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

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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 N

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, that(h)-5 te leg03 Tcg0 -1.1497 TD-0.0003 eg0p3 eg ssa107(i)-3991

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

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

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 body[50] 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 athstandingisss

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

Scharf[63] 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

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 taxes[79] 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 systems[82], 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 abandoned[84], 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 Spienza 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

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 designed[98] 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 of 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 desease'. Lack of a coherent

[98] Emphasized in the opening of the Rector of the University of Bologna conference op cit
[99] Facolta di Giurisprudenza,

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 Oxford[100] and Bologna[101] conferences and at a detailed analysis of ECJ tax decisions at the Institute of Advanced Legal Studies[102]. 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 equi-7.3(t)5a0006 Tct law thnc55 -1.9a8law 9i0trea((a)]TJ

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

confiscatory taxes. It has general definitions of taxation. It interpolates concepts like

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

The development of the doctrine in the courts has focused on a number of factors. In an ECJ formulation[124] 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 re

to pursue much wider objectives[133] 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-Fruend[136]

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 conclusions[140] 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

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 rebuttal[147] 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

> 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

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 s260[158] 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 was[162] bound by the cases propounding a wide choice principle and it was settled law that s260 could have no operation in these circumstances.

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

of law have been judicial, this new social complexity requires more active intervention [by] administrations ….”[176] 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 wag 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

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