THE MODEL LITIGANT AND LAW CLARIFICATION

ATP LEADERSHIP WORKSHOP: 17 SEPTEMBER 2008

JUSTICE G T PAGONE*

The ATP[1] was established as an ATO business line to deal with promoted tax exploitation schemes.[2] It is responsible for implementing promoter penalty laws and has an ongoing role to identify and investigate possible contraventions.[3] These tasks are, of course, to be performed in the context of the Commissioner as a model litigant and the constitutional separation of powers which sees the Commissioner as an administrator of the law declared by the courts.[4] This context is important for the ATP and in particular for those within it responsible for providing leadership and setting direction.

The Model Litigant

The *Judiciary Act 1903* (Cth) confers responsibilities on the Commonwealth Attorney-General, or persons appointed by him, to bring suits on behalf of the Commonwealth. The Legal Services Direction 2005 was made under s 55ZF of the *Judiciary Act 1903* and, amongst other things, requires the Commonwealth and its agencies to behave as model litigants in the conduct of litigation.[5] The model litigant guidelines are set out in an ATO practice statement for officers to follow[6] and was referred to in a speech made in November 2007 by Bruce Quigley, Second Commissioner of Taxation, Law, as the basis upon which the tax office approaches litigation.[7]

What the term "model litigant" contains is not entirely settled. In *Waterford v Commonwealth*[8] the appellant argued that the Commonwealth could not rely upon the doctrine of legal professional privilege to prevent the disclosure of documents because

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1 Aggressive Tax Planning.

2 Australian Taxation Office, Law Administration Practice Statement PS LA 2008/7 'Application of the promoter penalty laws (Division 290 of Schedule 1 to the *Taxation Administration Act* 1953) to promotion of tax exploitation schemes', 6-13.

3 Ibid.

4 *Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd* (2007) 158 FCR 325.

5 Commonwealth Attorney-General, "Appendix B: The Commonwealth's obligation to act as a model litigant" *Legal Services Direction 2005*.

6 PS LA2007/12: Conduct of Tax Office litigation in courts and tribunals.

7 Bruce Quigley "The Role and Implications of Litigation in Tax Administration", Australian Petroleum Production & Exploration Association, Annual Conference, Hobart, 22 November 2007.

8 (1987) 163 CLR 54.

it would be inconsistent with the Crown acting as a model litigant.[9] The contention was that the Crown, as a model litigant, did not need to engage in tactics or resist the disclosure of all relevant facts. The argument was not accepted by the High Court as a legal obligation on the Crown as model litigant. The term represents an ethical, rather than a legal, standard and is usually expressed in terms of general concepts such as fairness and integrity. In 1996 Dale Boucher said:

> The meaning of [model litigant] is sometimes expressed as being firm but fair. Sometimes, too, I have heard the obligation described as one of being fair and reasonable… [Some commentators] seem to reason that commercialisation means doing what your clients want without any questioning on a professional level at all and that being the model litigant means that you try not to win. We do not agree with that.[10]

Dal Pont has said:

> [G]overnment lawyers' conduct must be above reproach and be seen to be above reproach.
> …
> In conducting litigation government lawyers should act in an exemplary fashion and in a manner indicative of those standards that lawyers representing private litigants should seek to emulate.[11]

It is these general concepts which the Attorney-General's legal services directions has sought to fill with content.[12]

The ATP's work will be undertaken in that context. The Commissioner's duty, and therefore the ATP's duty, to act as a model litigant may arise for consideration at various points. It may arise, for example, during the course of investigations, negotiations or other dealings with a person who may be charged or who acts for a person who may be charged. The duty may need to be considered when briefing lawyers or in the conduct of litigation once commenced. Many of the promoter penalty

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9 Ibid, 56.

10 Dale Boucher "*An Ethical Code… Not a Code of Conduct*" (1996) 79 Canberra Bulletin of Public Administration 3, 4.

11 GA Del Pont, *Lawyer's Professional Responsibility in Australia* (2006, Thomson) 296-297.

12 See also: *Melbourne Steamship Co Ltd v Moorehead* (1912) 15 CLR 333, 342; *SCI Operations Pty Ltd v Commonwealth* (1996) 139 ALR 595, 613, 614, 621; *Yong Jun Qin v Minister for Immigration and Multicultural Affairs* (1997) 144 ALR 695, 704; *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, 40, 41; *Scott v Handley* (1999) 58 ALD 373, 383-4; *White v Minister for Immigration Multicultural Affairs* [1999] FCA 1433, [81]; *OneTel Ltd v Deputy Commissioner of Taxation* (2000) 171 ALR 227, 233; *ACCC v Warner Music Australia Pty Ltd* [2000] FCA 647; *Challoner v Minister for Immigration Multicultural Affairs* [2000] FCA 1601; *NAFK of 2002 v Minister for Immigration Multicultural Indigenous Affairs* [2002] FCA 1374, [9]; *NAOY v Minister for Immigration* [2002] FMCA 275, [8]; *Wodrow v Commonwealth of Australia* [2003] FCA 403, [38] - [43]; *ABB Power Transmission Pty Ltd v ACCC* [2003] FCAFC 261, [35].

provisions are expressed in wide language with potential application beyond the mischief which Parliament might be thought reasonably to have intended. The application of some of the more general provisions will necessarily require an exercise in judgment and care will need to be taken not to expose the Commissioner to the rebuke of a failure "to maintain the highest standards of probity and fair dealing".[13]

Evidence Gathering and Investigations

The investigation of potential tax exploitation schemes is perhaps the most significant function for the ATP. The task of ensuring that there are "no outbreaks of promoted tax exploitation schemes"[14] will require an appropriate identification of something as a tax exploitation scheme and the taking of defensible measures to prevent the "outbreaks". The meaning of tax exploitation scheme is found in s 290-65 and is in broad terms. The section provides:

> **290-65 Meaning of *tax exploitation scheme***
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> (1) A *scheme is a ***tax exploitation scheme*** if, at the time of the conduct mentioned in subsection 290-50(1):
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> (a) one of these conditions is satisfied:
>
> (i) if the scheme has been implemented—it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a *scheme benefit from the scheme;
>
> (ii) if the scheme has not been implemented—it is reasonable to conclude that, if an entity (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; and
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> (b) one of these conditions is satisfied:
>
> (i) if the scheme has been implemented—it is not *reasonably arguable that the scheme benefit is available at law;
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> (ii) if the scheme has not been implemented—it is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented.

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13 *Sebel Products Ltd v Commissioners, Customs and Excise* [1949] 1 Ch 409 (Vaisey J) 413.

14 ATP, "Living Our Strategy" ATP Leadership Workshop Agenda, Melbourne, 17-18 September 2008.

> Note: The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner of Taxation (for example, if that implementation were in accordance with a public ruling under this Act, or all participants had private rulings under this Act and that implementation were in accordance with those rulings).
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> (2) In deciding whether it is *reasonably arguable that a *scheme benefit would be available at law, take into account any thing that the Commissioner can do under a *taxation law.
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> Example: The Commissioner may cancel a tax benefit obtained by a taxpayer in connection with a scheme under section 177F of the *Income Tax Assessment Act 1936*.

A scheme will not be a "tax exploitation scheme" unless it comes within the terms of this section. Whether a scheme does come within the terms of the section, however, may be a matter of reasonable disagreement between reasonable people. The application of the section depends upon evaluative judgments about such matters as the purpose of an entity in entering into or carrying out a scheme and the reasonable arguability of a scheme benefit being "available at law". The section posits the various conditions for its operations as objective facts but they are apt to be unpredictable, uncertain and debatable. On the other hand, the ATP has "no business", or authority, to interfere with proper business dealings and practices. Accordingly, care should be taken to ensure that schemes are correctly identified as "tax exploitation schemes" if action against them is to be undertaken, and that such action which may be taken against them is defensible.

Another area where care will be required concerns the dividing line between a promoter caught by the legislation and an entity providing advice. The provisions do not apply to an entity who "merely" "provides advice about" a tax exploitation scheme. This dividing line set by the legislature is not an easy one to determine. In *Leary v Federal Commissioner of Taxation*[15] Brennan J drew attention to the distinction between a lawyer acting in the role of professional advisor and one acting in the role of an entrepreneur. His Honour said:

> It has not been material to consider whether it is possible for the role of a professional adviser and the role of an entrepreneur properly to coincide or overlap, but the appearance of solicitors performing these respective roles in the present case leads me to invite attention to significant differences between the two functions. These differences do not arise out of any judicial view as to the lawfulness or morality of tax avoidance: as to which see *Federal Commissioner of Taxation v. Westraders Pty. Ltd*. (1980) 54

[15] (1980) 47 FLR 414.

> A.L.J.R. 460; Commissioners of Inland Revenue v. Duke of Westminster [1936] A.C. 1; Latilla v. Inland Revenue Commissioners [1943] A.C. 377; In Estate of Vicars (1944) 45 S.R. (N.S.W.) 85, at p. 93; Re Weston's Settlements [1969] 1 Ch. 223, at p. 245. They arise because the field of professional activity is co-extensive with a lawyer's professional duty. That duty is to give advice as to the meaning and operation of the law and to render proper professional assistance in furtherance of a client's interests within the terms of the client's retainer. It is a duty which is cast upon a lawyer, as a member of an independent profession, whether his services are sought with respect to the operation of taxing statutes, the provisions of a contract, charges under the criminal law or any other of the varied fields of professional concern. It is a duty which arises out of the relationship of lawyer and client.
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> But activities of an entrepreneur in the promotion of a scheme in which taxpayers will be encouraged to participate falls outside the field of professional activity; those activities are not pursued in discharge of some antecedent professional duty. Entrepreneurial activity does not attract the same privilege nor the same protection as professional activity; and the promotion of a scheme in which particular clients may be advised to participate is pregnant with the possibility of conflict of entrepreneurial interest with professional duty. [16]

The distinction identified by his Honour between an entrepreneur and a person engaged in professional duty is a relevant distinction to the operation of the promoter penalty provisions. The section does not expressly exclude from its operation those activities falling within a professional's duty, but the distinction drawn by his Honour based upon a professional's duty, is likely to inform the legislation. It is possible that the legislation intrudes much more into the professional activities of lawyers and accountants than an application of the distinction drawn by Brennan J in *Leary*, however, his Honour's distinction is likely to serve as an important reference point. One reason why that is likely to be so is that activity falling within the "professional duty" of a lawyer (and today probably also a tax advisor who is not a lawyer) is an important pillar upon which the proper administration of the law fundamentally depends. Ordinary taxpayers frequently need professional assistance for no more sinister an activity than simply to comply with the complicated provisions that have become our tax laws. In that context, the law imposes obligations upon the professional to be proactive and to advise upon implications and structures even when the adviser might not be an expert in tax.[17]

These considerations will have an impact on how you may discharge your tasks. The Commissioner has extensive powers to investigate matters falling within his

16 Ibid, 434-435.

17 *Hurlingham Estates Ltd v Wilde* (1996) 37 ATR 261.

administration but the powers are not without limits and the discharge of those powers are not to be undertaken without careful regard to the responsibilities that go with the powers.

The Commissioner's resort to the statutory power exposes a recipient of a notice to additional risks and penalties. That fact alone may be sufficient to require that any person seeking to invoke the powers have good reason to do so. An ATO officer about to serve upon a person a notice under s 264 of the *Income Tax Assessment Act 1936* should usefully pause to consider whether the information about to be sought under compulsion is just as likely to be provided by a courteous request without imposing upon the recipient of the notice the additional statutory risks that flow from non-compliance. The ability to issue a notice under s 264 is not given to every member of the ATO but the use of the power may perhaps be more liberal than good governance within the ATO might justify. In any event, the way in which the powers are used should always be carefully considered.

Formal interviews under s 264 can proceed methodically, efficiently and fairly if properly organised and sufficient thought is given to how the interview will be conducted. The use of outside counsel to ask questions will sometimes make it easier for the authorised officer to be, and to be seen to be, more objective in evaluating the answers and the information received. The use of counsel to ask questions will make it easier for the authorised officer to listen to and to evaluate the answers and information obtained. This will better enable an authorised officer to identify any additional areas of enquiry either by the authorised officer personally asking questions for clarification or by identifying those areas for counsel to inquire into. Counsel, by their training and court experience, develop skills in eliciting information by question and answer in a way that is meaningful, useful and, where necessary or appropriate, capable of admission in evidence in court. Most ATO officers, including ATP officers, do not have the forensic skills, training or experience of that kind and cannot reasonably be expected to ask questions that elicit answers in a form that has probative value beyond the judgment of the particular interviewer.

In any event, the decision to conduct the formal interview will cause the interviewee to incur costs, disruption and at times personal anxiety. The elementary requirements of natural justice usually require giving adequate notice to persons who may be affected

by adverse decisions.[18] The content of the rules of natural justice will vary with the circumstances but the recipient of a notice under s 264 may conceivably require adequate notice to prepare. The consequences imposed by the statute should not be imposed upon interviewees without good cause. Good governance within the ATO requires that any decision to invoke statutory powers of this kind, carrying the consequences which they carry, be taken only after consideration of the desirability of the step and a weighing of the benefits and detriments both to the ATO and to the interviewee.

Once it is decided to embark upon the process of investigating by statutory means, it is essential that the mechanics of the process be thought out and planned. The legal control of the conduct of an interview lies with the authorised officer rather than any counsel, or other person, who may be asking the questions or who may be in attendance. Those involved on behalf of the ATO should, however, discuss and determine such matters as: who is to ask questions; whether the questions on different topics are to be asked by different people; the length of the interview; the breaks that are to be allowed during an interview session; and the presence, if any, and the role, if any, of legal advisors for the interviewee.

Questions being asked by more than one person on any one topic may not be useful, desirable or efficient. A questioner may be pursuing a line of thought when asking a series of questions which may be lost when another person cuts across those questions with other questions. In an extreme case it might also be oppressive to an interviewee to be subjected to questions from more than one person.[19]

The preparation for the interview will be important to its success and potential usefulness beyond the first steps of an audit. Any person who asks questions should be given a thorough understanding of the facts as they are known to the ATP. The matters to be explored should be identified precisely as well as the reasons for exploring them by the s 264 interview process. It should not be assumed, for example, that all external counsel will instinctively be aware of the nuances and ramifications of questioning upon a topic. It will always be more useful to identify both the matters to be identified and the reason for exploring them so that the person asking the questions can understand as fully as possible what it is to be investigated. For that task it will be

[18] *Baker v Gough* (1962) 80 WN (NSW) 1263.
[19] See *Lakatoi v Walker* [1999] NSWSC 1088.

useful to identify exactly what facts, issues and matters are to be explored and why they need to be explored. Consideration should also be given to whether some facts, issues or matters can more usefully be explored in some way other than a s 264 interview: getting details of company directors might be more usefully obtained by a corporate affairs extract rather than by asking a person in reliance upon their memory.

Careful consideration should also be given about whether to give the proposed interviewee some advance notice of the matters to be enquired into. In that context it may be useful to decide on the order of interviewing witnesses, and whether and when documents should be required to be produced. It may be desirable to have interviewees give consideration to some matters about which questions will be asked because the ATP may find it more useful to have a considered response on some matter rather than simply a person's recollection when asked for the first time without consideration or thought. Sometimes it will be useful to have a spontaneous response to a question without prior notice. But often it is best to obtain answers on questions which the interviewee has had time to consider. Giving notice enables the interviewee to look up records, check facts, consult with others, refresh memory and generally to provide a more informative response to what may be explored at the interview. It is generally better to provide copies of documents to the interviewee before the interview, particularly where there are many relevant documents. Human memory is fallible, and the purpose of a s 264 interview is to obtain information which the Commissioner can use to determine a matter falling within his legislative power. The Commissioner will not be assisted if the information obtained is based upon unreliable memory or guesswork.

It is often useful to have any s 264 interview summarised as a narrative of the facts established by the interview. That task should, in theory, be relatively easy especially when undertaken by experienced counsel. Questioners will commence any process of questioning with some idea of what they expect to enquire into or to establish. It is often the case that interviews under s 264 are conducted on the basis of an hypothesis to be tested. There will, therefore, often be some record before the interview of the facts which the interview is expected to establish or, at very least, intended to test. Many counsel prepare notes before an interview of the questions they intend to ask, or of the matters they expect to test or establish. These notes can form the basis of a subsequent narrative of facts that would otherwise be difficult to read or to find in a

transcript. Such a narrative should be cross-referenced to the transcript as well as to the documents in any book of documents created for the purpose of an interview. The cross-referencing of the narrative to the transcript and to the documents will enable a subsequent reader to find the transcript reference and the document said to support any fact which it is thought the interview established. This task will very substantially improve the usefulness of s 264 interviews. It would also be an important ATO internal control by reference to which decisions can be made about the usefulness and appropriateness of the exercise of the power. The ATO should have some means by which it can evaluate whether the burdens imposed upon interviewees were productive and defensible.

Negotiations and Settlements

A great deal has been written about the principles by which the Commissioner can, or should, settle cases.[20] The basis upon which any case is settled will, of course, always depend upon the particular facts. It might be useful, however, to give some thought to broader considerations affecting the conduct of negotiations and mediations that are frequently assumed without specific thought.

An issue of great importance which should carefully be considered in any negotiation (whether formal or otherwise) is the extent to which they are, or can be, conducted on a "without prejudice" basis. The law encourages discussions on a without prejudice basis as a means of facilitating disputes between parties. The application of those principles to government agencies is not, however, entirely without potential difficulties. The purpose of a without prejudice discussion is that a party may say something to another without that being used to the disadvantage of the divulging party in the future unless, of course, there is ultimate agreement and the agreement needs to be enforced. However, government agencies frequently have statutory duties which may be enlivened by something which has been told to them on a "without prejudice" basis. There is thus the possibility of a conflict arising between the maintaining of the confidence as a means of facilitating the resolution of disputes, on the one hand, and the discharge of statutory duties and enforcement of the law, on the other.

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[20] Australian Taxation Office, Law Administration Practice Statement PS LA 2007/23 'Alternative Dispute Resolution in Tax Office disputes and litigation'.

The settlement of disputes by a statutory office holder is also made complicated by the public functions that the officer holder discharges. It is much easier for a private individual to sacrifice his or her private rights and interests in order to reach a resolution of a private dispute. A statutory office holder, however, does not sacrifice private interests when agreeing to something less than the office holder had sought but, rather, sacrifices that person's view of a public right or entitlement. Giving up parts of claims by a statutory office holder must, therefore, be defensible as public acts, which are frequently the subject of scrutiny, review and accountability. What the statutory office holder may be sacrificing when compromising a claim is not merely the quantum to be secured from a person, or the extent of a penalty to be imposed upon a person, but a considered view of the meaning and operation of the law as it ought to be applied and, perhaps, as it is applied to others in like circumstances. In other words, the considerations when a matter is to be settled, negotiated or compromised include not only assessments about quantums that may be secured in continuing litigation, but also such fundamental issues as whether the statutory office holder has the entitlement to apply the law other than as the office holder believes it to be applied or in a way which will result in inconsistent application as between different members of the public. It is one thing for an office holder to be told that a case should be compromised because the facts may justify a variety of outcomes including a proposed compromise which in the opinion of an experienced litigator is regarded as reasonable. It is quite another thing, at least in principle, for a case to be compromised on the basis that some policy evident in legislation will not be enforced either at all or only against particular individuals.
