Strategies and tactics for managing disputes with the ATO

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'In Heaven there will be no law, and the lion will lie down with the lamb ... In Hell there will be nothing but law, and due process will be meticulously observed.'

(Grant Gilmore, *The Ages of American Law*, Yale, 1977, p 111)

The purpose of this paper is to examine the likelihood and future extent of GST disputes in Australia, and to briefly canvass some strategies and tactics for managing GST disputes with the ATO. The working assumption throughout this paper is that a dispute exists and requires resolution. I shall therefore not deal with managing processes at a time before a dispute arises, though this is obviously an important area. In this paper I shall cover:

- the likelihood and future extent of GST disputes in Australia;
- a strategic framework for managing GST disputes;
- assessment v declaration;
- disputes generated by GST rulings;
- 3 minor tactical issues; and
- concluding remarks.

Likelihood and future extent of GST disputes in Australia

The "honeymoon period" we have enjoyed since the introduction of GST will not last forever and is already showing signs of coming to an end. Giving evidence before a Senate Estimates Committee in 2002, the Commissioner of Taxation said "I have signalled that in the new financial year we are moving to a new phase of the bedding in of the system."[1] At the same time his GST Deputy Commissioner said: "We are still moving through that phase of verification checks and are yet ready to move into what I would call the full in-depth audit phase. That is starting now, as income tax returns that cover the first year of GST are coming in."[2]

There is little doubt that the ATO has since that time switched from education to compliance mode. The ATO was given $1.5bn over 4 years in the Federal Budget, from which the revenue expectations would be between $4.5bn (on a conservative multiple of 3) and $7.5bn (on a more likely multiple of 5).

The likelihood of GST disputes can only increase in these circumstances. Overseas experience also supports the conclusion that the number of GST disputes will increase.

Figure 1 is a graph showing the time taken to reach the first 1,000 VAT Tribunal decisions in the United Kingdom, and each 1,000 decisions thereafter. The United Kingdom VAT was introduced by the *Finance Act 1972* (UK) and commenced on 1 April 1973. It took more than 7 years to reach the first 1,000 decisions, 5 years to reach the next 1,000, 3 years the next 1,000, and then 10 months. There was a frenzy of activity over the next few years which then subsequently slowed. It currently takes between 1 and 2 years to reach a 1,000 case milestone.

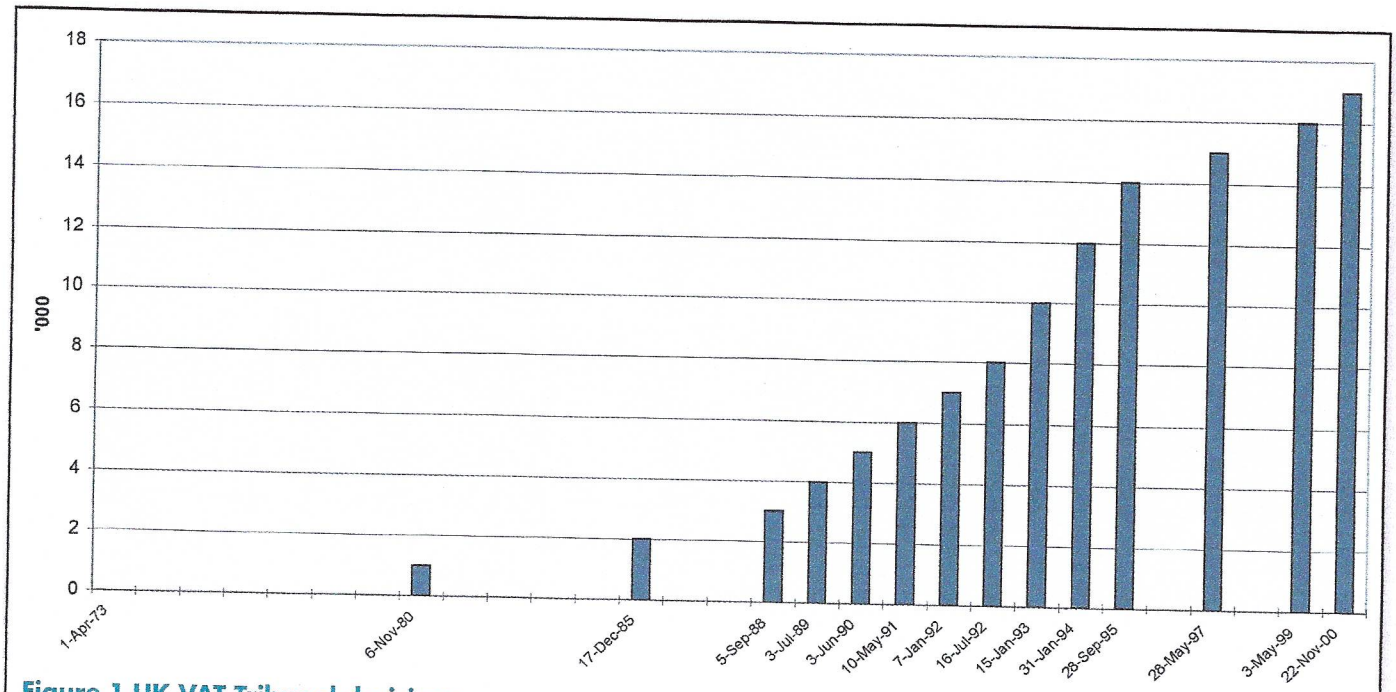

Figure 1 UK VAT Tribunal decisions

Set out at Figure 2 is a graph showing United Kingdom VAT cases as a percentage of all tax cases, as reported in *Simons Tax Cases*. I have excluded decisions of the European Court of Justice, which are invariably followed by the House of Lords. It can be seen that the first 2 decades since the introduction of VAT saw VAT cases account for about 10% of all tax cases, with some obvious variations. Since the mid-1990s, VAT cases have accounted for an average 35% of all tax cases, with 2 years exceeding 40%.

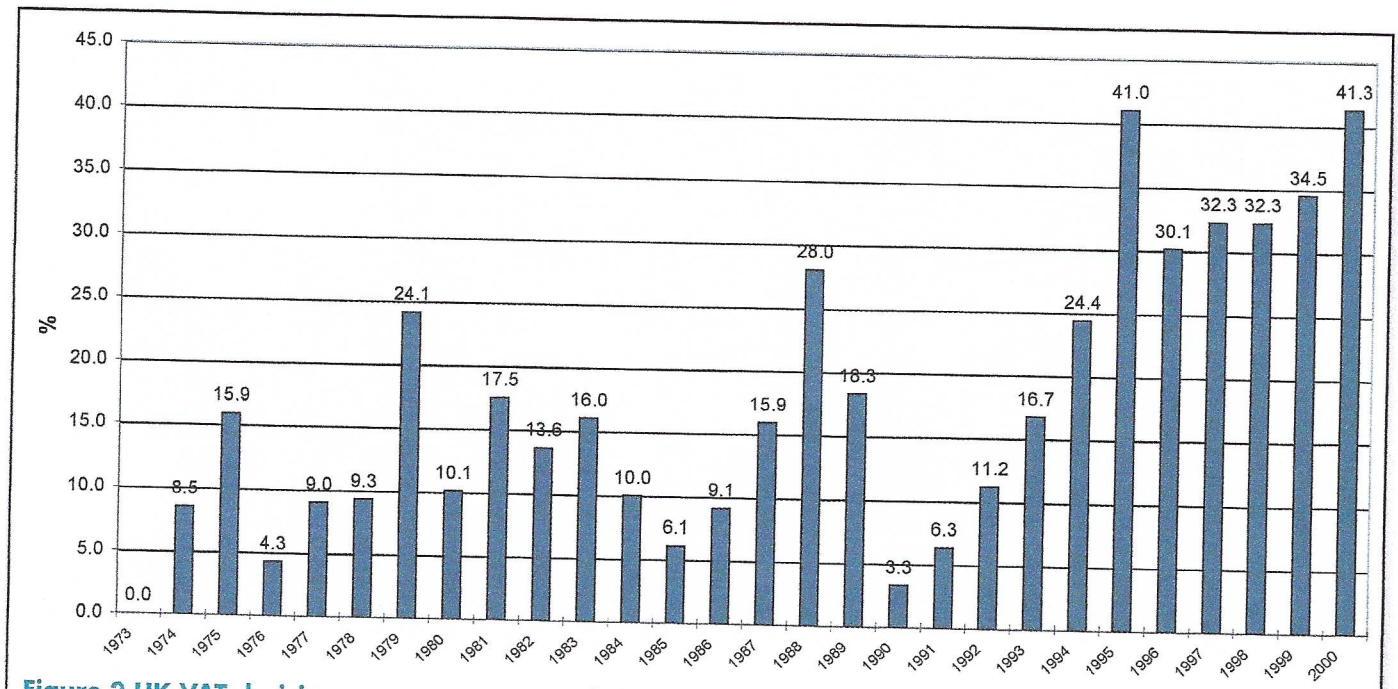

Figure 2 UK VAT decisions as a percentage of all tax decisions

Perhaps armed with the United Kingdom jurisprudence, New Zealand didn't take quite as long for disputes to make their way into courts and tribunals. The New Zealand GST was introduced by the *Goods and Services Tax Act 1985* (NZ) and commenced on 1 October 1986.

Set out at Figure 3 is a graph showing GST cases at the Taxation Review Authority as a percentage of all tax cases, as reported in the New Zealand Tax Cases. It can be seen that GST cases in the first 5 years of the GST accounted for less than 10% of all tax cases. Since 1991, however, GST cases have accounted for an average 29% of all tax cases.

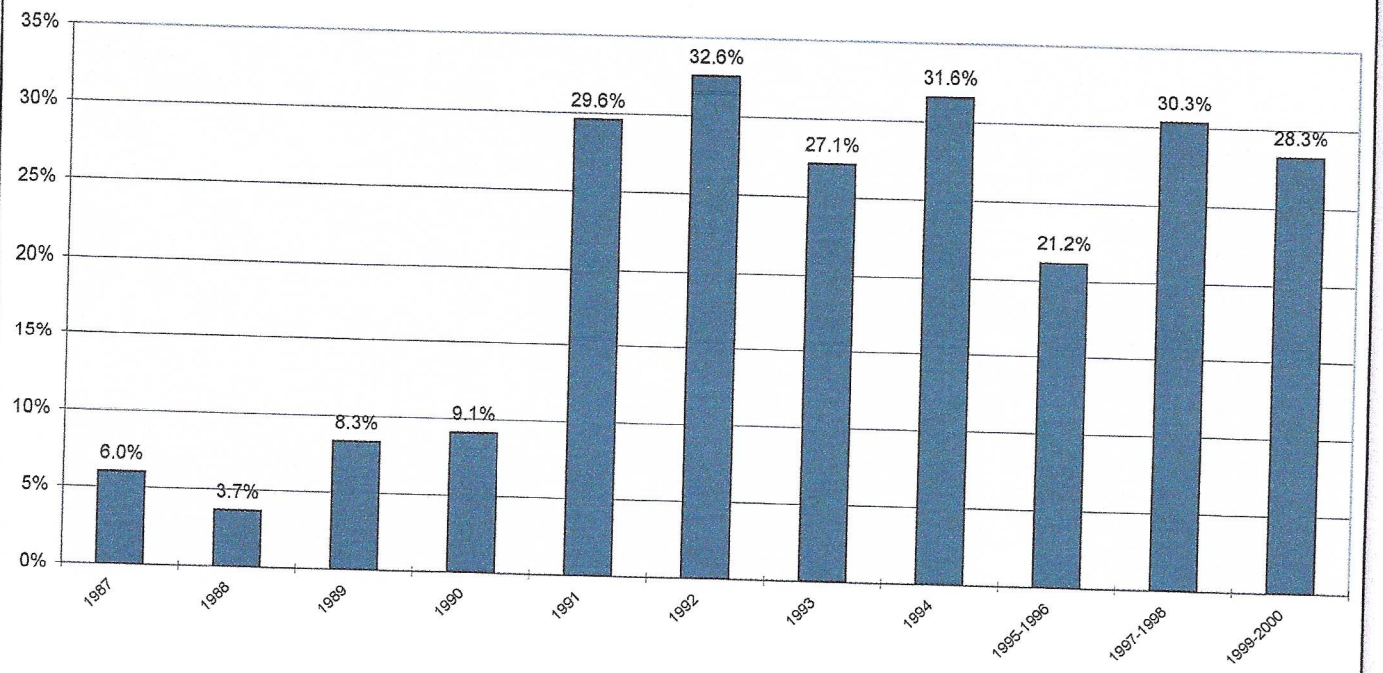

Figure 3 New Zealand GST cases as a percentage of Taxation Review Authority decisions

Set out at Figure 4 is a graph showing judicially decided GST cases as a percentage of all judicially decided tax cases, also as reported in *New Zealand Tax Cases*. Here it can be seen that since 1989, a mere 3 years after GST was introduced, judicially decided GST cases accounted for about 20% or more of all judicially decided tax cases.

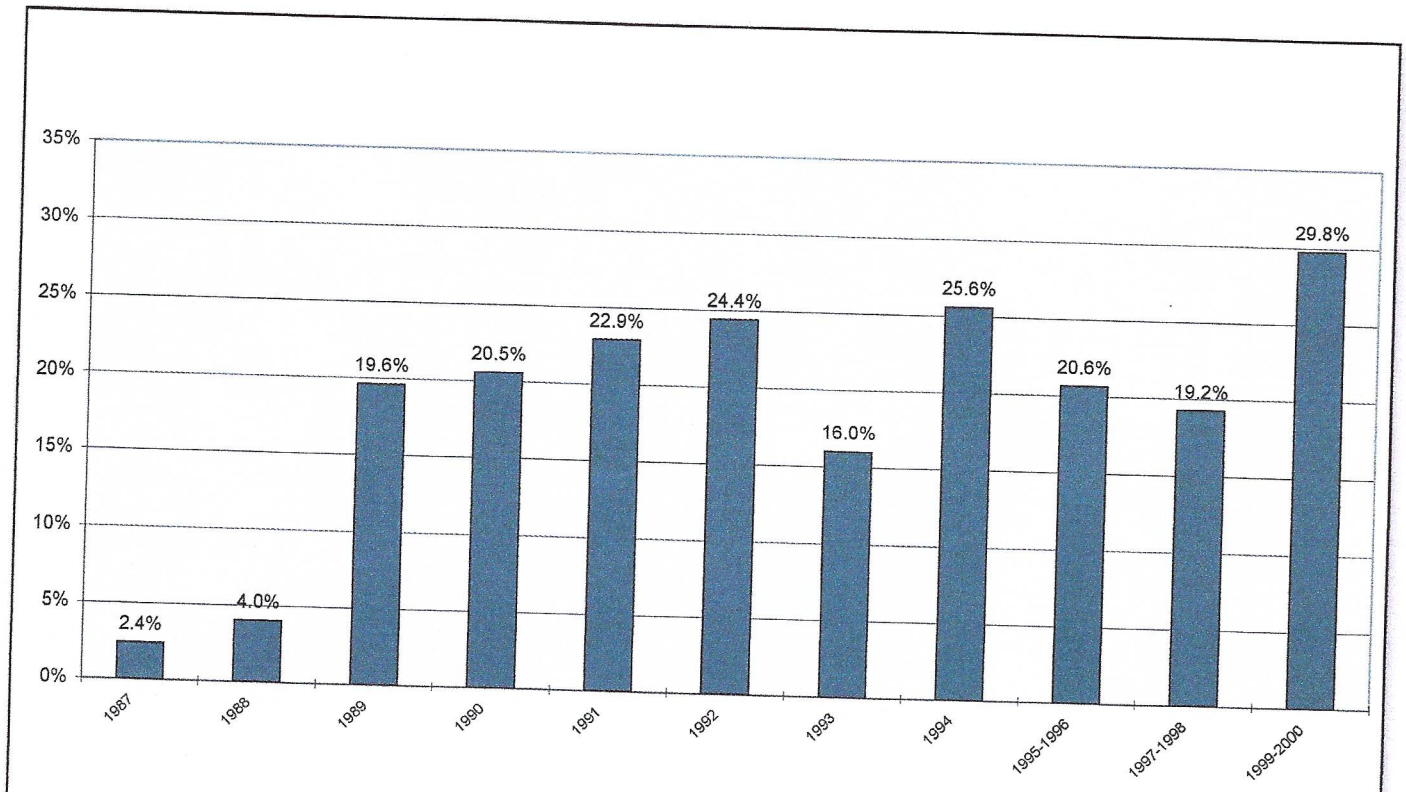

Figure 4 New Zealand GST cases as a percentage of judicial decisions

I have set out at Figure 5 a graph which consolidates the data from Attachments 3 and 4. It is clear that the level of GST disputes, as a percentage of all tax disputes, increased to relatively high levels in New Zealand after 3 to 5 years, compared with 20 years in the United Kingdom.

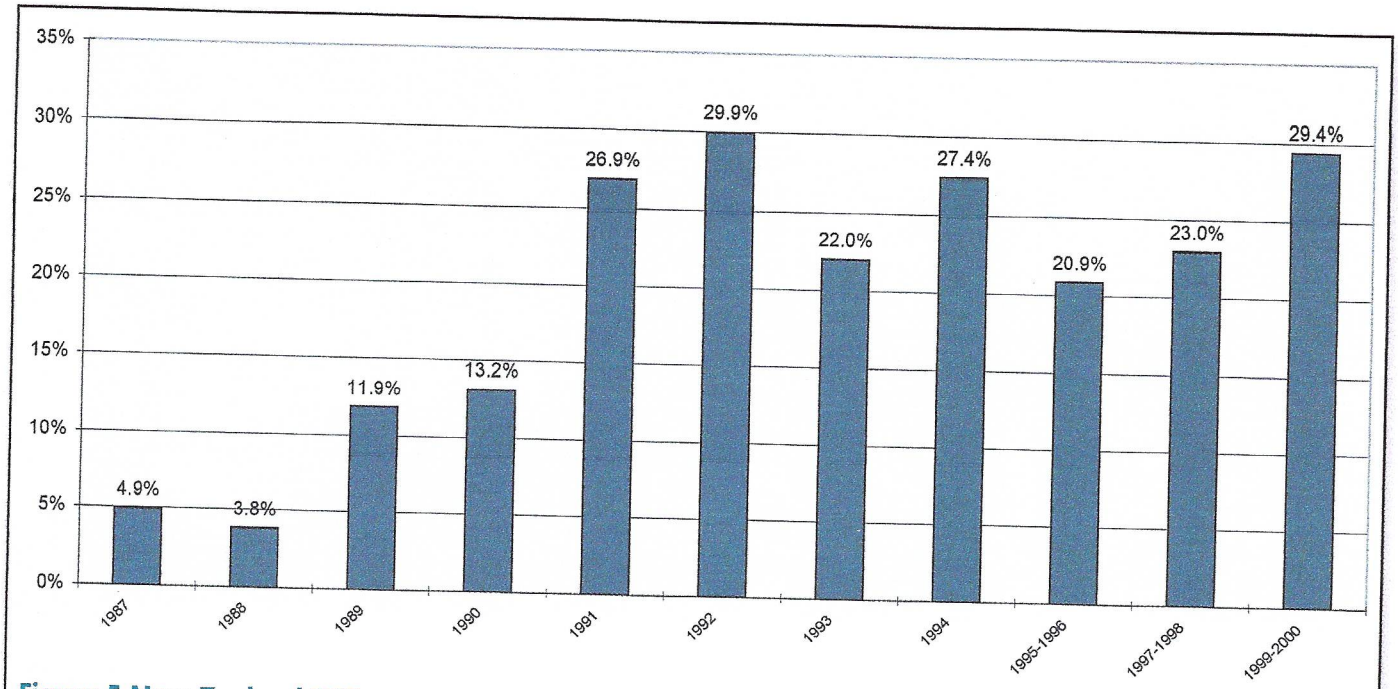

Figure 5 New Zealand GST cases as a percentage of all tax cases

It is most likely that we will see a marked increase in GST litigation within the next 2 to 3 years, and that this will remain high for at least the following decade.

Strategic framework for managing GST disputes

Every dispute is different, and every dispute has its own answer. One size rarely fits all, and individual facts are highly important, if not decisive. I will leave aside questions of evidence except to say that the facts of each case and, perhaps more importantly, the means available to prove those facts, is of first importance. I have seen great theoretical arguments crumble for want of facts. For the limited purpose of this paper I shall assume that you have logically probative facts in support of your position.

In building a strategic framework within which you can manage GST disputes I suggest you look first to outcomes, and second to the processes which support those outcomes. My own framework is built around the doctrine of separation of powers since our governmental structure, embodied in the Commonwealth Constitution, organises power and, hence, dispute resolution possibilities. This means I consider what dispute resolution possibilities exist under the legislative, executive and judicial arms of government.

In considering the legislative arm of government, I ask whether an amendment to the law is necessary in order to resolve the dispute. This question is often easily disposed of, usually by answering no, though in significant cases it may be the best strategy.

In considering the executive arm of government, I ask whether an approach to the ATO is desirable and, if so, to which individual ATO officer. Is it the right person, at the right level of seniority, with the right disposition, to deal with the particular dispute? Strategically, it is in my experience almost always desirable to speak with, and engage with, an ATO officer at an early stage. Tactically, the level of engagement will be determined by a number of factors including:

- the likelihood of a favourable answer;
- your prospects of success (in a technical sense); and
- the speed with which you need the dispute resolved.

A further tactical consideration involves making a judgment about whether the commencement of formal proceedings to resolve the dispute will improve your prospects of resolving a GST dispute with the ATO or exacerbate the issue further. Sometimes the commencement of proceedings will be the catalyst required for the ATO to take you seriously. It might also have the effect of escalating a dispute to a more senior or appropriate person. Conversely, the commencement of proceedings might see the ATO withdraw from serious discussion. It is a matter of judgment.

In considering the judicial arm of government, I ask strategically whether alternative means of resolving the dispute have been fully explored, such that a formal dispute mechanism is required, and tactically whether the commencement of formal proceedings might in any event aid those alternative dispute mechanisms. For the purpose of this discussion I shall include AAT proceedings as a "judicial" dispute mechanism, though constitutionally it belongs under the executive arm of government.

Sometimes there is no alternative but to commence formal proceedings. The most likely choice you will face at this point is whether to proceed by way of assessment or by way of commencing declaratory proceedings.

Assessment v declaration

For those steeped in the traditions of income tax, as I once was, thoughts of resolving disputes turn automatically to the process of assessment, objection and appeal. For GST disputes this process is invoked by the Commissioner on his own motion or by you requesting a special assessment.[3] You can then object against the assessment which is raised.

For those steeped in the traditions of sales tax, as I once was, thoughts of resolving disputes also turn to the commencement of proceedings seeking declaratory relief. This is a novel area for many practitioners and it is worthwhile taking a detour to see what this means in the context of GST disputes.

Declaratory proceedings were a common feature of sales tax disputes. For many years these proceedings were commenced in the state Supreme Courts or the High Court but not in the Federal Court. Most applicants commenced declaratory proceedings in the original jurisdiction of the High Court.[4] Invariably, an application was then made to the High Court to have the matter remitted to the Federal Court.[5] This avoided the difficulties

experienced by the applicant in *Kodak (Australasia) Pty Ltd v Commonwealth* (1988) 20 ATR 656. Kodak had sought a declaration that certain photographic negatives were exempt from sales tax. Lockhart J held that the Federal Court did not have jurisdiction to determine the matter. The Court was a creature of statute and provision was not made for declaratory relief.

In *Re The Totalisator Administration Board of Queensland* (1988) 20 ATR 94, the Queensland TAB sought a declaration that it was not liable to pay sales tax on material printed by it. The TAB did not resort to the objection procedure available to it and was not subject to an assessment. The Commissioner contested the jurisdiction of the Supreme Court of Queensland to determine the subject matter of the application. McPherson J held that the jurisdiction of the Court to make the declaration sought could not be said to have been impliedly ousted by the sales tax legislation and the procedures it afforded for challenging a liability to sales tax.

In *FCT v Biga Nominees Pty Ltd* (1988) 19 ATR 1037, Biga sued the appellant Commissioner of Taxation claiming, among other things, a declaration that a forklift truck which Biga claimed to be using for the purposes of operating a railway was exempt from sales tax.

The Commissioner pleaded by way of defence that Biga's statement of claim was bad in law and disclosed no cause of action on the ground that Biga had no standing to obtain the relief sought. The Commissioner had required the vendor of the forklift truck to pay sales tax on the basis that it was not exempt, and in that event Biga was obliged to pay the amount of that sales tax to the vendor.

The Full Court of the Supreme Court of Victoria, comprising Murphy, Gobbo and Southwell JJ, held that Biga's obligation as the direct purchaser to pay the tax gave it an interest clearly greater than ordinary members of the public. There was an obvious commercial disadvantage in being obliged to disgorge the amount payable in sales tax. Further, the question whether the exemption applied involved the affairs and activities of Biga. It was therefore held that Biga should be a party to any proceedings relating to the exemption, and Biga ought not have to rely upon the taxpayer to take proceedings.[6]

Following these decisions the Commissioner issued Sales Tax Ruling ST 2454. This ruling dealt with sales tax objection and appeal procedures; jurisdiction and standing in declaratory proceedings; and disputing sales tax liability generally. The Commissioner indicated at para 9 that he would not continue with jurisdiction and standing challenges to declaratory proceedings.

The original jurisdiction of the Federal Court was expanded in 1997 to include, among other things, any matter arising under any laws made by the Parliament, other than in respect of certain criminal matters.[7] As was noted at the time:

> *In terms of administrative law, the impact of the new provision will be primarily in relation to actions for declarations, particularly against the Commissioner of Taxation, which were often commenced in the High Court.*[8]

There is little doubt that declaratory relief will be a potent formal means of resolving GST disputes.

Given that a taxable supply or creditable acquisition under GST law will always involve 3 interested parties, namely the supplier, the recipient and the Commissioner, interesting questions are likely to arise about the addition of parties.[9] This is a different issue to that which has arisen recently regarding the joinder of parties in appeals against appealable objection decisions.[10]

In the light of this detour, which is to be preferred: assessment or declaration? As a general rule I prefer declaratory proceedings because:

- they are much faster than the traditional objection and appeal process.
- it is much easier for an applicant to limit the scope of declaratory proceedings compared to the objection and appeal process. An appeal against an assessment is a full appeal on fact and law.[11]

Disputes generated by GST rulings

I deal separately with GST rulings because many disputes are likely to flow from the GST rulings regime, both from adverse rulings and from taxpayers not having the protection they thought they had.

No formal appeal rights exist in relation to an adverse GST ruling. The issue of a private GST ruling does not give rise to an appealable objection decision, nor does it give rise to rights under the Administrative Decisions (Judicial Review) Act 1977.[12]

One consequence of a lack of appeal rights is that it becomes very difficult to obtain certainty in relation to proposed transactions. You cannot enliven the objection and appeal process by requesting a special assessment as there is nothing to assess in relation to a proposed transaction. It would also be difficult to obtain a declaration in relation to a proposed transaction as it is not the role of the courts to provide advisory opinions.

In the absence of statutory protection a ruling gives little or no protection as it does not give rise to an estoppel as against the statute,[13] though issues of procedural fairness might be relevant.[14] So how much protection does a ruling offer?

The only legislative reference to GST rulings is to be found in s 37 of the *Taxation Administration Act 1953*. A previous ruling must have "applied

to you" if you are to obtain the protection afforded by the statute. It is therefore important that the facts on which the ruling was based be clearly identified.[15] As with the income tax rulings system, a distinction might well be drawn between the way in which the law applies to a particular set of facts, and "the principles or reasoning" stated in the ruling.[16]

In GSTR 2001/6, for example, dealing with non-monetary consideration, there is a discussion of *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners*[17] and *Rosgill Group Ltd v Customs and Excise Commissioners*,[18] followed by a statement that "We consider that the principles on which these cases were decided are applicable in Australia".[19] It would be a brave taxpayer who relies on these "principles" without the protection of a private GST ruling.

Note also that you must have "relied" upon a GST ruling to obtain protection,[20] which is quite different to the income tax rulings system. Whether you have relied upon a ruling is a matter of fact, yet very few taxpayers retain any form of evidence that might prove this fact.

Three minor tactical issues

There are many other tactical issues in managing disputes with the ATO. I shall mention 3 in passing.

First, freedom of information (FOI) requests can be very valuable. Audit reports with handwritten annotations, internal memorandums and other useful documentation can unexpectedly turn up. The FOI process should be used in most serious disputes.

Second, administrative law remedies under the *Administrative Decisions (Judicial Review) Act 1977* and *Judiciary Act 1903* should always be fully explored.

Third, in the course of litigation, I have always sought evidence of relevant delegations and authorisations on which a purported exercise of power is based. On more than 1 occasion the Commissioner has been forced to withdraw proceedings when unable to produce the material requested.

Concluding remarks

As stated at the outset, the purpose of this paper is to examine the likelihood and future extent of GST disputes in Australia, and to briefly canvass some strategies and tactics for managing GST disputes with the ATO.

The "honeymoon period" for GST is rapidly disappearing and the ATO has switched from education to compliance mode with significant additional funding. The likelihood of GST disputes can only increase in these circumstances. It is most likely that we will see a marked increase in GST litigation within the next 2 to 3 years, and that this will remain high for at least the following decade.

Every dispute is different and there are numerous considerations. Is an amendment to the law necessary in order to resolve the dispute? Is an approach to the ATO desirable and, if so, to which individual ATO officer? What is the likelihood of a favourable answer? What are the prospects of success (in a technical sense)? What is the timeframe in which the dispute must be managed? Will the commencement of formal proceedings improve or exacerbate your prospects of resolving a dispute with the ATO? Have alternative means of resolving the dispute been fully explored?

Sometimes there is no alternative but to commence formal proceedings. The most likely choice at this point is whether to proceed by way of assessment or by way of commencing declaratory proceedings. There is little doubt that declaratory relief will be a potent formal means of resolving GST disputes and will generally be the favoured path, and interesting questions are likely to arise about the addition of parties.

Perhaps, then, in hell there will be nothing but GST, and due process will be meticulously observed!

(2003) 3 AGSTJ 6

Notes

1 M Carmody, Senate Estimates Committee, 22 February 2002.

2 R Matthews, Senate Estimates Committee, 22 February 2002.

3 See *Taxation Administration Act 1953* (Cth), ss 22 to 23.

4 Constitution, s 75(iii).

5 *Judiciary Act 1903*, s 44(1).

6 As to a plaintiff's real interest in obtaining a declaration see *Oil Basins Ltd v Commonwealth* (1993) 26 ATR 603.

7 *Judiciary Act 1903*, s 39B(1A).

8 Australian High Court & Federal Court Practice (CCH), p 3,273.

9 See *Federal Court Rules*, O 6 r 8.

10 See *Carter v FCT* (2001) 47 ATR 133; *Krampel Newman Partners Pty Ltd v FCT* (2001) 47 ATR 526; and *Cerche v FCT* (2001) 48 ATR 17.

11 *McEvoy v FCT* (1950) 9 ATD 206.

12 *See Hutchins v DCT* (1994) 29 ATR 52 at 56.

13 See *FCT v Wade* (1951) 84 CLR 105 at 116-117.

14 See *Bellinz Pty Limited v FCT* (1998) 38 ATR 350 at 371; and *One.Tel Ltd v DCT* (2000) 44 ATR 52 at 68.

15 See *Bellinz Pty Limited v FCT* (1998) 38 ATR 350 at 357; and (1998) 39 ATR 198.

16 *Bellinz* at 365 per Merkel J.

17 (1988) 3 BVC 428.

18 [1997] BVC 388.

19 GSTR 2001/6, para 79.

20 See *Magna Stic Magnetic Signs Pty Ltd v FCT* (1989) 20 ATR 1237.