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Yuri Grbich

New Modalities in Tax Decision-Making: Applying European experience to Australia

Yuri Grbich*

Abstract

This article criticizes the current situation in judicial decision making which it says is overly dominated by ‘old fashioned’ conservative legalistic analysis. It compares this with the UK’s experience of the European challenge to its Common Law. The article urges Australian jurisprudence to learn from the European civil law. By this means, it suggests, core public policy imperatives will be permitted to shape the tax decision making agenda. This would make Australian tax judges more accountable for the application of policies against tax avoidance, and other policies behind statutory rules. The article concludes by urging Australian tax teachers to contribute to the development of a culture of accountability by judges and to take the lead in criticizing the performance of judges in how they deal with policy and principles when making decisions.

GETTING TO THE NUB OF THE PROBLEM

There is a well known story, now an iconic myth of the information economy. As the story has it, Bill Gates was slow in picking up the significance of the looming internet revolution. He thought the internet was a mere toy for computer geeks. When he discovered his error, all hell broke loose at Microsoft. To remedy his mistake, it is said that he transformed the most successful company in history overnight and the jobs of a large chunk of its staff.

Are such radical solutions needed to deal with our intractable problems in taxation? We have long running systemic problems in Australia. The tax system has not responded systematically, in depth, and with sufficient clarity to a log of genuinely tough problems that continue to accumulate. The length and complexity of tax legislation is out of hand, let alone the masses of subordinate documentation and other material. We have thrown prodigious resources at tax avoidance but the problems continue to fester. Key concepts are not evolving at pace to respond to rapidly changing commercial realities and to rapidly evolving globalization of the Australian economy.

What is the current bottleneck? What is the nub of the problem lying in the ‘too hard basket’? Decision making by judges? Tax judges have become increasingly marginalized in tax rule making. But the position of tax judges at the commanding heights of the Australian tax decision making structure makes them the dominant players in defining the day to day rules of engagement. As a result, and notwithstanding the rhetoric, much of the operational part of the Australian tax decision making apparatus *still* works according to modalities which are, essentially, governed by old-fashioned 1930s pedantic legalism. The high-water mark was the

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infamous 1930s House of Lords decision in *IRC v Duke of Westminster*.¹ Like typical expats, Australians cling to this fossil more faithfully than the ‘mother country’. To be fair, the High Court modified its articulations in *FCT v Spotless Services Ltd*² and the Federal Court is not quite the fundamentalist artifact of the 1930s and 1970s. But decisions like *Cooper Brookes (Wollongong) Pty Ltd v FCT*³ and *Spotless and s15AA*⁴ are thoroughly marginalized in resolving major corporate tax cases and there has recently been something of a retro revival of the ‘good old’ 1970s.

Legalistic modalities at the nub of it

The tax system and the world in which it operates have gone through a revolution. But Australian tax judges, at least in the middle of the hierarchy which makes the lion’s share of the day to day tax decisions going to the courts, have modified their actual decision making behaviour only at the margins. Too often, judges do not look at construction of legislation as a means to an end: the effective articulation of core principles and the practical implementation of key legislative policy directives by delegated decision makers. Rather, it is treated as some disembodied, reified,⁵ word game with little to do with practical tax outcomes. Too often, the ‘least dangerous branch of government’ compromises the coherence and practical workability of policy initiatives pursued in tax legislation. The consequent comfort such modalities give to tax avoidance, which is largely driven by exploitation of these very rigidities in the rules, is now familiar.

But, far more significant, such modalities generate tax decision making which is expensive and ponderous and not sufficiently coherent to respond intelligently to fundamental challenges. Judges are not contributing effectively enough, consistently enough to the development of coherent doctrines to drive a changing tax system. The challenges include technological change, globalization and the wholly new problems created by breathtaking innovation in the finance sector. It diverts resources and intellectual energy from the crucial job of, gradually and with a clear vision, remoulding underlying concepts to deal with fundamental challenges to the tax system.⁶

Those who have heard my papers in recent Tax Administration conferences⁷ will be familiar with the analysis to back up these arguments and my detailed criticisms, in particular, of recent Federal Court tax decisions in major corporate tax avoidance and tax driven financing cases. At the core of the criticism is blinkered constructions of

¹ [1936] AC 1, 19: see Y Grbich, ‘The Duke of Westminster’s Graven Idol’ (1978) 9 *FLRev* 185.

² 96 ATC 5201

³ (1981) 147 CLR 297 where the High Court ignored the literal words of a bungled anti-avoidance statute where the context made its meaning clear; see also *FCT v Gulland* 85 ATC 4765, *FCT v Myer Emporium Ltd* 87 ATC 4363, *Coles Myer Finance Ltd v FCT* 93 ATC 4214.

⁴ *Income Tax Assessment Act 1936* Cth

⁵ Reified is from the same root as deified, words are raised over and above their functions and are given a separate life of their own.

⁶ I am talking about effective responses to avoidance and information hiding techniques, to new global arbitrage opportunities, to the shifted realities of emerging Asian economic dominance, particularly the time value of money, to the monkey that tax planners are making of the old tax and property law with derivatives and more sophisticated offshore in China.

⁷ Y Grbich, After ^{Bellinz} and Ralph: A new focus for decision making in the Australian tax system, in M Walpole and C Evans (eds) *Tax Administration in the 21st Century* (Prospect, 2001); Y Grbich, Tax Decision-making at the Crossroads: Strategic directions in M Walpole and R Fisher (eds) 5th *International Conference on Tax Administration* (Timebase, 2003)

Australian tax legislation and tortured drafting to overcome them. This sets up a vicious circle of even more narrow construction and pedantic legislation.

Of course, Australian judges are quite capable of avoiding narrow, pedantic modes of reasoning and have done so in a number of cases.⁸ The trouble is, they typically do so selectively and do not articulate the premise on which refusal to make such broad approaches is based. Crucial discretions exercised by judges in the routine course of tax decision making are not articulated. Judges are not properly accountable, outside the context of a convergent culture of fellow judges, for their exercise. There is not an adequate attempt to link the delegated rules created to legislative policy and to the wider context in which they operate.⁹ Fundamental criticism of judges for their performance is, all too often, treated as an attack on the fundamental bulwarks of civilization.

This paper is a work in progress and an eclectic selection from a forthcoming book which integrates these ideas into a larger picture of tax rule making.¹⁰ The paper takes some of my ideas from that book out for a spin. It runs through some insights gained from recent exposure to European tax institutions and uses a case study on the European doctrine of proportionality as a benchmark to assess Australian judicial performance in taxation.

NEW MODALITIES: THE EUROPEAN CHALLENGE TO COMMON LAW

Lord Hoffmann,¹¹ of the House of Lords, identified the dynamics:

...membership of the EU has required English judges to undergo a compulsory education in continental legal thinking. In having to deal with the European treaties and subordinate legislation, they have been exposed to statutory provisions which are abstract, general and open-textured; a style of legislation far from the finely tuned precision of [the UK] Parliamentary draftsman, but familiar enough to practitioners in a codified system of law. And with the continental style of legislation has come continental methods of construction, which allow a freedom to mould language almost sinful to puritan English sensibilities, and continental concepts such as good faith, proportionality and the rights of man.

European experience is valuable because the application of over-arching concepts, expressed as general principles, gives some hope of broad policy coherence. In contrast with much of the approach to similar legislative directives in Australia, judges and bureaucrats explicitly participate in shaping and tuning technical tax provisions to give operational form to the core statutory policy objectives. In contrast, the adversarial approach in Australian litigation process is carried over into the rule making work of tax judges who too often define their role as one of deconstruction of tax legislation. This process, retained as a protection of last resort to save us from tyranny, becomes a routine tool for pursuing unarticulated judicial agendas. These

⁸ Judges were able to over-reach some of the literalist approaches in later cases in areas like the old s26(a) and artificial attempts to get round undistributed profits tax with schemes which were technically effective but not politically acceptable; and there have always been the odd case where judges do not stop a taxpayer by pedantic reliance on the form of transaction, where its substance is otherwise.

⁹ See Y Grbich 'Is Economics any Use to Tax Lawyers?' (1980) 12 *MULR* 340.

¹⁰ Y Grbich, 'Advance Tax Rulings in Wider Australian and International Tax Rule Making Perspective' (in draft)

¹¹ Foreword to N Foster, *German Legal System and Laws* (Blackstone Press, 2nd ed, 1996), v

propositions will be explored using a case study. It contrasts modalities in the operation of the choice principle in Australia and the EU proportionality principle.

Let me red flag a crucial point. It is *not* that Australian tax decisions do not have policy outcomes or that our tax judges are innocent of them. It is that, in their *formal* justification for decisions, judges *pretend* they are unaware of these outcomes or that they play no part in decisions. As a wise person once said, it is terrible that policy decisions are made by unelected officials. There is only one thing worse. The self delusion that such decisions are not routine in most tough delegated decisions.

The UK has adapted far more adroitly to the challenges than Australia but has still failed to adapt quickly or deeply enough. A growing crisis has emerged in the UK as recently as the late 1990s. The ECJ boldly, some would say carelessly, has over-ruled structural elements of the UK direct tax system which most believed were set in stone. The civil law modalities of a European Commission and European Court of Justice, driven by the boldness and brashness of a heady EU vision, are pushing the pace. EU success in VAT integration has been very influential.

But it is in direct tax we are now seeing the crucial battles. The UK courts, in accordance with the famous Sixth Directive,¹² must “construe domestic legislation ... so as to accord with the interpretation of that directive as laid down by the European Court”¹³ and “the influence of European legislation with its broad principles, together with European methods of interpretation, is likely to increase in the UK courts”.¹⁴ But it goes much further. EU members must draft their own legislation in accordance with the principles laid down in EU directives.¹⁵ National legislation is demonstrably subservient to EU principles. The UK is rapidly transforming into, in all but its own nostalgic political rhetoric, a mere state (and not necessarily the most influential state) in a federated Europe. It has the final option of pulling out of the EU, but this will be increasingly costly. Australia is moving further and faster in the direction of subsuming its tax sovereignty to overarching transnational realities than most appreciate.

Let me make my argument crystal clear from the outset, so that the message is not confused. I am not asserting that the brave new world of tax in the EU is all good or all wise. In recent radical tax interventions, clearly the ECJ has acted like a bull in a china shop. Clearly the European performance on tax avoidance is not always a shining beacon. But the Europeans are setting the intellectual agenda. The US Supreme Court has operated with a more policy based orientation than our courts for many years. We must adapt with determination to the lessons of Europe, *both good and bad*. Unless Australian tax judges respond proactively to this ‘brave new world’ or we engineer changes to our decision making modalities in some other way, the challenges will escalate faster than our ponderous, legalistically shackled decision making can adapt and we will import the crises currently besetting the UK. Australia risks ending up high and dry on an intellectual Pacific no man’s land. Such a position will make Australian adaptation to entirely novel globalized environments, less than

¹² Directive of the EC Council 77/388 (May 1977)

¹³ Lord Keith in *Webb v EMO Air Cargo (UK) Ltd* [1992] 4 All ER 929, 939, though he did qualify it that this was so to the extent it did not distort domestic legislation, which is a bob each way.

¹⁴ Ibid

¹⁵ Acknowledgment to R Codara in a 2000 ATAX paper for emphasizing this point cited by James, who also points out that this leads to delays in finalizing disputes.

comfortable, particularly in the context of the recent US/Australia free trade agreement¹⁶ and increased regional interdependence in Asia. It will become a threat to social stability as ‘the battlers’ get a renewed insight into how loaded the day to day application of tax rules has become in Australia.

Judicial Modalities: Judge’s role in civil law Germany

In practice, the dominant modalities in Europe and the EU derive from German origins. Australia has traditionally tied its future to an English legal tradition, which is now an increasingly marginalized partner in a European momentum rooted in German traditions. The German Civil Code is the centre piece of all German civil law and “considered very abstract, very technical ... precise and consistent, especially in the use of legal concepts”¹⁷ and in common with most continental European systems, is based on a Roman law tradition.¹⁸ A Spanish academic, Gasparro Falsitta¹⁹ referred to the famous German *Tax* Codification early in the twentieth century as “the mother of all tax codes in Europe and Latin America in the twentieth century”.

The issue is the extent to which Australia needs to understand and to better mine this German experience in the future development of Australian tax law. What follows in this section is an elaboration based on insights and case studies of the civil law systems and institutions which are the intellectual foundation of the EU. These might trigger creative thinking about options for change. If you like, this becomes an exercise in structured lateral thinking for Australian decision makers.

Start with this articulation of civil law basics by Vranken²⁰

...the study of judicial “glosses” has always been essential for a proper understanding of the enacted laws in the civil law, even though it does not necessarily follow that case law can be put on the same pedestal as the common law. The perception in the civil law that court decisions do not constitute the law as such, but rather that they are applications –illustrations even – of the law as enacted by the legislature, is too deeply rooted for it to be different.

As Foster puts it, the “formal function of the judiciary which has developed in the German legal system is that judges simply apply the law and should not create it. [T]herefore the case law cannot ... have any general binding effect in other cases”.²¹ Generally speaking, and with exceptions, there is no concept of precedent. Only the strength of the ideas and reputation of the judge command respect and conformity. Older decisions receive less respect than recent decisions. Of course, the influence of judges extends as “very important role interpreters and developers of law”.²² The parallels are interesting. Paradoxically, the lack of formal stare decisis leads to greater

¹⁶ Note that the current US participation in the North Atlantic Free Trade Agreement has already seen US higher Courts subject to judicial review by an international tribunal in a corporate contract case (Adam Liptak, New York Times, 18 April 2004). The analogy with EU process described below is obvious and similar concerns are being raised. Acknowledgment to Matthew Wallace of Atax for this.

¹⁷ Foster at 229

¹⁸ G Dannemann, *Introduction to German Civil Law and Commercial Law* (British Institute Int and Comparative Law, 1993)

¹⁹ Falsitta at Bologna conference op cit

²⁰ M Vranken, *Fundamentals of European Civil Law* (Federation Press, 1997) 212

²¹ Foster at 70

²² Foster Ibid

attempts to generalize and adds power to the claims for the authority of judicial decisions and their contribution to doctrinal development.

There are in two parts to statutory construction in Germany. The objective rules, not altogether dissimilar to those in Australia, but with emphasis on “a contextual rule to interpret the provision in the context ... of the system of rules or the provision as a whole”.²³ This involves, says American Dickerson,²⁴ a search for the ‘cognitive’ meaning derived from a conscientious reading in context, as it would emerge for its intended audience’. The next, and distinct, process involves constructing meaning where none emerges. If objective rules do not give a clear answer, the judge resorts to ‘subjective rules’.²⁵

It was clear that generalized tax principles, like a general prohibition on double tax of the same income, formed a key dynamic of civil law systems, and in particular that of Germany, in dealing with tax problems.²⁶ The Germans, Fischer asserts, have highly developed systems for demarcating the comparative expertise and roles of lawyers and politicians. They have elaborated these into principles which limit legal intervention and which apply them with consistency across the various taxes. The judges distinguish legal principles from political ideology and properly weigh the competing principles of certainty and the assertion of broader legal values. The German Constitutional Court intervenes to enforce general principles, based on well understood values, of equality in treatment and the need to articulate proper justifications for any particular exaction of taxation.

Europeans reinvent decision making basics

Under pressure to coordinate the over-riding EU Treaty based rules²⁷ with the traditional laws and regulatory rules of member states, the EU has gone back to the drawing board and redefined the relationship of judges, administrators and the powerful European Commission. European modalities reinvent our wheel of policy and rule making. They largely eschew concepts ingrained in our system, like the separation of powers between the executive and bureaucracy and between the bureaucracy and judiciary. In the words of Raworth,²⁸ “a peculiar feature of the legal system of the EU is that no formal distinction is made between executive and legislative powers.” EU bodies, he elaborates, may have both an executive and legislative character in certain areas and procedures overlap. These differences provide a basis for lateral thinking for coherent thinking about how we get round our current road blocks.

A still embryonic confederation of autonomous states like the European Union has developed powerful tools to ensure judicial compliance with over-riding EU policy

²³ Foster at 64

²⁴ R Dickerson, *The Interpretation and Application of Statutes* (Little Brown, 1975) in Brooks 117

²⁵ Described by Foster Ibid: Teleological rule to determine meaning in light of the purpose of provisions; Historical rule similar to our mischief rule; Comparative rule Introduces analogies and context from other provisions and nearby legal systems; Grundgesetz (article 20(3)) rule requiring judges to be bound by ‘law and justice’ and to range beyond literal interpretations of the Code. See *Princess Soraya* Case25, judges create a civil law right for the Shah’s ex-wife to sue for civil defamation where only a criminal statutory head for this action existed.

²⁶ P Fischer, op cit

²⁷ See history of Treaties in P Raworth, *Introduction to the Legal System of the EU* (Oceana publications, 2001), 26ff

²⁸ op cit 109

directives in member nations. It is paradoxical that a unified nation like Australia, federated for a century and enjoying much less social and political diversity or tensions, has much weaker levers to ensure compliance by its own *federal* judges with a core national policy priority: the raising of federal taxes in a fair and efficient manner. Do our fundamental rules need changing? Do we have to tackle the fossilized judicial rule making?

EUROPEAN DECISION MAKING MODALITIES: A SUBTLE IMPLEMENTATION STRATEGY

There is a fundamental tension between the idea of a European union and a decision-making structure drawing on constituent nations, acting according to sovereign self interest. How does Europe create coherence and focus in a confederation of opinionated, culturally diverse and self-serving states? The frequent paralysis in the UN shows how hard this task is.

This tension assumes added significance when, as earlier articulated, we appreciate that EU rules become part of domestic law in member states. The ECJ has held²⁹ that provisions of the European Treaties over-ride conflicting law of member states, when that law post dates a Treaty. Craig says³⁰ of the spillover impact of the ECJ on the courts of constituent states:³¹

It is axiomatic that in formal legal terms the ECJ's decisions will have no impact in cases where there is no Community law component. It is equally clear that this formal legal result may not reflect reality. Even if national courts are under no duty to apply EC law [and also the law of nations with which they have increasingly intimate contact] they may well consider it, particularly if they believe that it may be of assistance in developing domestic law.

Essentially, and in contrast with much of tax decision making in Australia, Europe has used the interaction of the bureaucratic and judicial process as a potent tool for responding to social and political challenges. According to Andersen and Eliassen,³² echoed in an extensive literature, the 'EU represents a new type of complex, multi-level and loosely coupled decision-making and implementation [mechanism] It might be regarded as a new type of political structure.' Andersen and Eliassen analyze the EU³³ as a multi-layered, complex of competing and overlapping institutions which lack any obvious and clear authoritative centre. The institution emphasizes the importance of policy networks and decision *processes*.

The design of institutions, based on ideas which have germinated over many years, is central and important.³⁴ It is through an unusually thoughtful application of a "system of institutionalized, constitutional, precedential or otherwise standardized, patterned procedures which all actors commit themselves to use and respect."³⁵ The member states "are formally bound to comply with the procedures governing the operations

²⁹ *Van Gent en Loos v Nederlands Administratie der Belastingen* as cited in E Ellis and T Tridimas, *Public Law of the European Community; Text, materials and commentary* (Sweet and Maxwell, 1995), at 177

³⁰ P Craig 'Domestic Liability of Public Authorities in Damages: Lessons from the European Community' in J Beatson and T Tridimas, *New Directions in European Law* (Hart Publishing, 1998), 83

³¹ Similar point already noted this in relation to legal formalism,

³² SS Andersen and KA Eliassen 'Making Policy in Europe' (Sage Publications, 2nd ed, 2001), 3

³³ Ibid 15

³⁴ SS Andersen and KA Eliassen 'Making Policy in Europe' (Sage Publications, 2nd ed, 2001), 20

³⁵ D Puchala 'Of Blind Men, Elephants and International Integration' (1972) 10 *JCMS* 267, 279

and by the decisions taken by these institutions.”³⁶ But so are nations in other international and regional forums and they commonly get very little done.

The style of delegating decision making in Europe is to lay down a framework of general principles. These integrate and discipline the specific technical constructions of detailed tax provisions. The broad policy directives are king and judges generally apply them as the over-riding driver. In the application of these general purposes, not infrequently, judges go to the general purposes and context to override literal meanings of technical provisions and fill in gaps. This approach began with the individual civil law codes of Germany and France. It has achieved new significance in the EU, which has an elaborate framework to generate coherence and consistency over an increasing number of very disparate national interests and cultural traditions. Law and bureaucratic processes are at the very centre of this process. As Jean Paul Gaudin puts it:³⁷

Through the multiplication of continuous interactions between actors in a situation of interdependence, [under modern European concepts of Governance] the state would eventually become “a collection of inter-organizational networks composed of governmental and social participants, without a sovereign actor in a position to direct” ... the [sum total of the] multiple configurations of social and political networks Scarcely had it emerged when this highly managerial, incremental and ultimately rather utilitarian aim appeared somewhat limited ... [than attempts were made] to improve them by situating them with respect to goals of greater magnitude.

...

The EU has little in the way of formal sanctions to bring recalcitrants into line. Some have described it “as no more than a highly institutionalized form of international relations”³⁸ but that belies its genius. They deal with intransigence and non-compliance, familiar in some members, by gradually asserting principles and marginalizing the behaviour. Chalmers articulates the following threads, partly overlapping and some times in tension, which have been identified as the basis of the cohesion of the EU:³⁹

- By structuring debate and allocating roles to parties from individual states, they reconfigure power relations
- By lock-in to the EU they generate new expectations among the parties which make it difficult for any one party to deviate from established positions or norms
- The institutions socialize participants by getting individual actors from the constituent parts to engage with the beliefs and interests and commitment of others
- Institutions structure interactions and hence create a climate in which actors are less uncertain about how others might behave and hence facilitate deals which can set agendas and build coalitions

³⁶ D Chalmers, *European Union Law* (Dartmouth PCL, 1998), 83

³⁷ J-P Gaudin, ‘Modern Governance, Yesterday and Today: Some clarifications to be gained from French government policies’ in (1998) 155 *International Social Science Journal*, Governance issue, 47, 53, 54, 55 Quote within attributed to Rhodes. In relation to the last question, his view is the jury is out and pending public acceptance it is ‘only a managerial makeshift’.

³⁸ Chalmers at 330

³⁹ Ibid 84. This analysis is largely that of Chalmers but I have actively digested it to fit Australian vernacular and understandings.

- Under new ‘fusion theory’ states retain their own self-serving tendencies but the invisible guiding hand of self-interest, while refusing to comprehensively surrender sovereignty, gives them a structure in which to pursue that enlightened self-interest. As the institutions get more powerful, there is an incentive for states to increase their involvement to maximize their clout in the process and this in turn creates the spark of fusion and the convergence of interests and further strengthens the role of the central EU institutions.

To that should be added:

- The more general momentum to deregulating the world economies in the same time frame has led to an erosion of national economic controls on the cross-border movement of capital and technological developments, like the net and more efficient travel, made the shift of information and people so much easier.

It is a mistake to imagine that Europe represents a great, integrated design. The introduction of a German Civil Code a century earlier, and twenty years in the making, was one of the decisive steps in injecting national unity into the disparate kingdoms of Germany.⁴⁰ That experience, suitably modified, has served as the model for the broader systems of Europe. And what did Germany use to do the job? They imported, indeed gave rebirth to, an exotic Roman law model based on ‘absolutism and centralisation’.⁴¹ No doubt, the unifying cement of a powerful set of norms enforced by a powerful central organ was a process well understood by the founders of the EU seeking to create a new federated Europe from the spectre of Hitler’s horrible abuse of centralized authority. Europe, instead of pulling the teeth out of its central institutions and the coherence out of its decision making process, boldly mobilizes these powers for different purposes. This is why human rights protections and an EU social vision are such key components, with economic liberalism, in the vision of a new Europe.

Much of the secret lies in the opportunism of Eurocrats, ‘skilful at turning’ the ‘multiple (and by no means coherent) provisions’ of the key treaties ‘into an expansion of their *competences*’.⁴² Jean Paul Gaudin⁴³ argues that the claim of efficiency for these institutional modalities is not strong and ‘it can be seen from experience to be highly wasteful of time and energy’. But, in comparison with Australian tax decision making, at least the time and energy in those frustrating processes is focused on over-riding policy outcomes.

In short, Europe has powerful lessons for Australia and particularly the tax system in which the power of individual actors and pressure groups has not been properly defined in terms of wider national needs.

⁴⁰ RC van Caenegem, *European Law in the Past and the Future* (2002, CUP), 90

⁴¹ Ibid 97, also 4 significant in terms of the later history of Germany

⁴² Liberally extracted from PC Schmitter ‘Imagining the Future of the Euro-polity with the Help of New Concepts’ in FW Scharpf in G Marks FW Scharpf, PC Schmitter & W Streeck, *Governance in the European Union* (Sage Publications, 1996), 127.

⁴³ J-P Gaudin, ‘Modern Governance, Yesterday and Today: Some clarifications to be gained from French government policies’ in (1998) 155 *International Social Science Journal*, Governance issue, 55

BRIEF OVER-VIEW OF EU INSTITUTIONS

In the “classical summary of EU policy process – the Commission proposes, the European Parliament advises and the Council of Ministers decides.”⁴⁴ In the European Union ‘there is almost complete fusion of the two [executive and legislative] branches.’⁴⁵ Since the mid 1980s the European Commission has played an increasingly important role.

The European Parliament needs little comment. It is a directly elected assembly from the peoples in the states [the word in the Treaty]⁴⁶ who constitute the EU. It is based on universal suffrage. Representation is based on populations. The all important European Commission is politically responsible to Parliament.

The Council of Ministers, to use a rule of thumb, is the equivalent of the Australian Senate, a second chamber in a federal jurisdiction.⁴⁷ But according to Andersen and Eliassen,⁴⁸ this characterization understates its role as a decision maker and repository of legitimacy. As Jacobs and Karst put it: “In addition to its other powers, especially ... the Community budget, it is the Council which has the principal law-making power under the EEC Treaty.”⁴⁹ It represents the people of constituent nations indirectly through appointed members of national governments. It exercises more of a co-decision role with the European Parliament. It has a significant role in negotiating compromises on the tougher decisions and acts as a protector of ‘states rights’ through the consensual mode of its decision making. The relationship between these legislative bodies is more analogous to the Westminster system or the council of an international body⁵⁰ than the Senate in the US [and Australia federal] model.⁵¹ This is so, notwithstanding that, on the US model, members of the Commission are not members of the European Parliament.

European Commission: Practical dynamics of institutional coherence

A ‘Time’ European retrospective argued: “Success for Europe is the growing power of the European Commission and particularly its increasing boldness in exercising that power, thus silencing [nationalistic] obsessions.”⁵² Its unique feature is its agenda setting and implementation structure. It spans political and bureaucratic policy making. The European Commission carries the most cogent EU lessons for Australian institutional reform.

The Commission “enjoys a dual role as the EU’s executive and bureaucracy”,⁵³ though it is primarily executive. This is, essentially, the super cabinet of the EU, with the institutional grunt of Prime Minister and Cabinet in Australia. As Jacobs and Karst

⁴⁴ SS Andersen and KA Eliassen ‘*Making Policy in Europe*’ (Sage Publications, 2nd ed, 2001), 21; for a convenient access to the main constituent documents see E Ellis & T Tridimas, *Public Law of the European Community: Text, materials and commentary* (Sweet and Maxwell, 1995), 49ff

⁴⁵ P Raworth, *Introduction to the Legal System of the EU* (Oceana Publications, 2001), 211

⁴⁶ Art 137 EC Treaty; They do not even have to change the name to evolve into a formal federal government!

⁴⁷ SS Andersen and KA Eliassen ‘*Making Policy in Europe*’ (Sage Publications, 2nd ed, 2001), 26

⁴⁸ op cit

⁴⁹ FG Jacobs & KL Karst, ‘The “Federal” Legal Order: The USA and Europe compared’ in Secombe and Weller, *Integration through law* (1986) 184 cited in E Ellis & T Tridimas, *Public Law of the European Community: Text, materials and commentary* (Sweet and Maxwell, 1995), 51

⁵⁰ FG Jacobs & KL Karst, op cit 51

⁵¹ P Raworth, *Introduction to the Legal System of the EU* (Oceana Publications, 2001), 212

⁵² *Time* (European ed, 18 Aug 2003), A38

⁵³ SS Andersen and KA Eliassen ‘*Making Policy in Europe*’ (Sage Publications, 2nd ed, 2001), 23

articulate it:⁵⁴ “The Commission, the institution at the heart of the entire Community structure, is a political institution but independent of the member states. ... Beyond its function in the administration of the Community and as an enforcement agency, and a unique role as guardian of the community ... the Commission participates in ... the Community law-making process.”

The European Commission has powers for “adopting implementing rules ... directly from the Treaty”⁵⁵ as well as specific delegations from the Council of Europe. It even has an inherent jurisdiction, ‘to adopt implementing rules in specific sectors where the Commission has not been bestowed with such power’⁵⁶. But it has become much more dominant in EU processes than even this formulation indicates.⁵⁷ It is ‘guardian of the legal framework’ and the key driver of further European integration.⁵⁸ It shapes measures taken by the Council and the Parliament and initiates major policy directions.

The Commissioners are appointed from member countries; one commissioner from each member nation of the EU and two from larger players.⁵⁹ They are appointed for a renewable five years. But they are explicitly bound by the Treaties ‘to foreswear any national loyalties’⁶⁰ and to be ‘completely independent’⁶¹. In practice, Commissioners have identified with the culture and wider objectives of the EU. Though there are procedures for voting, they operate largely by consensus. Significantly, for our purposes, the Commission does not carry out its functions in the vast and complex continent of Europe but delegates them to the member states and the organs of member states are responsible for their implementation.⁶²

European law and European Court of Justice

Scharf⁶³ argues that the EU literature ‘focused too long only on aspects of intergovernmental negotiation while ignoring (or, at least, not taking seriously enough) the establishment by judge made law, of a European legal order that take precedence over national law.’ The European Court of Justice, subject to civil law modalities, has a role closely equivalent to the Australian High Court. Its 15 members are appointed by member states and can only be dismissed by their own colleagues.⁶⁴

⁵⁴ FG Jacobs & KL Karst, ‘The “Federal” Legal Order: The USA and Europe compared’ in Secombe and Weller, *Integration Through Law* (1986) 187,190-1 cited in E Ellis and T Tridimas, *Public Law of the European Community; Text, materials and commentary* (Sweet and Maxwell, 1995), 53

⁵⁵ Ibanez, *The Administrative Supervision and Enforcement of EC Law* (Hart, 1999), 20 quoting arts 48(3)(d) and 91 of the EC Treaty

⁵⁶ Ibid

⁵⁷ For example, PC Schmitter and FW Scharpf in G Marks, FW Scharpf, PC Schmitter and W Streeck, *Governance in the European Union* (Sage Publications, 1996), 1 argue the unheralded and seemingly modest Single European Act, which created the momentum for the move from EC to EU and the subsequent Maastricht Treaty, was given ‘legs’ in the early 1990s by 282 directives drafted by the Commission and approved by the Council of Ministers.

⁵⁸ Ibid 23

⁵⁹ Ibid 86

⁶⁰ SS Andersen and KA Eliassen ‘*Making Policy in Europe*’ (Sage Publications, 2nd ed, 2001)

⁶¹ Art 157 EEC Treaty

⁶² Jacobs op cit

⁶³ FW Scharf in G Marks et al, *Governance in the EU* (Sage Publications, 1996), 15

⁶⁴ P Raworth, *Introduction to the Legal System of the EU* (Oceana Publications, 2001), 211

Significantly, judges are appointed for only six years. It does not publish dissenting judgments.⁶⁵

The Court has been accused of activism. An MP in the United Kingdom, who tried to create a power to ensure its judgments did not apply in the UK, said it was a political court and had a bias to European integration.⁶⁶ As Vranken says: “The law making function of the courts in the civil law is not officially acknowledged. However, the various methods of statutory construction available to the courts have served as a guise to do precisely this. The European Court of Justice is no different from other civil law courts in this regard.”⁶⁷ Though not “bound by any formal doctrine of stare decisis, the Court very rarely reverses its own earlier decisions”.⁶⁸ The ECJ has been an important element in the evolution to a EU.

Tax integration in the EU

The common market attempts, according to the ECJ,⁶⁹ “the elimination of all obstacles to intra-Community trade in order to merge the national markets into a single market.” From the very implementation of the EEC Treaty in 1958, taxation integration was seen as a major part of the job and the Commission spent much time on it. It gave very high priority to indirect taxes.⁷⁰ Tax integration varies from complete uniformity through harmonization and coordination to mere approximation or attempted removal of some differences in member states.⁷¹ The tough job of direct tax harmonization in the EU has proved too much for the institution to date, with more promise than performance. This is a major challenge for the EU. To quote Williams:⁷²

...the tax policies of the European Union have been both an outstanding success and an almost total failure. The Community Customs Code is ... remarkable,... not just for its content, but for its very existence as a code of law applying directly to ... eighteen or more sovereign states. At the other extreme, the attempts to produce a common corporate tax system have failed time and again.

There has been much progress on uniformity or harmonization of indirect tax measures. As well as customs duties it includes excises and turnover taxes⁷³, which can act as substitutes for customs duties and, of course, VAT. Customs duties *between* EU states have largely gone. The EU wide adoption of VAT (and a European model which is less than perfect) has allowed VAT to replace a raft of confused individual national indirect taxes. This is of course an essential pre-requisite to an efficient single market in goods and services. EU directives have brought about steady removal of national differences in VAT⁷⁴ in favour of a move to Community wide standards.⁷⁵ These differences were quite marked in the original six states, in both system

⁶⁵ Ibid 25

⁶⁶ Chalmers at 326-7

⁶⁷ M Vranken, *Fundamentals of European Civil* (Federation Press, 1997) 73

⁶⁸ AJ Easson, *Taxation in the European Community* (Althone Press, 1993) 65

⁶⁹ *Gaston Schul* [1982] ECR 1409

⁷⁰ P Farmer and R Lyall, *EC Tax Law* (Clarendon Press Oxford, 1994) 13

⁷¹ Typology of D Williams, *EC Tax Law* (Longman, 1998), 35 drawing on confusions in EU texts.

⁷² D Williams, *EC Tax Law* (Longman, 1998) 7

⁷³ AJ Easson, *Taxation in the European Community* (Althone Press, 1993) 84ff

⁷⁴ B Terra and P Wattel, *European Tax Law* (Kluwer, 3rd ed, 2001), 235 ff full discussion

⁷⁵ B Terra and P Wattel, *European Tax Law* (Kluwer, 3rd ed, 2001), 7

structures and exemptions. New initiatives as the time of writing were moving into harmonization of VAT, with particular reference to collection mechanisms.⁷⁶

The wider political impact of these changes should not be missed. The “loss of boundary control”⁷⁷ over markets for capital, goods and services and labour, not political or military control, is the crucial step to creating transnational integration. In breaking down the economic boundaries of states, their sovereignty is weakened and they are subsumed into a larger collective. In contrast with Napoleon’s army and Britain’s navy, the rhetoric of competition, deregulated international markets and supra-national financial institutions, as much as its enormous military capacity, was the weapon of US international economic dominance until Japan and China learned their trick.

Direct tax harmonization stalled

There has been only halting progress on integration of direct taxes.⁷⁸ In contrast to the many provisions on indirect taxes, the Treaties are silent on direct taxes⁷⁹ and recent attempts to introduce them in the new Constitution of the EU appear to have stalled.

The interactions of EU member states are now characterized by a very large degree of economic and monetary integration, with unhindered and untaxed movements of workers and capital across borders and hence the creation of businesses increasingly spanning all of Europe.⁸⁰ This raises, as William’s says,⁸¹ a raft of practical issues of double tax and discrimination against migrant workers and the refusal of social welfare, including pensions and deductions, for which taxes have been collected. But, most important, it raises a large range of anomalies on corporate taxes and the taxation of saving and investment. This is the normal litany of problems with inconsistent corporate tax systems familiar to international tax experts and company tax theorists. The problems in accommodating cross-border transactions between tax jurisdictions with strikingly divergent company tax systems⁸², all the more immediate and pressing in an integrated market like Europe, are articulated in the Ruding report.⁸³ They include distortion of transactions, significant compliance costs in doing cross-border business and misallocation of resources. This imposes an excess burden on the cost of capital and opportunities for arbitrage and blatant tax avoidance.

Early attempts to harmonize individual income tax, in the 1962 Neumark Committee, were abandoned⁸⁴, possibly because there was a focus on the more immediate problem of indirect taxes, and until recently there seemed no immediate prospect of revival.⁸⁵ In 1967 detailed measures for tax harmonization were prepared by the EU

⁷⁶ Analysis relies on interview with Jan De Goede, Director of R and D, IBFD and Professor at Lodz

⁷⁷ FW Scharpf in G Marks, FW Scharpf et al, *Governance in the European Union* (Sage Publications, 1996), 16; the analysis draws heavily on this source.

⁷⁸ Professor Augusto Fantossi Univerita La Sapienza di Roma at Bologna conference op cit

⁷⁹ AJ Easson, *Taxation in the European Community* (Althone Press, 1993) 179

⁸⁰ See excellent discussion in D Williams, *EC Tax Law* (Longman, 1998) 17 and the recent movements which remove impediments for companies operating in other EU countries: P Dryber, ‘Full Free Movement of Companies in the EC at Last’ (2003) 28 *European LR* 528

⁸¹ op cit 99ff

⁸² In Europe they involve fully classical, various mechanisms for partial integration of entity and member taxation and widely varying tax rates.

⁸³ Report of the Committee of Independent Experts on Company Taxation (EC commission, 1992), 196ff

⁸⁴ S Cnossen, *Tax Coordination in the EC* (Kluwyer, 1987), 41

⁸⁵ D Williams, *EC Tax Law* (Longman, 1998), 97

Commission, with an emphasis on free movement of capital across European borders, corporate structures and the achievement of an even playing field for competition.⁸⁶ In 1970 the van den Tempel report was commissioned on individual income tax, which covered issues of dividend tax in the hands of shareholders. 1969 meetings of European heads of state and a 1971 report proposing the development of the EU, again, identified the abolition of tax frontiers and taxes which influence the movement of capital as major issues. Stagnation followed.⁸⁷

Direct tax harmonization: recent initiatives

The most recent formal report at the time of writing, the 1992 Ruding Report⁸⁸ was set up to address the impact of taxation on investment and allocation of profits between EU states. It noted a large number of differences in corporate tax systems and the corporate tax base. The report was not warmly received and was criticized by Fantossi⁸⁹ as being too focused on difficulties rather than opportunities. Direct taxes raise very sensitive issues and nations like the UK are very reluctant to surrender sovereignty on core issues like their monetary and direct tax policy. One French speaker at the Bologna conference in 2003 asserted bluntly⁹⁰ that, while EU directives have supremacy and are *normally* applied by the French Council of State, tax is a domestic issue for France and their application is selective because the European Convention does not apply. This is the problem for analysis.

From about 2000 the European Commission became far more aggressive in its mobilization of the various tools at its disposal to force the pace of direct tax harmonization.⁹¹ This involves both the prosecution of cases to the ECJ and the publication of Treaty interpretation provisions. This includes explicit articulations of the tax application and the limits of general norms in the Treaties with respect to tax competition. It has mobilized state aid investigations, which were not used in tax before, to combat tax provisions which provided a hidden subsidy to domestic business in a state to the relative disadvantage of other members of the EU. In another initiative litigation has been initiated to challenge the imposition of exit taxes on taxpayers leaving particular tax jurisdictions.

Having started these hares running and shifted the underlying norms, individual taxpayers have got the message and initiated actions in domestic courts of constituent nations based on the inconsistency of national tax laws with EU instruments. This has increased momentum and co-opted individual taxpayers, in effect, as an enforcement arm of the EU. This was particularly prevalent in the Netherlands and, to the consternation of tax lawyers, has recently been mushrooming in the UK. This has led to some controversy and calls for the abridgment of Commission powers but many consider it an implementation of the EU's core mission to remove barriers to trade. Significantly this development has led to attack on some forms of policy discrimination which is tolerated by the OECD model treaties. EU developments thus have wider international policy implications.

⁸⁶ P Farmer and R Lyall, *EC Tax Law* (Clarendon Press Oxford, 1994) 21

⁸⁷ P Farmer and R Lyall, *EC Tax Law* (Clarendon Press Oxford, 1994) 22

⁸⁸ Report of the Committee of Independent Experts on Company Taxation (EC Commission, 1992); chaired by Onno Ruding.

⁸⁹ Professor Augusto Fantossi Univerita La Sapienza di Roma at Bologna conference op cit

⁹⁰ Cyrill David at Facolta di Giurisprudenza, *Tax Law Principles in Europe* (16 September 2003, University of Bologna)

⁹¹ Analysis relies on interview with Jan De Goede, Director of R&D, IBFD and Professor at Lodz.

The strategy is emerging from the fog. Having failed in open attempts at direct tax integration, the EU appears to be using a sledge hammer to attack any provision which discriminates against investors in other EU countries. This makes the status quo untenable. At the same time, by moving to attainable milestones which mesh the treatment of company tax, a momentum for full integration is created. Models, once in place, as we saw earlier, make it very difficult to halt the momentum to integration. It all makes Australian tax reform problems seem modest by comparison. But the model for institutional renewal offers valuable lessons for getting through road blocks.

The ECJ has reiterated that “although direct taxation falls within the competence of the Member States, the later must ... exercise that competence consistently with Community law.”⁹² Under a calculated test case strategy, the European Commission, has used such tax articles as exist in the EC Treaty as a general source for deriving the concept of an intent to create free movement of capital and non-discrimination which carries through to tax. This injects into the tax analysis the familiar key pillars of the EU: the four freedoms for movement of goods, people, services and capital.⁹³

In 2003, after many false starts, there have finally been some significant milestones in the move to corporate income tax integration. The new German corporate income tax has been designed on principles of neutrality of treatment across borders. This reform, largely driven by the need to remove distortions to cross border investment in EU states, drops imputation in favour of a different corporate tax model which will, no doubt, act as a precedent from the intellectual leader of the EU for the other members of the EU.

The long awaited directives on taxation and withholding taxes on savings have been issued. The over-riding objective, in the absence of coordination of national systems for savings, is to remove distortions to smooth cross border flows of capital between member states of the EU. The 2003 Directive on taxation of interest⁹⁴ removes intra-EU interest withholding tax and ensures that interest payments are taxable only in the country of residence of the taxpayer receiving the interest.⁹⁵ An allied Directive⁹⁶ covers withholding tax on interest and royalties between associated companies in EU states. The principles articulated⁹⁷ are that in a single EU market ‘having the characteristics of a domestic market, transactions between companies of different

⁹² Terra and P Wattel, *European Tax Law* (Kluwer, 3rd ed, 2001), 29 and following for discussion of principles. The analysis here draws heavily on his rather longer discussion.

⁹³ Leads to a prohibition on discrimination by reason of nationality [analogy to state in Australia], free movement of goods and services across state borders, free movement of persons, capital and businesses across borders. But also includes wider doctrines like the ‘rule of reason’ applied to the movement of goods. This is analogous to the proportionality doctrine discussed in detail below. If the national tax rule is liable ‘to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty’ it must be ‘applied in a non-discriminatory manner’, justified by ‘imperative ... public interest’, ‘suitable for securing ... the objective’, ‘not go beyond what is necessary’ (Language from *Gebhard v Consiglio etc di Milano* [1995] ECR I-4165 cited in Terra & P Wattel, *European Tax Law* (Kluwer, 3rd ed, 2001), 33

⁹⁴ Council Directive 2003/48/EC on taxation of savings income in the form of interest payments. Operative 1 Jan 2004

⁹⁵ Art 1 op cit

⁹⁶ Council Directive 2003/49/EC on a common system of taxation of interest and royalty payments between associated companies of different EU states

⁹⁷ op cit preamble para (1)

member states should not be subject to less favourable tax conditions than those applicable to the same transactions carried out between [domestic companies]’.

BEYOND THE UK COMFORT ZONE: FEEDBACK ON RADICAL EU TAX INTERVENTIONS

Corporate tax integration and the problems with it were the centre piece of the 2003 annual conference on European tax in Bologna, Italy. This large conference with many of the key academic tax players from around Europe was specifically designed⁹⁸ to further tax integration and deal with the problems of implementing it.⁹⁹

In the Bologna conference and my extensive discussions with a range of experts across Europe, many considered the ECJ had over-reached. They criticized the tendency to apply the EU norms slavishly without sufficient reference to competing tax policy priorities, that the ECJ lacked the experience and tax expertise to balance sophisticated tax policy issues, took on fundamental tax issues without sufficient attention to the fundamental rules being rewritten and was moving too fast. Another view was that there was some method in this ‘madness’. The fundamental challenges could best be explained as a means of forcing negotiations toward a consensus on a new tax convention between EU states. If existing individual state corporate tax systems were rendered untenable, the only practical option became an agreement on principles for a new, harmonized, EU business tax system.

UK delegates emphasized the dangers of the radical changes currently being pursued in the EU. David Oliver of Cambridge University Law Faculty emphasized lack of EU awareness of the sovereignty of member states and, in particular, the very different approach of the UK, which eschewed general statements of principle such as those in the Spanish General Tax law. EU law was made part of UK domestic law as late as 1998. It was clear that the ECJ had adopted civil law models and these dominate the legal modalities in the increasingly integrated EU. The UK courts are unused to the wide ranging direct role of Constitutional courts in tax matters and the changes require very large shifts in their mode of reasoning. It is a revolution in approaches, in sharp contrast to the more customary evolutionary approaches of UK courts in rule making. Oliver argued that this activist model elevated the role of the courts and Commission and that many of the major initiatives lacked solid grass roots democratic support. Note the paradox that the Australian main institutional structure and tax code are a much closer analogy to Europe but Australian courts are more UK in their tax approach than the UK.

Professor David Southern contrasted the different development of English constitutionalism with the European system. Under the English system Parliament (and in particular the lower house) is omnipotent and not subject to political constraints. The language of the rule is everything. The EU chose the German model, he argued, because the UK got an ‘instability disease’. Lack of a coherent

⁹⁸ Emphasized in the opening of the Rector of the University of Bologna conference op cit

⁹⁹ Facolta di Giurisprudenza, *Tax Law Principles in Europe* (16 September 2003, University of Bologna); papers were in various European languages with oral translations into English but full written translations were not available and the versions here depend on the notes of the author. This means the responsibility for accuracy is mine and readers should guard against the possibility, before attributing statements to speakers that they might have lost something in the translation or transcription. The help of Professor Di Petrio and Marco Greggi in assisting attendance by the author and other Australian delegates is gratefully acknowledged.

identification of the principles underlying tax rules promotes the need for frequent rewrites of tax law to deal with emerging problems and incoherence. It tends to politicized every significant tax debate and to that, this author would add, to undermine Parliament's control. We can add that it gives excessive power to lobby groups who can target judicial discretions behind the cloak of complex technicalities and legalistic reasoning. Much of this analysis is extremely relevant to Australia.

The comparison between principles and rules was drawn out by a number of speakers at the Oxford¹⁰⁰ and Bologna¹⁰¹ conferences and at a detailed analysis of ECJ tax decisions at the Institute of Advanced Legal Studies¹⁰². The UK debate sometimes drifted to a point where the attempt to introduce precision in definitions obscured the key issues, hence underscoring the very issues articulated in this paper. French Professor Cyrille David, Sorbonne Law Faculty of the Paris University, identified the tensions with some clarity. There is a divergence between administrative and wider policy norms (like fairness or proportionality or equality of treatment) and the normal rules imposed by the rules and hierarchy of authority. This, in turn, raises the familiar Catch 22 generated by the imperatives for delegation in a mass decision making process: the need for consistent rules and the increased opportunity that spelling out of such rules provides for hijacking of such norms by delegated decision makers.

In continental Europe this tension is handled, in the civil law tradition, by hiving off the protection of fundamental administrative principles to administrative courts and leaving normal rules to the normal courts. If you think about it, this idea is not foreign to Anglo-Australian traditions. There is a solid common law precedent for this practice. It is the separate stream of equity which lived for centuries in constant creative tension with the common law before the fusion of law and equity and before equity got rheumatic. The creation of the office of Ombudsman is a modern, rather proscribed, version of the same idea. And, of course, there is the over-riding principles enshrined in the Australian written Constitution. It also raises issues, David explores, of the consistency with which such wider norms are applied and the difficulty of accessing them in the normal run of cases where costs and timeliness are a major issue. The preoccupation in the EU, as articulated by David, is to achieve coherence and consistency by strategies to increase the convergence of EU taxes and the understanding of their purposes. This process will always involve contradictions, he argues, because various taxes pursue divergent policies and because there are inherent contradictions in the wider norms and specific job of micro tax management.

If this argument applies to the UK, it applies much more strongly in Australia. Because judges have adopted, on the surface at least, self-restraint on entering policy, there is completely inadequate on-going dialogue on emerging principles and the appropriateness of the current principles. Ideas, Southern asserted, are not useless pondering on philosophy and the meaning of life but important beacons in the construction of a coherent tax system [both in transnational organizations like the EU and with nations like Australia¹⁰³].

¹⁰⁰ UK Tax Research Network Oxford conference (17 Sep 2003)

¹⁰¹ Facoltà di Giurisprudenza, *Tax Law Principles in Europe* (16 September 2003, University of Bologna) Professor Cyrille David, Université de Paris

¹⁰² British Institute of International & Comparative Law conference *EU and Tax Law – Fiscal and Wider Implications* (9 Dec 2003)

¹⁰³ This is author's addendum, not Southern's.

The search for coherent and more or less consistent norms across jurisdictions, Southern argued, is the key to tax harmonization both within the EU and, of course, in the move to coherent relations between other key players in the international arena. It has been started by the OECD in moves over recent years to marginalize tax havens. It is continuing in the various domestic rules to remove barriers where trading partners have comparable tax systems. It has been pushed by German attempts to design a corporate tax system built on the principle of neutrality between domestic and foreign sources of corporate income. Australia will have to grapple with these issues increasingly as it integrates its economy with the US and Asia and, if international trade liberalization, gets beyond the current stalemate, to the rest of the world economy.

Asserting core principles: Spanish fundamental law model¹⁰⁴

Part of the problem with broad directives to the tax judges in Australia in the past has been the ease with which they can be marginalized or ignored. There are civil law precedents in which important principles are given emphasis with quasi-constitutional tax legislation. This methodology could help address this problem.

Spain draws heavily on the German and Italian civil law models. The original 1919 German umbrella tax code, the *Abgabenordnung*,¹⁰⁵ was the basis of its 1967 fundamental tax law and Latin America imported it from Spain. Like the German model, it uses a general tax act to spell out fundamental rules and principles and specific legislation to elaborate it for each of the taxes. So the general tax act is quasi ‘constitutional’ legislation which spells out core principles and the very basic conceptual tax framework. Most significant for our purposes, it contains general anti-avoidance provisions and form-substance principles. It also contains general procedural rules for assessment and collection (analogous to the Australian Tax Administration Act but with much of the detail in regulations). Like a constitution, it is more stable than the legislation spelling out technical rules for specific taxes. The effect of this general tax legislation is to create uniform principles, as appropriate, for taxing events, the tax base and the tax unit. It spells out very basic protections like a general rule against double taxation or double dipping on deductions and exemptions. Professor Soler Roch¹⁰⁶ sees the articulation of high level general principles based on ‘a conceptual model’, as opposed to mere technical definitions, now ‘unanimously praised, as a decisive ‘guarantee of legal certainty’. This contrasts sharply with the unexamined *assumption* of many Australian practitioners and judges that it will lead to uncertainty.

In 2003, Spain was in the process of its first rewrite for 40 years. This contained a much more explicit attempt to establish a balance between powers of the tax administration and taxpayer rights.¹⁰⁷ This general tax law is ‘highly conceptual’,¹⁰⁸ using such broad concepts as ability to pay, equality, progressivity and constraints on

¹⁰⁴ This section draws heavily and directly from MT Soler Roch, ‘The Reform of the Tax Code Based on Experience of the Spanish General Tax Law’ Paper to Tax Research Network Oxford conference 2003 (17 September 2003, paper 4). Her analysis is pruned and largely phrased in more familiar Australian terminology but the ideas are an attempt to encapsulate her concepts.

¹⁰⁵ Rewritten in 1977 and continuously updated since. Acknowledge Prof Heinzen of Free University of Berlin

¹⁰⁶ Soler Roch op cit 5

¹⁰⁷ Published by House of Commons 6 June 2003

¹⁰⁸ Soler Roch op cit 4

confiscatory taxes. It has general definitions of taxation. It interpolates concepts like proportionality (see below) and ‘indirect costs’, presumably referring to transaction and compliance costs. Interestingly, the main debate in Spain was whether the general tax law needed to explicitly specify concepts articulated in the Spanish Constitution.

The earlier general tax legislation drew on the German model and contained a general principle of ‘substance over form’ which empowers the tax administration to define a taxable event ‘in accordance with its true nature, irrespective of the form or denomination given thereto by interested parties’.¹⁰⁹ This is, of course, a very wide power to re-characterize transactions according to their substantive commercial or non-tax outcomes. There was also a provision in the case of tax avoidance, analogous to, but weaker than, the general anti-avoidance provisions in Part IVA, enabling intervention by the Administration where there is a “proven intention to avoid tax.”¹¹⁰ Such an approach is, of course, far less effective than the Australian test based largely on inferences from objective actions and, given the difficult burden of proof. This, along with a 1995 provision for striking down shams, was rarely applied.¹¹¹ The administration relied on the substance doctrine. The 2003 draft strengthens the substance and avoidance intent rule. It strengthens the concept that the Administration has the power to characterize a scheme “irrespective of the classification previously given thereto by the interested party”.¹¹² The subjective intention rule was replaced by objective criteria, more closely analogous to the Australian general anti-avoidance rules. The test is now whether the acts of the business, individually or together “obviously contrived or inappropriate to achieve the result obtained” and, with echoes of recent debates in Australia, there are *no* significant results other than tax savings. This last rule would not, of course, capture a scheme which achieves commercial outcomes by a contrived, tax avoidance path but the general rule about substance might well pre-empt such techniques.

The debate in the UK, as we saw earlier, has focused on distinctions between ‘principles’ and ordinary law, between tax law used in its ‘ordinary’ and ‘legal’ sense. Such distinctions are another manifestation of the ability of tax lawyers to reduce a holistic communication into its constituent parts and, hence, to lose that meaning. The essential job? To create a hierarchy of concepts. The legislature can assist by pulling key concepts out from the ‘noise’. Where it fails to do the job, delegated decision-makers must do it. They need to resist getting sucked into sterile definitional debates; the very problem at issue.

The significant point about the Spanish experience is the general ‘quasi constitutional’ approach in which broad, over-riding principles are spelt out and, to that extent, whether we deal with the problem of judges going on frolics of their own and hiding it in a cloud of technical detail. It is not, of course, a magic bullet. It involves active judgment by decision makers. Slavish adherence to general principles is almost as bad as low level slavish application of rules. But it should cleanse and clarify by creating an explicit hierarchy of policies and hence a framework for principled criticism. It will promote transparency and accountability. It will promote coherence and consistency. It will assist those who wish to prevent fundamental principles from being submerged

¹⁰⁹ Article 25 of 1963 General Tax Law and Art 28(2) amended in 1995

¹¹⁰ Art 24 of 1963 General Tax Law

¹¹¹ Soler Roch op cit 15

¹¹² Art 15 2003 draft

in a self-justifying spiral of mindless technical analysis feeding on itself. And, yes, these sorts of problems are all too prevalent in Australian tax law and they do need addressing.

As a footnote, Australian lawyers and accountants are not unfamiliar with these devices. But, for the most part, they leave them at the door when they give tax opinions. Australian lawyers are familiar with rules in the Constitution which over-ride specific legislation and delegated rule making. Australian accountants are aware of the UK 'true and fair' over-ride which, in dealing with problems very similar to those involved in tax avoidance, imposes this general principle over and above specific rules for the drawing of accounts.¹¹³

CASE STUDY: COMPARE CHOICE PRINCIPLE & EUROPEAN PROPORTIONALITY DOCTRINE

Legal systems have internal dynamics which give them their special character, and it is important to understand these in order to appreciate what makes a legal tradition distinctive. But legal systems are not immutable. They can change through national and international pressures. Cross fertilization ... is an important facet of legal evolution.

John Bell¹¹⁴

Under the European Convention on Human Rights, if any state wishes to abridge the rights of citizens in a way which interferes with rights guaranteed under the Convention, "it must endeavour to ensure that, in every case in which that law may fail to be applied, any interferences caused will be found to be proportionate when judged against all the circumstances"¹¹⁵ We will use this case study to compare the operation of this proportionality principle in European public law¹¹⁶ with the sharply contrasting operation of the Australian judge made choice principle operating on the general tax anti-avoidance provisions. The two principles have analogous operation. Both set up over-arching principles to discipline detailed rules and ensure they do not offend core policy principles. But the approach is very different. This ability to maintain a creative tension in Europe contrasts sharply with the polarization in the Australian choice principle cases. In Australia, the approach of tax judges to the balancing job is thin on articulated policy appreciation or an iterative, evolutionary approach to the development of doctrine.

In the Australian general tax anti-avoidance provisions, the broad directives set up 'rules of fair tax play' whose purpose is to over-ride more specific tax rules in cases of tax avoidance. In Spain, such provisions are entrenched in a fundamental tax law. In

¹¹³ Acknowledgement to C James, *Beyond Separation of Powers: Re-engineering the process by which tax policy is translated into practical outcomes* (2002. Unpublished work for Current problems in Taxation at ATAX supervised by author). She also makes some very useful practical suggestions for use of this approach in VAT and practical suggestions which will hopefully be published.

¹¹⁴ J Bell 'Mechanisms for Cross-fertilization of Administrative Law in Europe' in J Beatson and T Tridimas, *New Directions in European Law* (Hart Publishing, 1998), 147

¹¹⁶ There is some controversy about whether the principle should apply to taxation. Professor Markus Heintzen of FUB quotes Hans-Jürgen Papier, president of the Federal Constitutional Court, in his book *Die Finanzrechtlichen Gesetzesvorbehalte und das Grundgesetzliche Demokratieprinzip*, 1973, s76 ff and Joachim Lang, *Vom Verbot der Erdrösselungssteuer zum Halbtteilungsgrundsatz*, *Festschrift für Klaus Vogel*, (2000) s173 ff. He quotes the decision of German Federal Constitutional Court (June 22, 1995; 2 BvL 37/91) Vol. 93 *Decisions of the Federal Constitutional Court*, 121 where the court says that any taxation in excess of about 50 percent is a violation of the guarantee of property by art 14 of German Constitution.

the case of the European Convention on Human Rights, government interference with the individual liberties of the citizen must be measured against a benchmark that such interference is not, in all the circumstances, a disproportionate curtailment of such rights. One of the most intractable problems in a wide-ranging general anti-avoidance provision is the relationship between the wide directives in that provision and detailed, technical provisions of tax legislation and particularly of deliberate tax expenditures. A great deal of superficial reasoning, often driven by other agendas, has driven analysis of this tension in Australia. In the overblown version in the extended choice principle articulated in *Cridland*¹¹⁷, it was held by the High Court that the general anti-avoidance provisions have *no* room for operation *at all* where some specific rule in the Income Tax Assessment Act gives the taxpayer a choice of options.

Of course, the dynamic approach to rule making in the proportionality doctrine now operates, not just in Strasbourg and the ‘dark’ reaches of Italy, but in relation to bread and butter domestic issues in the *English* Common law courts, which are the modern embodiment of our Australian judicial heritage!

European proportionality doctrine: key features

The doctrine of proportionality is a wide principle designed to forestall the use of “a steam hammer to crack a nut, if a nutcracker would do.”¹¹⁸ It is a doctrine which proscribes the measures used by public bodies to attain the use of legitimate public purposes. It ensures that public government intervention is strictly necessary and proportionate to that purpose. The doctrine is primarily “negative in application” and is used to decide whether “an administrative decision is disproportionate, thus causing injustice.”¹¹⁹ The doctrine¹²⁰ “apart from a balancing mechanism of conflicting interests and values, ... constitutes a key safeguard of the essence of fundamental rights”. The doctrine of proportionality is the centre piece of much European substantive and procedural tax law and is the subject of a number of monographs. It is merely one of a number of similar doctrines¹²¹ to guarantee due process and the protection of fundamental civil liberties.

Our treatment is short and eclectic to draw out relevant features for the case study. In detailed analysis of the operation of the proportionality doctrine Sales and Hooper¹²² frankly acknowledge a “significant tension between the requirement of legal certainty ... and the doctrine of proportionality ...” They seek “two competing social needs” and all legal systems are “the product of a compromise between these two social needs.” It is the maintenance of this creative tension at the practical level which determines the effectiveness of a legal regime and the emphasis will, as Nonet explains,¹²³ turn on patterns of error at a particular historical moment.

¹¹⁷ *Cridland v FCT* 77ATC 4538, 4541 (fully discussed below) and see earlier articulations in *Keighery Pty Ltd v FCT* (1957) 100 CLR 66; *FCT v Casuarina Pty Ltd* 71 ATC 4068

¹¹⁸ Lord Diplock in *R v Goldsmith* [1983] 1WLR 151, 155

¹¹⁹ N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (1996, Kluwer), 173

¹²⁰ N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (1996, Kluwer), 173

¹²¹ Another is the doctrine of legitimate expectations.

¹²² op cit 439. See also N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (1996, Kluwer), 142 and sources cited to the effect that legal certainty, important as it may be, is not an absolute value inc HLA Hart.

¹²³ P Nonet, *Administrative Justice* (Russell Sage Foundation, 1969), 3.

The development of the doctrine in the courts has focused on a number of factors. In an ECJ formulation¹²⁴ it requires the three constituent components of suitability, necessity and proportionality (using the term in its narrow sense). Suitability ‘suggests that an interfering action be at least regarded as suitable for attaining its aim’. Necessity ‘demands that authorities must choose the least restrictive among equally effective means. Proportionality ‘demands a proper balance between the injury to an individual and the desired community interest, prohibiting those measures whose disadvantages to the individual outweighs the purported community interest.’¹²⁵ The *Fromançais*¹²⁶ case requires that the means employed to achieve an aim corresponds to the importance of the aim and are necessary for its achievement. This is expanded in the *Fedesa*¹²⁷ case to require that the measures do not exceed the limits of what is appropriate and necessary in order to attain the objectives *and* that, where there is a choice between means to attain the objective, ‘recourse must be had to the least onerous’. These criteria indicate the richness of analysis and contrast sharply to the one dimensional analysis of Australian tax courts on the choice principle.¹²⁸ It revisits age-old issues about the boundaries between the competence of judicial and political institutions.¹²⁹

The proportionality doctrine, developed in the German Supreme Administrative Court and applied in other European jurisdictions like France, has been adopted by the EU courts since 1955¹³⁰ but gained increasing prominence during the 1970s and 1980s as a major tool in both EU substantive law and procedure.¹³¹ There are significant differences between the very specific and highly developed German rules and those in the EU.¹³²

The EU doctrine was originally a political doctrine which was part of the EC treaty designed to proscribe excessive arrogation of power by EU institutions at the expense of member states. It was essentially a doctrine to ensure that EU interventions achieved economic integration and no more. But, under the ECJ, it has been expanded

¹²⁴ Case C-331/88 *R v Ministry of Agriculture ...* [1990] ECR I-4023 quoted in Thomas *op cit* at 78

¹²⁵ Formulations all extracted from Y Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the European Commission of Human Rights* (Intersentia, 2002) 192

¹²⁶ Case 66/82 [1983] ECR 395, 404

¹²⁷ Case C-331/88 [1990] ECR I-4023, 4063 from Emiliou *op cit* 134

¹²⁸ Analysed in Y Grbich, *Tax Decision-making at the Crossroads: Strategic directions in M Walpole and R Fisher (eds) 5th International Conference on Tax Administration* (Timebase, Sydney, 2003).

¹²⁹ See discussion in N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (Kluwer, 1996) 171ff and refer to the large debate in the UK about the widespread intervention of ECJ into domestic UK law in pursuit of these doctrines.

¹³⁰ in *Fedchar* Case 8/55 [1954-56] ECR 292,299; Generally see Lord Hoffman ‘The Influence of the European Principle of Proportionality Upon UK Law’ in E Ellis, *The Principle of Proportionality in the Laws of Europe* (1999, Hart), 107 and G Note ‘General Principles of German and European Administrative Law: A comparison and historical perspective’ (1994) 57 *MLR* 19, 192

¹³¹ Source is N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (1996, Kluwer) and discussions with Professor Di Petrio Facolta De Giurisprudenza at University of Bologna. See extensive bibliography in Emiliou.

¹³² Covered in depth in N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (1996, Kluwer) particularly at 2, 134 on which this treatment draws extensively and see comparison with common law in R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (2000, Hart Publishing), xv

to pursue much wider objectives¹³³ and has reached into domestic law.¹³⁴ There are few areas of EU law where it is not now relevant.¹³⁵ In particular, its integration into domestic law has been the subject of heated debate and scholarly comment.

Why does common law have a problem learning from Europe?

... all purely intellectual obstacles to assimilation [of broad European principles into common law] are, in practice, surmountable; the real obstacles are to be found in the widely differing histories, political and social structures of European countries.’

Kahn-Fruend¹³⁶

The English legal system, in particular, has had to grapple with these specific problems as it integrates the proportionality doctrine, born in a different German and EU legal tradition, into its domestic administrative law. The difficulties this has caused English domestic law, says Thomas,¹³⁷ raise much more fundamental issues about the appropriate role of law [and judges] in a decision making process which so profoundly impacts on Government policy.¹³⁸ His hypothesis is that “any reconciliation of the principles [of proportionality and legitimate expectations] in English law ... would require a reconsideration of the basic conception of administrative legality [read the basic working premises of the approach of Anglo Australian tax courts to legal doctrine].”¹³⁹ Thomas’s conclusions¹⁴⁰ put the development of doctrines like proportionality down to the civil law ability to divide EU law into separate categories of public and private law. He blames the difficulty of adopting the principles into English law on the tradition of the common law of quarantining public law principles into a special category. Note that tax, even if many Australian judges have not yet realized it, is more public than private law.

Thomas’s argument offers good insights but his perspective is too narrow. While his argument can readily be accepted as historical explanation, it obscures more important observations which can inject clarity into the Australian tax experience. That is, the failure of the common law to adapt to the growth of legislation and the increased

¹³³ N Emiliou, *The Principle of Proportionality in European Law: A comparative study* (Kluwer, 1996), 140

¹³⁴ R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (Hart Publications, 2000); Y Arai-Takahashi, *The Margin of Appreciation Doctrine and the Principle of Proportionality in the Jurisprudence of the European Commission of Human Rights* (Intersentia, 2002)

¹³⁵ R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (Hart Publishing, 2000), 78 citing Advocate General Jacobs. Jacques Malherbe of the Catholic University of Louvan institutionalization argued that the key civil law concepts like proportionality were now institutionalized generally into EU law, including tax law.

¹³⁶ O Kahn-Fruend cited in R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (2000, Hart Publications), 112-3

¹³⁷ R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (Hart Publishing, 2000) who at 85 documents English use of the concept, for example in seventeenth century doctrines of disproportionate fines imposed by public authorities, and a lively debate about its extension but argues it ‘lacks authoritative presence’. He contrasts the well entrenched administrative concept of reasonableness. Readers might note that the later doctrine is almost completely absent from analysis of tax on either the taxpayer or revenue side, despite the public law nature of taxation. See also S Boyron, ‘Proportionality in English Administrative Law: A faulty translation?’ (1992) 12 OJLS 237; J Jowell & A Lester, ‘Beyond Wednesbury: substantive principles of administrative law’ (1987) *Public law* 368; J Schwartz, *European Administrative Law* (1992, Sweet & Maxwell) ch 5.

¹³⁸ op cit xv

¹³⁹ op cit, preface

¹⁴⁰ op cit 111

speed and depth of change, particularly in a codified area like tax. It includes failure to develop broad principles to crystallize and ensure orderly development by judges to discipline this growth and to contribute to intellectual constructs to guide it.

Thomas documents specific problems of adopting wide principles such as the proportionality doctrine into domestic common law.¹⁴¹ He sets out, at length, a history of confusion over whether such broad doctrines are substantive or procedural, of increasingly threadbare attempts to quarantine English law from the influence of European law on proportionality,¹⁴² of confusion and prevarication over the meaning of doctrines which “have failed to appreciate the nature of proportionality as a way of ensuring a relational relationship between means and ends, rather than simply a review of the merits...” The judges have lacked “the institutional confidence to undertake the assessments involved in a proportionality enquiry.”¹⁴³ He notes the diversity which the ECJ brings from member jurisdictions and the cross fertilization of collegiate judgments.¹⁴⁴ He contrasts the flexibility of EU law of comparatively recent origin and the more rigid and narrowly rationalist approaches of well establish common law. Thomas makes the telling point “that English law has lacked the cultural and institutional infrastructure which has characterized Continental legal systems and influenced the ECJ.” He links this to a reluctance to develop general doctrine.¹⁴⁵

Thomas articulates and rebuts the common justification for drawing very tight boundaries round judicial decision making which operates in highly politicized areas.¹⁴⁶ The rebuttal¹⁴⁷ is that the complexity of modern tax decision making makes recourse to judicial decisions and the position of judges much more central in generating operational norms. The weighing of alternative options for attainment of the same objectives under the proportionality doctrine [or choice principle] requires judges to be ‘informed of the purposes of public action’¹⁴⁸ and also to be more explicit about their increasingly strained rationalization that judges do not intervene on the merits in administrative decisions.

Thus, judges in Australia rely on a conservative and narrowly rationalist approach. They eschew active intervention according to broadly articulated principles of due process and fairness (let alone broader policy considerations). This is both an inadequate and loaded premise on which to construct a general approach to judicial decision making. Of course, this argument applies with particular force to decision making in areas, like sophisticated tax schemes, where the very operational objective is typically to exploit the rigidities of tightly drawn rules. The job of judges in these areas, to adapt the argument of Thomas,¹⁴⁹ is to keep an active and creative balance between the need for legal protection and legal regularity with the competing need for general norms which will wisely guide and discipline the body of rules. If they fail to

¹⁴¹ op cit 111

¹⁴² op cit 99

¹⁴³ op cit 111

¹⁴⁴ Although noting the advantages of dissents and differing views which “allows the law to develop through open debate.”

¹⁴⁵ op cit 111

¹⁴⁶ op cit 112

¹⁴⁷ This argument draws on R Thomas, *Legitimate Expectations and Proportionality in Administrative Law* (Hart Publishing, 2000), 112 but this is my argument not his.

¹⁴⁸ op cit 100

¹⁴⁹ op cit 112

articulate specific justifications to explain their broad approach, they create rule by men and institutions working towards ends which are often only broadly [I prefer the term ‘vaguely’] conceived and only partly defined or, indeed, understood by the actors’.¹⁵⁰ One might have thought that the articulation of such premises was at the very root of any honest adherence to the, much vaunted, ‘rule of law’, more honoured in the breach than the observance.

Of course, it is not suggested that the doctrine of proportionality should be indiscriminately applied to tax law. It is hard to use this as an operational concept for judicial intervention to control the rates of taxes but perhaps easier to see it operate if quarantined to various specific issues about the collection of taxes and concepts used to distribute the tax burden. This issue is currently one of controversy in Germany.¹⁵¹ The point of the analysis is not to argue for direct application but to give a benchmark against which to analyze the interaction of general directives in legislation and specific provisions.

Australian judicial performance on choice principle

This comparative analysis, the argument supporting it and the broader inferences resulting from it spell out with great clarity, the benchmark we should use in evaluating the choice principle, as applied in Australian tax courts. I want to use the European modalities as a benchmark for the judicially created choice principle as it applies to the general anti-avoidance provisions. The choice principle or some analogous concept is necessary to contain the tension at the borderline where there is a tax minimization transaction but the legislature has deliberately or implicitly created a tax concession. The obvious example is the explicit tax concessions for research and development investment or sunrise industries which exist in Australia and many other tax systems.

The choice principle reached its high water mark in Australia in the 1977 decision of Mason J in *Cridland v FCT*.¹⁵² The wide formulation in *Cridland* that when specific provisions in the Act, or, presumably, the judicial interpretation of them, gave an answer to any tax problem (not merely a tax concession), the choice principle removed any scope for the operation of the old general anti-avoidance provision in s260. *Cridland* involved a scheme to allow unit holders to arbitrage primary production averaging provisions by participating in a unit trust. Mahoney J in the New South Wales Supreme Court held¹⁵³ that s260 applied. He held¹⁵⁴ that the choice principle could not apply whenever provisions of the Act created tax consequences in particular circumstances. These provisions could not exclude s260 “however artificial a procedure and for whatever tax avoidance purpose.”¹⁵⁵

Mahoney J was reversed by the High Court. Mason J delivered a judgment in which Barwick CJ, Stephen, Jacobs and Aickin JJ concurred. He relied on *Mullens Investments Pty Ltd v FCT*¹⁵⁶ to hold that s260 did not apply because “the taxpayer is entitled to create a situation by entry into a transaction which will attract tax

¹⁵⁰ JDB Mitchell, *Constitutional Law* (1968, Green, 2nd ed) 7

¹⁵¹ Acknowledge Prof Heinzen of Free University of Berlin

¹⁵² 77 ATC 4538, 4541

¹⁵³ 76 ATC 4095

¹⁵⁴ at 4103

¹⁵⁵ *ibid*

¹⁵⁶ 76 ATC 4288, 4541

consequences for which the Act makes specific provision.”¹⁵⁷ His Honour added some obiter, gratuitous and, with the greatest respect, constitutionally arrogant advice to the Commissioner about the ‘long apparent’ ‘defects and deficiencies’ of s260¹⁵⁸ and, despite the Commissioner's victory in the lower court, expressed surprise at his reliance on it. This was the signal that s260, the old general anti-avoidance provision, was officially killed off by the judges.¹⁵⁹

The decision in *Cridland* was largely ignored by the majority of the High Court in *FCT v Gulland*.¹⁶⁰ The choice principle was put in its proper perspective by Brennan J in *Gulland*¹⁶¹, where he said it was merely a version of the well known principle ‘*generalia non specialibus derogant*’ and should both limit specific provisions where it is appropriate to apply it and not be allowed to annihilate the general anti-avoidance provisions themselves. The dissent of Deane J contained a full and explicit discussion of the old authorities. Surprisingly, while he disagreed with their reasoning, he thought he was¹⁶² bound by the cases propounding a wide choice principle and it was settled law that s260 could have no operation in these circumstances.

The frontal attack through the extravagant version of the choice principle was stemmed by Part IVA. But the problem is not dead. The new general anti-avoidance provisions have not properly resolved the issue and hence have delegated its final settlement to judges for some future time.¹⁶³ Deane's dissent in *Gulland*¹⁶⁴ was taken up some years later in *FCT v Rippon*¹⁶⁵, without any mention that Deane was the sole dissenter. Cooper J developed a pedantic threshold argument in the Full Federal Court in *Spotless*, to narrow that provision. It built on a sweeping version of the choice principle, combined with a broad commercial dealing exception, to take a frontal assault on the effectiveness of the general anti-avoidance provisions in Part IVA. According to this doctrine, if a scheme has a commercial outcome, no matter how artificial or blatant the particular steps used to attain that outcome, the general anti-avoidance provisions could not operate. Though the Full High Court overruled the Full Federal Court, this construction was not explicitly rejected by the High Court and no principled response was articulated for the tough cases. On the basis of such a sweeping doctrine, the new general anti-avoidance provisions in Part IVA would have narrow application.

¹⁵⁷ at 4542

¹⁵⁸ The thrust of which were reversed in later decisions in which the High Court attempted to resurrect s260 to combat the damage of public opinion and foreshadow the reforms in the pipeline in the new general anti-avoidance provisions in Part IVA

¹⁵⁹ The public outcry caused them to resurrect it and disown their own former doctrines but it was too late. A new general anti-avoidance provision was already on the drawing boards.

¹⁶⁰ (1985) 17 ATR 1; 85 ATC 4765

¹⁶¹ 85 ATC 4765, 4777

¹⁶² at 4787

¹⁶³ Section 177C(2) excludes from the operation of ‘tax benefit’, and hence from the operation of the anti-avoidance provisions, non-inclusion of benefits due to a ‘declaration, election or selection’ etc. But, significantly, the provisions do not spell out any effective limits to the exception. The provision in s177C(2)(a)(ii) which excludes schemes carried out ‘for the purpose of creating any circumstance’ necessary to enable the ‘declaration, election or selection’ etc to be given is far too wide and might catch someone going into an artificial film scheme solely to get the benefit of a tax expenditure with zero or very little funds flowing into the actual film.

¹⁶⁴ *FCT v Gulland* 85 ATC 4765

¹⁶⁵ 92 ATC 4689; involves an appeal from author's own decision in the Administrative Appeals Tribunal

According to the High Court in *FCT v Spotless Services Ltd*¹⁶⁶, Part IVA is not some disembodied marginal part of the Act but ‘as much part of the statute under which liability to income tax is assessed as any other provision’ of the Act.¹⁶⁷ But more than this, like the European human rights protections, the provisions of Part IVA over-ride the rest of the *Income Tax Assessment Act 1936*.¹⁶⁸ Where a scheme infringes the annihilation provisions by circumventing the thrust of specific provisions in the Act, even where it accords with the existing interpretation of those provisions, it will be struck out.

The choice principle must be given a balanced construction and that construction must be based on the place of the general anti-avoidance provisions in the Act. It clearly can not be, nor should it ever have been, a complete defence to general anti-avoidance provisions.¹⁶⁹ That such a manifestly untenable position took root in the High Court, and still raises its hydra-headed presence, raises very clear and present concerns about the modalities in which the judges work in Australia.

The choice principle must be seen, as is the proportionality doctrine in Europe, as one priority which must live in creative tension with the core statutory predication test. It has a useful sphere of operation in weighing specific legislative policy objectives against the more general objective of protecting the charges to tax from being artificially circumvented, but indiscriminate use of it is in clear conflict with the clear intent of Part IVA which, incidentally, over-rides most other provisions of Australian tax law.¹⁷⁰ The central insight, of course, is that general anti-avoidance provisions, just like the Treaty protections for human rights in Europe, must always live in unresolved tension with specific provisions in the Act. General anti-avoidance provisions must be seen in a *dynamic* context with a particular priority to assert. They must, *inevitably*, impact on the construction of specific provisions. Because this involves questions about the way in which conflicts about construction of the Act ought to be resolved, like the perennial questions about the trade-off between economic efficiency and distributional justice, such issues rarely lend themselves to definitive resolution. Depending on the precise nature of the trade off of the provisions and the scheme, one or other priority will be asserted in a particular situation.

To this day, apart from the strong analysis by Brennan CJ, there is precious little in the way of an articulated and systematically applied generalization about the job of this doctrine in the anti-avoidance armory, no spelling out of the essential tensions and precious little attempt to systematically structure the principles to guide this central issue in the general anti-avoidance provisions. The development of the proportionality doctrine in Europe stands in sharp contrast and demonstrates what judges should be doing in Australia.

Why did Australia go off the rails?

One of the reasons common law jurisdictions have not clearly identified the problems with judge focused delegated decision making is that, with not entirely unfamiliar,

¹⁶⁶ 96 ATC 5201

¹⁶⁷ at 5206ff

¹⁶⁸ s177B(1)

¹⁶⁹ Y Grbich, ‘Section 260 Revisited: Posing critical questions about tax avoidance’ (1976) *UNSWLJ* 211, 217

¹⁷⁰ s177B(1) *Income Tax Assessment Act 1936* except international tax agreements.

ethnocentricity they have marginalized the European experience. Vranken¹⁷¹ argues that mere technical comparison “is not sufficient in inducing a deeper understanding” of the “fundamentals of the European civil law.” He identifies differences in our history, mode of legal thinking, distinctive institutions, sources of law and ideology as the mix of factors producing distinct paradigms. But there is, he argues,¹⁷² “one fundamental difference which goes to the very core” of the difference. It is the “perception of the concept of law itself”. This concept, developed in Europe from the Bologna model, created in the Renaissance universities of Italy. Vranken says:¹⁷³

In a more contemporary context, law study continues to be an intellectual discipline first and foremost. The practical application of the law ...occupies second place. The importance that law teachers in the civil law attach to impressing upon their students the general rules and principles is by no means accidental. ... [L]aw continues to be approached as a philosophy subject at heart.

This contrasts sharply with Australia where the pendulum has swung dangerously far in the other direction. Legal philosophy is almost completely marginalized in taxation and is a term of abuse. Even generalization and discussion of general principles in ‘practical’ subjects like tax is considered an irrelevance by judges and, in turn, by students. Law was still a practical vocation based on apprenticeship which came very late to Oxford and Tax was still taught part time out of LSE when I read for my PhD.

But, as Vranken says,¹⁷⁴ the civil law approach does not mean civil law judges are not creative. He cites judicial doctrines developed in France which convert fault-based tort liability into a dual system of fault and non-fault and in Germany where there has been a surprising rewrite of the law of contract. But, and here is the essence, “at no time can individual cases be allowed to blur the broader picture.” And this is the precise problem in Australian judge made tax law, where the technical tail, most emphatically, does wag the policy dog. To drive the point home, Vranken argues:¹⁷⁵

When court decisions shape the ... civil law it is the result of an interactive process involving not only the legislature but also an ever vigilant scholarly community that observes, commends or criticizes the courts so as to ensure that any shaping or re-shaping of the law remains a controlled activity.

In other words, this can be read as an indictment of the Australian and UK scholarly community who identify with the profession and are far too subservient in their attitude to the judicial thinking that dominates the commanding heights of the Australian tax system.

CONCLUSIONS

- 1) Like it or despair about it, the brunt of tax rule making will move, as it has increasingly in recent years, to tax administrators. As Alberto Ibanez says “[At] the end of the twentieth century [globalization] ..., among other factors, [has created] very complex societies with enormous information flows which require an increasing amount of specialized knowledge and the use of technologies Despite the fact that, traditionally, the bodies entrusted to ensure the enforcement

¹⁷¹ M Vranken, *Fundamentals of European Civil Law* (Federation Press, 1997) 214

¹⁷² op cit 215

¹⁷³ op cit 215

¹⁷⁴ op cit 216

¹⁷⁵ op cit 216

of law have been judicial, this new social complexity requires more active intervention [by] administrations¹⁷⁶ In tax, judges were simply not capable of responding to the escalating demands of this job.

- 2) Notwithstanding their increasing marginalization in rule making, the judges in Australia still command the heights of the tax decision making process. They largely control the detailed rules of engagement. Their modalities of analysis can derail the entire tax decision making process. Tax judges must accept their contribution to the vicious downward spiral of legalistic constructions and more convoluted legislation. They must adapt their working modalities to the new, radically changing environment in which our tax system must operate. We must not suffer the hijacking of core policy decisions by low level debates about words in a vacuum or the exercise of judicial discretion hidden behind a jungle of complexity. Australian judicial performance in developing core principles and structuring them could benefit from study of civil law experience. Australia must learn from both the modalities and the many mistakes of Europe.
- 3) The essence of the civil law is that core policy imperatives shape the agenda. They discipline analysis of technical tax details and the creation of detailed rules by delegated decision makers, *including judges*. In Australian tax cases this discipline has broken down. Barren verbal analysis and technical minutiae was the policy dog. Judicial accountability is 'in-house' and over the years has not, notwithstanding the 'right' rhetoric from the High Court, rooted out these systemic problems.
- 4) Civil law experience with the use of, quasi constitutional, fundamental tax laws may translate into the Australian system. It may help make Australian tax judges somewhat more accountable for applying the manifest policy of general tax anti-avoidance provisions and statutory directives to have regard to substance, as well as red flagging other fundamental norms in the tax system.
- 5) But Australia can no longer wait for the ponderous common law to adapt. Parallel to judicial reforms and the increase of *real* accountability for tax judges, we must work towards strengthening other delegated tax decision making institutions. Such tax reform must draw on the track record of the EU, particularly the unique European Commission. This includes an agenda setting and implementation capacity which spans political and bureaucratic decision making.
- 6) This will involve far more than rebottling old wine in new bottles. We need a sharp rethink of our delegated decision making institutions and the new ideas to drive their work. If the tax system is to become a proactive and sharply honed tool for taking on the tough log of problems which are currently languishing, we need to refashion institutional modalities. This means intelligent social engineering. Institutions must have the capacity to articulate and to gradually evolve core legislative policy directives in a climate of intellectual rigour. They must develop the capacity to intelligently structure those concepts into guidelines for clear and consistent implementation. This demands we learn from recent Australian quick fixes.

Australian tax teachers need to be more active and more fundamental critics of the performance of judges. They are one of the few groups who have the objectivity and skills to make judges meaningfully accountable in complex tax cases, where normal

¹⁷⁶ A Ibanez, *The Administrative Supervision and Enforcement of EC Law* (Hart, 1999), 1

processes of democratic accountability are effectively marginalized. They need to develop a great deal more independence and the courage to make the necessary hard criticisms. In Professor Di Petro's introduction at the Bologna Tax Conference,¹⁷⁷ academic writing was seen as holding a significant role in emphasizing principles which should be considered in the drafting and implementation of legislation. Di Petro said it was the *core* job of *academics* in Europe to emphasize principles where they were neglected by legislators and judges. Australian tax teachers need to take this on board.

¹⁷⁷ Facoltà di Giurisprudenza, *Tax Law Principles in Europe* (16 September 2003, University of Bologna)