 42 indicated that the "value" or persuasiveness of an authority would be judged by reference to its:

* **Persuasiveness:** an authority which has extensive reasoning, relating relevant law and facts, will be more persuasive than one which simply states a conclusion;

* **Relevance:** an authority which has some facts in common with the tax treatment at issue will not be particularly relevant if the authority is materially distinguishable on its facts, or is inapplicable to the tax treatment at issue; and

* **Source:** a High Court decision on all fours with the tax treatment i question will be accorded more weight than a Federal Court decision, which in turn will be accorded more weight than a decision of the AAT.

It is a matter of weighing all the authorities, for and against a position. Accordingly, for example, the fact that a public ruling has been issued on a point does not mean that a taxpayer cannot establish a

[14] *Walstern Pty Ltd the FC of T* 2003 ATC 5076, Hill J at 5096 (para 112). Hill J noted in *Walstern* that the views of two leading tax counsel could not be taken into account because they were not in evidence (and may not have been directed to the specific facts of the case), and advice from the taxpayer's accountants could not be taken into account because they were not directed to the facts of that case.

[15] See Woellner, "Avoiding a bum RAP", at 177. By contrast, in *Prebble & Anor v FC of T* 2002 ATC 5045, Cooper J at 5053 referred to a leading text-book of the time, a letter from the Deputy Commissioner, ATO advance opinion is and private rulings - not as direct relevant authorities, but "merely to demonstrate that other reasonable minds construing the sections came to the same conclusion as to their proper construction and operation".

RAP[16] – however, the ATO has indicated that in such circumstances, the taxpayer will need to establish that there were "sound reasons" for adopting their interpretation[17].

In some situations, different authorities may point in different directions. In those circumstances, it will be necessary to "weigh" the authorities against one another, using factors such as those outlined above, to reach an overall conclusion.[18]

In situations where there are no relevant authorities (as in *Cameron Brae*[19]), the 1992 Explanatory Memorandum indicated that what is required "is that the taxpayer has a well reasoned construction of the applicable statutory provision which it *could* be concluded was about as likely as not the correct interpretation" (emphasis added).

5. Applying the test: is the taxpayer's interpretation "about as likely to be correct as incorrect, or ... more likely to be correct than incorrect", judged at the time it is made.

The test is tautologous, since an argument which was more likely to be correct than incorrect would by definition be (at least) about as likely to be correct as incorrect[20]. And, as noted above, the objectivity of the test is reduced by the use of the judgmental word "about"[21].

Putting that to one side, the interpretation of the test by some judges seems to have changed in recent times.

The test is applied at the time the statement is made – e.g. when the tax return was lodged[22], not with the benefit of hindsight (at least in theory).

In the Explanatory Memorandum, it was said that:

> "the test does not require the taxpayer's position to be the "better view"; the standard is "about as likely as not" and not "more likely than not". However, the reasonably arguable position would not be satisfied if a taxpayer takes a position which is not defensible, or that is fairly unlikely to prevail in court. On the contrary, the strength of the taxpayer's argument should be sufficient to support a reasonable expectation that the taxpayer could win in

[16] MT 2008/2 at paras 47-48.
[17] MT 2008/2, para 47.
[18] Jorgensen R, "Penalties & reasonably arguable positions", (April 2011) 45(9) Taxation in Australia,. 550 at 556-557.
[19] *Cameron Brae Pty Ltd v FC of T* 2007 ATC 4936, Stone and Allsop JJ at 4952.
[20] McCabe (M) suggested in *Reeders v FC of T* 2001 ATC 2334 at 2337 that a test whose criterion is "more likely than not" is pragmatically unworkable, since in order to relieve a taxpayer of liability, the auditor would have to admit that the taxpayer's argument was in fact the better one (in which case, the penalty should not have been imposed in the first place).
[21] The statutory test has also vacillated - perhaps intentionally, perhaps by oversight, the 2001 legislative amendments removed the word "about" from the test, leaving it as a 50/50 test ["as likely to be correct as not" – clearer, but harder for a taxpayer to satisfy], though this was quickly changed back to the current wording.
[22] *Sent v FC of T* 2012 ATC ¶20-318, Murphy J at 13,590.

court. The taxpayer's argument should be cogent, well grounded and considerable in its persuasiveness'[23].

In *Walstern Pty Ltd*, Hill J observed that the application of the test begins with the assumption that the taxpayer's argument is wrong, and:

> "it is not necessary that the decision maker formed the view that the taxpayer's argument in an objective sense is more like the right than wrong.… This… follows from the fact that ... The premise against which the question is raised for decision is that the taxpayer's argument has already been found to be wrong. Nor can it be necessary that the decision maker formed the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision maker considers to be the correct argument for the decision maker has a ready formed the view that the taxpayer's argument is wrong. The standard is not as high as that. The word "about" indicates the need for balancing the two arguments, with the consequence that there must be room for it to be argued which of the two positions is correct so that on balance the taxpayer's argument can objectively be said to be one that while wrong could be argued on rational grounds to be right...
>
> … The two arguments… will be finely balanced. The case must be one where reasonable mind could differ as to which view, that of the taxpayer was ultimately adopted by the Commissioner was correct. There must, in other words, be room for a real and rational difference of opinion between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless "about" is likely to be correct as the correct view. A question of judgement is involved".

This is generally accepted as the correct approach.

However, judges in more recent cases seem to have been satisfied with lesser standards. For example:

- In *Prebble*[24] it was enough that, in the absence of relevant authorities at the time of th e taxpayer's statement[25], there were two reasonable instructions of the (ambiguous) section "open";

- In *Pridecraft*[26], while the court indicated that it was applying the Hill test[27], it sufficed that there was "room for a rational argument" that the taxpayer's interpretation was correct;

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[23] Explanatory Memorandum to the *Taxation Laws Amendment (Assessment) Bill 1992*, page 5. "To the extent that the matter involves an assumption about the way in which the Commissioner will exercise a discretion, the matter is only ***reasonably arguable*** if, had the Commissioner exercise that discretion in the way assumed, a court would be about as likely as not to decide that the exercise of the discretion was in accordance with law": sec 284-15 (2).

[24] 2002 ATC 5045, Cooper J at 5050-5051, 5054.

[25] The decision in *Harris,* ultimately adverse to the taxpayer (on appeal), was handed down several years after the taxpayer made its statement, and the court in *Prebble* rejected the ATO's argument based on that decision.

[26] 2005 ATC 4001, Sackville J at 4024.

[27] See *FC of T v R & D Holdings Pty Ltd* 2007 ATC 4731, Heerey and Edmonds JJ at 4741 (Stone J agreeing at 4748); [2007] FCAFC 107; (2007) 160 FCR 248.

- in the influential decision in *Cameron Brae*[28], a majority of the Full Federal Court held that while it was "clear" that the taxpayer's argument was wrong, in a situation where no authority squarely cover the situation, a RAP was established where the question was "open to debate in the sense of being arguable". Their Honours did not provide any authority for, or reasoning for their (re)formulation of the test, and their formulation is somewhat difficult to reconcile with a requirement that it "would be concluded" that the taxpayer's arguments was about as likely to be correct.

- In *Allen & Anor (as Trustees for the Allen's Asphalt Staff Superannuation Fund) v FC of T*[29], the court applied (and arguably extended) *Cameron Brae* in holding that in a context where there was no authority squarely covering the [statutory construction] point, it was sufficient that the taxpayer's position was "debatable". The court was heavily influenced by the fact that "the legislature itself had considered that the taxpayer's position was sufficiently arguable to warrant" introducing amending legislation.

  In reaching its decision, the court observed that:

  > "75. ... On the approach in *Cameron* Brae, while a court may come to a clear view on a question of statutory adverse to the taxpayer, that view is not decisive against the conclusion that the taxpayer's position was reasonably arguable",

  and that "the approach taken by Stone and Allsop JJ in *Cameron* Brae, with which we respectfully agree, is somewhat less strict than that suggested by Hill J in *Walstern*", concluding that the taxpayer had established a reasonably arguable position as there "was room for a real and rational difference of opinion" on the point of statutory construction[30].

- Similarly, Murphy J in *Sent v FC of T*[31] noted without disapproval that *Cameron Brae* had adopted a "somewhat less strict approach" and applied a test of whether the question was "open to debate in the sense of being arguable", an approach approved by a differently constituted Full Federal Court in *Allen v Commr of Taxation*[32];

- Conversely, the decision in *Knox*[33] held that on the law and facts before it, the authorities were not ambiguous, and there was not more than one construction of the law which was sufficiently open, so that no RAP had been established.

- Recently, Middleton J in the *Traviati* appeal simply cited the *Cameron Brae* test and observed that for the purposes of the appeal, he "did not need to determine the exact scope

[28] 2007 ATC 4936, Stone and Allsop JJ at 4952 (Jessup J, dissenting, did not consider the point).
[29] 2011 ATC ¶20-277, Keane CJ, Greenwood and Middleton JJ at 12,766.
[30] 2011 ATC ¶20-277, Keane CJ, Greenwood and Middleton JJ at 12,766-12,767 ("Having regard to the heavily disadvantageous consequences for the taxpayers of supine acquiescence in the view that 'income' in s 237(7) of the ITAA 1936 did indeed mean assessable income, and the availability of rational grounds for resisting those consequences...").
[31] 2012 ATC ¶20-318
[32] 2012 ATC ¶20-318, Murphy J at 13, 590 (para 218).

[33] *Knox v FC of T* 2011 ATC ¶10-225, SA Forgie (DP) at 4522.

of what is reasonably arguable"[34], observing (without comment) that in *Cameron Brae*, Stone and Allsop JJ "described the test as whether the relevant position was 'open to debate in the sense of being arguable'"[35]. On the other hand, Middleton J subsequently noted that the 7 propositions formulated by Hill J in *Walstern* "are generally accepted to be the correct approach to the application and interpretation of s 226K [the predecessor to s 284-90(1)]". The case probably therefore does not add to the debate on this point.

While one can understand that courts may struggle in determining the precise limits of a test as vague as the RAP "about as likely" standard, arguably cases such as *Prebble* and *Cameron Brae* seem to have strayed from the statutory test without offering any detailed - or indeed any in some cases – analysis in support of their divergent view. It would seem clear that there can be "room for rational argument" without this compelling a conclusion that it "would" be concluded in those circumstances that the taxpayer's case was about as likely to be correct as incorrect.

Similarly if it is "clear" that the taxpayer's argument is wrong, and is merely "open to debate in the sense of being arguable", this does not seem to indicate that the arguments are "finely balanced", or (to return to the statutory test) necessarily predicate that the objective conclusion on the facts "would" be that the taxpayer's argument is about as likely to be right as wrong. Many things are arguable, or open to debate – that UFOs exist, the earth is flat, the moon is made of green cheese, or St George will win the NRL – without it being concluded that they are about as likely to be right as wrong, or "reasonably" arguable. Indeed, if the taxpayer's argument is "clearly" wrong, it is hard to see how it can at the same time be "about" right, or could be argued on rational grounds to be right!

Must the taxpayer have *intended* to create a RAP, or have exercised reasonable care in reaching their position?

An interesting issue is whether the taxpayer needs to have actually undertaken the exercise of considering whether their position is "reasonably arguable" prior to making their statement, or whether it suffices that their position turns out to be "reasonably arguable", without the taxpayer or their advisers ever considering this question?

The RAP provisions do not, in terms, require that the taxpayer have consciously created their RAP argument prior to making their "statement" to the Commissioner. Section 284-15(1) only requires in terms that it would be to be concluded in the circumstances that the taxpayer's argument was about as likely to be correct as incorrect. The Explanatory Memorandum simply stated that the "crux of the standard is that taxpayers should not take positions at law which, at the time taken, are not about as arguable as an alternative position" - this suggests that the issue is whether the position the taxpayer takes was actually "reasonably arguable" at the time it was taken, not that the taxpayer appreciated that their position satisfied the "reasonably arguable" test.

The point does not appear to have arisen directly in case law to date, perhaps because the interpretation suggested above has simply been assumed to be correct. It is possible to argue on policy grounds that the taxpayer should only be relieved from penalty where they have actually

[34] *The Commr of taxation of teh Commonwealth of Australia v Traviati* [2012] FCA 546.
[35] *The Commr of Taxation of the Commonwealth of Australia v Traviati* [2012] FCA 546, Middleton J at para 40.

evaluated their position prior to making the statement, and formed the view that it was “reasonably arguable”. However, had the government wished to place this responsibility on the taxpayer, it would have been easy enough to reword sec 284-15(1) to say something along the lines of "a matter is reasonably arguable if, after reviewing the relevant authorities, the taxpayer formed a conclusion which, in the circumstances and having regard to relevant authorities, is about as likely to be correct as incorrect, or is more likely to be correct than incorrect”[36].

It will be interesting to see whether the point arises directly in the future, and if so what approach the courts take.

More controversially, the question has arisen of whether a taxpayer, in addition to having a reasonably arguable position, must also have exercised “reasonable care” in developing that position.

Hill J in *Walstern Pty Ltd* commented (obiter) that:

> "an argument could not be as likely as not correct if there is a failure on the part of the taxpayer to take reasonable care. Hence the argument must clearly be one where, in making it, the taxpayer has exercised reasonable care. However, reasonable care will not be enough for the argument of the taxpayer must be such as, objectively, to be "about as likely as not correct" when regard is to be had to the material constituting "the authorities"."[37]

Justice Hill's interpretation is consistent with the Explanatory Memorandum to the 1992 Act, which under the "Key Features" of Chapter 4 Penalties" notes, as quoted above, that "taxpayers with large claims… will *in addition* [to exercising reasonable care] be required to ensure…" that they have a RAP. Similarly, the flow chart on page 3 of the Explanatory Memorandum (reproduced below) also assumes that a taxpayer must have taken reasonable care to before they may even possibly satisfy the RAP test:

Scanned flow chart

Clearly, then the Government had in mind that the two tests were cumulative, i.e. that a taxpayer must have taken reasonable care and also have a RAP to escape penalty. This is certainly one logical view, and presumably the Explanatory Memorandum could be used as extrinsic material under sec 15 AB of the *Act Interpretation Act 1901 (Cth)*[38].

[36] See Woellner R, “Avoiding a bum RAP” at 173.
[37] 2003 ATC 5076 at 5095 (para 108, Point 6).
[38] Though Middleton J gave such materials short shrift on appeal in *Traviati* (above).

It is extremely rare indeed that I would disagree with Justice Hill, for whom I had and have the highest respect. However, the legislation does not expressly require this[39], and conceptually it would seem quite possible for a taxpayer to have a RAP without having taken reasonable (or any) care. The two tests are conceptually quite distinct. The "reasonable care" test is a combination of a subjective and objective elements (what a reasonable objective person would have perceived, given the personal characteristics of the taxpayer), whereas the RAP test is wholly objective (would it be concluded that the taxpayer's position was "reasonably arguable" as defined).

There is therefore no necessary connection between the tests or their outcomes. Thus, for example, it is quite clear that a taxpayer with a large shortfall may have taken reasonable care but still be liable to a penalty for failure to adopt a reasonably arguable position – that, after all, is the very intent of ss 284-75(2) and 284-90(1) Items 4-6. Valiant arguments to the contrary by adventurous taxpayers have failed: see *Sent*[40].

Conversely, imagine, for example a case where a trustee without consulting any brochures, fact sheets, websites, experts, textbooks or other authorities or resources, decides after tossing a coin that they will claim work-travel expenses for travel between a home office where they conduct a small business and a separate place of employment. Depending upon the facts, they may have a reasonably arguable position), but they clearly have not taken reasonable care – but I doubt that in those circumstances (assuming that there was a large shortfall) a court would uphold a 25% penalty for failure to take a reasonably arguable position on the basis that even though the taxpayer was probably correct, they had not taken reasonable care. Perhaps this was what the "Government" or "Parliament" intended, but it is not what the legislation says, and it is not necessarily the most obvious policy outcome.

Does establishing a RAP mean that the taxpayer has automatically deemed to have taken "reasonable care"?

Controversially, some decision-makers have reversed the above reasoning and held that where the taxpayer has proven a RAP, this *automatically* means that they must have taken reasonable care in their tax affairs, so that they cannot be penalised for a failure to take reasonable care: see e.g. F O'Loughlin (SM) in *Shin v FC of T*[41]. Subsequently, in *Traviati*, Mr O'Laughlin (SM) in the AAT held that:

> "16. The Commissioner's contention that the reasonable care and reasonably arguable position test are separate tests is based heavily on the Explanatory Memorandum to the *Taxation Laws Amendment (Self Assessment Bill 1992*. It does not refer to the explanation of the hierarchy of the penalty provisions that was given when the reasonably arguable test was introduced.

[39] See Woellner R, "Avoiding a bum RAP", at 173.
[40] 2012 ATC ¶20-318, Murphy J at 13,588-13,589.

[41] *Re Jungim Shin v F of T* 2010 ATC ¶10-166, F O'Loughlin (SM) at 3,754-3,755.

17. The Commissioner's contention [also] does not appear to be consistent with the policy underlying the penalty for failing to take reasonable care. That policy was noted by Hill J in *Walstern* ... in the following terms:

> '*... while all taxpayers would be penalised if they failed to exercise reasonable care*[,] it *was thought appropriate ... for taxpayers who made large claims ... to exercise greater care ...*"...

19. Recognising the reservations expressed in *Shin*, the conclusion is that:

- (a) the reasonably arguable test is a higher standard to meet than the reasonable care standard; and
- (b) if a taxpayer has adopted such a reasonably arguable position the reasonable care standard should be accepted as having been met.

20. That outcome is consistent with the remarks in the Second Reading Speech… that if a taxpayer comes to a conclusion that is reasonable that they should not be subject to any penalty…". [42]

Mr O'Loughlin's approach placed significant weight on the (perceived) concept of a cumulative ascending "hierarchy" or "step-ladder" of penalties in Div 284's predecessor, ranging from the least serious (lack of reasonable care and RAP) through recklessness to the most serious (intentional disregard of a taxation law), with the taxpayer arguing that where they satisfied one of these tests (e.g. by exercising reasonable care), none of the "more serious" provisions above it in the hierarchy (e.g. RAP) could apply.

As with the reverse proposition above, however, the "automatic inclusion of reasonable care" argument does not logically follow. The two tests are conceptually different, and as illustrated by the example above, it is quite possible to achieve a RAP without having taken any care at all. Indeed, the RAP test was always intended to operate as a "stand-alone" provision and stands outside any hierarchy of penalty tests.[43]

In the recent decision of the Federal Court on appeal in *Traviati*, Middleton J upheld the Commissioner's appeal from Mr F O'Loughlin's 2011 decision, and held that the tests for reasonable care and RAP were separate and distinct. Middleton J observed that:

> "34. Sections 226G and 226K [the forerunners to ss 284-75(2) and 284-90(1)] were quite different in their terms. ... [and] (c)onsidered as self-contained expressions, 'reasonable care' and 'reasonably arguable' suggest that two different - and independent – standards applied ... Reasonable care suggests an objective test, but the particular (and subjective) circumstances relevant to the taxpayer are to be considered in applying the test... A reasonably arguable position, on the other hand, suggests an entirely objective test directed

[42] *Traviati and Commissioner of Taxation* 2011 AATA 478 (8 July 2011) AAT, F O'Loughlin (SM) - after referring to the Explanatory Memorandum and comments by Hill J in *Walstern* and Finn J in *R & D Holdings Pty Ltd v DFC of T* [2006] FCA 981 at [182]. The decision in *Traviati* on this point was subsequently overturned on appeal: see *The Commr of Taxation of the Commonwealth of Australia v Traviati* [2012] FCA 546 (1 June 2012).
[43] MT 2008/2, para 67.

> to the merits of the tax position put forward by the taxpayer. It is not concerned with the taxpayer's behaviour or efforts in preparing their tax return..."[44]

For the reasons discussed above, this seems to be the clearly preferable view.

6. The level of penalty applicable:

In *Walstern*, Hill J suggested that :

> "It is clear from the Second Reading Speech to the *Taxation Laws Amendment (Self Assessment) Bill* 1992 ... that while all taxpayers would be penalised if they failed to exercise reasonable care it was thought appropriate ... for taxpayers who made large claims, generally in excess of $10,000 to exercise greater care and thus to pay a greater penalty – a further 25% ..."[45].

This may have been simply a loose use of language, but sec 284-90 (and its predecessor, sec 222C of the *ITAA 1936*) clearly state that where the taxpayer has a shortfall amount resulting from treating a matter in a way that was not reasonably arguable, the penalty is "… 25% of your shortfall amount or part" (Item 4; cf Items 5 and 6). Sub-section 284-90(2) then provides that if 2 or more items in the penalty Table apply, only the item levying the highest base penalty is to be used.[46]

Conclusion:

The aim of the "Reasonably Arguable Position" provisions is (reasonably) clear, but their wording and structure have thrown up difficult issues from the outset, and after 20 years in the Act, a surprising number of basic issues remain unresolved.

Perhaps most surprising is that, after 20 years, the most basic element of the provisions, the long-accepted judicial formulation of the test for what is "about as likely" to be correct as incorrect has been thrown into confusion by recent decisions centring around *Cameron Brae*. These decisions – often without any reasoning or authority – have seemingly re-interpreted the judicial interpretation of the statutory test and made it substantially easier to satisfy, requiring only that a position be "open to debate", or "arguable".

This re-interpretation seems inconsistent with the wording and policy aim of the provisions, and the resultant uncertainty will continue until a definitive decision on the point is made by the Full Federal and/or High Court.

Similarly, questions of whether opinions of eminent practitioners are "authorities" for the purposes of the RAP test, whether a taxpayer must intend to create a RAP or can benefit from sheer blind

[44] [2012] FCA 546, paras 36-37 (accessed 18th June 2012).
[45] *Walstern Pty Ltd v FC of T* 2003 ATC 5076, Hill J at 5,094.
[46] Cf *The Commr of Taxation of the Commonwealth of Australia v Traviati* [2012] FCA 546.

luck, and the converse question of whether establishing a RAP will automatically protect a taxpayer from a penalty for failure to take reasonable care all remain unresolved, with inconsistent decisions of the Federal Court and AAT extant.

Hopefully, at least some of these issues may be resolved within the next 20 years, so that taxpayers and their (non-authoritative private sector) advisers can plan their affairs with more certainty!

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June 2012.

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