

# Speech to the City of Sydney Law Society Inc.

## *Key Issues in Challenging the Commissioners' Decisions*

Bryan Pape\*

*Nothing is certain but death and taxes.*

Benjamin Franklin

*There is no equity about a tax.*

Rowlatt J.

*Through the tax cases one could often gain a clear insight  
into the ways in which commerce actually works.*

Sir Owen Dixon

### **Introduction**

1. I propose to consider four issues and in doing so I draw upon the administration of our Federal and State revenue laws. They have application in other fields. First, who are the commissioners? Secondly, what type of decisions do they make, particularly those involving the exercise of a discretionary power. Thirdly, with respect to a discretionary power, is it subject to judicial review or is it one where the adjudicator can stand in the shoes of the Commissioner and do over again what the Commissioner did? Finally, what are some of the pitfalls to be avoided in challenging the Commissioners' decisions.

### **Who are the Commissioners?**

2. The Macquarie Dictionary defines *Commissioner* as someone commissioned to act officially. This authority is sourced either in the Executive or by the Legislature. For the Commonwealth, the Governor General has appointed a Commissioner of Taxation and three Second Commissioners.<sup>1</sup> The Commissioner has the general administration of the taxation laws. Since 14 December 1984 they can only be removed from Office on an address praying for their removal on the ground of *proved misbehaviour or physical or mental incapacity* being presented to the Governor-General by each House of Parliament in the same session of the Parliament.<sup>2</sup> This provision is virtually identical to s. 72 (ii) of the *Australian Constitution* which provides for the removal of Justices of

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<sup>1</sup> S. 4 *Taxation Administration Act 1953* (Cth), (TAA).

<sup>2</sup> S.6C(1) *Taxation Administration Act 1953* (Cth), inserted by Act No. 123 of 1984.

the High Court and other Federal courts on the grounds of *proved misbehaviour or incapacity*. The Chief Executive Officer of Customs is also liable to be removed on the same grounds.

3. Other than for the fact that their term of appointment is for 7 years the Commissioner of Taxation has the same degree of independence as a High Court Justice. Where the latter is both immovable and infallible, the former are immovable so long as the TAA remains unamended. In short, it is difficult, if not impossible, for Government to interfere with the way the taxation laws are administered. As such the implementation of some contentious policies might go unchallenged. Yesterday it was reported that ‘company boards will be expected to sign off from July on an Australian Taxation Office schedule disclosing borderline tax positions’.<sup>3</sup> Because the *Income Tax Assessment Act 1997* (Cth) takes its stand at midnight on 30 June, it seems difficult to justify the Commissioner intruding into a taxpayers affairs before any return of income is lodged. Nevertheless, for the 2012 year of income it is proposed that corporations will be obliged to include in their returns a schedule which disclose material positions ‘that are less likely or about as likely to be correct or incorrect’. Is this a purpose of the Act? It smacks of more of the *in terrorem* approach to tax administration. As Thomas Jefferson said, *it is better to keep the wolf out of the fold than to trust to drawing his teeth and claws after he shall have entered*.<sup>4</sup> I leave for another day how this obligation on the Directors might affect the relationship at law between the Board and the CEO.
4. With respect to the Commissioner conducting random tax audits that policy was effectively sanctioned by the majority of the High Court in *Industrial Equity Limited v Deputy Commissioner of Taxation*:

*It is true that the Commissioner offered no reason as to why the category of the top 100 companies had been chosen. It is not hard to imagine that the activities of a particular group of taxpayers might give rise to concern on the part of the Commissioner that their affairs call for examination with a*

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<sup>3</sup> Katie Walsh, ‘Big business forced to reveal tax positions’, *The Australian Financial Review*, 12 April 2011 at p.3.[ C.f. Schedule 25A with respect to overseas transactions and transfer pricing.]

<sup>4</sup> Thomas Jefferson, ‘Notes on Virginia; The Writings of Thomas Jefferson’ at p.165 as cited in Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution*, (1980).

*view to determining whether their returns or assessments truly reflect the taxable income of the taxpayers concerned. It may appear, for instance, that they are engaged in an unusual form of commercial transaction apparently designed to avoid the production of assessable income or that a type of deduction claimed by taxpayers in the particular group seems unduly high when compared with a similar deduction claimed by other taxpayers. On the other hand, it may be no more than that a particular group is capable of ready identification for audit purposes. In either event it is likely that the number of taxpayers in the group in question is such that an inquiry into the affairs of all of them is impracticable. In those circumstances, the selection of some taxpayers for "audit" may be random but nevertheless be for the purposes of the Act. The Commissioner was conducting an "audit" into the affairs of I.E.L. and its associated companies for a recent period of four years.<sup>5</sup>*

5. A policy of the random auditing of taxpayers seems to be justified as an exercise in verification of what had been previously lodged with the Commissioner to satisfy the criterion for a purpose of the Act. Whether the disclosure of 'borderline tax positions' fails to answer the description of a purpose of the Act is arguable. Dissenting in the *IEL* case, Gaudron J. remarked:

*There is a difference between, on the one hand, a "roving enquiry" undertaken for the purpose of determining whether an assessment should be made or amended and, if so, the making or amending of that assessment, and, on the other hand, a "roving enquiry" undertaken with a view to doing one or more of those things should some matter be revealed in the course of the enquiry. In the former situation the enquiry is at all stages attended with a purpose of the Act. In the latter, some such purpose may be formed during the course of the enquiry but, unless and until it is formed, there is no purpose other than that of ascertaining whether some revelation touching the taxpayer's income or liability will emerge. That does not of itself constitute a purpose of the Act for until some matter is thus revealed no purpose of the Act can be served. As no other purpose can reasonably be*

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<sup>5</sup> (1990) 170 CLR 649 at para. [24]

*ascribed to the policy decision to audit "the top one hundred companies" and as the policy decision ultimately identifies the sole purpose of the audit undertaken with respect to IEL and its associated entities and, hence, the sole purpose of the decisions to exercise the right of access and the power to require the production of documents, those last decisions must be held not to have been made for a purpose of the Act.*<sup>6</sup>

6. In NSW there is a Chief Commissioner,<sup>7</sup> whose primary role is the Executive Director of the Office of State Revenue. Unlike the Commonwealth, the State Chief Commissioner appears to be employed under the *Public Sector Employment and Management Act 2002* (NSW). While Judges of the Supreme Court are liable to be removed<sup>8</sup> on the same grounds as their Federal counterparts, the Chief Commissioner does not appear to have the benefit of such a stringent provision.

### **Types of decisions.**

7. The primary decision is the assessment. With respect to the income tax laws it is primarily taxpayers themselves who self assess. The Commissioner's assessment is invariably an amended assessment arising from an audit of a taxpayer's affairs. Sometimes it is a primary assessment where the taxpayer has failed to lodge a return of income. There the Commissioner is authorised to make a judgment of the taxable income.<sup>9</sup> That judgment is usually based on an increase in the net assets between the end and the start of the year of income adjusted by an estimate of the taxpayer's private expenditure. Transfer pricing assessments aimed at stopping international profit shifting also provide for an exercise of the Commissioner's judgment of the taxable income.<sup>10</sup> Another example is the Commissioner's decision to apply the anti-avoidance provisions set out in Part IVA. There are a multitude of other decisions ranging from extensions of time to pay or time to lodge returns, to payments of liabilities by instalments and to the exercise of discretionary powers.

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<sup>6</sup> Ibid at para . [19] .

<sup>7</sup> S.60 *Taxation Administration Act 1986* (NSW).

<sup>8</sup> S.53 (2) *Constitution Act 1902* (NSW).

<sup>9</sup> S.167 *Income Tax Assessment Act 1936* (Cth)

<sup>10</sup> Division 13, *Income Tax Assessment Act 1936* (Cth), s.136 AD

8. Provision is made under Part IVC of the *Taxation Administration Act 1953* (Cth) for excessive assessments to be objected against.<sup>11</sup> Dissatisfied taxpayers can then have the Commissioner's decision on the objection reviewed by either the Administrative Appeals Tribunal or the Federal Court. Where the assessment involves the exercise of a discretionary power, particularly where a remission is sought to reduce a penalty it is important to correctly decide where to go.

**Discretionary powers.**

9. Discretionary powers cannot be exercised arbitrarily or capriciously. They must be exercised reasonably. The *Administrative Decisions (Judicial Review) Act 1977* (Cth) (the ADJR Act) lists a number of factors to be taken into consideration in reviewing judicially whether a power has been improperly exercised. A non-exhaustive list is provided by s.5(2):

- (a) *taking an irrelevant consideration into account in the exercise of a power;*
- (b) *failing to take a relevant consideration into account in the exercise of a power;*
- (c) *an exercise of a power for a purpose other than a purpose for which the power is conferred;*
- (d) *an exercise of a discretionary power in bad faith;*
- (e) *an exercise of a personal discretionary power at the direction or behest of another person;*
- (f) *an exercise of a discretionary power in accordance with a rule or policy without regard to the merits of the particular case;*
- (g) *an exercise of a power that is so unreasonable that no reasonable person could have so exercised the power;*

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<sup>11</sup> See also Draft Ruling TR2010/D10 *Income Tax Objections Against Income Tax Assessments*, Issued 15/12/2010.

(h) *an exercise of a power in such a way that the result of the exercise of the power is uncertain; and*

(j) *any other exercise of a power in a way that constitutes abuse of the power.*

10. The nub of the issue is of course, proof. Where do you find the evidence to establish such a claim? Fortunately s.13 of the ADJR Act comes to the aid of the applicant. Here the decision maker within 28 days is required *to furnish a statement in writing setting out the findings on material questions of fact, referring to the evidence or other material on which those findings were based and giving the reasons for the decision.*
11. A corresponding provision is found in s. 49 of the *Administrative Decisions Tribunal Act 1996* (NSW). Last month a discussion paper on the *Reform of Judicial Review in NSW* was released by the NSW Department of Justice and Attorney General. It can be found on the Department's website.<sup>12</sup>
12. So for the present in NSW, a plaintiff seeking judicial review of the exercise of a discretionary power must rely on declaratory relief under s 75 of the *Supreme Court Act 1970* (NSW) and injunctive relief under s. 66 or the former prerogative writs of mandamus and prohibition under s.69.

### **Judicial Review or Executive Review**

13. One of the difficulties of Acts like the ADJR Act is that Parliament has the power to exempt a range of decisions from judicial review. A good illustration is the decision of the Commissioner of Taxation in reviewing an objection against an amended assessment of income tax which involves the Commissioner exercising a discretionary power. Here the ADJR Act exempts review of this decision because Part IVC of the *Taxation Administration Act 1953* (Cth) provides a complete remedy.<sup>13</sup>
14. Judicial review will not provide satisfactory relief in some instances. If the decision maker has properly taken into account factors **a, b and c** to produce result **x**, such a decision, of itself, is not amenable to judicial review. If it is contended that having taken into account factors, **a, b and c**, the result which should have been produced is **y**, then

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<sup>12</sup> [http://www.lawlink.nsw.gov.au/lawlink/legislation\\_policy/ll\\_lpd.nsf/vwFiles/Reform\\_of\\_Judicial\\_Review\\_in\\_NSW\\_Discussion\\_Paper.pdf/\\$file/Reform\\_of\\_Judicial\\_Review\\_in\\_NSW\\_Discussion\\_Paper.pdf](http://www.lawlink.nsw.gov.au/lawlink/legislation_policy/ll_lpd.nsf/vwFiles/Reform_of_Judicial_Review_in_NSW_Discussion_Paper.pdf/$file/Reform_of_Judicial_Review_in_NSW_Discussion_Paper.pdf)

<sup>13</sup> S.3 and para (e) of Schedule 1.

calling in aid the judicial power of the Commonwealth would be futile. What is required is a re-exercise of the executive power of the Commonwealth. That is work for the Administrative Appeals Tribunal, which is an arm of the executive not the judiciary. (Here the Presidential Members of the Tribunal, being Judges of the Federal Court are exercising the executive power of the Commonwealth and not its judicial power). As Kitto J. said,

*(Its function is merely to do over again (within the limits of the taxpayer's objection) what the Commissioner did in making the assessment - not to give a decision affecting the taxpayer's legal situation, but to work out, as a step in administration, what it considers that situation to be. The Board is "in the same position as the Commissioner himself", as the Privy Council said in Shell Co. of Australia Ltd. v. Federal Commissioner of Taxation (1931) AC 275, at p 298; (1930) 44 CLR 530, at p 545 . It is "only another executive body in an administrative hierarchy":*<sup>14</sup>

In short, Commonwealth Administrative Tribunals like the AAT 'stands in the shoes of the Commissioner' to do over again what the Commissioner did. Hopefully for the dissatisfied taxpayer, in the present illustration, to produce result y rather than x.

15. In matters involving the executive of the Commonwealth it is important to keep in mind the limitations placed on the review of administrative decisions, because of the doctrine of the separation of powers between the judiciary and the executive as held in the *Boilermakers case*.<sup>15</sup> In *Commissioner of Taxation v Jackson*<sup>16</sup> the Commissioner sought to rely on Part IVA of the *Income Tax Assessment Act 1936* (Cth) (the general anti-avoidance provisions). The application was rejected on the grounds that it have required the Court to make an executive determination to include an amount in the taxpayer's assessable income.

### **The Separation of Powers Doctrine in NSW**

16. Disputes with respect to revenue legislation on NSW are governed by Part 10 of the *Taxation Administration Act 1996* (NSW) (TAAN). Three of the most common revenue

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<sup>14</sup> *Mobil Oil Australia Pty. Ltd. v. Federal Commissioner of Taxation* (1963) 113 CLR 475 at p.503.

<sup>15</sup> *R v Kirby; Ex parte Boilermakers' Society of Australia ("Boilermakers' case")* (1956) 94 CLR 254

<sup>16</sup> (1990) 27 FCR 1

laws<sup>17</sup> which are most likely to give rise to objections against the excessiveness of assessments of tax are:

- The *Duties Act 1997* (NSW);
- The *Land Tax Management Act 1956* (NSW); and
- The *Payroll Tax Assessment Act 1997* (NSW).

Taxpayers have 60 days to lodge an objection with the Chief Commissioner against an assessment of tax.<sup>18</sup> If dissatisfied with the Chief Commissioners decision on the objection they can seek a review<sup>19</sup> of the decision before the Administrative Decisions Tribunal<sup>20</sup> or can apply for a review before the Supreme Court<sup>21</sup> and is treated as an appeal under the *Supreme Court Act 1997* (NSW).

17. Importantly the powers of the tribunal and the court on a review are as follows:<sup>22</sup>

*(1) The court or tribunal dealing with the application for review may do any one or more of the following:*

*(a) confirm or revoke the assessment or other decision to which the application relates,*

*(b) make an assessment or other decision in place of the assessment or other decision to which the application relates,*

*(c) make an order for payment to the Chief Commissioner of any amount of tax that is assessed as being payable but has not been paid,*

*(d) remit the matter to the Chief Commissioner for determination in accordance with its finding or decision,*

*(e) make any further order as to costs or otherwise as it thinks fit.*

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<sup>17</sup> S.4 TAAN

<sup>18</sup> S.86 TAAN

<sup>19</sup> S.96 TAAN

<sup>20</sup> Revenue Division of the ADT

<sup>21</sup> S.97 TAAN

<sup>22</sup> S. 101 TAAN

18. It is noteworthy that paragraph (b) purports to give the power to the Court to make an assessment, which is an executive act. This need to be contrasted with the Federal Court which has no such power because of the doctrine of the separation of powers. The preferable course would be to remit the matter to the Chief Commissioner for determination in accordance with the Court's finding. What follows here is that Court appears to be able to stand in the shoes of the Chief Commissioner or administrator to do over again what they have done.
19. If State Supreme Courts are subject to supervision as Chapter III Courts as seems to have been held in *Kirk v Industrial Court*,<sup>23</sup> then the doctrine of the separation of powers would apply to deny the State Courts from exercising the discretionary power of the Chief Commissioner. To this extent s. 17(1)(b) above would be invalid because it would be tantamount to the exercise of executive power. See also *Chief Commissioner of State Revenue v Tasty Chicks Pty. Ltd.*<sup>24</sup> where the Court of Appeal held that on an appeal from the ADT, it was an appeal in the nature of judicial review and there was no warrant for it to re-exercise the Commissioner's discretion.

The majority judgment in *Kirk* observed:

*At a State level that distinction [between courts and administrative tribunals] may not always be drawn easily, for there is not, in the States' constitutional arrangements, that same separation of powers that is required at a federal level by Chapter III of the Constitution. No less importantly, behind the conclusions expressed in Craig lie premises about what is meant by jurisdictional error.*<sup>25</sup>

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***In considering State legislation, it is necessary to take account of the requirement of Ch III of the Constitution that there be a body fitting the description "the Supreme Court of a State", and the constitutional corollary that "it is beyond the legislative power of a State so to alter the***

<sup>23</sup> (2010) 239 CLR 531, [2010] HCA 1

<sup>24</sup> [2010] NSWCA 326. (An application for special leave to appeal to the High Court has been filed).

<sup>25</sup> (2010) 239 CLR 531 at para [69]

*constitution or character of its Supreme Court that it ceases to meet the constitutional description.*"<sup>26</sup> [My emphasis]

.....

*The supervisory role of the Supreme Courts exercised through the grant of prohibition, certiorari and mandamus (and habeas corpus) was, and is, a defining characteristic of those courts. And because, "with such exceptions and subject to such regulations as the Parliament prescribes", s.73 of the Constitution gives this Court appellate jurisdiction to hear and determine appeals from all judgments, decrees, orders and sentences of the Supreme Courts, **the exercise of that supervisory jurisdiction is ultimately subject to the superintendence of this Court as the "Federal Supreme Court"** in which s71 of the Constitution vests the judicial power of the Commonwealth.*<sup>27</sup> [My emphasis]

.....

*There is but one common law of Australia. The supervisory jurisdiction exercised by the State Supreme Courts by the grant of prerogative relief or orders in the nature of that relief is governed in fundamental respects by principles established as part of the common law of Australia. **That is, the supervisory jurisdiction exercised by the State Supreme Courts is exercised according to principles that in the end are set by this Court.** To deprive a State Supreme Court of its supervisory jurisdiction enforcing the limits on the exercise of State executive and judicial power by persons and bodies other than that Court would be to create islands of power immune from supervision and restraint.*<sup>28</sup> [My emphasis]

.....

*Rather, the observations made about the constitutional significance of the supervisory jurisdiction of the State Supreme Courts point to the continued need for, and utility of, the distinction between jurisdictional and non-jurisdictional error in the Australian constitutional context. The*

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<sup>26</sup> Ibid, at para [96]

<sup>27</sup> Ibid at para [98]

<sup>28</sup> Ibid at para [99]

*distinction marks the relevant limit on State legislative power. Legislation which would take from a State Supreme Court power to grant relief on account of jurisdictional error is beyond State legislative power. Legislation which denies the availability of relief for non-jurisdictional error of law appearing on the face of the record is not beyond power.*<sup>29</sup> [My emphasis]

### **Some Pitfalls to be Avoided**

20. Recently the *Civil Dispute Resolution Act 2011* (Cth) was passed by the Commonwealth Parliament. The operative parts are yet to come into force. Essentially it provides that an applicant who institutes civil proceedings in an eligible court must file a ***genuine steps statement*** at the time of filing the application.<sup>30</sup> This statement must specify the steps that have been taken to try and resolve the issues in the dispute. Correspondingly the respondent must file a genuine steps statement in answer before the first hearing date.<sup>31</sup>
21. Care needs to be taken in drafting objections. If there is no new material included then it is likely that the objection will be disallowed. In framing the objection, the issues need to be identified, and evidence marshalled to support succinct submissions. It is often useful to split the objection into Parts, e.g. Part 1 - Facts, Part II – Issues and Part III – Contentions. Of course a Chronologies of Events and Documents are always helpful and should be included as Annexures. Time spent in drafting accurate objections is never wasted. It is the precursor to the preparation of an advice on evidence for a review if the objection is disallowed. Here too witness statements should be taken as early as possible.

### **Conclusion**

22. United States Chief Justice Marshall's dictum that the, *the power to tax involves the power to destroy*<sup>32</sup> is worth recalling to remind ourselves of the importance of the proper enactment and administration of the taxation laws. I cite *Austin v Commonwealth*<sup>33</sup> as a

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<sup>29</sup> Ibid at para [100]

<sup>30</sup> S.6(1)(2)

<sup>31</sup> S. 7(1)(2)

<sup>32</sup> *McCulloch v Maryland* 17 US 316 (1819) at 431.

<sup>33</sup> (2003) 215 CLR 185 at para. [8].

regrettable, Australian illustration of this phrase. Gleeson C.J. in stating that unreasonableness is not a ground for the invalidity of a tax described the predicament which the plaintiff found himself:

*If he remains in office until the age of compulsory retirement, 72, his accumulated superannuation surcharge debt will be \$550,780, and he will be entitled to a gross annual pension of \$267,433. Allowing for income tax on the pension, it will take approximately four years before his net pension receipts equal his surcharge liability; a liability he will have to discharge at the time he commences to receive the pension.*

23. In summary, there are three key issues in successfully challenging the Commissioners' decisions:

- First, there is a need for a clear, concise and correct notice of objection against the excessiveness of the assessment;
- Secondly, there is a requirement to choose the Court or Tribunal to give the best remedy if the taxpayer is dissatisfied with the Commissioner's decision in disallowing the objection. The salient factors are usually confidentiality, (the AAT can order that the proceedings be heard in private<sup>34</sup>), re-exercising of discretionary powers and not being exposed to an order for costs.
- Thirdly, the use of alternative dispute resolution procedures like mediation, case appraisal and neutral evaluation ought to be considered.

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13 April 2011

[3958 Words]

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<sup>34</sup> S.35(2) *Administrative Appeals Tribunal Act 1975* (Cth)