

## IS THE ATO A LAW UNTO ITSELF?<sup>1</sup>

ROBIN WOELLNER\*

### I BACKGROUND

Over recent years, tax advisers and others have complained that the Australian Taxation Office on occasions issues rulings, determinations, media releases and, indeed, assessments inconsistent with single judge decisions in the Federal Court with which the ATO does not agree.

The 2002 decision in *Essenbourne v Commissioner of Taxation (Commonwealth)*<sup>2</sup> is often cited as a clear example of this phenomenon. The issues in *Essenbourne* were whether:

- (i) the taxpayer was entitled to a deduction for payment made to a superannuation fund in respect of an employee share plan, and
- (ii) the payment created a taxable fringe benefit<sup>3</sup>.

Kiefel J held that the relevant expenditure was not incurred in gaining or producing assessable income or necessarily incurred in carrying on a business, was capital in nature (so that it was not deductible in any event), and in addition, in his view would be caught by Part IVA.

In relation to FBT, her Honour held that there could only be a taxable fringe benefit where the ATO was able to identify a particular employee to whom the benefit was provided, rather than simply identify a general benefit provided to employees at large,

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<sup>1</sup> I wish to thank Professor Stephen Graw for his perceptive comments on an earlier draft of this Paper.

\* Professor Robin Woellner, Pro Vice Chancellor for Law, Business and the Creative Arts at James Cook University.

<sup>2</sup> 2002 ATC 5210, (Kiefel J, Fed Ct).

<sup>3</sup> Above, 5214.

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and it was this fringe benefits tax issue which indirectly led to the subsequent issues addressed below.

The ATO made it clear that it did not accept Kiefel J's decision as being correct<sup>4</sup>. This view was consistent with the ATO's prior practice, as it had indicated in Taxation Ruling TR 1999/5 that it would apply the "general benefit" view<sup>5</sup>, and would take the opportunity to test the point in future cases - which it subsequently did in *Essenbourne*<sup>6</sup>.

The Commissioner subsequently issued a Media Release indicating that he would not appeal the decision in *Essenbourne*: because the Court had held that the payment to the fund was not deductible, so that the ATO had therefore "won" the case on this point, and as a result there was no basis on which the ATO could appeal from Kiefel J's decision on the FBT point (Edmonds J in the Full Court had expressed doubt on the ATO's argument on this point). The ATO announced, however, that it did not agree with Kiefel J's reasoning on FBT, and would in future apply the "general benefit" interpretation to disallow objections raising this issue.

It was unfortunate that the FBT point was not taken to the Full Court (perhaps through the Test Case programme), as this would have avoided five years of uncertainty and the risk of having the ATO continuing to issue incorrect assessments to taxpayers over that period.

Subsequently, the ATO argued the FBT point - unsuccessfully - in a series of decisions given by the AAT and single judges of the Federal Court<sup>7</sup>, all in effect rejecting the ATO's view on the fringe benefit point: see *Benstead Services Pty Ltd v FC of T*<sup>8</sup> (AAT),

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<sup>4</sup> Commissioner of Taxation speech 14 March 2003, and Media Release of the same date.

<sup>5</sup> Robertson above, 638.

<sup>6</sup> Taxation Ruling TR 1999/5, paras 45-49.

<sup>7</sup> Various views on *Essenbourne* as "clearly correct", "not clearly wrong", or following it because of judicial comity.

<sup>8</sup> 2006 ATC 2511, 2521 (PE Hack, PM McDermott RFD, RG Kenny AAT), where the ATO actually accepted that the AAT was bound to apply the *Essenbourne* approach.

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and the single judge Federal Court decisions in *Walstern v FC of T*<sup>9</sup>; *Spotlight Stores Pty Ltd v FC of T*<sup>10</sup>; *Caelli Constructions (Vic) Pty Ltd v FC of T*<sup>11</sup>; and *Cameron Brae v FC of T*<sup>12</sup>.

Having subsequently failed to take the opportunity to seek a resolution of the issue by the Full Federal Court in *Pridecraft*<sup>13</sup>, the ATO sought to test the point directly in *FC of T v Indooroopilly Children Services (Qld) Pty Ltd*<sup>14</sup>.

## **II THE DECISION IN INDOOROOPILLY**

In *Indooroopilly*, the basic facts were that in an attempt to attract and retain staff for its child-care centres, ABC Learning Centres Ltd ("ABC Public") wished to set up an employee share scheme. Under the scheme, ABC Public would gift a number of its shares to a discretionary trust, in which the potential class of beneficiaries was limited to employees of a series of Regional Management Companies ("RMC"s) which had been licensed by a subsidiary of ABC Public to operate the child-care centres. Indooroopilly was one of these RMCs.

ABC Public sought a private ATO ruling on whether the issue of ABC Public shares generated a fringe benefit in relation to either ABC Public or any of the RMCs. The

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<sup>9</sup> 2003 ATC 5076 (Hill J Fed Ct).

<sup>10</sup> 2004 ATC 4674, 4704 (Merkel J Fed Ct), indicating that the earlier decisions were not clearly wrong, and he would therefore follow them: see Robertson M ("A disregard of the law – Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd" 2007 TIA (41, 11), 635, 636) – and below on the subsequent 2005 appeal to the Full Federal Court under the name of *Pridecraft*.

<sup>11</sup> 2005 ATC 4938, 4950-51 (Kenny J Fed Ct) - distinguishing *Essenbourne* on the facts, but "assuming as I do that *Essenbourne* correctly states law on this point".

<sup>12</sup> 2006 ATC 4433 (Ryan J, Fed Ct).

<sup>13</sup> On appeal to the Full Federal Court [*Pridecraft Pty Ltd v FC of T; Spotlight Stores Pty Ltd* 2005 ATC 4001], the ATO's submission was expressly worded so that the Full Federal Court was asked to decide the FBT issue *only if* the payments in question were found to be deductible. As the payments were in fact held non-deductible, the Court accordingly declined to rule on the FBT point. It is not clear why the ATO did not take the opportunity to have the point clarified by the Full Court, particularly as it kept the *sec 51* and *Part IVA* points "alive" as alternative points for decision.

<sup>14</sup> 2007 ATC 4236 (Full Fed Ct - Stone, Allsop, Edmonds JJ). See further Bender P, "Indooroopilly - the Tax Office cringes at the fringe", (2007) 10 CCH Tax Week, 1.

ATO ruled that the issue of shares create a fringe benefit in respect of the RMCs, but not in relation to ABC Public. On appeal by ABC Public, the Full Federal Court held that the ATO's interpretation was wrong, and that as indicated by the previous line of cases, there was no fringe benefit created because the shares gifted to the discretionary trust were not provided in respect of particular employees.

The Commissioner subsequently indicated that the ATO would not seek special leave to appeal the FBT point to the High Court, and henceforth would apply the law as confirmed by the Full Federal Court. This was perhaps surprising - having held the line on its view for some five years in the face of a sequence of decisions by single Federal Court justices, one might have expected the ATO to push for a determinative decision from the High Court. In the circumstances, the High Court might well have given serious consideration to an application for special leave<sup>15</sup>.

While the taxpayer's win in *Indooroopilly* on the substantive FBT point was important, the broader significance of the case arose from a number of critical comments from the members of the Full Federal Court on the ATO's conduct of the case.

The genesis of these critical comments arose from submissions made by the ATO to the Court, in which the ATO had stated<sup>16</sup> that in light of decisions such as *Business World Computers Pty Ltd v Australia Telecommunications Commission*<sup>17</sup>:

“8. The fact that there are single judge decisions on the meaning of the definition of ‘fringe benefit’ does not mean that the Commissioner was bound to follow those decisions as against taxpayers who are not privy to those decisions.

9. There is no principle of estoppel that would bind the Commissioner to apply the single judge decisions to which the respondent was not a party, in relation to

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<sup>15</sup> Despite the High Court's indication that normally a decision of the Full High Court will be determinative in taxation matters - see Woellner Robin et al, 17<sup>th</sup> edn (CCH Aust Ltd, Sydney, 2007), 1922-3.

<sup>16</sup> Quoted by Edmonds J, 2007 ATC 4255.

<sup>17</sup> 1988] 82 ALR 499, 504.

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the application of the FBT Act to the arrangement the subject of the respondents ruling request<sup>18</sup>.

This stark formulation provoked an interesting exchange between Bench and Counsel. Edmonds J observed<sup>19</sup> that when challenged from the Bench that

“a proposition such that the Commissioner does not have to obey the law as declared by the courts until he gets a decision that he likes was astonishing”,

Counsel for the Commissioner had indicated that these propositions had been put in response to the taxpayer’s specific contentions (presumably, that the ATO was obliged to apply those decisions), and had not been intended to assert that in exercising statutory discretions the ATO was generally entitled to disregard judicial decisions contrary to the rule of law. Indeed, Counsel indicated that the ATO had issued its private ruling contrary to the prior single Justice decisions precisely in order to enable the Full Federal Court to reconsider those decisions and thus determine the correct legal principle<sup>20</sup>.

Edmonds J. suggested that in making the ruling in *Indooroopilly*, the ATO was required either to apply the principle established in the earlier single judge decisions or to else seek a declaration from the Federal Court on the law to be applied<sup>21</sup>.

Allsop J was also very critical of the ATO, and given the tenor of his comments, it is appropriate to reproduce them at some length<sup>22</sup>. Allsop J stated that:

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<sup>18</sup> D Bennett QC, H Burmester QC and J Hmelnitsky, “Application of Precedent to Tax Cases – Further Opinion on Declaratory Proceedings” (18 June 2007), 4, 23 – advice to ATO on relevant aspects of the judgment of the Full Federal Court in *Indooroopilly*. – at 23 state that the ATO is not required to follow a single instance judicial decision where “there are good arguments that, as a matter of law, that decision is incorrect” – in which case “an early test case is the appropriate procedure”.

<sup>19</sup> 2007 ATC, 4255.

<sup>20</sup> Indeed, the Commissioner subsequently indicated informally that this had been the consistent ATO practice for some time, and that in his view, without such an approach, the opportunity for the High Court to determine key principles established on appeal in seminal cases such as *Curran* and *Slutzkin* would never have arisen.

<sup>21</sup> 2007 ATC, 4256.

<sup>22</sup> Edmonds J endorsed the comments made by Allsop J on this issue.

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"3. ... From the material that was put to the Full Court ... taxpayers appeared to be in the position of seeing a superior court of record in the exercise of federal jurisdiction declaring the meaning and proper content of a law of the Parliament, but the executive branch of the government, in the form of the Australian Taxation Office, administering the statute in a manner contrary to the meaning and content as declared by the Court; that is, seeing the executive branch of government ignoring the views of the judicial branch of government in the administration of a law of the Parliament by the former. This should not have occurred. If the [ATO] has the view that the courts have misunderstood the meaning of a statute, steps can be taken to vindicate the perceived correct interpretation on appeal or by prompt institution of other proceedings, or the executive can seek to move the legislative branch of government to change the statute....."<sup>23</sup>.

His Honour indicated that "considered" determinations of a court which determine the meaning of a statute "are not to be ignored by the executive as *inter partes* rulings binding only in the earlier *lis*. ..."<sup>24</sup>. He was also highly critical of "some inferential suggestion in argument" by the ATO that it was "somehow" required by unidentified legislation to administer the legislation in accordance with its "own view of the law and the meaning of statutory provisions, rather than by following what the courts have declared"<sup>25</sup>.

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<sup>23</sup> Allsop J quoting Marshall CJ in *Marbury v Madison* 5 US 87, at 111 (1803).

<sup>24</sup> Allsop J referring to the comments by Mahoney J. in *P & C Cantarella v Egg Marketing Board* [1973] 2 NSWLR 366, 383.

<sup>25</sup> 2007 ATC, 4239. The ATO's oblique reference was perhaps to s 359-(5)(1) which Section 359-5(1) [read with s359-35(1)-(3)] TAA provides that on application, unless a specified exception applies, the Commissioner must "make a written ruling on the way in which the Commissioner considers a relevant provision applies or would apply to you in relation to a specified scheme...". A private ruling is a "taxation decision", and a dissatisfied taxpayer may object to it: s 359-60(1), (2).

This was a remarkable judicial attack on the administration of the tax system by the ATO<sup>26</sup>, and raises a number of significant issues which are discussed below.

### **III REACTIONS TO *INDOOROOPILLY***

The ATO issued a subsequent Impact Statement, indicating that it would seek advice from the Solicitor-General on the questions of the application of precedent and the possibility of obtaining an advisory opinion – this advice was received subsequently<sup>27</sup> and is discussed below.

In the meantime, not surprisingly, the comments by the Full Federal Court in *Indooroopilly* generated some opposite but vigorous reactions from commentators.

At one extreme, Mark Robertson argues that the ATO's approach in *Indooroopilly* amounts to a breach of the rule of law and the boundary between the proper roles of the executive and judiciary (offending the separation of powers doctrine). Robertson's thesis is that, in its excessive zeal to protect the revenue, the ATO has objectified and demonised<sup>28</sup> "tax promoters" or "aggressive tax planners", as "enemies of the State" – thus justifying any action against them, even if in breach of the rule of law<sup>29</sup> and even though no illegal conduct may be involved<sup>30</sup>.

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<sup>26</sup> Perhaps significantly, in a speech delivered after the Full Federal Court's decision in *Indooroopilly*, the Commissioner confirmed the ATO's role as an "administrator" of the law rather than a policy or law maker: M D'Ascenzo, "Creating the right environment: transparency, cooperation and certainty in tax", Speech to the Financial Executives International of Australia, Intercontinental Hotel, Sydney (19 June 2007).

<sup>27</sup> Bennett, Burmester and Hmelnitsky, above.

<sup>28</sup> Robertson draws on the work of Anne Applebaum (in *Gulag: A History*, Penguin 2003) and employs an analogy to Russia under Joseph Stalin, where people were disenfranchised by being characterised as "enemies of the people", "wreckers" or "saboteurs" deemed dangerous to the State, and therefore stripped of ordinary legal and other rights. Robertson argues that the terms "tax promoter" and "aggressive tax planning" are used by the ATO today in a similar pejorative and dehumanizing way: Robertson above, 635.

<sup>29</sup> Above, 636.

<sup>30</sup> Above, 635, referring also to Applebaum's citation of Hannah Arendt, above, 21. Robertson warns that a well-intentioned creation of an "objective enemy" may be even more dangerous than one created with malign intent.

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In support of his argument, Robertson refers to cases such as *Benstead Services Pty Ltd v FC of T*<sup>31</sup>. His argument also obtains some support from comments made by the Inspector-General of Taxation. In his Report on *The Review of Tax Office Management on Part IVC Litigation*<sup>32</sup>, the Inspector-General of Taxation concluded (among other things) that:

1. The ATO sees litigation as a means of validating its interpretation of legislation and ensuring that taxpayers comply with its view of the law, rather than as a means of clarifying the meaning of the law, so that “community perceptions that, at times, the Tax Office has a ‘win at all costs’ approach to litigation are justified”<sup>33</sup>; and
2. In his view, the ATO action in departing from decisions of a court or tribunal in similar cases where the ATO believes this is necessary in order to protect the Parliamentary intent, “provide a basis for the perception that the Tax Office is prepared to act, and in some cases has acted, outside the rule of law”<sup>34</sup>.

Similarly, Nicols and Peadon suggest that the ATO settled several test programme cases that would have further clarified the meaning of the key Part IVA *ITAA 36* general anti-avoidance provisions because the ATO was advised the cases were unlikely to support its interpretation<sup>35</sup>.

These comments may suggest that, in the heat of battle, officers of the ATO can sometimes forget that as an agency of the Federal government, the ATO "has no private or self-interest of its own separate from the public interest it is constitutionally bound to

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<sup>31</sup> 2006 ATC 2511, 2521 (PE Hack SC, PM McDermott RFD and RG Kenny (AAT)). ”.

<sup>32</sup> Australia, Treasury David Vos, Cth of Aust (7 August 2006).

<sup>33</sup> Key Finding 4.1; Key finding 4.2.

<sup>34</sup> Key Findings 4.4; see the vigorous exchange of views in KF 4.6 [A.3c.27-34].

<sup>35</sup> The ATO apparently advised the Inspector-General that it did so because it wanted to “ensure that no case detracted from the favourable High Court decision in *FCT v Hart* (2004) 217 CLR 216”: Nicols P and Peadon C, “Is the Tax Office turning over a new leaf in its approach to dispute resolution?”, Allens Arthur Robinson (“AAR”), 2007 Focus – Tax, [www.aar.com.au](http://www.aar.com.au), (accessed 30 August 2007) 3 – citing their June 2007 AAR note on “*Inspector-General's report raises concerns for all taxpayers*”.

serve<sup>36</sup>, and that the public interest role of the ATO is simply to ensure that taxpayers are assessed on the correct amount of tax under the existing law.

In contrast to these views, the Hon Daryl Davies QC took quite a different approach to the two key issues raised by the comments of the Full Federal Court in *Indooroopilly*<sup>37</sup>.

**3.1 The question of the availability of declaratory orders:** Davies argues that the suggestions by Allsop and Edmonds JJ in *Indooroopilly*, of alternative approaches was misconceived. Their Honours had suggested that a preferable course of action for the Commissioner in *Indooroopilly* would have been for him either to seek a legislative amendment or a declaratory ruling from the Federal Court. Looking at each in turn:

On the question of legislative change, Davies notes that legislative time in Federal Parliament is scarce and that it is hard to get amendments into the legislative programme and then passed into law.

This certainly seems often to be the case – though the ATO appears able to push legislation through very quickly when it deems it necessary. Moreover, it is difficult to accept – once it appeared that the opportunity to test the point in court was likely to be delayed significantly – that the ATO could not have sought legislative clarification at some time during the intervening years.

On the question of whether the ATO could have sought declaratory orders from the Federal Court, Davies' response is that the Federal Court has no power to make declaratory orders on the meaning of taxation legislation in circumstances such as those in *Indooroopilly*.

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<sup>36</sup> Lee Steven (Assistant Victorian Government Solicitor) "The State as Model Litigant", September 2006 Victorian Government Solicitor's Office, Lunchtime Seminar Series, 3, quoting Justice Finn in the *Hughes Aircraft* case (albeit in a different context).

<sup>37</sup> Davies, Hon Daryl QC "The relationship between the Commissioner of Taxation and the Judiciary", 2007 TIA (41, 11), 630.

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It is certainly well-established that under the Commonwealth Constitution, Federal Courts exercising judicial power generally can only determine a question of law when the issue affects parties' rights or liabilities in relation to a "matter"<sup>38</sup>, and cannot generally provide declaratory opinions<sup>39</sup>.

In this context, it was unfortunate that Edmonds J in *Indooroopilly* did not specify the source of power he had in mind for the Federal Court's declaratory orders he referred to.<sup>40</sup> However, two possible sources of such a power could be:

(1) *s 39B(1A)(c) of the Judiciary Act 1903 (Cth)*, which provides, so far as relevant, that:

"(1A) The original jurisdiction of the Federal Court of Australia ... includes jurisdiction in any matter: -  
(c) arising under any laws made by the Parliament, other than [criminal matters]; and

(2) *s 21 of the Federal Court of Australia Act 1975 (Cth)*, which provides, so far as relevant, that on the direction of the Chief Justice:

"(1) The Court may, in relation to a matter in which it has original jurisdiction, make binding declarations of right, whether or not any consequential relief is or could be claimed.  
(2) A suit<sup>41</sup> is not open to objection on the ground that a declaratory order only is sought".

Both provisions appear to give the Federal Court jurisdiction to make declarations of right in appropriate cases, and taxpayers have succeeded in obtaining declarations of right in some cases. The issue for consideration is whether *Indooroopilly* was such a case.

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<sup>38</sup> *In re Judiciary and Navigation Acts* (1921) 29 CLR 267; Davies (above), 630-1: see L Zines, *The High Court and the Constitution*, (4th edn 1997) Butterworths; compare PH Lane *Commentary on the Australian Constitution* (2<sup>nd</sup> edn 1997), Law Book Co; Bennett, Burmeister and Hmelnitsky (above) 9-10.

<sup>39</sup> Bennett, Burmeister and Hmelnitsky, above, 5-15.

<sup>40</sup> Interestingly, Edmonds J appeared (as Edmonds SC) for the taxpayer in *Unisys* (below) in an application for declaratory relief in relation to the interpretation of the *ITAA 1936*.

<sup>41</sup> Under *s 4* of the Act, "suit" is defined (unless the contrary intention appears) to include "any action or original proceeding between parties".

Since both of the above provisions raise similar issues, it is proposed to examine only the position in relation to *s 39B (1A) (c)* in detail.

Uninstructed by authority, one would think that at the ATO ruling stage, it could be argued that the required elements for a declaratory order could be met, i.e. that there was:

- a **“matter”** (i.e. a “justiciable controversy”) within the broad meaning discussed below. Certainly the decision on a private ruling application is not purely “hypothetical”, because one would think there must be a real likelihood that the transaction will proceed, as otherwise the ATO would presumably decline to rule under *s 359-35(2)(a)* of the *Taxation Administration Act*;
- there will arguably be a **proper “contradictor”** (normally the ATO), who will have an interest in putting a case contrary to that put forward by the taxpayer<sup>42</sup> (or vice versa); and
- the matter will be one “arising under” a federal law within the broad meaning of that term<sup>43</sup> (since the *TAA* ruling provisions create enforceable legal rights in the taxpayer and obligations on the ATO).

There have been a number of cases in the tax context<sup>44</sup> where parties have sought declarations from the Federal Court on various taxation issues<sup>45</sup> (indeed, in *Bob Jane T-Marts Pty Ltd v FC of T*, the ATO itself sought a declaration on the question of how to determine the sale value of locally manufactured and imported tyres sold by retail<sup>46</sup>).

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<sup>42</sup> Though Bennett, Burmester and Hmelnitsky at 15 suggest there may be no “contradictor” in the legal sense because taxpayers may be unwilling to take on the cost and/or inconvenience of challenging the ruling: surely a strange comment in light of the actual facts in *Indooroopilly!*

<sup>43</sup> Allsop, below.

<sup>44</sup> As Davies himself notes – above, 631.

<sup>45</sup> Davies, above, 631. See for example *Marana Holdings* 2004 ATC 4256 – where, as noted above, Edmonds SC appeared for the taxpayer.

<sup>46</sup> 99 ATC 4437, 4451 (Finklestien J – Fed Ct).

#### IV THE IMPLICATIONS OF THE CASE LAW FOR THE AVAILABILITY OF DECLARATORY ORDERS IN *INDOOROPILLY*:

There does not seem to have been a decision directly on the point at issue in *Indooroopilly*, though the decisions are suggestive.

In terms of the elements of *ss 39B (1) (c)* and *21*, the term “matter” is defined in very broad terms for the purposes of *s 39B (1A)*<sup>47</sup>. Indeed, as Justice Allsop indicated in a Paper to the NSW Bar Association in 2003 (some four years before his decision in *Indooroopilly*), the “matter” which must be found is:

“... the justiciable controversy between the actors to it comprised of the substratum of facts and claims representing or amounting to the dispute or controversy between ... them. ... It is the whole controversy in respect of which it is the function of the court to quell...”<sup>48</sup>

He goes on to note that there are “non-controversial matters” which are accepted as being within this federal jurisdiction<sup>49</sup>, and that a “controversy may be evident between parties well before either party decides to go to court ... and that it may, at that point, bear a federal character”<sup>50</sup>.

Despite the width of this definition, case-law suggests that there could be some difficulty in using these provisions in the taxation context to provide a “pure” declaratory order on

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<sup>47</sup> “Matter” is defined in *s 2* of the Act to include “any proceedings in a Court, whether between parties or not, and also any incidental proceedings in a cause or matter”. “Cause” is then defined in the same section to include “any suit, and also includes criminal proceedings”, while “suit” in turn is defined to include “any action or original proceeding between parties”; see the observations by Lindgren J in *White Industries Australia Ltd & Anor v FC of T* 2007 ATC 4442, 4458.

<sup>48</sup> Justice James Allsop, “Federal Jurisdiction and the Jurisdiction of the Federal Court of Australia”, paper to the NSW Bar Association (Sydney – 21 October 2003), 10.

<sup>49</sup> Referring to *Hedge, as Administrator of Goldfields Medical Fund Inc* [2002] FCA 1498 (orders re administrator’s proposed course of action); and generally *Petrotimor Companhia de Petroleos S.A.R.L. v Commonwealth of Australia* [2003] FCAFC 3, 83.

<sup>50</sup> Above, 14.

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questions of interpretation of tax law for ruling purposes. Indeed, following the passage in his Paper quoted above, Justice Allsop added the caveat that the “best known limitation [on *s 39(1A)(c)*] is that it does not include advisory opinions ... [because] the Constitutional purpose of courts exercising ... the judicial power of the Commonwealth ... to quell controversies, not to answer hypothetical questions or questions for advice put to them whether by private parties, the Parliament or the Executive...”<sup>51</sup>.

This observation is interesting, in light of his Honour’s unqualified statement in *Indooroopilly*<sup>52</sup> that he had “had the considerable advantage of reading the reasons” of Edmonds J, and agreed with them. Of course, his Honour may have had a different source of power in mind (technically Edmonds J’s “reasons” for decision did not include his observations on declaratory relief), and Allsop J did not include declaratory relief in the “remedies” he suggested the ATO might pursue to “vindicate the perceived correct interpretation” of a provision<sup>53</sup>. Nevertheless, if his Honour had doubts about the application of the “hypothetical question” exception, one might have expected him to voice them in the context of the vigorous exchange of views in *Indooroopilly*.

#### **V TAXATION CASE-LAW ON *SEC 39(1A) (C)*:**

There is an emerging body of case-law on the availability of declaratory orders in taxation matters.

A useful starting point is the decision in *Marana Holdings Pty Ltd & Anor v FC of T*<sup>54</sup>, where the Commissioner and taxpayer agreed that it was appropriate for the Full Federal

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<sup>51</sup> Above – see also at 17-20 where his Honour discusses the difference between “merely interpreting” a federal law, and a matter “arising under a federal law”, by reference to *Felton v Mulligan* (1971) 124 CLR 367; *LNC Industries v BMW Aust Ltd* (1983) 151 CLR 575, and *Abebe v Commonwealth* (1999) 197 CLR 510.

<sup>52</sup> 2007 ATC 4236, 4238.

<sup>53</sup> Above, 2007 ATC 4238.

<sup>54</sup> 2004 ATC 5068.

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Court to give a declaratory order determining whether the sale of a certain strata-title unit was input taxed under *s 40-65* of the *GST* legislation, and the court did in fact make declaratory orders (in favour of the Commissioner)<sup>55</sup> under *ss 39B (1A)(c)* and *21*<sup>56</sup>.

*Marana* involved the type of issue on which the ATO might well be called upon to rule. However, it should be noted that the case arose in the context of reviewing the decision of Beaumont J at first instance, rather than as an application for a declaratory order “ab initio”.

In *Unisys Corporation Inc v FC of T*<sup>57</sup>, the Commissioner had issued a notice requiring payment of withholding tax, penalties and interest on profits which the taxpayer claimed were made through a permanent establishment in the USA and were therefore exempted from liability to Australian tax under the relevant Double Tax Agreement. Gzell J made a declaratory order that that the USA premises in question did not constitute a permanent establishment as defined in the DTA, and therefore declined to set aside the Commissioner’s notice. Interestingly, in *Unisys*, the declaratory relief was granted although no formal assessment as such had issued – though the taxpayer’s liability had in a sense “crystallized”.

In *Remuneration Planning Corporation Pty Ltd v FC of T*<sup>58</sup> Gyles J declined to intervene under *s 39B* to pre-empt the ATO from enforcing Public Ruling TR 99/5. His Honour’s reasons were that (i) the Ruling was of “general operation”, (in that it was not directed to any particular person), (ii) it was “purely advisory” (in that it simply notified the public of the ATO’s view on a tax issue) and thus did not affect rights or liabilities in the relevant sense, and (iii) it could not disadvantage the taxpayer, because under the Rulings system, the most the taxpayer could be required to pay was the proper amount of tax.

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<sup>55</sup> 2004 ATC 5068, 5080 (Full FC: Dowsett, Hely and Conti JJ).

<sup>56</sup> See at first instance 2004 ATC 4256 (Beaumont J – Fed Ct).

<sup>57</sup> 2002 ATC 5146 (Sup Ct NSW, Gzell J). As noted, Edmonds SC (with Mr. Harper) appeared for the taxpayer in *Unisys*!

<sup>58</sup> 2001 ATC 4130 (Gyles J – Fed Ct).

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Gyles J observed that:

“The applicant’s complaint ... is that tax officials are likely to act in accordance with the Ruling in exercise of their powers [which is likely and] may lead to clients of the applicant being assessed for tax upon the basis of the Ruling. There are, however, elaborate provisions for appeal against assessments pursuant to Pt IVC of the Administration Act, including a full merits review by the Administrative Appeals Tribunal... [The] Federal Court does not have any general supervisory role over the Executive, nor any role to enforce statutes save when a proper justiciable controversy is brought before it by the proper parties.....The contrast between public rulings and private rulings is instructive. Private rulings do affect individual taxpayers, and there is an appeal system.”<sup>59</sup>

Gyles J’s final comments are interesting, and might suggest that his Honour may have been more inclined to provide declaratory orders had the case involved a private ruling (as in *Indooroopilly*), despite the existence of an appeal system for such rulings.

Of more direct relevance to the current context is the decision in *Young v FC of T*<sup>60</sup>. There, the taxpayer applied (among other things) for a declaration under *s 39B (1A)* that the actions of the Commissioner in adopting and announcing a policy<sup>61</sup> on how the ATO proposed to treat equity-linked bonds were unlawful. In the Federal Court, Gyles J declined to exercise his discretion to grant the remedy sought<sup>62</sup> because of the cumulative effect of a number of factors:

1. The mere fact that the taxpayer had to make a decision as to whether or not to accept the “settlement” option offered under the Policy was not “in any relevant sense” adverse to him, and he therefore had no standing to complain about

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<sup>59</sup> 2001 ATC 4130, 4135 (Gyles J).

<sup>60</sup> 2000 ATC 4133 (Fed Ct – Gyles J).

<sup>61</sup> In ATO Media Releases 99/21 (15/6/1999) and 99/84 (30/11/1999), together with a note on the ATO website: see 2000 ATC 4133, 4136 (Gyles J).

<sup>62</sup> 2000 ATC, 4140 - though His Honour indicated that while it was “doubtful” that any of the Commissioner’s arguments individually was sufficient to justify refusing the orders sought, their “combined effect” persuaded him.

- possible breaches of law involved. The only person who could complain about possible breaches of law would be the Commonwealth Attorney-General<sup>63</sup>.
2. it was clear that the ATO's Policy was inflexible and that the ATO intended to apply it, so that the issue was not "hypothetical" in a technical sense. However, if relief was refused, the only result would be the issue of an assessment. In his Honour's view, although the issue of an assessment would create a debt due for which the Commonwealth could sue and commence "garnishee" proceedings, the "lack of any act to scrutinise is a factor against the grant of relief ... particularly ... where the act in question, assessment, cannot for relevant purposes, be challenged otherwise than in accordance with Part IVC of the *Taxation Administration Act* ..." <sup>64</sup>. His Honour noted that the "existence of other remedies has always been a powerful factor against the grant of relief of the kind envisaged by s 39B of the *Judiciary Act* ..." <sup>65</sup>;
  3. while ss 175 And 177 ITAA (the privative clauses channeling tax reviews and appeals through Part IVC TAA) do not apply to the period prior to the issue of an assessment, it would be anomalous to allow the taxpayer to argue before assessment issues which could not be argued after the assessment "when it is only the assessment which gives effect to the unlawfulness so far as the [taxpayer] is concerned" <sup>66</sup>.

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<sup>63</sup> Ibid – citing *Bateman's Bay Local Aboriginal Land Council v Aboriginal Community Benefit Fund Pty Ltd* (1998) 194 CLR 247, 260-4.

<sup>64</sup> 2000 ATC 4133, 4140-41 (Gyles J), citing respectively *Kenny J in Hammersly Iron Pty Ltd v National Competition Council* (1999).164 CLR 203, 225-7 (hypothetically); and on the exclusive operation of Part IVC, *DFC of T v Richard Walter Pty Ltd* 95 ATC 4067, *Sunrise Auto Ltd v FC of T* 95 ATC 4840, *Golden City Car & Truck Centre Pty Ltd v DFC of T* 99 ATC 4131, and *San Remo Macaroni Co Pty Ltd v FC of T* 99 ATC 5138. Similarly, in *Bob Jane T-Marts Pty Ltd v FC of T* 99 ATC 5100, 5102, the Full Court of Hill, Sundberg and Mansfield JJ observed that the first instance judgment "demonstrated" the inappropriateness of declaratory relief in such circumstances, because the parties had been left with no order biding upon them.

<sup>65</sup> 2000 ATC, 4140.

<sup>66</sup> 2000 ATC, 4141.

Accordingly, “in all the circumstances”, Gyles J concluded that if relief were granted, it would “intrude” into the assessment process, and a declaration “would either be a surrogate injunction (which is undesirable) or have no utility”<sup>67</sup>.

With respect, his Honour’s analysis is not compelling, particularly in relation to precluding arguments at the pre-assessment stage because of *ss 175 and 177*, and his suggestion that an order would have no utility. On this approach, a taxpayer is placed in the unenviable position of having to wait for the issue of an arguably wrongful assessment, and then incur considerable and arguably unnecessary expense and inconvenience in pursuing the formal objection/appeal process – which in any event might not resolve the particular issue: as *Essenbourne* and *Pridecraft* attest. Thus, in circumstances such as those arising in *Young* (where the ATO announced its intention to apply a particular policy which would impact adversely on a taxpayer), the taxpayer might well find it “useful” to obtain a declaration on the correct legal position, and thus avoid expensive and possibly inconclusive litigation.

Subsequently, the taxpayer in *Haritopoulos Pty Ltd v DFC of T* unsuccessfully sought declarations under *s 39B (1A)* of breaches of obligation by the ATO to provide particulars of penalties and injunctive relief to restrain the ATO from enforcing an assessment and penalties<sup>68</sup>. The case does not provide any particular new insights in this context.

The taxpayer in *White Industries Australia Ltd & Anor v FC of T* fared much better – albeit at a preliminary stage. There Lindgren J found that there was a “matter arising under a federal law” within the meaning of *s 39(1A)(b)* where the taxpayer had challenged the ATO’s decision to seek access to certain accountant’s papers which the taxpayer argued were “restricted source” or “non-source” documents protected by the ATO’s informal guidelines. However, the proceedings were only preliminary in nature,

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<sup>67</sup> Citing *Neeta (Epping) Pty Ltd v Phillips* (1974) 131 CLR 286, 307; 2000 ATC, 4141 – Gyles J ordered the taxpayer to pay the ATO’s costs.

<sup>68</sup> 2007 ATC 4365, 4371-2 (Besanko J),

and again the dispute arose in the context of an appeal against ATO objection decisions, rather than a request for a purely advisory opinion *ab initio*.

Most recently, the taxpayer in *Bilborough v DFC of T* also failed to obtain relief under *s 39(1)*, on the basis that the ATO was under no legislative duty to take particular steps in compromising tax debts<sup>69</sup>. The situation with private rulings in *Indooroopilly* can be distinguished on this point, but the case offers little to support an argument for purely declaratory relief.

#### **VI CONCLUSION – IS DECLARATORY RELIEF AVAILABLE?**

Overall, the case-law to date gives some support for an argument that “purely” declaratory relief on intended rulings may be obtained under *s 39B(1A)(c)*, though there are a number of potential barriers to such relief. It would seem that there is an arguable case that in such circumstances: an order in relation to a proposed ruling on a future proposed course of conduct would not be “hypothetical”; that there could be a “matter arising under a federal law” where a taxpayer applies for a ruling; and that declaratory relief under *s 39B(1A)(c)* could in such circumstances provide practical relief and not lack “utility”.

On the other hand, there is a clear judicial reluctance to grant declaratory orders under *s 39B* in the tax context, with the existence of the Part IVC objection and appeal procedure is often seen as a barrier to such orders (*Young*). Accordingly, it would seem that a declaratory order will be the exception rather than the rule, and orders have been declined in relation to a Public Ruling (*Remuneration Planning*) and enforcement of a policy announcement (*Young*), though orders have been granted in relation to GST and double tax treaty provisions (*Marana, Unisys*), and there is an arguable case for orders in limited circumstances in relation to private rulings.

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<sup>69</sup> 2007 ATC 4552.

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2007 Refereed Conference Papers**

Interestingly, in their August 2007 advice to the ATO on the comments on declaratory orders by Edmonds J in *Indooroopilly*, Bennett, Burmester and Hmelnitsky, while supporting the ATO's approach, suggest that a federal court may provide a declaratory order in limited circumstances in the tax context.

They argue that in appropriate circumstances, a court can make declaratory orders in relation to a matter that has not yet occurred, or a proposed scheme or transaction<sup>70</sup>; or to determine what course of conduct a person should adopt to avoid some legal liability<sup>71</sup> or determine legal rights such as beneficial ownership of property<sup>72</sup>. In their view, the Federal Court also "has undoubted jurisdiction to make a declaratory order" in a range of circumstances prior to the issue of an assessment, including in relation to a taxpayer's liability to income tax or GST<sup>73</sup>, and if the taxpayer could demonstrate a good reason why the dispute should be resolved prior to ruling or assessment, the court "might be persuaded to continue with the matter"<sup>74</sup> – as noted below, avoidance of delay, expense and uncertainty might constitute a "good reason" for an order.

However, they argue that it will not be appropriate to make declaratory orders in an *Indooroopilly* situation because:

- (i) once the Commissioner has formed his "view" and made the ruling, his statutory task is complete and there is then no *legal* controversy remaining to found a

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<sup>70</sup> Above, 11-12, citing Barwick CJ in *The Commonwealth v Sterling Nicholas Duty Free Pty Limited* (1971-1972) 126 CLR 297, 305 – see also paras 29-30.

<sup>71</sup> Above, 11 - citing *Russian Commercial and Industrial Bank v British Bank for Foreign Trade Limited* [1921] 2 AC 438.

<sup>72</sup> Above, 11 – citing *Sarkis v DFC of T* (2005) ATC 4205.

<sup>73</sup> Bennett, Burmester and Hmelnitsky, above, 16 – citing *Platypus Leasing inc & ors v Commissioner of Taxation* 61 ATR 239, where McLellan CJ at CL in turn cited *Oil Basins Ltd v The Cth and the Commissioner of Taxation* (1993) 178 CLR, 643, 652 ff; followed in *TAB Ltd v Commissioner of Taxation* (2005) 59 ATR 430.

<sup>74</sup> And in their view, the parties' wish to determine the correct tax liability of a proposed transaction or conduct would constitute a justiciable controversy: above, 17 – citing *Platypus Leasing*, above.

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declaratory order<sup>75</sup>. This argument has some merit, though presumably even if correct, an objection against the ruling would create a pre-assessment legal controversy;

- (ii). there may be no contradictor, in that taxpayers may be unwilling to take on the cost and/or inconvenience of challenging the ruling. This argument is a little puzzling in light of the actual facts in *Indooroopilly*<sup>76</sup>; and
- (iii). review of rulings should be through the normal statutory Part IVC procedures of objection and appeal<sup>77</sup>. As a general point this may be true, but pursuit of the Part IVC procedures can be lengthy, costly, and inconclusive (as *Essenbourne* and *Pridecraft* showed), and courts have permitted taxpayers to use *s 39B* procedures in a range of cases;

Similarly, they argue that it will “usually be prudent” for the Commissioner not to seek a declaration until after issuing an assessment because (in addition to the factors above):

- (iv). “in the absence of some special reason” the specific objection and appeal; provisions in Part IVC should not be “displaced” by declaratory orders<sup>78</sup>. It might be argued that the avoidance of considerable delay and expense might be seen as a “special reason” in some circumstances; and
- (v). A declaration would move the onus of proof to the Commissioner contrary to *s 14ZZO* and *14ZZK TAA*<sup>79</sup>, and in any event might not resolve all issues between the taxpayer and Commissioner<sup>80</sup>. The first point should not be an insuperable

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<sup>75</sup> Bennett, Burmester and Hmelnitsky, above, 13-14: though “no doubt there is a dispute in a vernacular sense because the taxpayer and the Commissioner have different views about the operation of the law”.

<sup>76</sup> Above, 15

<sup>77</sup> Above, 16.

<sup>78</sup> Above, 17 – citing *Bob Jane T-Marts Pty Ltd v Commissioner of Taxation* (1999) 94 FCR 457.

<sup>79</sup> Above, 18.

<sup>80</sup> Above, 18-19 - citing *Commissioner of Taxation v ANZ Savings Bank Limited* (1994) 125 CLR 213.

barrier in pre-assessment situations, while the second is not unique to declarations (see above).

Perhaps the question of whether declaratory orders are available on the interpretation of taxation legislation should be tested by the ATO directly, and then – if it is found that there is no present power to make such orders – the government could, if it deemed it appropriate, introduce specific legislation to provide the power<sup>81</sup>.

**3.2. the precedent issue:** In relation to the Court’s criticism of the ATO’s failure to follow decisions of single Federal Court judges, Davies argues that the Commissioner is not bound to “apply immediately every statement of law adumbrated by a judge or judges. A decision of a court binds the parties but it does not bind either of the parties in other litigation with other people”.

Accordingly, Davies argues that if the Commissioner is advised that a judicial decision may be wrong and should be tested before a Full Court, but believes it cannot appeal in the present case or otherwise have the issue raised in appropriate litigation, sometimes the only way to achieve this may be for the ATO to issue assessments contrary to the interpretation applied by the single judge decisions – as it did in *Indooroopilly*<sup>82</sup>.

Davies’ views are interesting. Certainly, it is well established that a single judge of the Federal Court of Australia is bound by decisions of the Full Court, but *not* by decisions of other single Federal Court judges<sup>83</sup>, though ordinarily a single judge will follow a

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<sup>81</sup> Modelled perhaps on provisions such as *s 125 of the Patents Acts 1990 (Cth)* – which permits a person wishing to exploit an invention to make an application for a non-infringement declaration.

<sup>82</sup> Above, 632, 637. Compare Bennett et al (above) 3, 23, and especially 24 (para 70) – they support this view, provided the ATO “is open about its intentions” and as quickly as possible (i) “puts those affected on notice” that it considers the decision wrong and proposes not to follow/apply it, and (ii) proceeds to test the point (quoting the earlier 2005/2006 advice given to the ATO by the Solicitor-General and Chief General Counsel).

<sup>83</sup> *Minister for Immigration and Multicultural Affairs (MIMA) v Farahanipour* [2000] FCA 609 (Carr J); *Trade Practices Commission v TNT Management Pty Ltd* (1985) 1 FCR 172; *Telstra Corporation Ltd v Treloar* [2000] FCA 1170; Hill J in *Walstern* (above), quoted with apparent approval by Ryan J in *Cameron Brae* (above) 2006 ATC, 4454.

decision of a fellow single judge “unless convinced that the earlier judgment was wrong”

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However, while Davies is correct on the technical *stare decisis* issue, Bennett, Burmester and Hmelnitsky, while generally supporting the ATO’s approach, note that in the face of a series of decisions applying the same principle, “it will always be more difficult to justify a private ruling that ignores those decisions even for the purposes of a test case, and legislative change may be necessary”<sup>85</sup>.

In addition, Davies’ comments are arguably tangential to the point raised by Allsop and Edmonds JJ. It is extremely unlikely that all three eminent members of the Full Federal Court in *Indooroopilly* were unaware of the doctrine of precedent as it applies to a line of single Federal Court Justice decisions. The comments by Allsop and Edmonds JJ were directed rather to the issue of whether the ATO as part of the executive arm of government could simply choose not to apply a pronouncement of law by single Judges of the Federal Court until the Full Federal (or High) Court of Australia had ruled on it.

Put so baldly, this would be a startling proposition, and the ATO would be unlikely to support the (il) logical corollary that citizens should be equally free to disregard such Federal Court decisions where the taxpayer receives considered advice that a decision is arguably wrong.

Moreover, if the ATO seeks to challenge an established court decision, it should try to clarify the law as quickly as possible, rather than waiting for what the ATO might see as

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<sup>84</sup> *Burchett J in La Macchia v Minister for Primary Industries and Energy* (1992) 110 ALR 201, 204. Indeed, “while of the greatest persuasive authority” single High Court judges have been held not to bind a State Court of Appeal *Bone v Commissioner of Stamp Duties* [1972] 2 NSW LR 651, 664 (Hope JA); 654 (Jacobs P); *Businessworld Computers Pty Ltd v Australian Telecommunications Commission* (1988) 82 ALR 499, 504 (Fed Ct) Gummow J; cf *Appleton Papers Inc v Tomasetti Paper Pty Ltd* [1983] 3 NSWLR 208, 219 (McClelland J); *Perron Investments Pty Ltd v DFC of T* (1989) 90 ALR 1, 34 (Hill J).

<sup>85</sup> Bennett, Burmester and Hmelnitsky, above, 23.

the “strongest” case to support its interpretation<sup>86</sup>. Davies’ argument therefore loses some force in relation to *Indooroopilly* in light of the fact that the ATO did not have the point tested by the Full Federal Court two years earlier, when it had the opportunity to do so in *Pridecraft* (above). An outsider might interpret this as indicating that the ATO had sought to pick and choose the most favourable facts (to it) on which to test its view. Such an approach would be inappropriate in light of the obligation on the ATO to act as a “model litigant” (discussed below).

It should also be noted that by adhering to its unsupported view of the law – ultimately proven to be wrong - for several years, the ATO had exposed taxpayers during that period to the risk of wrongful assessments and penalties, and the ATO’s approach probably also deterred a number of honest taxpayers and advisers from using what turned out to be a perfectly legitimate tax minimisation technique.

A further issue raised by the decision in *Indooroopilly* is:

**VII HAS THE ATO MET THE REQUIREMENTS OF ACTING AS A “MODEL LITIGANT”  
IN RELATION TO *INDOOROOPILLY* AND OTHER CASES?**

Even if one were to accept the arguments offered by Davies and the ATO’s advisers, the history of the *Indooroopilly* litigation does not show the ATO in a particularly flattering light – especially when the ATO regularly exhorts taxpayers and advisers to obey the spirit as well as the letter of the law.

This issue is of considerable importance, because the appearance of fairness and transparency, and the confidence of taxpayers and advisers that the ATO is acting with integrity are – as the ATO has often acknowledged - essential to the encouragement of

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<sup>86</sup> Bennett et al, above, 2-3, 23, take a similar view.

voluntary compliance, which is in turn essential to the effective operation of the tax system<sup>87</sup>.

In any event, as an agency of the Federal Government, the ATO is required to act as a “Model Litigant”, and some may feel that in cases such as *Pridecraft* and especially *Indooroopilly* its actions may fall short of the very high standards required of a Model Litigant.

### VIII THE REQUIREMENTS OF A MODEL LITIGANT

The Model Litigant guidelines set out the requirements that governments and their agencies must observe in conducting litigation – they are in essence “best practice” requirements for public sector litigation.<sup>88</sup>

The Model Litigant requirements for federal bodies are contained in the *Legal Practice Guidelines on Values, Ethics and Conduct* issued by the Commonwealth Attorney-General in November 1995, under s 55ZF of the *Judiciary Act 1903* (Cth).<sup>89</sup>

The key requirements of a Model Litigant include requirements that the agency must:

- (1) act ... fairly in handling claims and litigation brought for or against the Commonwealth or its agency<sup>90</sup>; and in particular:
- (2) (a) deal with claims promptly and not cause unnecessary delay in the handling of claims and litigation ...;
- (c) act consistently in the handling of claims and litigation<sup>91</sup> ...;
- (g) not rely upon technical defences unless the government’s or agency’s interests would be prejudiced by the failure to comply with a particular requirement<sup>92</sup>; and

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<sup>87</sup> The ATO also clearly recognizes the crucial role played by tax advisers in mediating taxpayer conduct and maximizing voluntary compliance: see Woellner et al (above), 2040-41.

<sup>88</sup> Lee, above, 3; see also the other cases cited by Lee (above), 1, footnote 1.

<sup>89</sup> The genesis and content of the Commonwealth and Victorian guidelines are discussed by Lee (above), in “The State as Model Litigant” – see the references he cites at 15-16; compare Townsend M, “Should the model litigant rules apply to responsible and referral authorities in planning disputes”.

<sup>90</sup> Lee above, 9 – while he is writing in relation specifically to the Victorian guidelines, for present purposes they are essentially the same as the Commonwealth ones.

<sup>91</sup> Lee, above, 9.

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2007 Refereed Conference Papers**

- (h) not undertake and pursue appeals unless the government or its agency (as the case may be) believes it has reasonable prospects for success or the appeal is otherwise justified in the public interest<sup>93</sup>.

Note 3 to the requirements indicates that a Model Litigant must act in relation to litigation “with complete propriety, fairly and in accordance with the highest professional standards...”, while, Note 4 indicates that these obligations “may require more than merely acting honestly and in accordance with the law and court rules ... [and also go] beyond the requirement for lawyers to act in accordance with their ethical obligations”.

However, the guidelines do not prevent the Commonwealth and its agencies such as the ATO from “acting firmly and properly to protect their interests”<sup>94</sup>.

Overall, the Model Litigant requirements set “an extremely high bar to jump over”<sup>95</sup>, particularly as a Model Litigant is expected to comply with the spirit as well as the letter of the obligations<sup>96</sup>.

As noted earlier, the Inspector-General of Taxation identified in his 2006 Report a number of areas in which he concluded that the ATO had (or there was at least a community perception that it had) failed to meet the requirements of a Model Litigant. The failings identified by the Inspector-General included the ATO:

- (i) using litigation to confirm its view of the law for compliance purposes, rather than to clarify the law;
- (ii) declining improperly to follow decisions of courts or tribunals and thus in some cases acting outside the rule of law;
- (iii) lacking objectivity in its approach to litigation; and
- (iv) “strong” – and not entirely unjustified - community perceptions that the ATO’s approach and conduct were not consistent with the model litigant rules<sup>97</sup>.

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<sup>92</sup> Lee, above, 11.

<sup>93</sup> Lee, above, 11-12.

<sup>94</sup> Note 4 to the Guidelines.

<sup>95</sup> Lee, above, 9.

<sup>96</sup> *Wong Tai Shing v Minister for Immigration, Multicultural and Indigenous Affairs* [2002] FCA 1271 (Wilcox J).

<sup>97</sup> Report of the Inspector-General of Taxation (Mr David Vos) on *Review of Tax Office Management of Part IVC litigation* (above), Key Findings 4.1, 4.2, 4.3, 4.4, 4.6, 4.10, 4.13.

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2007 Refereed Conference Papers**

The ATO vigorously disputed each of these findings.<sup>98</sup>

Flowing from these perceived “flaws” in ATO litigious processes, the Inspector-General recommended among other things that the ATO should develop a practice statement, preferably of the status of a Taxpayer’s Charter, and publish in that statement its philosophy and approach to tax litigation, the Model Litigant requirements and the role of the Office of Legal Services Co-ordination in administering the guidelines<sup>99</sup>. The ATO responded by publishing in June 2007 a Practice Statement on its approach to litigation<sup>100</sup>.

It should be noted that a problem with the Model Litigant Rules is that they are only enforceable by the Commonwealth Attorney-General, and not by a taxpayer<sup>101</sup>. While Lee suggests that other accountability mechanisms could include the Auditor General, Parliamentary questions, the Ombudsman and the media<sup>102</sup>, these avenues are unlikely to provide taxpayers with adequate solutions in many cases.

It is submitted that, whatever the technical position in relation to precedent, declaratory orders and the like, the ATO should at all times act as a Model Litigant – even if at times this requires it to act in a way that does not fully exploit its technical position.

## **IX CONCLUSION**

The issue is not the integrity of the Commissioner of Taxation or his officers – I hold the Commissioner and the senior officers I have met in the very highest regard. It is not even a question of whether or not ATO in fact operates as a “law unto itself”, or – in one sense – whether it always satisfies the requirements of a Model Litigant.

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<sup>98</sup> Inspector- General Report, above, incorporating the ATO responses to Key Findings.

<sup>99</sup> Subsidiary recommendations 4.1, 4.2.

<sup>100</sup> PS LA 2007/12, “Conduct of Tax Litigation in Courts and Tribunals” (Issued and effective from 21 June 2007).

<sup>101</sup> *Judiciary Act 1903* (Cth), ss 55ZG (2), 55ZH (1) (3) - see Lee, above, 13-14.

<sup>102</sup> Lee, above, 14.

The overriding problem is that to a number of practitioners, the ATO **appears** to act inappropriately at times - as in *Indooroopilly*. That is, whatever the reality, there are clear **perceptions** among a significant group of tax professionals (and some members of the Bench) that the ATO acts at times in a high-handed manner which seems at odds with its public interest duty. This may reflect no more than excessive zeal by the ATO to protect the revenue and the community (as the ATO interprets these concepts), but it creates significant potential problems for the tax system.

Thus, even if the ATO's approach of not following decisions of single Federal Court judges in certain circumstances is *technically* correct, the way it has been handled over the past several years seems to have created a very negative perception, and sits uneasily with the ATO's obligations as a Model Litigant.

It is essential that these perceptions of the ATO (particularly among practitioners) be changed positively, in order to restore the confidence of the tax profession and the public in the ATO<sup>103</sup>.

This may simply require better communication, allied to a commitment to test all contentious points at the earliest reasonable point, rather than waiting for the "perfect wave". After all, presumably the court will interpret the law correctly whether or not the ATO believes that a particular fact situation is the most favourable possible to its argument. Delay in seeking clarification invites criticism by the community and by senior judges and imposes significant uncertainty and compliance costs on taxpayers and their advisers.

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<sup>103</sup> It is important not to over-estimate the damage caused by incidents such as *Indooroopilly* on the relationship between the ATO and its constituencies – according to ATO surveys, in 2006 some 73% of community respondents felt that overall, the ATO was doing a good job, while tax agent satisfaction with ATO services has also been high (though dipping a little in 2006): Commissioner of Taxation, *Annual Report 2005-06* above, 47-48 and 49-50 respectively.

This is a serious issue, because if the profession or the public lose faith in the transparency or integrity of the ATO or its practices, the current high levels of voluntary compliance may be imperiled. In turn, without widespread voluntary compliance, the effective operation of the overall tax system would be put at risk.

This Paper has considered possible approaches to remedying the current procedural problems.

It has been suggested that there is an arguable case for courts to provide declaratory remedies under the current statutory framework in situations such as *Indooroopilly* -, though on the case-law to date there appear to be significant barriers to the making of such offers in the tax context.

Perhaps the point needs to be tested directly. Then, if relief under provisions such as ss 21 and 39B is held not to be available to taxpayers in circumstances such as *Indooroopilly*, legislative amendment could be provided to expressly enable the taxpayer or Commissioner to seek declaratory or similar orders in limited circumstances<sup>104</sup> – such as those in *Indooroopilly* or perhaps *Young* - before an assessment or formal dispute arises thus saving considerable time, effort and expense.

It would be necessary to limit any such amendment appropriately, to avoid the declaratory remedy effectively replacing the Part IVC statutory review and appeal process otiose, but this could be achieved by defining the scope or timing of such relief.

Alternatively, the ATO could be required to ensure that it acts more quickly in future to clarify the law. This might be achieved through more rigorous enforcement by the Attorney-General of the Model Litigant guidelines or by exposing the ATO to litigious or

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<sup>104</sup> See note 99 above.

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2007 Refereed Conference Papers**

monetary “penalty” if it fails to do so. As a less desirable and more difficult option, perhaps there could be provision for a limited preliminary trial on the questions of law<sup>105</sup>.

However, the fundamental point is that the perception of unfairness in the ATO’s approach to litigation must be seen to improve. The ATO needs to be – and be perceived to be - acting as a Model Litigant in all circumstances. It must be beyond reproach.

The ATO’s new Practice Statement PS LA 2007/12<sup>106</sup> is a good start, but the ATO must live up to its role as a “model litigant” even in the heat of battle, and not act in ways that create or continue a perception – regardless of the reality - that it believes it is a “law unto itself”.

Time will tell.

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<sup>105</sup> Lee, above.

<sup>106</sup> PS LA 2007/12, above, see especially paras 2-4.