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# DOWN WITH HUBRIS! A MESSAGE ON TAX REFORM FOR AUSTRALIAN TAX SPECIALISTS

The Institute of Chartered Accountants in Australia
National Tax Conference,
Melbourne, 7 April 2011

The Hon. Michael Kirby AC CMG

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## THE MEANING OF MEANING

When pressed for a title for these words, to such a distinguished audience of experts on tax law and practice, I naturally thought of the most upsetting, objectionable and insulting thing I had ever suggested about you, in the course of my quarter century of appellate judicial service. Nothing like an insult or tow by a keynote speaker to get the audience's adrenalin running at an early hour in the morning.

In 2000, in Federal *Commissioner of Taxation v Ryan*[1], I said:

> "It is *hubris* on the part of special[ists] ... to consider that 'their Act' is special and distinct from general movements in statutory construction which have been such a marked feature of our legal system in recent decades. The *Income Tax Assessment Act* 1936 (Cth) is not different in this respect. It should be construed, like any other federal statute, to give effect to the ascertained purpose of the Parliament."

This was a theme – the danger of *hubris* – to which I returned over and over again in the course of my judicial reasoning. It was not confined to

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* Past Justice of the High Court of Australia (1996-2009); Board Member, Australian Centre for International Commercial Arbitration (ACICA) (2010-); Member, Arbitration Panel, International Committee for Settlement of Investment Disputes (ICSID) of the World Bank (2010-).

1 (2001) 201 CLR 109 at 146 [84].

tax law. But because of the amount, duration and complexity of that field of law (not to say its commercial importance and the large sums of private and public moneys it affected), the charge of *hubris* had a special resonance for professional work in the field of taxation.[2]

In the course of their practice, some lawyers, accountants and other professionals, range over a wide field of law. However, the very particularities of tax law are such that they tend to get hived off to specialists who rejoice in spending their lives examining, reflecting upon and dissecting the interstices of our increasingly complex taxation legislation. Not for you, for the most part, the shambolic factual line drawing that masquerades as the modern law of tort, particularly negligence. Nor the dreamy spires of great political concepts that lay in wait to be revealed to those who engage with the joys of constitutional adjudication. Tax is hard because it is detailed, complicated and imports precise notions of commercial and property law, in part ancient and, in part, constantly evolving. Because tax law is hard, it needs, and attracts, fine minds and precise ways of thinking. Those who want an easy life of vague generalities in the law and practice, need not apply.

Before returning to my insult, I therefore pay a softening tribute to the sharp intellects that devote their lives to taxation law and practice. One might find a greater collection of sheer human brain power in a conference of nuclear physicists, genome computerists or nano-technologists. But in legal and accounting circles, there are unlikely to be audiences of higher average talent than found in tax. For one reason or another, tax practitioners have distained the Elysian fields for lives of precise concentration and detailed analysis. You deserve, and I offer

[2] See e.g. *Steele v Federal Commissioner of Taxation* (1999) 197 CLR 459 at 477 [52].

you, the community's respect. However, this falls short of affection because of the deep resentment that tends to collect equally around the very thought of paying money either to the Australian Taxation Office or to tax advisers.

My grand remonstrance of *hubris* sounded fine when I put it on paper. To tell the truth, it was probably targeted at my colleagues who were obtuse enough to resist the force of my reasoning in *Ryan's Case* (concerning a 'nil taxation' return), more than to the rank and file of tax and accounting professionals. But whether deserved or not in the particular instance, there is justification in alerting specialists to the dangers of getting too close to the assumptions, traditions, settled practices and usual ways of thinking that tend to accumulate in the specialist life. To get through busy days, it is natural, even necessary, to reduce as much as possible the application of clear rules (including rules of thumb) and settled ways. I make no complaint about that so long as the mind of the expert is constantly alert to the possibility of error; of exceptions; of invitations to new ways of thinking; and rejection of established ways that has become encrusted with the barnacles of the past.

In a way, the Australian Constitution imposes on any discipline which is connected with the application of law, a discipline of fresh thinking. This is because of the fact that the Constitution establishes the principle of the rule of law[3]. Ultimately, where you have the rule of law, you commit the last word about what it requires, in particular cases, to a judicature of independent officials, called judges. They operate within a hierarchy, bound by appellate procedures and traditions. They comply with

[3] *Australian Communist Party v The Commonwealth* (1951) 83 CLR 1.

approaches to decision-making declared or established by the hierarchy of courts: ultimately in this country, by the High Court of Australia.

This means that important decisions, especially of basic doctrine or legal principle, get to be made, ultimately, by a very small group of men (now including women) who are not, and cannot be, specialists in *every* field of law that comes before them. The Australian Constitution postulates that the final court will have the special responsibility of supervising every conceivable area of legal decision-making. Most especially, of interpreting and upholding the meaning of the Constitutions of the Commonwealth and of the States, and giving effect to the whole body of public law, by which our country is governed.

In the past, it has been traditional for the Justices of the High Court of Australia to include lawyers who have had years of practice in tax law. That was a special need during most of the twentieth century when the High Court was effectively the final tax court of appeal for most revenue cases. Today, that is no longer so in practice, because of the introduction of the universal procedure for special leave to appeal to open the doors of the High Court. Most tax cases now stop, and should stop, in the Full Court of the Federal Court[4]. The specialist skills that are required for a highly proficient revenue practitioner will not necessarily be the preferred (certainly not the only) qualification for the nuanced functions of interpreting the Constitution and giving it meaning for the peace, order and good government of the Commonwealth and its people.

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[4] *Paul Soneco (No.87) Pty Ltd v Commissioner of Taxation* (1993) 93 ATC 4828 at 4828 per Brennan J; *Federal Commission of Taxation v Westfield* (1992) 22 ATR 400 at 402. See also D.G. Hill, "What Do We Expect From Judges in Tax Cases?" (1995) 69 ALJ 992 at 999.

Plagued by latter-day doubt, I questioned my mind as to whether my charge of *hubris* was really fair: after all, no tax specialist had ever written to claim unique talent across the whole horizon of the law. What did *hubris* mean? This took me into the great dictionaries of our language, starting with Dr. Samuel Johnson's *Dictionary of the English Language* (1979) (a thoughtful gift which I treated on capital account for an earlier speech given in Melbourne).

Alas, the word did not appear in that dictionary, although the vulgar Anglo-Saxon neighbouring word "hubbub" was there from Milton's *Paradise Lost*[5]. In all probability, the word *hubris* was omitted because, in those halcyon days, everyone who was learned knew the Greek original, a fact that probably also explains the omission of the word from the *Shorter Oxford English Dictionary*, first published in 1933[6]. That work acknowledged "hubristic", recognised as an English word a century earlier, derived from the Greek *hybristic* meaning "insolent, contemptuous". It was necessary to invoke the *Macquarie Dictionary of Australian English*[7] to elicit the extra meaning that the word *hubris* enjoys as a noun in ordinary Australian usage today, namely "insolence ... *stemming from excessive pride*". At its source, this was the human fault attributed by the Ancients to Icarus who, thinking humans were equal to gods, flew too close to the sun, occasioning a sudden plunge to earth as his punishment.

Can I really say that Australian tax specialists portray a fault so gross? With the wisdom of hindsight, the word was probably excessive to the idea I was trying to communicate. This was no more than that

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5 Dr. Johnson's Dictionary refers to this word appearing in *Paradise Lost* by John Milton, b2.

6 Volume 1, p930 (1933) as reprinted 1965, 3rd edition reprint.

7 Federation Edition, 2001, Vol.1, 924.

specialists need constantly to be on their guard against an inflexibility of thinking and to be open to fresh ideas. That injunction is the text for these remarks. A merit of judicial retirement, at least for some, is that it encourages scholars and other pundits to pour over one's life[8] or over one's judicial reasons and writings[9]: seeking to make sense of it all. This is so although we all know, in our private cogitations, that absolute logic and consistency are rarely achieved in the messy business of a human lifetime, including in its professional endeavours.

In a book about my judicial reasoning published in 2010, I learned that, as President of the New South Wales Court of Appeal, I participated in about 20 cases relating to tax law, the majority concerned with New South Wales stamp duty, land tax and the (now abolished) death duties. During my 13 year service in the High Court of Australia, I sat on almost all the tax cases decided during that term, about 50 in all, three-quarters of which concerned income tax[10].

I was relieved to find that the examination led Professor Miranda Stewart to conclude that I was not over all either a "Commissioner's judge" or a "taxpayer's judge". Certainly, my opinions indicated that protection of the revenue from extraneous attack was an important consideration[11]. Still, my conclusions in the Court of Appeal were judged even in respect of both sides.

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8 See A.J. Brown, *Michael Kirby: Paradoxes/Principles* (Federation Press, Sydney, 2011).

9 I. Freckelton and H. Selby (Eds), *Appealing to the Future: Michael Kirby and his Legacy* (Thomson Reuters, Lawbook Co, 2009), esp. at 797.

10 Miranda Stewart, Ch.31 "Tax" in Freckelton above n9, 798.

11 See e.g. *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* (2006) 228 CLR 168 at 198 [86]; *Federal Commissioner of Taxation v Murry* (1998) 193 CLR 605 at 632 [77].

In the High Court, including in dissent, over all, I was found to have decided more decisions for the revenue than for the taxpayer. This was most strikingly so in income tax cases where the ratio was about one-third for the taxpayer and two-thirds for the Commissioner. However, Professor Stewart softened that blow by pointing out that my ratio was exactly the same as that of the overall record of the High Court on income tax appeals in recent years[12]. So I suppose I can take some comfort in this retrospective knowledge. Of course, at the time of decision-making, one never thinks: 'Well, I'd better find this one for such-and-such a side to even up my score'. Judges of our tradition, as I myself did, simply seek to reach the right conclusion on the accepted evidentiary basis: applying the Constitution and laws as they best understand them to be. We may like or dislike what the judges decide in Australia. But at least we know that both the law and eight centuries of tradition and history discipline the minds of those with the last say to ensure that they avoid preconceptions; that they know or find the applicable law; and that they resist all external pressures or suggestions which are commonplace in many other countries.

As befits a final court, there was a fair sprinkling of dissenting opinions in my record. And there were also many joint or concurring ones. Writing separately is a burden to be avoided unless the outcome or reasoning of one's colleagues is unacceptable to conscience. The High Court of Australia is not Tammany Hall where deals are done: such as 'you vote for me this time, and I'll scratch your back next time'.

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[12] The Inspector-General of Taxation, *Report on Review of Tax Office Management of Part IVC Litigation* (28 April 2006), p35, sets out statistics on tax decisions of the Federal Court, Full Federal Court and High Court in the 2003-4 year. The High Court ratio was 3:1 in favour of the Commissioner, while in all other courts the ratio was at least 2:1 in favour of the Commissioner and sometimes higher. As Professor Stewart points out, *ibid* 799, n8, it is important to note that most tax disputes are settled through administrative processes, the majority in the taxpayer's favour and a significant proportion of appeals are settled before trial. *Ibid*, 35.

The very nature of a final court, in particular, is that it accumulates a great history. It (now) only tends to get significant cases. Many of them chosen for special leave are cases where there has been a dissent in the courts below. Most appeals should not be there if the law and justice of the case are cut and dried and if there is no legitimate argument or point of view for the side that eventually loses.

Everyone in this audience will know that many, or most, of the decisions on tax law that reach our highest courts are reasonably disputable with arguable propositions that support the other side. This proposition was expressed rather bluntly by David Bloom QC in a recent paper presented to the Taxation Institute of Australia in which he described the High Court's decision in *City Link*[13] (in which I dissented) as "Taxpayers' heaven" and *McNeill*[14] (in which I did not participate) as "The opposite of heaven"[15]. Although he was the losing counsel in the latter case, seemingly he could not bring himself to describe the outcome as "hell". Presumably, the interminable and ultimately unsatisfying reasoning assigning receipts to income or capital account did not classify as worthy of the deepest netherworld. Rather it was something more like purgatory or limbo (assuming that the latter still exists).

## PURPOSIVE CONSTRUCTION

Going in detail through the decisions in which I took part in the High Court, although doubtless comforting to myself, would hardly be a beneficial use of your time. Instead, I have chosen to identify two large themes that run through my judicial reasoning and to conclude with two

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13 *Federal Commissioner of Taxation v City Link Melbourne* (2006) 228 CLR 1.

14 *Federal Commissioner of Taxation v McNeill* (2007) 229 CLR 656.

15 D. Bloom, Paper presented to the Taxation Institute of Australia, 52nd conference, Hobart, 2007.

general thoughts. The themes are stimulated, in part, by Justice Tony Pagone's excellent recent article on a judicial perspective for legislating for economic concepts. My closing thoughts are stimulated by the 2010 Melbourne Tax Lecture by Justice Richard Edmonds on tax reform[16]. I commend both of these essays to your attention. Each is written by experienced judges who were outstanding advocates who appeared before me as advocates, and who now serve the community as judges, deciding difficult cases.

My first particular point is to suggest once again the importance of re-aligning the approach of the courts to the interpretation of taxation legislation in a way that more closely coincides with the contemporary approach of the courts to the interpretation of legislation generally.

Early in the twentieth century, as acknowledged by the High Court of Australia, the approach of Australian judges to taxation legislation was largely a carbon copy of the 'literalist approach' adopted at that time by judges in England[17]. The judges who embraced this approach were not lackeys of the ruling or propertied classes, although the clearest exposition of the approach in England was probably in an important case involving the Duke of Westminster, possibly the largest and most noble landowner in the kingdom[18]. Instead, they were following an approach to the interpretation of revenue legislation devised by English judges over the centuries. It was one that could be justified in moral and quasi-political terms.

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[16] T. Pagone, "Some Problems in Legislating for Economic Concepts – A Judicial Perspective", unpublished paper deliver to the Federal Treasury on 2 December 2010 in a Revenue Group Seminar Series.

[17] R. Edmonds, "Judicial Perspective on Tax Reform" to be published in (2011) *Melbourne University Law Review* (forthcoming.

[18] See e.g. *Internal Revenue Commissioners v Duke of Westminster* [1936] AC 1. See Stewart, above n10, 805

At the time the approach was adopted, the English (and later United Kingdom) Parliament was not really representative of the whole citizenry of the country. That fact is unlikely to have greatly troubled their Lordships, because neither were they representative. And, in any case, most of the citizens did not pay tax to the revenue in those days, unless it was in the form (common enough from medieval times) of import duties and other indirect taxes.

The English were constitutionally jealous of tax-raising. Historically, they became resistant to handing too much power to the profligate Crown, which often squandered its revenue on unpopular wars. Adopting a strict approach to tax legislation was therefore consistent with both history and constitutional principles as well (if they thought of it) as placing a check on the still basically unrepresentative legislature of those times. If Parliament, for whom the judges may long have harboured an elitist contempt, wanted to impose taxes on people such as themselves, they had to do so in plain terms. They had to express it clearly. They had, in short, to spell it out in unmistakable language. In part, this was not an approach to interpretation confined to revenue law. It was a general approach. But it was applied with vigour and particular enthusiasm in the interpretation of tax statutes. The rule or approach was adopted that favoured the taxpayer and required the revenue to establish its entitlement to collect taxation in the precise language of the enactment.

In the twentieth century, this approach to interpretation remained solidly in place until the last three decades. To some extent, this was simply because of the habit of following English judicial authority and

approaches – a habit reinforced by the ever-present risk of reversal by the Privy Council. Until 1986, it remained (a small area of constitutional law aside) the effective final court of appeal of the Australian judicature[19].

There can be no clearer example of the literalist approach to the interpretation of legislation than is found in the constitutional decision of the High Court of Australia in 1921 in the *Engineers' Case*[20], where the Court swept aside, as heretical, the otherwise perfectly sensible notion that the federal Constitution imported an implied assumption about the continuing role and powers of the States and replaced this notion with an 'open sesame' principle for federal power in the literalism of constitutional adjudication that has prevailed ever since[21]. If the federal Constitution gave a foothold for federal legislation, that was enough. The ambit of the grant of power was not to be read down by other general provisions of the document or implications derived from the federal character of the polity. At least this was so with very few exceptions, limited to the most extreme circumstances[22].

This simplistic approach to judicial interpretation of legislative words spilled over into every nook and cranny of judicial interpretation. It was natural that Australian judges, acting in this way in all the other departments of the law where they were called upon to act, should do so in revenue cases. History, training and philosophical inclinations combined together to make the Australian judiciary a sometimes hostile

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19 Until finally terminated by the *Australia Acts* 1986 (Cth) (UK).

20 *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129; (1921) 29 CLR 406.

21 See e.g. Work Choices Case: *New South Wales v The Commonwealth* (2006) 229 CLR 1.

22 *Bank of NSW v The Commonwealth* (Bank Nationalisation Case) (1948) 76 CLR 1 at 184-5; *Bourke v State Bank of NSW* (1990) 170 CLR 276 at 285; *Nintendo Co Ltd v Centronics Systems Pty Ltd* (1994) 181 CLR 134 at 160 applying *Attorney-General (Cth) v Schmidt* (1961) 105 CLR 361 at 371-2. Cf. *Work Choices* (2006) 229 CLR 1 at 210-212 [499]-[506].

environment for the construction of parliamentary law. More often than not, this body of was seen as intruding into the beautiful landscape of the common law, as elaborated by the judges themselves. Yet whereas such an approach might have been justified by broad political consideration in the interpretation of legislation taking up citizens' rights, or possibly expressing constitutional entitlements in a national federation, was it still justified in other fields of parliamentary law-making? Such as in tax law?

As the twentieth century marched on, several developments began to produce a change of approach:

- First, there was the growth of the role of government as a protector of civil rights and welfare. The emergence of a welfare state in Australia and New Zealand preceded such developments elsewhere. It was reinforced in both countries by the core value of industrial conciliation and arbitration.
- Secondly, in both countries, the expansion of the franchise to include all adult citizens, including women, and to create national parliaments, rendered it more questionable that judges should enjoy the authority to frustrate the lawmaking of such parliaments.
- Thirdly, the birth of hugely detailed legislation, such as the Australian 1936 tax statute became, was recognised as cumbersome. Yet it was an inevitable consequence of an overly literalistic and pernickety approach to judicial interpretation.
- Fourthly, the enormous demands of war, especially the Second World War and post-war reconstruction, increased the needs for federal revenue, whichever political grouping was in power in Canberra.

- Fifthly, from England, judicial decisions were delivered which cast in doubt the appropriateness of the literalist approach and even its scientific foundations[23]. English law lords began to point out that no-one else construed or understood meaning from words examined in isolation or without reference to context and purpose[24]. This shift in the judicial template belatedly reached the Australian courts so that today the orthodoxy that is recognised in repeated decisions of the High Court of Australia obliged judicial interpreters to examine the words of legislation, of course, but to seek to derive their meaning from text, context and purpose put together[25].
- Sixthly, this judicial movement, in its turn, produced and was further stimulated by, federal and State legislation encouraging a purposive construction and permitting access to a wider range of material in support of that approach[26]. Curiously, and no doubt for unexpressed reasons, the shift in judicial interpretation generally has not, so far, reached into interpretation of the Australian Constitution.

It is against the background of these developments that it is appropriate that I should return to the interpretation of revenue law. Justice Pagone explained the basic problem in the context of the seeming hostility of the

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[23] M.D. Kirby, "Towards A Grand Theory of Interpretation: The Case of Statutes and Contracts" (2005) 24 *Statute Law Review* 95 at 103 ff.

[24] See e.g. Lord Hoffman in *R v Brown (Gregory*) [1996] AC 543 at 561. Applied *Collector of Customs v Agfa-Gevaert Ltd* (1996) 186 CLR 389 at 396-7. See also e.g. *Director of Public Prosecutions (NT) v WJI* (2004) 219 CLR 43 at 70 [84]; *Chang v Laidley Shire Council* [2007] 234 CLR 1 at 17 [44].

[25] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408; *Newcastle City Council v GIO General Ltd* (1997) 191 CLR 85 at 112-113; *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 381 [69], 384 [78].

[26] E.g. *Acts Interpretation Act* s15AA ("Regard to be had to purpose or object of Act") and s15AB ("Use of extrinsic material in the interpretation of an Act").

courts to earlier approaches to anti-avoidance legislation, as in s260 of the 1936 Act[27]:

> "It was lawyers, that is judges, who looked at bare words on a piece of paper and said on occasions that surely the breadth of s260 was not intended to capture everything which its literal meaning might permit[28]. It was the same lawyers who said that surely s260 was not intended to apply to choices which the taxing provisions elsewhere encouraged taxpayers to obtain."

According to Justice Pagone, as is the way in the law, this approach eventually produced a counter-reaction in judicial opinion and the enactment of Part IVA of the 1936 Act. However, he proceeds[29]:

> "This has led to a series of mental gymnastics in a recent line of cases that may, in turn, either seriously undermine the operation of Part IVA or, if the emerging jurisprudence is correct, be exposing what may always have been a fundamental flaw in its drafting[30]. In this emerging jurisprudence, the judges are seeking to give linguistic meaning to words on paper. There is no enquiry into what fiscal or economic purpose is served by construing s177C as requiring a comparison of what was actually done with what the taxpayer would, or might reasonably, otherwise have done. Indeed, it may be hard to see a fiscal or economic point to such a requirement. But the words are there and the generalist lawyer's approach is to supply general linguistic meaning to them."

In trying to deconstruct the reasons as to why, in the case of schemes, judges often approach tax legislation in a manner that still seems to "accountants, economists, auditors or people of business and commerce" as a trifle unrealistic, Justice Pagone rejects the suggestion that it is merely a question of the ambiguity of language:

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[27] Pagone, above n16, 2.

[28] *W.P. Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66; *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290; *Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314; *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330.

[29] Pagone, above n16, 3.

[30] Pagone, above n16, 3 citing *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255 at 276 per Sackville J; *AXA Asian Pacific Holdings Ltd v Federal Commissioner of Taxation* (2009) ATC 20-151 [118] per Jessup J; *Commissioner of Taxation v AXA Asian Pacific Holdings Ltd* [2010] FCAFC 134.

> "It is a much more fundamental issue concerning a mismatch between disciplines which see lawyers applying analytical reasoning which is different from the analytical reasoning [of practical people]. Embedded in that mismatch of disciplines is a jurisprudential question about whether judges should, or even can, apply the disciplines and rigours of fields of learning in which they have no training or experience."

To answer this basal question, Justice Pagone suggests alternative solutions. One is the creation of a specialist Tax Court where, presumably, all the judges would be appointed in the hope that they would give effect to a particular approach to the purpose of tax law. I have expressed my disagreement with this idea[31]. In any case, as is acknowledged[32], any such court would be subject to appeals to, or review by, the High Court of Australia so that the 'generalists' could not so easily be outflanked by the 'tax specialists'.

The alternative model is for the creation of a tax tribunal similar to the Trade Practices Tribunal. This would incorporate in the decision-making body not only a judge but also an economist and perhaps someone from business or the tax office "so that the decision of the tribunal will necessarily be informed by the internal deliberations of those with the required knowledge and training". It is suggested that this might open up a wider range of arguments and more informed reasoning about the real purposes of revenue law, in order to escape from the continuing loyalty to textual literalism. This may be an idea worth exploring. But once again, the Constitution assures facilities of constitutional review in the generalist courts. When, 35 years ago, the Arbitration Commission endeavoured to escape the overly judicial approach to the large

[31] M.D. Kirby, "Hubris Contained: Why A Separate Tax Court Should Be Rejected" (2007) 42(3) Taxation in Australia 161.

[32] Pagone, above n16, 9.

economic decisions entrusted to it, it was rebuked by the High Court for running its proceedings like an academic seminar, rather than as a national tribunal obliged to act with judicial impartiality even though held not to be judicial[33].

I do not suggest that there are any easy solutions to the problems of bringing revenue law and decision-making in the courts more closely into line with the interpretation of federal legislation generally. The contrary inclination seems to be strong. It often stands in the way of serious return to basics. I discovered this in my last judicial years when I questioned some basic assumptions[34], although I observe that, since my departure, the inclination to undertake the search appears to have been reborn, at least to some extent, in the High Court[35].

The fundamental fact remains that an enormous change has come over the interpretation of federal legislation in the courts of Australia. It is part of a broader change of statutory interpretation more generally. It is wrong in terms of basic legal principle to cut federal revenue law off from this beneficial development. It is contrary to the approach endorsed by the Federal Parliament and often applied by the courts. It is out of line with the modern realities of the relationship between the judiciary and the legislatures of the nation. Sooner or later, a change will come. However, the likelihood is that a change, to be lasting, will need a

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[33] *R v Commonwealth Conciliation and Arbitration Commission; Ex parte Angliss Group* (1969) 122 CLR 546. *R v Isaac; Ex Parte State Electricity Commission (Vict)* (1978) 140 CLR 615.

[34] *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* (2006) 228 CLR 168 at 198; *Federal Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204.

[35] *The Aid/Watch Case* in the High Court. See *Aid/Watch Incorporated v Federal Commissioner of Taxation* (2010) 85 ALJR 154. See A. Susskind, "Lawyers need to keep an eye on 'Third Sector' shake up", *Law Society Journal* (NSW), April 2011, 24; D. Mortimer, "Charity need not be taxing" *Law Institute Journal Victoria*, April 2011, 33.

catalyst or a stimulus from the parliaments themselves to encourage and support a new judicial and administrative approach.

One way of setting upon the journey towards a change would, as it seems to me, be for the adoption of a more realistic approach to the doctrine of "sham" as applied to Australian tax avoidance schemes. This was an approach that Justice Lionel Murphy, in a characteristically original opinion urged in 1980 in *Federal Commission of Taxation v West Traders Pty Ltd*[36]. In doing so, as so often, he reached not for English judicial authority but for reasoning in the highest court of another great common law federation, United States of America[37]. That Court had enunciated and applied an approach similar to "sham" in terms of rejection, of "artifice" and mere "formalisms" which the courts decided had been adopted solely to alter tax liabilities and which would seriously impair the effective administration of the legislation enacted by Congress.

In her reasons at the trial level in the Federal Court in the *Raftland Case*[38], part of the reasoning of Justice Kiefel drew on such 'sham' analysis. Coincidentally, by the time *Raftland* came to be argued, Justice Kiefel had been appointed to the High Court of Australia. Of course, she took no part in the decision. Nevertheless, perhaps unconsciously, the fact that she was now on the court may have helped the plurality in the High Court to declare that her Honour's conclusions about the intentions of the parties in that case, concerning the

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[36] (1980) 144 CLR 55 at 80.

[37] Gregory v Helvering 293 US 465 at 470 (1935); *Commissioner of Internal Revenue v Court Holding Co 324 US 331 at 334 (1945).*

[38] *Raftland Pty Ltd as trustee for Raftland Trust v Federal Commissioner of Taxation* (2008) 238 CLR 516. See at 618 [90]; 62 ATR 49 at 68; [2006] ATC 4,189 at 4,206. The Full Court decision is reported at (2007) 65 ATR 336; [2007] ATC 4,104 at 4,122-4,123.

propounded documents of their scheme, should not have been disturbed by the Full Court of the Federal Court. Likewise, I found that such conclusions represented "sensible and rational inferences drawn from the evidence"[39].

There are, of course, difficulties in 'sham' analysis, not least for the revenue. This is because the Commissioner is ordinarily seeking to uphold its assessment based, at least in part, on the documentation. Still, a more realistic judicial approach to evidence of 'masquerade' and 'artifice' may be overdue. A more consistent approach involving a purposive construction of federal taxation law would not only have the advantage of conceptual neatness. It would effectively force judges and the Parliament itself into a clearer expression, and divination, of the lawmaking purpose. This is now a commonplace in other areas of federal law.

Conceding the difficulties mentioned by Justice Pagone, the time may have come for our courts to venture upon the journey where judicial angels have so far generally feared to tread. This might even, on occasions, lead to sensible conclusions that the purpose of the law in question is to raise revenue for government; that this is the objective authorised by the parliament, and that 'masquerades', 'artifices' or 'shams' should not succeed in defeating such objectives. The more the law in the courts looks more like the law in the books, the more likely it is to be respected, equitable and simple.

[39] *Ibid,* (2008) 238 CLR 516 at 618 [90].

## REFORM OF TAX LAW

Such concepts of equity, efficiency and simplicity, bring me to the lecture by Justice Edmonds delivered in Melbourne in August 2010. For a lecture on a "Judicial perspective on tax reform"[40], the lecture is expressed in extremely blunt language.

Justice Edmonds decries the "present politicisation of the debate" about tax reform[41]. He does not hold back from calling particular areas of our present law "an absolute disgrace"[42]. He describes the tax legislation as "far more complex" than it was even when earlier reform efforts (such as the Asprey Committee) called for removal of the blights of inequity, inefficiency and distortions. He comes close to embracing Professor Ross Parsons' judgment that the present system "can only be described as an 'institution in decay'"[43].

For all those who seek a telling summation of the sorry history of endeavours at tax law reform in Australia, since the Commonwealth first entered the field of income taxation in competition with the States in 1915, there could be no more powerful starting point that Justice Edmonds' lecture. Everything is there: the history of the previous approaches, old and new; bold and cautious, general and particular. The history of the judicial attitudes that have provided the backdrop against (and occasional need for) reform. The record of reforms in the areas of capital gains, imputations, foreign tax credits and goods and services taxes adopted in recent decades. The laudable criteria for reform that are generally accepted to give the country a simple and

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40 Above n17.

41 *Ibid,* MS p2 [2].

42 *Ibid*, MS p6 [13] referring to fringe benefits tax.

43 R. Parsons, "Income Tax – An Institution in Decay?" (1986) 12 *Monash University Law Review* 77.

efficient taxation system, even at some reduction in the attempts to achieve fine-combed individual equity. And the ways that reforms might be considered by the Federal Parliament, as proposed by the 2010 Henry Review[44].

Like Justice Pagone, Justice Edmonds calls attention to the disharmony that has arisen, and persisted, between what judges have called the "natural legal meaning" of the core concept of "income"[45] and the "ordinary usage meaning" preferred by economists and observers of a practical bent described by Justice Pagone and earlier by Professor Parsons. This distinction is traced to legal history. But, whatever its source, it has bedevilled tax law and cases. It has produced much artificiality, uncertainty, inefficiency, cost and criticism. As Justice Edmonds points out, no attempt to reform the Australian taxation system will probably succeed unless it addresses what he calls the "architectural or structural complexity". Nor will it make an impact until it accepts that a compromise is needed between pursuit of the criteria of individual equity and the attainment of overall efficiency and administrative economy in the operation of the system as a whole.

At a micro level, I came face to face with this conflict myself when completing my most recent tax return. To claim with perfect accuracy (supported by the necessary documentation) the rebates, with their internal adjustments, for unrecovered health care costs, it was just too time-consuming in my busy life to discover the precise net sum to which I was entitled, in order to lodge the provable rebate in my return. The

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[44] Australia, *Australia's Future Tax System*, Report to the Treasurer, 23 December 2009 (Canberra 2010) ("Henry Report").

[45] Edmonds, above n17, MS p12 [25]-[26] referring to *Federal Commissioner of Taxation v Fuller* (1959) 101 CLR 403 per Dixon CJ.

marginal *cost* of the calculation and paperwork was not worth the marginal utility of identifying, calculating and sustaining the rebate. Examining each chemist's receipts to *exclude* non-medicinal charges in a bundle of receipts I had kept was simply too time-costly. The result was a nil claim. No doubt if the lure of the potential rebate had been larger, I might have persisted. But, despite the urgings of my trusty tax agent, Joe Ciccia of Weston Woodley, who is in the audience, I gave up: eventually worn down by other priorities.

There is a lesson of general application in this homely tale. I would not be alone in this. The rebate looks good. But in practice, it involved too much work. The attempt to permit perfect *equity* to individual taxpayers comes at a cost in time and at a significant cost in public administration. The same is true for many of the business burdens imposed by the GST. This too I have discovered personally since by judicial retirement.

Decades ago, in the Law Reform Commission, we confronted similar issues under many guides. One of these was the need for 'standard cover' in common forms of insurance. Occasionally, the broad and simple sweep of legislation which is fair, efficient and economic for those affected over all, is to be preferred to the well-meaning, but ultimately hopeless and inefficient endeavour to provide a system of perfect individual equity at high costs of delivering that equity.

I came away from Justice Edmonds' lecture with a sense of discouragement. It was best formulated by Ken Henry himself when he said in a passage quoted by Richard Edmonds[46]:

[46] Ken Henry, "Tax Reform: Opportunities and Challenges", address to the ATAX Conference, 21 June 2010, Sydney. Cited Edmonds, above n17, at 2 [1].

> "It is difficult to find consensus views among academics, perhaps especially in the social sciences in which even the most abstract theoretical proposition will betray a normative position. And yet, in the domain of tax policy debates, achieving academic consensus is the easy part. It is much tougher to convince a wary public; tougher still a cynical media. And it is virtually impossible – in Australia at least – to secure political consensus on any tax proposal other than a straightforward tax cut."

The urgent need for simplification of taxation legislation; fundamental changes to its 'architecture' and 'structure'; introduction of broad guiding principles for the assistance of administrators and courts; serious non-partisan dialogue about the Henry proposals for reform; and new attitudes towards judicial interpretation, all constitute the challenges that lie before us. But do they require us to contemplate a bridge too far?

As one whose judicial heart often fell when I was obliged to open an Australian taxation statute, I feel sure that there has to be a better way. But if there is, it is difficult to achieve it in the democracy that is called Australia. In Canada, the conservative government of Joe Clark fell quickly because it was reform of tax laws[47]. The same happened to Dr. John Hewson, in opposition in Australia when he proposed a goods and services tax. The same result almost stopped John Howard in the early years of his government. It would likely have done so but for the propitious intervention of an even more demonic Australian bogey man, the boat people.

The only possible circumstance that I can see as opening up a root-and-branch reform of Australian tax law would be for a federal election to deliver a government of either persuasion with a majority similar to that

[47] Hugh Segal, *Right Balance* (2011, Douglas & McIntyre, Vancouver), 152.

recently won by Mr. Barry O'Farrell MP in New South Wales in the Lower House. But with as large a majority in the Upper House as well. In the present closely divided political times, when the mantra against any new taxation can be such a winning slogan, these seem to be pipe dreams.

If the legislature is frozen, the only realistic prospect for a measure of reform may lie in the adoption of new directions by the judiciary. That, I suggest, is the central relevance of these remarks. The new judicial directions should include a willingness to escape (as in other fields) from excessive literalism in construing taxation statutes; a greater inclination to embark candidly on a purposive construction of those laws; a heightened preparedness to disallow schemes of tax avoidance which are mere 'shams' or 'artifice'; bits and pieces of reform that could include more legislative guidance to the courts on principles of construction; and simplification of particular exceptions, rebates and qualifications expensive to deliver a simpler system, perhaps with a sweetener affording readily demonstrable alternative measures of broad equity as a substitute for the present burgeoning statutes.

For the moment, the way ahead does not look bright for major taxation law reform in Australia. The overall institution will probably remain 'in decay'. But the good news is that work for those who labour in the field of tax law and practice will remain plentiful. It will be complicated, time-consuming and expensive for the taxpayers and community who ultimately pay for this system. And that all means that it will be remunerative and plentiful for experts in your field.

## A CLOSING TRIBUTE AND CHALLENGE

I therefore end as I began, with praise for the role that the accountants, lawyers, officials and other experts play in the operation of the Australian tax law. As Tony Abbott recently said colourfully, in a different context:

> "[It] ain't beautiful; but [it] is a winner".

And every time I feel discouraged about Australia's revenue laws, I remember the special role of those laws in the overall success of our Commonwealth project. At the beginning of the twentieth century, two large, well resourced, newly settled countries were predicted to be the shining lights of the century to come: Australia and Argentina[48]. At the beginning, they ran neck and neck in GDP per capita. As the century marched on, Argentina fell away, with military coups, social unrest, declines in education and social opportunity, wars and the rest. Some of the reasons for the decline have been attributed to the breakdown of infrastructure, and especially of the tax system. The wealthy evaded or avoided taxation, leaving the burden of funding government to fall on the working poor.

In Australia, our taxation system may have been cumbersome and expensive to administer. But it remains in place as law. It still does so to reinforce notions of civic sharing of responsibility for the society we live in. It is basically honest: plodding, familiar and growing weary with the years – but still, for the most part, obediently observed.

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[48] This is described in M.D. Kirby, "Of 'Sham' and Other Lessons for Australian Revenue Law (2008) 32 *Melbourne University Law Review* 861 at 877-8 by reference to e.g. Lee J. Alston and Andrés A. Gallo, "The Erosion of the Rule of Law in Argentina 1930-1947: An Explanation of Argentina's Economic Slide from the Top Ten" (2003), 2-4>http://papers.ssrn.com/sol3/papers.cfm?abstract_id=463300>. See also K.L. Sokoloff and E.M. Zolt, "Inequality and Taxation: Evidence From The Americas On How Inequality May Influence Tax Institutions" (2006) 59 *Tax Law Review* 167 at 201-2, 241.

This international comparison of two promising countries, often re-told, carries a fundamental lesson for us. It is that tax reform is not only about raising revenue for expanding government purposes. It is also about notions of civil participation, community justice and shared responsibility. That is why it is so contrary to our national interests to allow Ross Parsons' "institutional decay" in taxation law and practice to continue or to become terminal.

The contribution of tax specialists to our society, seen in this light, is enduring, notable and praiseworthy. But the greatest contribution that could be made by your specialty at this time would be to support vigorously the call for a serious bipartisan dialogue armed to true reform, modernise and simplify the Australian tax architecture and structure. It is easy for a learned academy or a professional body like the Institute to continue with things as they are: with business as usual. The message for this Institute and for the judiciary, however, is that this approach is not a long-term option in Australia. I challenge the collective brain power and influence of the Institute at this conference to reflect on what the minimal changes need to be and how the political and governmental institution of our country can bring them about. And then to work to bring the changes into effect quickly. If there were broad professional consensus, it would surely give the cause of reform a much needed stimulus[49]. For the present, Australia is in the tax doldrums. And our maritime forebears would tell us, that the doldrums is not a good place to be for long.

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[49] Cf. F. Anderson and J. Kehoe, "Labor urged to confront tax reform" *Australian Financial Review*, 5 April 2011, pp1, 10, S10-12.