APPLICATION OF PRECEDENT TO TAX CASES – FURTHER OPINION ON DECLARATORY PROCEEDINGS

1. In light of the recent judgment of the Full Court in *Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd* [2007] FCFA 16 (hereafter *Indooroopilly*), we are briefed to advise in relation to what process the Australian Taxation Office (ATO) should follow in future to challenge perceived incorrect views of the taxation laws expounded by the judiciary in a way that is consistent with the Commissioner's obligations to administer the law as interpreted by the judiciary.

2. We are asked to advise the ATO on the following questions:

   (a) What process should the ATO follow to challenge perceived incorrect views of the taxation laws expounded by the judiciary in a way that is consistent with the Commissioner's obligations to administer the law as interpreted by the judiciary?

   (b) To what extent is the process suggested in previous joint opinions given by the Solicitor-General and Chief General Counsel consistent with the approach suggested by the Court in *Indooroopilly* and to what extent, if any, does the process need to be altered having regard to the Court's observations in *Indooroopilly*?

   (c) Should the Commissioner use declaratory proceedings, as suggested by Edmonds J, or other types of proceedings to obtain a prompt determination by the courts of questions that the ATO thinks have

been wrongly decided but for one reason or another the Commissioner has been precluded from appealing or decided not to appeal?

(d) Should the Commissioner use declaratory proceedings to determine whether his proposed change of position in relation to certain managed investment schemes in the agribusiness sector is correct?

3. In providing this advice we have been asked to consider the use of declaratory proceedings in income tax and GST disputes before an assessment is issued. We have also been asked to consider a particular proposal in relation to certain deductions claimed in connection with particular agricultural schemes.

4. The reference in these questions to earlier opinions is to opinions given on 15 December 2005 and 16 January 2006 by the Solicitor-General and Chief General Counsel in relation to the application of precedent in tax cases generally and, in particular, the manner in which earlier Court decisions may be challenged. That advice said:

> We consider that, in order to resist accusations that the ATO is disregarding judicial decisions contrary to the rule of law, it is important that, if the ATO considers that a decision is wrong, it should as soon as possible put those affected on notice of this view. It should only seek to challenge an earlier decision where it has legal advice to the effect that the decision is wrong. To avoid criticism it will also normally be appropriate, if the ATO launches a challenge to the earlier decision, to fund or organise suitable assistance to

> bring a test case. Pending the outcome of such a decision, other taxpayers affected should be informed of the proposed course of action. ....
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> The position is, however, quite different where the law has been administered for a period of time on the basis of a judicial interpretation and the Commissioner subsequently decides that that interpretation is wrong or that it is prejudicial to the revenue. In that situation it is far more difficult to justify seeking to overturn the established interpretation on which the law has been administered and a taxpayer's liability determined. See recent remarks by the Victorian Court of Appeal in *Smith v Transport Accident Commission* [2005] VSCA 251, esp [18],[41],[45].To act in this way can be seen as disadvantaging one group of taxpayers over another. It, therefore, seems important, in our opinion, that a challenge to a decision considered wrong as a matter of law should occur as soon as possible after the particular decision, and that the Commissioner publicly indicate that he considers that the decision is wrong as a matter of law and that he will be seeking an opportunity to have the matter reviewed. He should normally take steps to generate and fund a test case on the point. In this way the model litigant obligations are met

That advice recognised that private rulings may on occasion be used to allow the Commissioner to argue that an earlier judicial decision is incorrect, and that was not seen as a problem provided that the Commissioner is open about his intentions.

Indooroopilly

5. The taxpayer in *Indooroopilly* applied to the Commissioner of Taxation for a private ruling under Part IVAA of the *Taxation Administration Act* 1953 (the "***Administration Act***"). The question on which the Commissioner was asked

to rule was whether the issue of certain shares gave rise to a fringe benefit within the meaning of the *Fringe Benefits Tax Assessment Act* 1986 (Cth) (the "**FBTAA**"). That question turned largely on the definition of "fringe benefit" in section 136 of the FBTAA and, in particular, whether it was necessary to be able to identify particular employees to whom benefits were provided.

6. On that question both Kiefel J (in *Essenbourne Pty Limited v Commissioner of Taxation* 2002 ATC 5201) and Hill J (in *Walstern v Commissioner of Taxation* (2003) 138 FCR 1) had held that section 136 should be construed so as to require particular employees to be identified. Other judges had either assumed that proposition to be correct or had not been satisfied that it was clearly wrong: see the references at para [13].

7. The Commissioner disagreed with the construction suggested by Kiefel J and Hill J and ruled accordingly. On appeal to the Federal Court, Collier J followed the earlier judgments and allowed the taxpayer's application. The Commissioner then appealed.

8. The Full Court (Stone, Allsop and Edmonds JJ) rejected the Commissioner's construction of section 136 and dismissed the appeal. In so doing, both Allsop and Edmonds JJ were sharply critical of the fact that the Commissioner had issued his ruling contrary to the earlier single judge decisions: Allsop J at [3] to [7], Edmonds J at [41] to [48]. Their remarks were made in the context of the respondent's notice of contention which sought to affirm the trial judge's decision on the basis that the Commissioner was "bound" to follow the earlier judgments: [41].

9. Additionally, Edmonds J (with whom both Stone and Allsop JJ agreed) said at [47]:

> "At the time the Commissioner issued the ruling, Hill J in *Walstern* had indicated that, in his view, Kiefel J's construction was 'clearly correct' and Merkel J in *Spotlight Stores* had indicated his satisfaction that both those decisions were not clearly wrong and that he intended to follow them. In those circumstances, faced with the ruling application, in my opinion, it was incumbent on the Commissioner, having taken the view that findings of fact precluded him from appealing *Essenbourne* — a view with which I have already expressed my disagreement — either to follow the construction embraced in those cases or seek a declaration from the Court as to the proper construction and apply that construction in the ruling."

10. It is against this background that the questions on which we are asked to advise have arisen. In particular, we are asked to comment on the Court's suggestion that the Commissioner should have sought a declaration prior to issuing his ruling in *Indooroopilly.*

11. Despite the stark alternative posed by Edmonds J, it is not entirely clear how he considered that declarations could be sought in all cases, given the well established limitations on their use, the existence of the assessment and private ruling systems and the procedures for challenging them. It may be that his Honour had in mind that the Commissioner, instead of ruling, should have sought a declaration as to the fringe benefits tax liability of the taxpayer. If that is what his Honour had in mind then there are various considerations, discussed below, as to why that will generally be inappropriate. He appears to have envisaged, however, that the Commissioner would seek a declaration as to how he should rule. If that was the course his Honour had in mind then there are, in additional to the general considerations, more serious obstacles which we discuss in the following paragraphs.

Availability of Declarations in Income Tax Cases Generally

12. There are numerous situations in which it may be appropriate to seek a declaration in relation to the operation of Federal income tax legislation. It would be difficult to list or even categorise all of those situations, however it is clear that a Court will grant a declaration in cases where, for example, no assessment has issued or where liability does not depend on a notice of assessment: *Unisys Corporation Inc v Commissioner of Taxation* (2002) ATC 5146 (withholding tax), *Bluebottle UK Limited v Deputy Commissioner of Taxation* (2006) ATC 4803 (notice to pay money to Commissioner under section 255 of the *Income Tax Assessment Act* 1936); *Marana Holdings Pty Limited v Commissioner of Taxation* (2004) 141 FCR 299 (GST).

13. The question of whether and in what circumstances the Commissioner should seek a declaration where he has been asked to make a private ruling, however, raises issues which can only be resolved by reference to the particular features of the statutory ruling regime in Division 359 of Schedule 1 to the *Administration Act.*

Division 359

14. Like its predecessor (Part IVAA of the *Administration Act*), Division 359 contains a comprehensive regime for the making of private rulings by the Commissioner on the way in which a tax law applies to certain facts.

15. There are several features of that regime which are important to note. The provisions in relation to rulings are now contained in part 5.5 of Schedule 1 to

the *Administration Act*. Section 357-5 states the objects of the Part as follows:

> (1) The object of this Part is to provide a way for you to find out the Commissioner's view about how certain laws administered by the Commissioner apply to you so that the risks to you of uncertainty when you are self assessing or working out your tax obligations or entitlements are reduced.
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> (2) This object is achieved by:
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> (a) making advice in the form of rulings by the Commissioner available on a wide range of matters and to many taxpayers; and
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> (b) ensuring that the Commissioner provides rulings in a timely manner; and
>
> (c) enabling the Commissioner to obtain, and make rulings based on, relevant information; and
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> (d) protecting you from increases in tax and from penalties and interest where you rely on rulings; and
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> (e) protecting you from decreases in entitlements where you rely on rulings; and
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> (f) limiting the ways the Commissioner can alter rulings to your detriment; and
>
> (g) giving you protection from interest charges where you rely on other advice from the Commissioner, or on the Commissioner's general administrative practice.

16. The Part relates to public rulings (Division 358), private rulings (Division 359) and oral rulings (Division 360). Subdivision 357B contains certain rules common to all three types of ruling.

17. The central provision in Division 359 is section 359-(5)(1). It provides:

> "The Commissioner may, on application, 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. Such a ruling is called a ***private ruling***."

18. The "relevant provisions" are defined in section 357-55 as follows:

> Provisions of Acts and regulations of which the Commissioner has the general administration are relevant for rulings if the provisions are about any of the following:
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> (a) *tax;

(b) Medicare levy;
(c) fringe benefits tax;
(d) *franking tax;
(e) *withholding tax;
(f) *mining withholding tax;
(fa) *petroleum resource rent tax;
(g) the administration or collection of those taxes;
(h) a grant or benefit mentioned in section 8 of the *Product Grants and Benefits Administration Act 2000*, or the administration or payment of such a grant or benefit;
(i) a *net fuel amount, or the administration, collection or payment of a net fuel amount.

19. "Scheme" is defined in section 995-1 of the *Income Tax Assessment Act* 1997 ("**ITAA 97**") to mean:

(a) any *arrangement; or
(b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

20. Section 357-100 is a privative clause. It provides:

The production of:
(a) a *public ruling or *private ruling; or
(b) a document signed by the Commissioner, a Second Commissioner or a Deputy Commissioner, purporting to be a copy of the ruling or of a notice of withdrawal of a public ruling;
is conclusive evidence of the proper making of the ruling, or of the withdrawal of the public ruling.

21. Once made, a ruling binds the Commissioner where the taxpayer relies on it: section 357-60. The Commissioner retains a discretion to apply the law to a taxpayer more favourably than the way in which he has ruled: section 357-70. The Commissioner may revise a ruling but only before the scheme to which it relates commences: section 359-55. Similarly, a taxpayer will lose the benefit of a private ruling if the Commissioner later issues an inconsistent public ruling but only if the scheme to which it relates has not yet commenced: section 357-75.

22. Once a private ruling has been issued and the scheme to which it relates has commenced, the Commissioner has no discretion or power to retreat from it even if a Court in another matter later construes the tax law in a less favourable way. In this respect, the ruling binds the rights of the Commissioner and the taxpayer notwithstanding the interpretation of a tax law by the Courts: see the observations of Gummow J in *CTC Resources NL v Commissioner of Taxation* (1994) 48 FCR 397 at 402E-F. In other words, the Commissioner will be bound by a wrong private ruling.

23. A private ruling is taken to be a taxation decision within the meaning of part IVC of the *Administration Act* (section 359-60(2)) and a taxpayer may object if "dissatisfied" with it (section 359-60(1)). The *Administration Act* therefore provides the same rights of objection and appeal to the Administrative Appeals Tribunal or the Federal Court as are available in relation to assessments generally.

24. The question for the Court in proceedings in relation to a private ruling is whether the ruling "should not have been made or should have been made differently": section 14ZZO of the *Administration Act*.

Jurisdiction of Courts to make Declarations Generally

25. The jurisdiction of Courts to make declarations depends, as in any proceeding, upon the existence of some controversy. A Court exercising federal jurisdiction has no power to give an advisory opinion: *In re Judiciary Act and Navigation Act* (1921) 29 CLR 257. In *Bruce v Commonwealth Trade*

Marks Label Association (1907) 4 CLR 1569 at 1571 the High Court said the Court was:

> "limited to determining the rights of persons or of property, which are actually controverted in the particular case before it....But the court is not empowered to decide moot questions or abstract propositions...which cannot affect the thing in the case before it."

26. This proposition, as *In re Judiciary Act and Navigation Act* makes clear, is one which goes to the jurisdiction of the Court to grant the relief and not merely to the exercise of the Court's discretion in cases where it has jurisdiction: see also *Forster v Jododex Australia Pty Limited* (1972) 127 CLR 421 at 437-438 and *CTC Resources* at 406-407 per Gummow J and at 428 per Hill J.

27. This proposition does not, however, necessarily prevent a Court from granting a declaration in relation to a matter that has not yet occurred or a proposed scheme or transaction. As Barwick CJ said in *The Commonwealth v Sterling Nicholas Duty Free Pty Limited* (1971-1972) 126 CLR 297 at 305:

> "Of its nature, the jurisdiction includes the power to declare that conduct which as not yet taken place will not be in breach of a contract or a law. Indeed it is that capacity which contributes enormously to the utility of the jurisdiction."

28. What is required is that the question be:

> "a real and not a theoretical question; the person raising it must have a real interest to raise it; he must be able to secure a proper contradictor, that is to say, some one presently existing who has a true interest to oppose the declaration sought": *Russian Commercial and Industrial Bank v British Bank for Foreign Trade Ltd* [1921] 2 AC 438 at 448 per Lord Dunedin, cited with approval by Gibbs J *Forster v Jododex* at 1312.

29. However, as Gibbs J went on to note, beyond that there is little guidance that can be given. It is certainly the case that questions which are based upon

hypothetical or assumed facts will not be the subject of declaration: *University of NSW v Moorhouse* (1975) 133 CLR 1 per Gibbs J at 9-10. Nor will a declaration be granted where there is no certainty that future conduct will be engaged in: *Re Trade Practices Act 1974 (s163A) and Re an Application by Tooth & Co Ltd* (1978) 19 ALR 191 at 201-203 per Bowen CJ and Franki J and at 209 per Brennan J.

30. This rule does not prevent a party from seeking a declaration to determine what course of conduct it should adopt to avoid some legal liability: *Russian Commercial and Industrial Bank v British Bank for Foreign Trade Limited* [1921] 2 AC 438. Lord Sumner said at 452:

> "For many years it has been accepted practice in cases in the Commercial List to hear and determine claims for a declaration of right, when a real and not a fictitious or academic question in involved and is in being between two parties, in order that they may know what business course to take without having to run the risk of acting and finding themselves liable in damages, what at las the matter is brought before the Court."

31. Although sometimes described as a "commercial rule" (e.g. P.W. Young Q.C. *Declaratory Orders* (2nd Ed.) Butterworths 1984 at [718]) the principle stated by Lord Sumner in the *Russian Bank* case also extends to other situations. In *Sarkis v Deputy Commissioner of Taxation* (2005) ATC 4205 the plaintiff Deputy Commissioner obtained a declaration as to whether the defendant judgment debtor was the beneficial owner of certain property. The plaintiff sought the declaration in order to determine whether or not to commence execution proceedings which would have been futile if the defendant had not been the beneficial owner: Nettle JA at [20] to [21].

32. In our opinion, the fact that a ruling request relates to a proposed transaction or to facts which have not yet occurred would not of itself deprive a Court of jurisdiction to grant a declaration. As discussed below, there are more fundamental reasons why a declaration would be unavailable in relation to private ruling requests, namely the absence of a justiciable controversy, and why other considerations generally make such an application inappropriate in any event.

33. The requirement that there be relative certainty about the likelihood of the scheme being entered into would nevertheless be bound to present practical problems for the Commissioner if he were to seek declaratory relief. Unless a taxpayer volunteers evidence about the matter, neither the Commissioner nor the Court will ever be in a position to know whether a scheme is sufficiently likely to be entered into to found the Court's jurisdiction (see Brennan J in *Re Trade Practices Act* at 209) or, alternatively, to warrant the exercise of its discretionary power to grant a declaration.

34. More fundamental difficulties with the Court's suggestion that the Commissioner obtain declaratory relief before issuing a private ruling are presented by the nature of the Commissioner's power under section 359-5 and in the tension between obtaining declaratory relief, on the one hand, and the scheme for objection, decision and appeal contained in Part IVC of the Administration Act, on the other.

The Commissioner's Power to Make a Ruling

35. As noted above, the Commissioner is empowered to make a ruling on the way in which he "considers" a tax law will operate: section 359-5(1). It is clear the Commissioner is doing no more than expressing his "view" (section 357-5(1)) or providing "advice" (section 357-5(2)).

36. It is difficult in this context to identify what, if any, controversy exists prior to the making of a private ruling. 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. However, there does not appear to be any controversy in a legal sense. This is because the Commissioner's task effectively ends once he has formed his "view". Indeed it is only where the Commissioner has a "view" that the problems now under consideration ever arise.

37. The facts of *Indooroopilly* illustrate this point. At the time when the Commissioner was asked to rule, he already (or soon thereafter) had an opinion about the operation of section 136 of the FBTAA. That opinion was admittedly contrary to the manner in which the Courts had construed the section but was nonetheless reached in good faith. It is difficult to know what the Commissioner could have asked the Court that he did not already know or, to put it another way, it is difficult to know what more the Commissioner needed to know before he could issue his ruling. There would have been no utility in the Court granting a declaration at that point because the only identifiable controversy (namely what "view" or "opinion" the Commissioner comes to) was already resolved.

38. It is important to remember that it is *not* a requirement of the statutory scheme that the view be correct. As noted above, a wrong ruling is valid and binds the Commissioner. This is to be contrasted to those administrative decisions which lack validity where they can be shown to be made in error: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355; *Minister for Immigration and Multicultural Affairs v Bhardwaj* (2002) 209 CLR 597. In some cases, it is arguable that a decision-maker could approach the Court to determine a legal question, the answer to which was important in ensuring that the opinion was validly formed or that a satisfaction was properly arrived at.

39. However, that is not the case in respect of the Commissioner's opinion for the purposes of section 359-5. Once the Commissioner has formed a view – irrespective of whether it is right or wrong – he is bound to make the ruling accordingly. There will of course be disputes about whether the ruling, once made, should have been made differently, but only where a taxpayer is dissatisfied with the ruling and appeals the matter pursuant to Part IVC of the *Administration Act*.

40. Given that the Commissioner's power is to form a "view" or "opinion", there would not appear to be any utility in seeking a declaration as to what his view or opinion should be. In fact, the Commissioner may, because of the statutory scheme, be entitled to ignore the declaration if it does not coincide with his own view. This may then make obtaining a declaration difficult as it could be seen as purely hypothetical.

41. If it were the case that the Commissioner approached the Court *before* he had formed any view about the operation of the law, it is, we think, almost inevitable that the Court would decline to make a declaration on the basis that it was doing no more than giving an advisory opinion on the way in which the Commissioner should form a view.

Other Considerations

42. These considerations are in our view sufficient to conclude that it would be undesirable for the Commissioner to seek declaratory relief prior to issuing private rulings in circumstances like those in *Indooroopilly*. However, other aspects of the statutory scheme also support this conclusion.

43. In *CTC Resources*, Gummow observed at 407A:

> "the rigour of the rule preventing conferral of federal jurisdiction to give advisory opinions has been mitigated by the broad scope of the declaratory judgment, but this still requires a controversy and a contradictor." (our emphasis)

44. The requirement to identify a contradictor is more than a formal requirement. The absence of a contradictor will suggest that the declaration is not sought in order to resolve a controversy. There is a real possibility that a taxpayer who has sought a ruling will have no interest in taking part in "pre-emptive" legal proceedings, with or without test case funding. A taxpayer in that position will be entitled to await a ruling and, if dissatisfied and if the taxpayer considers the matter worth pursuing, object against it.

45. More importantly, however, the clear scheme of Division 359 is that the Commissioner will form a view and issue a ruling prior to the commencement

of legal proceedings. Those proceedings will take the course of other tax litigation within the rubric of Part IVC of the *Administration Act.*

46. Given that both courses – issuing a ruling contrary to Court decisions and funding an appeal or, alternatively, bringing declaratory proceedings and funding a contradictor – involve the (unwilling) taxpayer in litigation to re-argue a point which has already been decided in previous cases in the taxpayer's favour, there does not appear to be any principled reason to prefer the course suggested by Edmonds J over the course clearly contemplated in the legislation. On the contrary, this fact points to the former course as being undesirable.

47. In our opinion, the Commissioner should be slow to attempt to invoke the jurisdiction of the Courts in a private ruling case other than in the manner contemplated by Division 359 and Part IVC of the *Administration Act.*

Use of Declaratory Proceedings Before an Assessment has Issued

48. In our opinion, for similar reasons, the Commissioner should also be reluctant to seek declarations even where the Court has undoubted jurisdiction to make such an order, such as in relation to a taxpayer's liability to income tax or GST prior to the issue of notices of assessment. In our opinion, those cases give rise to the same concerns.

49. Although there can be little doubt that a Court would have jurisdiction to grant declarations in appropriate cases before the issue of an assessment (see *Platypus Leasing Inc and ors v Commissioner of Taxation* (2005) 61 ATR

239), there are reasons why it will usually be prudent to await the issue of an assessment before invoking Court proceedings.

50. In *Bob Jane T-Marts Pty Limited v Commissioner of Taxation* (1999) 94 FCR 457 the Full Court of the Federal Court was critical of the parties for having attempted to resolve a sales tax dispute in proceedings for declarations. In *Forster v Jododex*, Walsh J said at 427:

> "In my opinion, when a special tribunal is appointed by a statute to deal with matters arising under its provisions and to determine disputes concerning the granting of rights or privileges which are dependent entirely upon the statute, then as a general rule and in the absence of some special reason for intervention, the special procedures laid down by the statute should be allowed to take their course and should not be displaced by the making of declaratory orders concerning the respective rights of the parties under the statute."

51. These considerations will apply in every case. Moreover, it will invariably be the taxpayer and not the Commissioner who would require an urgent determination of a dispute prior to the issue of an assessment. If a taxpayer were to demonstrate some good reason why the dispute should not await the issue of an assessment or a private ruling and the invocation of Part IVC of the *Administration Act*, then the Court might be persuaded to proceed with the matter. For the reasons discussed in *Platypus Leasing*, the parties' desire to ascertain the tax liability that would result from entering into a transaction or adopting a course of conduct would be sufficient to give rise to a justiciable controversy.

52. However it may be difficult for the Commissioner, as the moving party, to demonstrate why a dispute with a particular taxpayer should not await the issue of an assessment and the usual objection and appeal procedure. This

would be so even though, technically, the same justiciable controversy could be shown to exist as in the previous example. It is unlikely that the Commissioner's general policy about the application of a tax law would be sufficient reason to take a particular taxpayer's dispute outside the statutory objection and appeal process.

53. Aside from these considerations, such a course would require the Commissioner to assume an onus of proof which he does not otherwise bear (see sections 14ZZO and 14ZZK of the *Administration Act*). In our view this is an important consideration which should not be underestimated. Unless the Commissioner is in a position to state with certainty what the facts relevant to a taxpayer's liability are, he faces difficulty in establishing an entitlement to relief or, alternatively, it may be necessary to agree facts with the taxpayer in circumstances where the Commissioner has not had a full opportunity to determine all of the relevant facts himself.

54. Furthermore, there will always be some doubt as to whether the declaration, even if granted, will resolve all issues between the taxpayer and the Commissioner in any event. In proceedings under Part IVC of the *Administration Act* the Court (or Tribunal, as the case may be) will determine whether the assessment is excessive. Once the proceedings are concluded, the taxpayer's liability for tax for a year of income will have been ascertained.

55. However a declaration as to a particular item of income or a particular deduction will not always allow a conclusion to be drawn as to the amount of tax payable by a taxpayer in any given year. An example of this may be seen in *Commissioner of Taxation v ANZ Savings Bank Limited* (1994) 125 ALR

213. In that case, the Commissioner successfully defended an assessment on a basis quite different to the basis upon which the assessment had originally been issued. A declaration as to the "particular" of the assessment which was originally in dispute in that case would not, therefore, have been a reliable means of determining the taxpayer's liability for that year.

56. Furthermore, because of the discretionary nature of the remedy it will not always follow that the failure by the Commissioner to obtain a declaration will necessarily be because the Commissioner's view of the law is wrong. Relief may be refused for discretionary reasons without creating a binding ruling on the legal issue. In that case, the legal issue would remain to be determined in Part IVC proceedings.

Proposed Change of Position in Agribusiness Cases

57. We have also been asked to consider the Commissioner's approach to a possible change of position in relation to certain "agribusiness" schemes. In a current public ruling the Commissioner has stated that certain outgoings may be deductible under section 8-1 of the ITAA 97. The Commissioner has issued a draft ruling in which he has taken the view that those outgoings are not deductible.

58. In our opinion, this situation differs from the situation in *Indooroopilly*. Here, the Commissioner is proposing to alter his position by withdrawing a public ruling, something which is clearly contemplated by Division 358 of the *Administration Act*.

59. In our opinion, the Commissioner should not attempt to bring proceedings for a declaration to test the correctness of the view expressed in the draft public ruling. Such proceedings would almost certainly involve a hypothetical or advisory opinion: see *Young v Commissioner of Taxation* 2000 ATC 4133. Nor, in our opinion, for the reasons set out above, should the Commissioner attempt to seek declaratory relief in relation to an identified taxpayer who proposes to claim the kind of deduction in question.

60. To the extent that the Commissioner wishes to have his views in relation to the deductibility of certain outgoings tested in Court, the Commissioner should adopt the processes suggested in the earlier opinions to which we have referred. It is likely that the best course will be to identify a matter in which a ruling on the issue has been sought, to issue a ruling on the basis of the Commissioner's view and, in the event that the taxpayer objects against the ruling, conduct the resulting appeal under Part IVC of the Administration Act as part of the test case programme.

61. In an appropriate case it may also be possible to seek a direction from the Chief Justice pursuant to section 20(1A) of the *Federal Court of Australia Act* 1976 that the matter be determined by a Full Court, however that would be a matter for the Court. It would be essential in such a case that the Commissioner be in a position to prove all of the facts relevant to determining the question in issue or, alternatively and preferably, have an agreement with the taxpayer as to those facts. It would also be necessary that the question involved be a legal question of general importance.

62. There is, in addition to the general concerns outlined in this memorandum, a further reason why the Commissioner should not use declaratory proceedings to determine whether his proposed change of position in the agribusiness cases is correct, namely the desire to have this issue resolved, as far as possible, prior to the commencement of the 2008/2009 financial year. In any declaratory proceedings there is a risk that the Court will decline to grant relief on some discretionary basis and that the time spent in conducting the proceedings will therefore have been wasted.

63. Given the fact that the Federal Court will now generally allocate hearing dates for private ruling cases at the very first directions hearing and given also that the process of agreeing facts for the purpose of declaratory proceedings is unlikely to be any quicker than the process of making a ruling and invoking the provisions of Part IVC of the *Administration Act*, we do not consider that there is any reason to assume the risk inherent in declaratory proceedings that relief will be refused on a discretionary basis. On the contrary, we consider that these are reasons to invoke the more certain jurisdiction under the *Administration Act*.

Conclusions

64. In light of the above, we answer the questions as follows.

(a) What process should the ATO follow to challenge perceived incorrect views of the taxation laws expounded by the judiciary in a way that is consistent with the Commissioner's obligations to administer the law as interpreted by the judiciary?

65. The Commissioner should normally use private rulings or the issue of assessments, rather than declarations, in order to test interpretations of the tax law. Declarations have a number of limitations. They require a contradictor. They cannot be used to answer hypothetical questions and they are more easily sought by a taxpayer than by the Commissioner. They will not necessarily lead to a final determination about a taxpayer's tax liability.

66. The more important issue is that steps be taken quickly to identify a suitable case involving a private ruling or assessment to test a decision that is considered incorrect. If a suitable case can be found and proceedings by a taxpayer brought, at that stage there may be case management options such as a stated case or referral to the Full Court that may assist speedily to resolve the issue in an authoritative way.

(b) To what extent is the process suggested in previous joint opinions given by the Solicitor-General and Chief General Counsel consistent with the approach suggested by the Court in *Indooroopilly* and to what extent, if any, does the process need to be altered having regard to the Court's observations in *Indooroopilly*?

67. We do not consider that the recent decision in *Indooroopilly* requires us to change the views expressed in the earlier advice. The problem in *Indooroopilly* appears to have arisen from a perception that the Commissioner was clinging to an interpretation of the law that had been disagreed with by a number of single instance judges, and that prompt action had not been taken to have this issue resolved by the Full Court.

68. We do not consider that the critical comments of the judges in *Indooroopilly* can be taken as meaning that the ATO must always follow a single instance decision of a judge. For the reasons previously given, that is not required if there are good arguments that, as a matter of law, that decision is incorrect and action is being taken to clarify the position. That does not mean that in issuing private rulings the Commissioner is generally free to ignore judicial decisions. However, where there is a concern with a particular interpretation and the Commissioner intends to issue a ruling contrary to prevailing judicial opinion, we consider that an early test case is the appropriate procedure.

69. In *Indooroopilly*, while the ATO saw it as a test case, that was not how the Court saw it. This may partly have been because at the time of the ruling there were already a number of judicial decisions that had considered the issue yet the ruling had appeared to ignore or give little weight to them. It was probably the perception that the Commissioner stuck doggedly to his preferred interpretation, regardless of authority, that gave rise to the criticism by the Court in *Indooroopilly*. Whilst a quicker test of the issue should probably have occurred, even if that involved an appeal in a case that was not otherwise an ideal test case, it is unclear precisely what course should have been taken. In particular, we do not express any concluded view about whether *Essenbourne* or *Spotlight Stores* was necessarily the appropriate case for that purpose, or whether the observations of Edmonds J in relation to the appeal in *Essenbourne* at paragraph [47] of *Indooroopilly* are correct. Nevertheless, once there is a series of decisions expressing the same view it will always be more difficult to justify a private ruling that ignores those decisions even for the purpose of a test case, and legislative change may be necessary.

70. As indicated in the earlier advice, if the ATO considers that the interpretation of the tax laws in a given case is wrong, it is important that prompt action be taken to test the issue, that there be legal advice that supports the view that the decision is legally wrong and that the Commissioner publicly indicate the reason for his actions and his proposed course.

71. He should until the issue is resolved, so far as possible, avoid acting in a way affecting the affairs of similarly affected taxpayers that could give rise to accusations of inconsistency. This may involve putting assessments, rulings, objections or appeals on hold so far as possible pending resolution of the test case, advising affected taxpayers of the reasons for the apparent delay and explaining the steps being taken to resolve the legal issue in question. This course will not, however, be convenient to every taxpayer and it is possible that the Commissioner will have no choice but to continue with the objection and appeals process in relation to other taxpayers in any event: section 14ZYA of the *Administration Act*. Time limits applicable to the Commissioner may also require assessments to be issued notwithstanding the fact that the issue remains unresolved. These are practical considerations that can only be addressed case by case.

(c) Should the Commissioner use declaratory proceedings, as suggested by Edmonds J, or other types of proceedings to obtain a prompt determination by the courts of questions that the ATO thinks have been wrongly decided but for one reason or another the Commissioner has been precluded from appealing or decided not to appeal?

72. For the reasons already given, we consider that in most situations it will be inappropriate for the Commissioner to seek to use declarations as a way to test interpretations of the tax law he considers incorrect. In many cases, a declaration will not be available at all because the question will be hypothetical or advisory. There may conceivably be situations where a declaration will be appropriate but generally we consider that the use of private rulings or assessments will continue to provide the best way to test an issue.

73. The best way to test issues is to identify test cases quickly and use references to Full Courts or other case management procedures to enable an early hearing. It is important from a public perception point of view that test cases be brought not merely because the Commissioner considers a previous case to be wrong but only where he also has legal advice that suggests the decision is wrong as a matter of law. As earlier advice indicated, the legal advice can include advice from within the ATO. What is important, however, is that the legal advice look objectively at the issue in terms of available legal argument. It is not sufficient to conclude that the interpretation given by the courts does not accord with the original intent.

(d) Should the Commissioner use declaratory proceedings to determine whether his proposed change of position in relation to certain managed investment schemes in the agribusiness sector is correct?

74. Whatever course of action might be open to a taxpayer (as to which see paragraph 51 above), the Commissioner should not attempt to have this issue

resolved in proceedings for declarations. The Commissioner should instead adopt the course suggested in the earlier opinions, namely to identify a matter in which a ruling on the issue has been sought, issue a ruling on the basis of the Commissioner's view and, in the event that the taxpayer objects against the ruling, conduct the resulting appeal under Part IVC of the *Administration Act* as part of the test case programme. The Commissioner should then use appropriate case management procedures, including an application to have the matter determined by a Full Court if otherwise appropriate, in order to obtain an early resolution of the issue.

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