IN THE HIGH COURT OF AUSTRALIA

BRISBANE REGISTRY **No. B 63 of 2017**

ON APPEAL FROM THE FULL COURT OF THE FEDERAL COURT OF AUSTRALIA

BETWEEN: **THE COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA**

Appellant

and

MARTIN ANDREW THOMAS

Respondent

RESPONDENT'S SUBMISSIONS (PENALTY)

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Part I: Certification

1 The submissions are in a form suitable for publication on the Internet.

Part II: Issues arising

2 Contrary to the appellant's submissions at [2], the issue in this case is whether Greenwood J at first instance was correct in allowing the respondent's appeal against penalties. The respondent says that Greenwood J was correct in holding that the penalty assessment was intrinsically wrong for the reasons his Honour gave.

3 But Greenwood J should have held also that the appellant's alternative penalty assessments process, which are not protected for legal error by s 175 of the 1936 Act, was not a proper process and that the assessed penalties (to the respondent and to the trustee in the alternative) should have been set aside as invalid.

Part III: Certification regarding s 78B *Judiciary Act 1903*

4 The respondents has considered whether any notice should be given in compliance with s 78B of the *Judiciary Act 1903* (Cth) and has determined that notice is not required.

Part IV: Contested statement in the appellant's narrative of relevant facts found or admitted

5 The respondent refers to [5] to [8] of the submissions of the respondent in B60 of 2017.

Part V: Appellant's statement of applicable legislation

6 The respondent refers to [9] of the submissions of the respondent in B60 of 2017, and to:

(a) Division 298 in schedule 1 *Taxation Administration Act* 1953 ("TAA");

(b) Definition of "assessment" in section 6 (1) of the 1936 Act; and

(c) Sections 175 and 177 of the 1936 Act.

Part VI: Argument in answer to the appellant's argument

7 The respondent appealed against penalties for the years ended 30 June 2006, 2007, 2008 and 2009. Greenwood J allowed that appeal and set aside the Commissioner's relevant objection decision. The Full Court dismissed the appellant's appeals.

8 The matter of penalties should not be remitted to the Full Court.

9 This Court is, it is respectfully submitted, in as good a position as, and possibly better than, the Full Court to determine if the respondent's claim for refundable tax offsets, if

this Court reverses the Full Court's decision that his claim was correctly made, was in law not a reasonably arguable claim.

10 This Court is in as good a position as the Full Court to examine Greenwood J's reasoning on the issue raised in the Notice of Contention.

11 If the penalty assessment is ultimately upheld, then the matter should be remitted to the Administrative Appeals Tribunal to review the objection decision on the remission of the penalty.

Part VII: Respondent's argument on its Notice of Contention

(a) Introduction

12 The relevant arguments of the parties, and the reasoning and conclusions of the Greenwood J, are set out within [548] to [586] and especially at [582] – [586] of his Honour's reasons. It is submitted that there is no error in his Honour's reasoning and conclusion that the culpability provisions in Division 284 of Schedule 1 TAA are not engaged, and that the penalty assessment was intrinsically wrong. It is submitted that his Honour's reasoning is clearly correct as demonstrated by the decision of the Full Court in the respondent's favour on the primary tax. The respondent's argument is set out at heading (c) below

13 The issue raised in the Notice of Contention is important because:

(a) its resolution has potential financial consequences to the respondent, in that interest on a penalty liability only runs after a *valid* assessment is notified;[1] and

(b) in debt-recovery proceedings Courts have hitherto assumed that the decision of this Court in **Commissioner of Taxation v Futuris*[2] about the effect of s 175 of the 1936 Act applies equally to penalty assessments.

14 Greenwood J at [576] to [579] rejected the respondent's submission that the alternative penalty assessments were invalid.

15 The appellant had assessed on the alternative basis that the trustee was liable to tax under s 99A of the 1936 Act because no beneficiary was presently entitled to the income, and imposed a 25% culpability penalty on the basis that the statement that the respondent and Martin Andrew Pty Ltd were presently entitled and liable to tax was false or misleading and was not reasonably arguable; he conceded before Greenwood J that he was wrong and the assessments to the trustee for 2006 to 2008 and for penalties were wrong.

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[1] Section 298-25 in schedule 1 *Taxation Administration Act* 1953 ("TAA")
[2] (2008) 237 CLR 146, (2008) HCA 32

(b) The penalty assessments were invalid or void

16 It is submitted that Greenwood J erred in not setting aside the penalty assessment on the basis that it, together with the penalty assessment of the trustee, was *invalid*.

17 The appellant issued *alternative* penalty assessments (to Mr Thomas and to the trustee in respect of the liability to tax on the s 95 net income) on the basis that each of two views of the tax laws was at the same time both clearly correct and so wrong as not to be reasonably arguable.

18 It is not suggested that there is any conscious maladministration in the *Futuris*[3] sense. There need not be to invalidate the alternative penalty assessments, for they are not assessments within the statutory description in s 175 of the 1936 Act[4], and there is no cognate provision that limits the scope of judicial review of penalty assessments for jurisdictional or non-jurisdictional error (as summarised by Kirby J in *Futuris*[5]). Moreover, section 298-30 in Division 298 in schedule 1 TAA as it stood in the relevant years, in contrast to s 177 of the 1936 Act, expressly contemplates that the making of a penalty assessment can be challenged in Part IVC proceedings.

19 The omission of a penalty assessment made under Division 298 in schedule 1 of the 1936 Act from the protection of s 175 of the 1936 Act cannot be characterised as a mere legislative slip. There is all the difference in the world between a taxpayer's duty to pay tax and a taxpayer's incurring a penalty. In *Compania General De Tabacos, De Filipinas v. Collector of Internal Revenue*,[6] Justice Oliver Wendell Holmes said

> Taxes are what we pay for civilized society ... A penalty, on the other hand, is intended altogether to prevent the thing being punished.

20 Since at least the inception of the 1936 Act, Parliament has required the respondent to apply his mind actively to the question of the assessment of penalties. Even a penalty apparently automatically imposed by the Act is not assessed as such until the Commissioner has applied his mind to whether the circumstances require a lesser penalty.[7]

21 Here what the appellant was required by the statute to apply his mind to was whether the taxpayer had made a false or misleading statement that was not reasonably arguable within Division 284 in schedule 1 to the TAA. That required the appellant to form a view that his own view is correct and that the alternative view is not reasonably arguable. He was also required to consider whether a lesser penalty ought to be imposed in the circumstances before issuing a penalty assessment under Division 298 in schedule 1 TAA.

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[3] *Commissioner of Taxation v Futuris* (2008) 237 CLR 146, [2008] HCA 31.
[4] See definition of "assessment" in section 6(1) of the 1936 Act
[5] At 182[122], 183[128] & ff.
[6] 275 U.S. 87 (1927) at [100].
[7] *Jolly v Federal Commissioner of Taxation* (1935) 53 CLR 206, *Sanctuary Lakes Pty Ltd v Commissioner of Taxation* (2013) 212 FCR 483, [2013] FCAFC 50.

22 That stands in stark contrast to the Commissioner's income tax assessment process, where it is open to him, if he is uncertain as to which taxpayer has derived the income in question, to assess multiple taxpayers who he believes might have derived the income (which he did here and also did in the *Caratti* matter). And Parliament has prevented a curial diving into that process by s 175 of the 1936 Act.

23 What the appellant actually did here is not properly assess the legal merits of the alternative positions – each cannot be both reasonable and unreasonable at the same time. Yet still he proceeded to punish both the respondent and the trustee on the basis that ultimately one view might eventually prevail in his favour.

24 What should each of them have done to prevent this punishment? What was their correct conduct? Not put in tax returns at all, thus attracting a 75% penalty for failure to lodge? Obviously not. Each to take the opposite view and together pay double tax, even though the Commissioner accepts that only one lot, at best, would be payable? Parliament's purpose – to prevent unreasonable claims being made against the Revenue – is defeated if this alternative process is valid. Greenwood J erred in likening this punishment process to the issuing of alternative income tax assessments.

25 This single punishment decision – to issue alternative penalty assessments in order to punish each taxpayer in a significant monetary amount for making a false statement that was not reasonably arguable to be correct, but which the respondent assessed as being correct - was not a proper decision having regard to the well-known observations in *Avon Downs v Commissioner of Taxation*:[8]

> "The conclusion he has reached may, on a full consideration of the material that was before him, be found to be capable of explanation only on the ground of some such misconception. If the result appears to be unreasonable on the supposition that he addressed himself to the right question, correctly applied the rules of law and took into account all the relevant considerations and no irrelevant considerations, then it may be a proper inference that it is a false supposition. It is not necessary that you should be sure of the precise particular in which he has gone wrong. It is enough that you can see that in some way he must have failed in the discharge of his exact function according to law."

(c) The penalty assessment was intrinsically wrong

26 In *D Marks Partnership by its General Partner Quintaste Pty Ltd v Commissioner of Taxation*,[9] Griffiths J, with whom Logan J indicated his agreement if it were necessary for him to do so,[10] said:

> "126 ... it is notable that the Commissioner himself issued primary and alternative assessments, the latter being based on the hypothesis that, as was contended by the taxpayers, the D Marks Partnership was a valid corporate limited partnership in the relevant years. It is relevant to have regard to the fact that the Commissioner issued primary and alternative

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[8] (1949) 78 CLR 353, 360.4.
[9] (2016) 245 FCR 247, 274 [126], [2016] FCAFC 86
[10] at 267[91] and 267-268[95]; see also per Pagone J at 294[173]-295[175].

> assessments predicated respectively on whether the D Marks Partnership was a valid corporate limited partnership because this fact is part of "the circumstances" as referred to in s 284-15."

27 It is even more notable, here, that:

(a) the Commissioner imposed *penalty* assessments on the basis that each of his own alternative views was not reasonably arguable (or that neither of his alternative views was reasonably arguable);

(b) the Supreme Court of Queensland – a relevant authority in considering what is a reasonable argument - in *Thomas Nominees* agreed with the taxpayers' views; and

(c) Greenwood J preferred another view of Division 207 altogether, against which the appellant cross appealed to the Full Court and now appeals to this court.

28 Greenwood J made findings that the trustee received the franked dividends into a bank account and that Martin Thomas regularly withdrew those dividends from his bank account as a beneficiary. The Act assumes that it is Mr Thomas who should include those trust dividends in his assessable income and obtain the franking credits. It is the problematic difference between distributable income and s 95 income, as compounded by their interaction with Division 207, that can make the tax treatment difficult, not any culpable conduct on the part of the taxpayer. As Latham CJ and Williams J said in *Federal Commissioner of Taxation v Whiting*[11]:

> "The main assumption underlying the Act would appear to be that the person who derives the income should be in a position to pay the tax out of the income.
>
> Any other construction of the Act would place beneficiaries in a difficult position."

29 It is respectfully submitted that these matters provide further support for the submission that his Honour's decision on Mr Thomas's lack of culpability in this very difficult area does not disclose error requiring correction.

30 Despite propounding *another* construction of the legislation than that which was the subject of assessments or as submitted to Greenwood J, and asserting that Greenwood J's own statement of the law was wrong, the appellant still impliedly maintains that the respondent's statement as to the operation of the tax laws was false and misleading and not reasonably arguable, even though it was accepted by Applegarth J and the Full Court. He misstates the respondent's case by attacking a straw man that he calls the "Bifurcation Assumption".

31 Moreover, the appellant accepted, until making his applications for special leave to appeal, that streaming of franking credits is possible if the resolutions are done properly. So it was a matter of the interpretation of the resolutions, not the proper application of the tax law, that was in question until the matter made its way to this court.

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[11] (1943) 68 CLR 199, 215.7

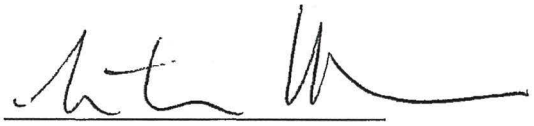
32 As well, the fact that the Full Court has accepted the respondent's claim is, it is respectfully submitted, enough to require the appellant's appeal in these proceedings to be dismissed.

Part VIII: Estimate

33 The estimated time required for the respondent's oral argument is included in the estimate of time in the submission of the respondent in B60 of 2017.

These submissions were settled by F L Harrison QC and M L Robertson QC

22 December 2017



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