

MELBOURNE UNIVERSITY LAW REVIEW
OF 'SHAM' AND OTHER LESSONS FOR AUSTRALIAN REVENUE
LAW *

The Hon Justice Michael Kirby AC CMG **

TAX LAW AND THE GENIUS OF THE CONSTITUTION

The starting point for a reflection on Australia's revenue law must necessarily be the Constitution. In that document, the power to enact laws imposing taxation is expressed in very wide terms¹. However, from its earliest days, the High Court of Australia has insisted that, to be a law with respect to "taxation", the law must not be arbitrary. It must be based on an ascertainable criterion and susceptible to judicial scrutiny². Whereas in other polities, laws with respect to taxation may, if they please, be substantively and procedurally arbitrary, in Australia, the contrary is the case.

* Text of the Annual Taxation Lecture given at the University of Melbourne on 20 August 2008.

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¹ *R v Barger* (1908) 6 CLR 41 at 94-95 per Isaacs J; 114 per Higgins J; [1908] HCA 43. See *Commissioner of Taxation v Futuris Corporation Ltd* [2008] HCA 32 at [79].

² *Deputy Federal Commissioner of Taxation v Brown* (1958) 100 CLR 32 at 40 per Dixon CJ; [1958] HCA 2. See also at 52 per Williams J.

2.

The purpose of this lecture is to draw attention to two recent decisions of the High Court of Australia that have touched upon these dual features of our federal taxation law. Ultimately, decisions as to whether the constitutional criteria have been met belong not to elected politicians or to officials but to the courts, ultimately to the High Court.

Any attempt to render a tax imposed by federal law incontestable in Australia would take the law concerned beyond the legislative power granted to the Parliament by the Constitution³. This insight imposes on our revenue law, distinctive features, three of which I intend to explore in this lecture. I will do so by reference to *Raftland Pty Ltd, Trustee of the Raftland Trust v Commissioner of Taxation*⁴ ("Raftland") and *Commissioner of Taxation v Futuris Corporation Limited*⁵ ("Futuris"). I will close with observations of a general kind addressed to the important contribution that revenue law, and revenue lawyers, make to law and governance in Australia, and thus to the nation's economic and social success.

³ *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 633 at 639-640 per Gibbs CJ, Wilson, Deane and Dawson JJ calling on *Australian Communist Party v The Commonwealth* (1951) 83 CLR 1 at 258 per Fullagar J [1951] HCA 5.

⁴ (2008) 82 ALJR 934; 246 ALR 406; [2008] HCA 21.

⁵ [2008] HCA 32.

3.

The Law School of the University of Melbourne, which sponsors this annual lecture, has long enjoyed particular strengths in the fields of corporations and business law and revenue law. To those subjects, in my own *alma mater*, the University of Sydney, Professor Ross Parsons, between the 1950s and 1970s, made a specially important contribution. It was Professor Parsons who introduced me to the challenges of revenue law. That law was then contained in statutory provisions that, from today's perspective, seem tiny and very simple by contrast with the laws of today. Ross Parsons taught Murray Gleeson, Mary Gaudron, William Gummow, Graham Hill, me and many others to search for legal principles in the mass of statutory detail. Great is the debt owed by judges and other lawyers, as well as by accountants and taxation administrators, to the scholars and teachers who accept the obligation of bringing order and discipline to this vital area of the law.

It is because, ultimately, federal revenue laws must be susceptible to judicial examination to ensure "compliance with the constitutional limits upon that power"⁶, that the substance and procedures of federal taxation laws must, in the end, be capable of coming under the scrutiny of courts. In this respect, the development and exposition of Australia's taxation law comes eventually to a judicial bench that is not necessarily *specialist* in experience but *generalist* in its composition and function.

⁶ *MacCormick* (1984) 158 CLR 622.

Traditionally, some members of the High Court, in their legal practices and professional backgrounds, will have had close familiarity with revenue law. But not all. This too is part of the genius of the Constitution. Specialists can sometimes become too close to the assumptions and doctrines of the past. They may adhere to legal theories, long after these have lost their usefulness. They may cling to the ideas in apparent disharmony with the attempts of the legislature to introduce new concepts. They may be blind to changes in the economic and social context within which the law operates. Such blindness may influence even their reading of comparatively clear statutory provisions whose meaning appears plain to the non-specialist.

Justice Gummow pointed this out in his recent essay "Form or Substance?" It was the error that once beset the High Court of Australia in its exposition of the meaning and operation of ss 90 and 92 of the Constitution⁷:

"... [T]he ever-shifting, ever-unsatisfactory case law construing both s 90 and s 92 of the Constitution had been blighted by the refusal of the Court to look behind the form provided by the text of s 90 and s 92 to an appreciation of the nineteenth century political and economic theories and debates upon free trade and protectionism which preceded the adoption of the Constitution. ... [T]o read s 92 in its historical context⁸ is ... [to give] s 92 a reach beyond the

⁷ (2008) 30 *Australian Bar Review* 229 at 240-241 (hereafter "Gummow").

⁸ See now *Betfair Pty Ltd v State of Western Australia* (2008) 82 ALJR 600; [2008] HCA 11.

elimination of discriminatory burdens of a protectionist kind upon interstate trade and commerce. Here then, in matters of the highest law in our system, are differing applications of the notions of form and substance".

Inspired though I was by Ross Parsons's instruction on revenue law, chance considerations took my legal career on a different path⁹. Perhaps my fate was sealed by the Pope's line that the young Murray Gleeson and I so nonchalantly drew in our early law school days: dividing our shared burdens among the topics we studied. If to him we assigned revenue law, to me we assigned jurisprudence and legal theory. Upon this division of the legal subjects may have hung the special focus of our respective legal interests in the decades that were to follow. If, in revenue law, he had the particular knowledge and expertise, perhaps it was for me to feel a need to scrutinise the outcomes more critically, in according with deep-lying principles and to question received wisdom. This is what I take the Constitution to require.

Thus, although in the United States of America, the Supreme Court, hearing taxation and other appeals, is not a court of general jurisdiction, deciding cases on a whole range of legal problems, including from State courts, in Australia (as earlier in Canada) the highest court is such a court. The obligation of revenue lawyers to submit and argue their contentions before an ultimate national appellate

⁹ M D Kirby, "Ten Parables for Freshly-Minted Lawyers" (2006) 33(1) *The University of Western Australia Law Review* 23 at 25.

court of general jurisdiction, is, I suggest, a healthy corrective against over-specialisation, self-satisfaction and professional hubris¹⁰. This is one of the reasons why, below the High Court, I favour the continuation of the role of the Federal Court of Australia in taxation appeals. I disagree with the idea of creating a specialist court of taxation appeals which would run the risk of divorcing taxation law from the invigorating *stimuli* of general legal developments - a subject to which I will return¹¹.

SHAM - THE RELUCTANT EMBRACE

Against the background of this introduction to my three themes, I turn to the first. It concerns the role that reasoning by reference to an opinion that transactions constitute a "sham" can play in Australian revenue law, as illustrated by the recent decision in *Raftland*¹². Self-evidently, nothing that I say in these or any other remarks expands the matters for which that decision (or any other) stands, in terms of legal doctrine. The *ratio decidendi* of *Raftland*, as of any other case, can only be derived from the judicial reasons offered to support the court's dispositive orders¹³.

¹⁰ *Commissioner of Taxation v Ryan* (2001) 201 CLR 108 at 146 [84]; [2001] HCA 4.

¹¹ M D Kirby, "Huberis Contained: Why a Separate Australian Tax Court Should be Rejected" (2007) 42 *Taxation in Australia* 161.

¹² (2008) 82 ALJR 934.

¹³ *Garcia v National Australia Bank Limited* (1998) 194 CLR 395 at 417-418 [56]; [1998] HCA 48.

The facts of the *Raftland* case were complex. The broad circumstances were that a company, Raftland Pty Ltd, was a member of a group of companies involved in real property development and leasing. In 1995 and in subsequent tax years it sought to minimize its income tax by channelling profits through an entity with substantial accumulated tax losses. An unrelated loss-bearing unit trust was "acquired" through a firm of accountants. The loss bearing trust was designated as the "tertiary beneficiary" of a discretionary trust within the group. Raftland was the trustee of that trust. Ostensibly, the tertiary beneficiary was entitled to receive distributions from the discretionary trust. Group profits for the 1995 tax year were distributed to Raftland. In turn, it passed resolutions to distribute its entire income to the loss-bearing trust in two transactions. In fact, the second and much larger transaction was never paid.

The Commissioner of Taxation disallowed Raftland's objection to an amended assessment made by him relying initially upon Pt IVA of the 1936 Act. Subsequently, the Commissioner relied on s 100A of the Act to sustain his assessment. The primary judge (Kiefel J) dismissed Raftland's appeal. Like the primary judge, the High Court held that the apparent discrepancy between the entitlements appearing on the face of the parties' documents and the way the funds were in fact applied raised a question as to whether the documents could be accepted at face value. Particular documents and transactions could be questioned and ultimately disregarded if there was other evidence of the intentions of the

parties evidencing purposes different from those apparent in the documents and demonstrating that the documents could not, and did not, constitute the entirety of the parties' agreed arrangements. The orders of the primary judge were thus sustained. The High Court preferred her Honour's analysis to that of the Full Federal Court.

Upon the subject of "sham" analysis, there was a division of opinion in the High Court, reflected in the approaches severally taken in the three judicial opinions written to support the High Court's unanimous orders.

- Three judges (Gleeson CJ, Gummow and Crennan JJ) noted that the Commissioner of Taxation had "relied, with good effect, before Kiefel J [the trial judge], upon an argument that invoked the concept of "sham" but that such argument was not "aimed at the entire complex of arrangements"¹⁴. Crucially, the joint reasons depended for their conclusion that there was an "apparent discrepancy between the entitlements appearing on the face of the documents and the way in which the funds were applied". According to the joint reasons, this "discrepancy" gave rise "to a question whether the documents were to be taken at face value" or as "not fully disclosing the legal rights and entitlements for which it provides on its face"¹⁵. As the joint reasons noted, in

¹⁴ (2008) 82 ALJR 934 at 940 [8].

¹⁵ (2008) 82 ALJR 934 at 944 [33].

such a case, the parol evidence rule in Australia, forbidding access to evidence outside the parties' written agreements to contradict or vary the legal purport of those instruments, does not apply¹⁶. Upon that footing, the joint reasons acknowledged that "the term 'sham' may be employed here"¹⁷. Whilst the word, and the reasoning it introduced, had to be deployed with caution (so far as it suggested the presence of fraud), it could be deployed in *Raftland's* case "to deny the critical step in [*Raftland's* argument]"¹⁸;

- In separate concurring reasons, Heydon J, in *Raftland*¹⁹ concluded that it was not possible in the case to assert that there had been a "sham", in the sense of "a transaction aimed at deceiving third parties". Heydon J stated that "the trial judge did not make a finding to that effect, and does not seem to have been explicitly invited to do so". "In these circumstances", he concluded, "it would be difficult in this Court to make that finding in this case"²⁰. Instead, the contested provision of the Raftland trust deed was to be seen as "valid and operative between the parties" but "omitting (designedly or otherwise) some particular term which

¹⁶ (2008) 82 ALJR 934 at 944 [33] referring to *Hoyts Pty Ltd v Spencer* (1919) 27 CLR 133 at 144; [1919] HCA 64.

¹⁷ (2008) 82 ALJR 934 at 944 [35].

¹⁸ (2008) 82 ALJR 934 at 944 [36].

¹⁹ (2008) 82 ALJR 934 at 966 [173].

²⁰ (2008) 82 ALJR 934 at 966 [173].

had been verbally agreed upon"²¹. This would render it, effectively, a mere piece of machinery falling short of the "only real agreement" between the parties and thus unenforceable for that reason, without resort to a doctrine of "sham"²²;

- In my own reasons, I contested Heydon J's approach to the applicability of "sham" analysis in the case. I did so by reference to my appreciation of the objective features of the complex written transactions between the parties. It was that analysis that governed the outcome of the appeal²³. I also relied on the conclusions upon these matters expressed by the primary judge; her express invocation of the orthodox understanding of the appearance of a legal "sham"²⁴; the justification given by the primary judge for the imposition on Raftland, as a consequence, of additional tax for "recklessness" in making its return²⁵; the differences that then emerged between the primary judge and the Full Court resolved in the joint reasons (and by myself) in favour of the approach of the primary judge²⁶; and the terms in which the

²¹ (2008) 82 ALJR 934 at 966 [177].

²² (2008) 82 ALJR 934 at 966 [177].

²³ (2008) 82 ALJR 934 at 948 [58]. See also at 952-953 [90]-[92].

²⁴ (2008) 82 ALJR 934 at 954 [95] citing the primary judge (2006) 227 ALR 598 at 618 [89]-[90].

²⁵ (2008) 82 ALJR 934 at 955 [98] citing (2006) 227 ALR 598 at 621 [105].

²⁶ (2008) 82 ALJR 934 at 949 [63]-[64]; 964 [155]-[157].

Commissioner's arguments had been addressed to the High Court, expressly supporting the "sham" analysis adopted at first instance²⁷.

Now I reach the interesting questions. If there were so many reasons for analysing the *Raftland* case in terms of "sham" in terms of the evidence in the case; the analysis at first instance; the differences on appeal; the consequential arguments; the contested issues; and reasons of principle, what explanation can exist for the apparent disinclination of some judges to adopt that tool of analysis? At least, what reason can exist for an unwillingness to do so robustly, when the case arrives in appellate courts? Specifically, what is the reason for the discernable reluctance of Australian judges, particularly in cases of revenue law, to embark upon an application of the notion of "sham" for legal purposes as expressed in the language that the High Court adopted in *Equuscorp Pty Ltd v Glengannan Investments Pty Ltd*²⁸.

The notion of a "sham", for the purposes of legal analysis, has existed in Australian law, at least since the earliest days of the High Court. It was explained by Isaacs J in *Jaques v Federal Commissioner of Taxation*²⁹ as involving the use of documents that were "inherently

²⁷ (2008) 82 ALJR 934 at 952-953 [90] citing [2008] HCA Trans 009 at 94 [4222].

²⁸ (2004) 218 CLR 471 at 487 [48]-[49]; [2004] HCA 55. This passage had been cited by the primary judge: (2006) 227 ALR 598.

²⁹ (1924) 34 CLR 328 at 358; [1924] HCA 60.

worthless". As he said: "no enactment [is needed] to nullify [the transaction]" where that is so."

THREE REASONS FOR RELUCTANCE OVER 'SHAM'

I postulate three fundamental reasons why courts, including in Australian revenue cases, have been reluctant to engage with a robust application of "sham" analysis and, indeed why they have embraced the narrow principle stated in *Equuscorp*, (which was nonetheless sufficient to import the concept of "sham" into the reasoning in *Raftland*). In *Equuscorp*³⁰, another case of complex and seemingly artificial documentation, the High Court had said:

"'Sham' is an expression which has a well understood legal meaning. It refers to steps which take the form of a legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences"³¹.

The three reasons for this judicial reluctance over "sham" appear to be:

- (1) The law, including in revenue cases, operates on evidence, commonly in such cases, documentary evidence. In applying the rules of the common law and the provisions of revenue legislation,

³⁰ (2004) 218 CLR 471 at 486 [46].

³¹ Referring to the oft-quoted definition of Lockhart J in *Sharrment v Official Trustee in Bankruptcy* (1988) 18 FCR 449.

courts ordinarily act upon the assumption that such documents are intended to, and do, define the relevant relationships of the parties to them, upon which the provisions of revenue law are intended to attach. In the busy lives of officials, lawyers and courts, it is easier to apply legal rules to the facts derived from such documents rather than to go beyond, and outside, the documents or to address the supposed 'true facts' of the parties' relationships. There are those who draw back in distaste (if not resistance) to the suggestion that they should go behind the documents and give effect to contradictory 'realities'. Finding and applying the relevant law to ascertained facts is difficult enough without injecting a larger and more onerous enquiry. Ascertaining facts apparently in conflict with the written texts by which parties have defined their relationships necessarily involves cost and a degree of inefficiency which the law is understandably reluctant to allow. This is the basic reason behind the parole evidence rule that normally restrains those who seek to go outside, or against, the written documents by which parties have defined the relationships by which they agree to be bound.

There may be a psychological reluctance on the part of lawyers, especially those trained in the strict disciplines of property law (in which I would include revenue law). They may resist the needless opening up of evidence and analysis directed at complex factual reality, as distinct from the legal instruments in which parties have stated to the world their agreed arrangements for the deployment

of their property. In revenue matters especially, such arrangements are frequently detailed, careful and complex. The definition of property interests usually demands nothing less. In a sense, the edifice of legal rules is substantially built upon documentation which the parties propound. Whilst courts, both of common law and equity, will sometimes go behind such documents, doing so is exceptional. It is generally uncongenial. Often, it runs against the grain of property lawyers who are usually most comfortable working in the concrete world of written instruments where property rights, privileges and obligations are ordinarily to be found. The messy world of a contradicting actuality may be distasteful to neat and tidy legal minds. Such considerations may help to explain the common reluctance of property lawyers to stray far from the written texts with which they feel at home. In this final reason I indulge in a little psychological speculation. But I may not be far from the mark.

- (2) The second reason goes beyond the foregoing generalities which, however, find a measure of reflection in evidentiary and other rules of law. In Australian revenue law, as elsewhere, there has been a vigorous judicial and academic debate³² over the invocation of "sham" analysis to permit revenue authorities to go

³² See eg Tiley, *Revenue Law*, 5th ed (2005), 107 and *Paintin and Nottingham Ltd v Miller Gate and Winter* [1971] NZLR 165 at 175 (NZCA) per Turner J. See *Raftland* (2008) 82 ALJR 934 at 952 [89].

behind the written instruments by which taxpayers, and those with whom they deal, attempt to express their relationships for revenue law purposes. At the heart of this debate has been a recognition of the fact that self-interested conduct by taxpayers might sometimes encourage arrangements of extreme artificiality in order to reduce tax liability. At the same time arises a recognition that courts cannot "ignore the [reality] that ... tax laws [now] affect the shape of nearly every business transaction"³³, such that businesses plan their affairs around the realities of tax liability, competition law and other commonly applicable statutes³⁴. In effect, a business that failed to do so would be in breach of its obligation to its shareholders. Between the legitimate purpose of the law to strike down completely artificial 'schemes' and the commercial imperative to design transactions so as to place taxpayers in as advantageous a position as the law permits, lies the territory of debate over impermissible tax avoidance and acceptable tax minimisation.

As I remarked in *Raftland*³⁵, in 1935 the Supreme Court of the United States in *Gregory v Helvering*³⁶ expressed a doctrine akin

³³ *Frank Lyon Co v United States* 435 US 561 at 580 (1978) cited *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404 at 416; [1996] HCA 34.

³⁴ *Commissioner of Internal Revenue v Brown* 380 US 563 at 579-580 (1965); cf *Spotless* (1996) 186 CLR 404 at 415-416.

³⁵ (2008) 82 ALJR 934 at 956 [107]ff.

to "sham" in order to enhance the ability of the revenue to disregard seriously artificial transactions albeit of ostensible legal regularity and effect:

'The whole undertaking ... was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganisation, and nothing else. ... To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose'.

Ten years later the same Court in *Commissioner of Internal Revenue v Court Holding Co*³⁷ reinforced a similar approach in the context of revenue law:

"To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress".

Revenue law in Australia has generally resisted such reasoning. The literal approach to the interpretation of most statutes, adopted by the High Court in its earlier years, condoned many 'schemes' of tax avoidance that were upheld despite their obvious artificiality³⁸. By 1980, these decisions produced a strong protest, in the High

³⁶ 293 US 465 at 470 (1935).

³⁷ 324 US 331 at 334 (1945).

³⁸ See eg *Curran v Federal Commissioner of Taxation* (1974) 131 CLR 409; [1974] HCA 46.

Court, written by Murphy J, calling for the abandonment of what he described as "strict literalism" in the interpretation of statutes, particularly revenue statutes. In *Federal Commissioner of Taxation v Westrad Pty Ltd*³⁹, Murphy J, citing the foregoing United States decisions, appealed for a broader, purposive approach to the interpretation of revenue law in Australia⁴⁰:

"Progress towards a free society will not be advanced by attributing to Parliament meanings which no one believes it intended so that income tax becomes optional for the rich while remaining compulsory for most income earners".

Whilst the appeal of Murphy J did not produce immediate judicial support in the High Court, nevertheless, as quite often happened, it worked as a catalyst for an ultimate response. At first, this happened in a series of decisions in the newly created Federal Court of Australia, which had assumed from the High Court the primary responsibility for taxation appeals. Then, in turn, in the High Court, two developments happened that were supportive of arguments by the revenue, urging courts, in cases involving highly artificial transactions, to travel behind the parties' documentation, so as to consider the apparent realities, and thereby to test the imputed "intentions" of the parties purportedly stated in their documents. The first consequence was a general shift in the

³⁹ (1980) 144 CLR 55 at 79; [1980] HCA 24.

⁴⁰ (1980) 144 CLR 55 at 80.

approach of the High Court away from a purely "literalistic" examination of legislation in favour of a consideration of the *context* of the statutory words and the *purposes* that the law was designed to achieve⁴¹. The second was a greater willingness of courts to acknowledge "sham analysis" in particular circumstances so as to derive the real intentions of the parties to transactions having revenue consequences⁴².

As Australian revenue law presently stands, the appeal by Murphy J for the development of a comprehensive doctrine of "sham", capable of dealing with *all* "artificial and contrived transactions for tax avoidance purposes"⁴³ remains out of favour in the High Court. The continuing reluctance of the Court to adopt such an approach may be seen in its rejection of the "fiscal nullity" notion at common law, adopted by the House of Lords in *W T Ramsay Ltd v Inland Revenue Commissioners*⁴⁴. In the High Court of Australia, this notion has been rejected, in part because of the enactment of

⁴¹ *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408; [1997] HCA 2; *Newcastle City Council v GIO Ltd* (1997) 191 CLR 85 at 112-113; *Project Blue Sky Ltd v Australian Broadcasting Corp* (1998) 194 CLR 355 at 381 [69], 384 [78].

⁴² *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449 at 453-454 affirmed *Equuscorp Pty Ltd v Glengallon Investments Pty Ltd* (2004) 218 CLR 471 at 486 [46]; [2004] HCA 55.

⁴³ *Federal Commissioner of Taxation v Westradars* (1980) 144 CLR 55 at 79.

⁴⁴ [1982] AC 300.

particular federal statutory provisions, adopted for the specific purpose of inhibiting unacceptable forms of tax avoidance⁴⁵.

- (3) The third reason for the reluctance of Australian courts to venture too vigorously into the field of "sham" analysis was referred to, in *Raftland*, in the joint reasons⁴⁶, with which I relevantly agreed⁴⁷. This was encapsulated in the explanation that in *Raftland* as in other cases where the "sham" doctrine has been invoked, the Commissioner must be quite careful. He must deploy a surgeon's scalpel rather than a butcher's axe. The former will permit him to persuade the Court to disregard *particular* transactions or *aspects* of those transactions, without bringing down the whole analysis upon which he relies to uphold his assessment of taxation due, addressed to the income of a particular taxpayer. To the extent that any "sham" analysis were to demolish the entire edifice, built upon the documentation produced by the parties (and to invite the Court to go behind those documents and to analyse the so-called "real" or "true" dealings of the parties), it might produce an outcome inimical to the Commissioner's fundamental assertion that the named taxpayer was the recipient of the identified

⁴⁵ *Federal Commissioner of Taxation v Patcorp Investments Ltd* (1976) 140 CLR 247 at 292 cited *John v Federal Commissioner of Taxation* (1989) 166 CLR 417 at 434-435; [1989] HCA 5.

⁴⁶ (2008) 82 ALJR 934 at 940 [8].

⁴⁷ (2008) 82 ALJR 934 at 952 [86].

"income" so as to give rise to the liability in that taxpayer to income tax under the statute as claimed by the Commissioner.

Thus, "sham" in revenue law, like truth in evidence law, can be loved too unwisely and pursued it too keenly⁴⁸. Too ardent a desire to tear up the written documents by which the parties have purported to express their relationships (and to search for the "reality" and "truth" behind their dealings) might take the inquisitor into outcomes which neither the taxpayer nor the revenue really want. Perhaps this consideration, most of all, helps to explain the psychological reluctance of revenue lawyers in Australia to abandon their documents in favour of what they would doubtless regard as a chimerical quest for illusory actuality.

THE CURRENT DOCTRINE OF 'SHAM'

The contemporary debates about "sham" in revenue law occur in the context of a wider discourse about the law's attitude to form and substance. As Gummow J recognised in his recent essay on that subject, the law generally (but not always) assigns a greater weight, or even decisive effect, to substance rather than form⁴⁹.

⁴⁸ cf *Pearse v Pearse* (1846) 1 DeG & SM 12 at 28; 63 ER 950 at 957.

⁴⁹ Gummow (2008) 30 *Australian Bar Review* 229 abstract.

Nevertheless, this is not always so, including in revenue law. Sometimes the law is properly attentive to considerations of form. Recently, in *R v Clarke*⁵⁰, a criminal case, Lord Bingham of Cornhill, in the House of Lords, said⁵¹:

"Technicality is always distasteful when it appears to contradict the merits of the case. But the duty of the court is to apply the law, which is sometimes technical, and it may be thought that if the state exercises its coercive power to put a citizen on trial for serious crime a certain degree of formality is not out of place".

In joint dissenting reasons in *Ayles v The Queen*⁵², Gummow J and I applied Lord Bingham's *dictum* to the context of criminal procedure. By contrast, the majority in that case invoked considerations of substance. They rejected the arguments as to form despite the admitted deficiencies in the procedures that had been followed by the prosecution. Once again, the divergences of opinion over such matters emerged⁵³. They have also frequently been apparent in revenue cases where the proponents of "sham" have appealed to *substance* and the opponents have insisted on the application of the revenue law to the

⁵⁰ [2008] UKHL 8.

⁵¹ [2008] UKHL 8 at [17].

⁵² (2008) 82 ALJR 502 at 509 [28] per Gummow and Kirby JJ (diss); [2008] HCA 6.

⁵³ cf *Weiss v The Queen* (2005) 224 CLR 300 at 311 [26]ff; [2005] HCA 81.

forms evident in the parties' documentation. This was the ground upon which battle was joined in *Raftland*.

Within the dialogue about form and substance, historically, it was the solicitude of courts of equity to uphold charitable purposes in wills and trusts that promoted an approach that addressed the manifest intention of the relevant actors, despite their failure to perfect that intention by taking the proper legal or formal steps⁵⁴. In such cases, it was equity's search for the "intention" of the actors that introduced a vehicle to overcome the apparent impediment of documentary or other formal defects⁵⁵.

This line of reasoning found its way into Australian revenue law in *Scott v Commissioner of Taxation [No 2]*⁵⁶. Windeyer J there remarked:

"The difficult and debatable philosophic questions of the meaning and relationship of reality, substance and form are, for the purposes of our law generally resolved by asking did the parties to enter into the ostensible transaction meant to be in truth their transaction, or did they mean it to be, and in fact use it as, merely a disguise, a façade, a sham, a false front - all of these words have been metaphorically used - concealing their real transaction".

⁵⁴ Gummow (2008) 30 *Australian Bar Review* 229 at 232.

⁵⁵ *Attorney-General (NSW) v Perpetual Trustee Co (Ltd) (Milly Milly Case)* (1040) 63 CLR 209 at 226-227 per Dixon and Evatt JJ; [1940] HCA 12.

⁵⁶ (1966) 40 ALJR 265 at 279.

Subsequently, in *Gurfinkel v Bentley Pty Ltd*⁵⁷ Windeyer J observed:

"Of course, if it can be shewn by parol evidence that both parties to a transaction adopted the form they did as a disguise, then their true intent and not the form will prevail. Thus agreements that were in form sales have sometimes been held to be mortgages when the form of a sale has been adopted as a disguise".

Once this approach to the controversy about "sham" in the revenue context is appreciated, it has to be accepted that the operation of the law in this respect is inescapably opaque. This is because, as Gummow J concluded in his treatment of the topic, "policy choices are made. But frequently what is not found is the articulation of the reasons supporting one such choice rather than another"⁵⁸. Some of the policy choices that are at work in this area of the law have already been identified by me. Once they are understood, it should occasion little surprise that the way they play out in the particular case will often be hotly contested.

The foregoing considerations bear out the practical comment made by Dowsett J, in the Full Federal Court, in his concurring reasons in that court in *Raftland*⁵⁹:

⁵⁷ (1966) 116 CLR 98 at 114; [1966] HCA 75.

⁵⁸ Gummow (2008) 30 *Australian Bar Review* 229 at 241.

⁵⁹ (2007) 65 ATR 336 at 342 [4].

"... Whether or not the parties intended that legal or equitable rights and obligations be created by the various transactions into which they entered [needs to be considered] ... [T]he question to be addressed is whether the parties intended that the various transactions take effect, or whether they were really trying to camouflage the real nature of the deal between them. In such a case the court must decide where reality stops and camouflage starts".

Dowsett J was correct to identify the problem as he did. It is obviously a problem for characterisation that depends upon the assessment by the decision-maker of the entirety of the evidence. About that assessment, informed minds will sometimes differ. Nevertheless, as Richardson J (a judge with much knowledge in this area) remarked in the Court of Appeal of New Zealand, it is often the case that⁶⁰:

"The true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out: not on an assessment of the broad substance of the transaction measured by the results intended and achieved or of the overall economic consequences".

'Schemes' of varying degrees of complexity and artificiality will sometimes be so obvious as to invite a conclusion that the documents have set out to disguise the true nature of the dealings and to present to the world an appearance of their *intended* relationships that differs from

⁶⁰ *Marac Life Assurance Ltd v Commissioner for Inland Revenue* [1986] 1 NZLR 694 at 706.

the actuality. It was just such arrangements that caused the legislature to enact both general⁶¹ and specific⁶² provisions in taxation legislation, aimed to target varying degrees of artificiality and to permit, or even oblige, courts to initiate a search for the "real" or "true" effect of the dealings.

Where anti-avoidance legislation exists, it is perhaps understandable for courts to feel a measure of reluctance about developing broad common law notions such as "sham" and, instead, to apply the express provisions of the statute. However, in terms of legal principle, the common law does not normally stand paralysed simply because legislative provisions have been adopted. The existence of Pt IVA of the *Income Tax Assessment Act* 1936 (Cth), or of s 100A (which was in issue in *Raftland*) does not mean that the tool of analysis potentially afforded by "sham" doctrine is unavailable to decision-makers. It simply means that any resulting common law doctrine must continue to evolve in the orbit of the statutory provisions that have been enacted⁶³.

A feature of the cases in which the contention is made that the documentation, relied on by the taxpayer, constitutes a "sham" is that

⁶¹ *Income Tax Assessment Act* 1981 (Cth), s 260.

⁶² eg *ibid*, s 100A.

⁶³ (2008) 82 ALJR 934 at 965 [159] citing *Road and Traffic Authority (NSW) v Royal* (2008) 82 ALJR 870 at 888 [93]; [2008] HCA 19.

the documents are commonly extremely complex, sometimes for the very purpose of hiding what is suggested to be the "real transaction". That, in part, was the conclusion of Kiefel J at first instance in *Raftland*⁶⁴. It was a conclusion reached in many earlier cases. A good example was *R v Inland Revenue Commissioners; Ex parte Matrix Securities Ltd*⁶⁵. There Lord Templeman referred to what he called "[t]he trick of circular, self-cancelling payments with matching receipts and payments". *Equuscorp* also appeared to be such a case. In *Equuscorp*, however, the boot was on the other foot. The taxpayers having improvidently entered into a complex 'scheme', the High Court held that they should be fixed with its obligations. If they set out to take the legal benefits, they should be prepared to assume the legal burdens.

It is obviously important for decision-makers to observe the requirements of procedural fairness in cases where "sham" analysis to be invoked. This is because (as the joint reasons noted in *Raftland*) allegations of the existence of a "sham" transaction will sometimes involve a suggestion of fraud. The law has always insisted that allegations of fraud must be pleaded, proved and argued for clearly and directly, not left to implication. If the revenue is to allege that particular transactions of a taxpayer constitute a "sham", so that the documentation does not disclose the taxpayer's "real" or "true"

⁶⁴ (2006) 227 ALR 598 at 617 [86]

⁶⁵ [1994] 1 WLR 334 at 345.

intentions, it is essential that such a contention should be made clear. Only that course will ensure that the allegation can be put in issue and addressed by relevant evidence⁶⁶. Also relevant, in this regard, is the *locus* of the burden of proof in the case, given that a suggestion of "sham" is easily made but, where essential, needs to be clearly proved or disproved, by the party which in law bears the legal obligation to do so.

The mere fact that a transaction appears to be artificial, circular, designed to achieve a reduction of tax liability or commercially uneconomic is not sufficient to warrant a conclusion that it represents a "sham", authorising a court to disregard it for subsequent legal analysis⁶⁷. By the same token, if parol evidence is admitted to cast doubt on the reality and actuality of the arrangements expressed in the written documents, a court is not obliged to accept those documents on their face, unquestioningly. It is not required blindly to apply to a party's assertions about the status and character of its transactions.

Under *Equuscorp*, the test in Australia addresses the intentions of the parties⁶⁸. In *Raftland*, I put it this way⁶⁹:

⁶⁶ (2008) 82 ALJR 934 at 952 [89].

⁶⁷ (2008) 82 ALJR 934 at 958 [118], 963 [149].

⁶⁸ (2008) 82 ALJR 934 at 961 [130]-[134].

⁶⁹ (2008) 82 ALJR 934 at 964 [146]-[149].

"In essence, the parties must have intended to create rights and obligations different from those described in their documents. Such documents must have been intended to mislead third parties in respect of such rights and obligations⁷⁰ .

Where a court is considering a suggestion of sham that has a reasonably arguable evidentiary foundation, the court will not be confined to examining the propounded documentation alone. It may examine (and draw inferences from) other evidence, including the parties' explanations (if any) as to their dealings, and evidence describing their subsequent conduct⁷¹ .

To justify a conclusion that documents constitute a sham, the requisite intention to mislead must be a common intention of the parties⁷² . An exception may exist where the acts and documents reflect a transaction divisible into separate parts, such that a transaction is a sham as to part only of the transaction⁷³ .

Neither the complexity nor the artificiality of a transaction⁷⁴ , nor any circularity evident in it⁷⁵ , nor the apparent lack of commercial or economic sense⁷⁶ will of themselves, alone or in combination, necessarily warrant a conclusion that a transaction constitutes a sham⁷⁷ . Nor does a departure by the parties from the terms of their original agreement necessarily indicate that they never intended that agreement to be effective and binding

⁷⁰ *Stone (HM Inspector of Taxes) v Hitch* [2001] STC 214 at [66].

⁷¹ *Stone* [2001] STC 214 at [65].

⁷² *Stone* [2001] STC 214 at [69].

⁷³ See *New Zealand Commissioner of Inland Revenue, "Sham – meaning of the term"* (1997) 9(11) *Tax Information Bulletin* 7 at 7-8.

⁷⁴ *Sharrment* (1988) 18 FCR 449 at 454-5; *Oakey Abattoir Pty Ltd v FCT* (1984) 15 ATR 1059.

⁷⁵ *Sharrment* (1988) 18 FCR 449 at 458.

⁷⁶ See *Disputant (TRA 98/055) v CIR* (2005) 22 NZTC 12,155 at [116].

⁷⁷ cf *Accent Management Ltd v CIR* (2007) 23 NZTC 21,323 at [59].

according to its tenor⁷⁸. Nevertheless a sham can develop over time if there is a departure from the original agreement and the parties knowingly do nothing to alter the provisions of their documents as a consequence.⁷⁹

In the limited circumstances so described, the justification for invoking "sham" analysis remains⁸⁰:

"[W]here justified, it may rescue the decision-maker from being led by the nose into the artificial task of defining the legal rights and obligations of the parties by reference to their proved documents and related conduct alone, where extrinsic evidence demonstrates that they constitute a sham and were not intended to be effective or have their "apparent, or any, legal consequences".⁸¹

For a court to call a transaction a sham is not just an assertion of the essential realism of the judicial process, and proof that judicial decision-making is not to be trifled with. It also represents a principled liberation of the court from constraints imposed by taking documents and conduct solely at face value. In this sense, it is yet another instance of the tendency of contemporary Australian law to favour substance over form. As such it is to be welcomed in decision-making in revenue cases".

The consequence of adopting this approach in *Raftland* was that the conclusions of Kiefel J, at trial, were restored. The High Court held that her Honour's conclusions about the intentions of the parties, concerning the propounded documents, should not have been disturbed

⁷⁸ *Stone* [2001] STC 214 at [68].

⁷⁹ *See Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 at 588.

⁸⁰ (2008) 82 ALJR 934 at 964 [151]-[152].

⁸¹ *Equuscorp* (2004) 218 CLR 471 at 486-7 [46]

by the Full Court. Those conclusion reflected "sensible and rational inferences drawn from" the evidence. The result was that the primary judge's orders were restored. That was the effect of what the High Court's orders provided. I considered that the High Court should endorse reasoning by reference to the analytical tool of "sham" in cases of this kind⁸²:

"[The High] Court should not be diffident to invoke the tool of reasoning that sham provides ... nor should it be hesitant in utilising the word "sham" when explaining its reasons. So long as the legal preconditions are established, the decision-maker should call a spade a spade - and a sham a sham".

KEEPING ABREAST OF THE LAW OF JUDICIAL REVIEW

A generous performer will always offer an audience an *encore*: something additional to the advertised programme that leaves those attending convinced that they have received their money's worth. As it happens, I have two *encores* for revenue lawyers beyond the sonata on sham, derived from a theme of *Raftland*.

The first is a reminder of the importance for revenue lawyers of remaining abreast of developments in federal administrative law generally. I have been tracking these developments closely since 1976 when, with Brennan J and others, I served as a foundation member of

⁸² *Raftland* (2008) 82 ALJR 934 at 964 [158].

the Administrative Review Council. It was that body that supervised the introduction of the new federal administrative law in Australia. This included the enactment of the *Administrative Appeals Tribunal Act 1975* (Cth) and the *Administrative Decisions (Judicial Review) Act 1977* (Cth). These developments of administrative law are amongst the most notable advances in Australian law that have occurred in my professional lifetime⁸³.

It is all too easy for lawyers who live and work in a specialised field of law (such as revenue law) to overlook, or even to be unaware of, developments in the law elsewhere that may affect the remedies now available, relevant to their clients' needs. This was one of the points that I called to attention in *Futuris*⁸⁴. That case was decided three months after *Raftland*.

There are many points of importance in *Futuris*. For present purposes, there are two that need specially to be noted because, in my opinion, they affect the correct approach to the remedy of judicial review when that relief is invoked in contemporary challenges before federal courts in revenue cases.

⁸³ cf *R v IRC; Ex parte National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617 at 641 per Lord Diplock; cf *Futuris* [2008] HCA 32 at [133].

⁸⁴ [2008] HCA 32 at [135].

Virtually since the earliest days of the Commonwealth, judicial review has been claimed in revenue cases. Because for three parts of the last century, the High Court itself was the main or only court available to give judicial relief against administrative decisions concerned with federal income tax, that court developed a large body of case law explaining where the remedies of judicial review, under the Constitution and by statute⁸⁵ would be available. The chief cases are all too familiar to revenue lawyers⁸⁶. Generally speaking, they have sent those lawyers, when claiming such relief, searching for indications that the administrator has acted in breach of the rules of procedural fairness ('natural justice'); acted in bad faith; or made an assessment that is flawed because (contrary to the statute) it was merely temporary or provisional in character.

A point that I made in *Futuris*⁸⁷ was that, outside revenue cases, the categories of "jurisdictional error"⁸⁸ have expanded significantly in

⁸⁵ See now *Judiciary Act* 1903 (Cth), s 39B.

⁸⁶ For example, *Federal Commissioner of Taxation v Australian Boot Factory Ltd* (1926) 38 CLR 391 at 397 per Isaacs J; [1926] HCA 45; *Federal Commissioner of Taxation v Hoffnung & Co Ltd* (1928) 42 CLR 39 at 54-55; [1928] HCA 49; *Batagol v Federal Commissioner of Taxation* (1963) 109 CLR 243; [1963] HCA 52; *F J Bloeman Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 360 at 377-378; [1981] HCA 27; *Deputy Commissioner of Taxation v Richard Walter Pty Ltd* (1995) 183 CLR 168 at 199-200 per Brennan J; [1995] HCA 23.

⁸⁷ [2008] HCA 32 at [132]-[143]. As there pointed out, the ambit and nature of the remedies of judicial review are also relevant to the operation of the purported privative provisions in ss 175 and 177(1) of the *Income Tax Assessment Act* 1936 (Cth).

Australia in recent years, partly under the influence of earlier judicial decisions in England⁸⁹. According to Professor Aronson⁹⁰, there are now six categories of "jurisdictional error" recognised by Australian courts. There should perhaps be still more categories. However that may be, the present point is that it is a serious mistake for revenue lawyers, seeking the remedies of judicial review, to treat the early High Court taxation decisions on the topic as expressing exhaustively the grounds for judicial review that will now be given effect. Revenue law is not divorced from developments occurring in the law of judicial review more generally. In *Futuris*, I observed⁹¹:

"For decades, taxation decisions arising in judicial review proceedings have typically concerned the suggested tentative or provisional character of such decisions of their lack of good faith. This does not justify treating those two categories as covering the entire field of disqualifying legal

⁸⁸ "Jurisdictional error" was an expression first used in the recorded arguments of counsel in *R v Kirby; Ex parte Transport Workers' Union of Australia* (1954) 91 CLR 159 at 168; [154] HCA 19. The expression was first used in judicial reasons in *R v Coldham; Ex parte Australian Workers' Union* (1983) 153 CLR 415 at 423 per Murphy J; [1983] HCA 35. See *Futuris* [2008] HCA 32 at [5] and [133].

⁸⁹ The two additional categories of "bad faith" and "breach of natural justice" are attributed to Lord Reid's speech in *Anisminic v Foreign Compensation Commission* [1969] 2 AC 147 (HL) at 171; cf M Aronson, "Jurisdictional Error Without Tears", in M Groves and H P Lee (eds), *Australian Administrative Law - Fundamentals, Principles and Doctrines* (207) 330 at 335-336.

⁹⁰ Professor M Aronson points out that the first six points in his catalogue derive from *Craig v South Australia* (1995) 184 CLR 163 at 176-180; [1995] HCA 58.

⁹¹ [2008] HCA 32 at [133].

(or 'jurisdictional') error ... As the two nominated categories of invalidity have arisen in taxation cases for at least eighty years⁹², there is a risk that specialists in taxation law will overlook, or ignore, the considerable subsequent advances in administrative law, in particular within judicial review. Specialist disciplines, including in law, can occasionally be myopic and inward-looking".

A second lesson from *Futuris*, also derives from developments in judicial review of administrative action more generally. It is that, such remedies (whether derived from the Constitution, or by analogy from like provisions in federal legislation) are all discretionary in character. Where particular statutory remedies are provided that permit a more ample examination of the administrative decision (including on the merits) it is consistent with long-standing principles for the court, whose remedies are invoked, to deny judicial review upon discretionary grounds, obliging the applicant, instead, to pursue the specific statutory remedies first⁹³.

Especially is this so, where the evidence demonstrates that (perhaps to avoid the descent of a statutory time limit), the applicant has actually applied for the statutory remedies, as indeed the taxpayer had done in *Futuris*. In such circumstances, to refuse judicial review, in the

⁹² For example see *Australian Boot Factory Ltd* (1926) 38 CLR 391 at 397 per Isaacs J; *Federal Commissioner of Taxation v Hoffnung Co Ltd* (1928) 42 CLR 39 at 54-55; [1928] HCA 49.

⁹³ *Futuris* [2008] HCA 32 at [157]ff. This was a point previously made by the author in *Re Carmody; Ex parte Glennan* (2000) 74 ALJR 1148 at 1156 [37]; [2000] HCA 37 and *Re Heerey; Ex parte Heinrich* (2001) 285 ALR 106 at 109 [17]; [2001] HCA 74. The point was approved in a Full Court in *Glennan v Commissioner of Taxation* (2003) 77 ALJR 1195 at 1198; [17]. See *Futuris* [2008] HCA 32 at [160]-[165].

exercise of the court's discretion (and to oblige the applicant first to pursue the application under the statute) fully conforms both to long-standing legal rules and to economic and prudent judicial practice⁹⁴.

THE NATIONAL IMPORTANCE OF REVENUE LAW

My second *encore* is of a completely different character. It involves a few parting words of praise and appreciation for revenue law and revenue lawyers and for the importance of their work in the Australian Commonwealth.

At the beginning of the twentieth century, two new nations were commonly identified as offering the greatest promise for the prosperity and well-being of their peoples. They were Australia and Argentina⁹⁵. At that time, the GDP per capita of those living of each country was fairly close⁹⁶. The prospects for each nation appeared equally promising.

⁹⁴ See eg *Ex parte Corbishley; re Locke* [1967] 2 NSW 547 (NSWCA) at 548 per Wallace P, 548 per Jacobs JA, 551 per Holmes JA; *Ultra-Tune (Australia) Pty Ltd v Swann* (1983) 8 IR 122 at 1 (CA) at 122 per Hutley JA; *Boral Gas (NSW) Pty Ltd v Magill* (1993) 32 NSWLR 501 at 510-513. Other English and Australian cases are collected in *Futuris* [2008] HCA 32 at [157]-[159].

⁹⁵ A Gallo and L Alston, "The Erosion of the Rule of Law in Argentina, 1930-1947: An Explanation of Argentina's Economic Slide from the Top 10" (2003) at 2-3, available at SSRN: <http://ssrn.com/abstract=463300>.

⁹⁶ In 1900, Australia was ranked 3rd in the world in terms of GDP per capita. Argentina was ranked 13. See A Gallo, "Argentina-Australia: Growth and Divergence in the Twentieth Century", conference paper at the XIVth International Economic History Congress, Helsinki, Finland, 21-25 August 2006, at 9.

However, in the course of the ensuing century, Argentina, despite the great natural resources of the country, fell far behind⁹⁷. It did so largely because of the imperfections of its governance. The Australian people, generally speaking, have continued to prosper under their 1901 Constitution.

Amongst the reasons commonly advanced for these contrasting outcomes have been the inefficiencies and imperfections of the Argentinian law and practice on taxation. For much of the last century, the wealthy in Argentina reflected the nightmare that haunted Lionel Murphy in his dissent in *Westraders*⁹⁸:

"... [I]ncome tax becomes optional for the rich while remaining compulsory for most income earners".

The example of Argentina's past misfortunes remain before us as a warning. In Australia, we must continue to uphold by law a legal regime of national taxation that obliges administrators to conform to their legal obligations; to act fairly; and to avoid procedures or outcomes that are so disproportionate as to be irrational or manifestly outside their statutory authority. At the same time, we must uphold the purposes of

⁹⁷ In 2002, Australia was ranked 8th in the world in terms of GDP per capita. Argentina was ranked 27. See A Gallo, "Argentina-Australia: Growth and Divergence in the Twentieth Century" at 9.

⁹⁸ (1980) 144 CLR 55 at 8. See K Sokoloff, "Inequality and Taxation: Evidence from the Americas" in (2006) 59 *Tax Law Review* 167 at 201-202 and 241.

our revenue statutes and reject any notion that the paying of lawful taxes is optional. We must do so whether by the use of "sham" analysis applied to artificial transactions or by invoking laws rendering defined 'schemes' ineffective at law.

I pay tribute to the teachers, legal practitioners, accountants, administrators and judicial officers who labour in the intricate and complex field of Australia's revenue laws. They should never be in doubt about the importance of their discipline for, or of their own signal contributions to, the prosperity, good governance and welfare of the people of Australia.

THE UNIVERSITY OF MELBOURNE

FACULTY OF LAW

ANNUAL TAXATION LECTURE

MELBOURNE, 20 AUGUST 2008

**OF 'SHAM' AND OTHER LESSONS FOR AUSTRALIAN REVENUE
LAW**

The Hon Justice Michael Kirby AC CMG