THE TAX INSTITUTE

34th National Convention

Session 10/3

Fraud and Evasion

National Division
13-15 March 2019
Grand Chancellor Hotel, Hobart

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1 Fraud and Evasion

The policy of the law is that taxpayers with simple tax affairs should be able to treat their tax affairs as closed after two years, and four years otherwise.

Outside those limitation periods, the Commissioner may only amend an assessment if he has formed the opinion that there was "fraud or evasion".

That is a simplistic and idealistic view. There are numerous examples of extended and unlimited amendment periods related to the operation of particular provisions. Sometimes those particular exceptions to the above rule about limited time for amendment reflect the particular problems raised by special provisions. I put those to one side.

Fraud or evasion in terms of section 170 *Income Tax Assessment Act 1936* opens the door to an unlimited time for amendment, regardless of the taxing provisions concerned. Item 5 at section 170(1) simply provides:

> The Commissioner may amend an assessment at any time if he or she is of the opinion there has been fraud or evasion.

Those words have a long heritage. According to searches at Austlii, the first use in Australasia was in a New Zealand stamp duties law of 1867.[1] However the present context, relating to opening up periods of review, appears only to have emerged later. When it emerged in Federal income tax, in 1922, it was actually part of a reform introducing a limited period of amendment. There was no time limit previously.

Looking to the present, there is chatter that the Commissioner is becoming more inclined to form the opinion that there was fraud or evasion, allowing him to amend taxpayers' assessments outside the review period. The hard statistics about that may not bear that out. But the Commissioner has recently provided some visible process and rigour to making such determinations.

Such a decision raises the stakes for taxpayers under audit. To begin, anyone who has ever acted for a taxpayer who is accused of fraud or evasion will know that the accusation stings. On the other side is a revenue authority suddenly less willing to compromise or discuss matters with someone they regard as having not been straightforward with the ATO.

The accusation makes the relationship between the parties fraught. Advisers' full skills of persuasion and communication come to the fore in attempting to have both sides look beyond these natural, human reactions.

With the allegation of fraud or evasion generally goes a higher level of penalty given the way that behaviour is relevant there; and most likely some element of uplifted penalty. With multiple past years of tax assessments, together with the high level of penalty, and the burden of interest going back possibly more than a decade, you have a problem which is often insoluble in monetary terms.

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[1] Section 27 of *The Stamp Duties Act Amendment Act 1867* (NZ).

Though perhaps justified, or even required, by the legislation, such assessments and liabilities can themselves be an impediment to progressing the relationship between taxpayer and ATO.

Having set the scene, I briefly now treat each of the following topics:

- Elements of fraud or evasion
- Taxpayers' options when the Commissioner has formed such an opinion
- A survey of the case law, ancient and modern, and some predictions.

2 The First High Court Decision

Waterhouse v Deputy Federal Commissioner of Land Tax, South Australia (1914) 17 CLR 665 was, as the title suggests, about Commonwealth land tax. Substantial land was transferred for £13,000 by husband to wife, for which she paid £8,000 cash with the £5,000 left outstanding bearing interest at 4%. The facts upon which the High Court of Australia proceeded included that:

- The wife had begun to pay down the outstanding balance, having already paid £600 off the £5,000 debt.
- The transfer from husband to wife was intended to pass the property in the land, and property did pass.
- Importantly - one object of the parties was to reduce the amount of tax to which the transferor's land as a whole was liable.

The land tax legislation tackled this problem by providing that transfers between husband and wife could be treated by deeming husband and wife to be joint owners of all the land owned by either of them, "unless the Commissioner is satisfied that the transfer was not for the purpose of evading land tax".

The deeming provision was struck down as unconstitutional, but not on the basis that the Commissioner's judgment as to evasion somehow ousted the jurisdiction of the courts impermissibly. (As we shall see, that kind of allegation has been made later.)

Rather, the deeming provision could not be supported under the taxation power of the Commonwealth Constitution. These were early days in the High Court of Australia's constitutional jurisprudence, and we should be cautious about the conclusions of that early Court. Nevertheless, the principal basis for invalidating this provision was that the subject of taxation was land, but this deeming provision taxed a person on a different thing altogether, a deemed ownership of land. Under sections 51 and 55 of the *Constitution*, the deeming was impermissible.

Only Barton J (who had been the first Prime Minister) deals with the consequence of the Commissioner being judge of whether an impost fell on someone who had not persuaded the Commissioner of an absence of evasion. Barton J said at pages 673-674:

> It is true that the Commissioner has power to exempt them from the consequences if he is satisfied that the purpose was not to evade the tax, but this is not to say that the clause means to make the parties immune from the tax if the transaction is an innocent one. Innocence is no safeguard, and the liability automatically ensues unless the Commissioner intervenes, and in the absence of such intervention it must follow a transfer which is entirely lawful. …
>
> Attributing to Parliament, then, a knowledge of the course of legal decision [sic] in the ultimate Court of appeal [the Privy Council], it intended to tax the parties to an innocent transaction unless the Commissioner intervened. …

Even then, Barton J does not say that the power of the Commissioner to determine whether he was satisfied as to an absence of evasion was the invalidating factor. This is the closest the early High Court comes to such reasoning.

3 A Customs Duty Decision

When next the High Court of Australia considered the topic of "evade", it was in *Wilson v Chambers and Company Pty Ltd* (1926) 38 CLR 131, concerning alleged evasion of customs duty.

A person in Australia who had sought import of paint, the consignee, was charged with an offence of evading payment of customs duty.

The facts were these. The consignee had sought 7.5 tons of paint. It was to be shipped on board a steamer from England consigned to Sydney. The ship instead arrived at Port Kembla, omitting to call at Sydney. She arrived at Port Kembla and only remained there 13 hours for the purpose of bunkering.

The consignee's representative, and an employee of the ship owners, went to Port Kembla to meet the ship. The consignee told the ship owner that there was paint on board the ship for the consignee, and the consignee was going to land it there. Port Kembla was an appropriate port in terms of the Customs Act and there was a customs officer in attendance.

The consignee had also been engaged by the ship owner to clear the ship on its behalf (a reference to clearing for customs apparently).

But while the ship was lying at Port Kembla, the consignee arranged with those on board the ship that they should buy the whole of the paint on terms that it should remain on the ship to be used as required (for painting the ship) and to be paid for as used by the ship. The ship left Port Kembla with the paint, some of which was afterwards used in Melbourne in painting the ship. The paint was dutiable under the customs tariff. No duty was paid. No entry was made for customs duty purposes.

The consignee was charged, relevantly, with evading payment of duty. The magistrate dismissed the charge. (In the High Court of Australia, other charges which were dismissed by the magistrate were also dealt with, but are not currently material.)

Knox CJ said at page 136:

> The second charge was that of evading payment of duty … The distinction in meaning between the words "evade" and "avoid" in well established, and a charge of evading payment is not made out by evidence which proves no more than that the person charged failed or omitted to pay an amount payable by him. There was nothing to suggest that the agreement to sell the paint to the ship was other than a genuine agreement, nor did the evidence tend to show that the respondents did not honestly believe that in the circumstances it was not necessary to enter the goods or to pay duty in respect of them, or that their intention in selling the goods was to escape payment of duty. In fact the evidence proved no more than an omission to pay duty which was legally payable.

Isaacs J found that duty should have been paid on the paint. Nevertheless, Isaacs J said at page 141:

> Did, then, the defendant evade payment? It depends on what is meant by the word "evade" in the particular context. The word itself is not rigid. As was said … in Simms v Registrar of Probates, "everybody agrees that the word is capable of being used in two senses: one which suggest underhand dealing, and another which means nothing more than the intentional avoidance of something disagreeable. Beyond this, nothing is to be found having much bearing on the construction of the word, which depends entirely upon its use in the Colonial Acts." That is to say, we start with

> the alternative possible meanings of the word itself and as to anything further we are thrown upon the construction of the statute in hand. …

His Honour went on to say at page 142:

> Whether in a given statute it connotes guilt or innocence and in what circumstances depends entirely on the true construction of the statute itself. Here the "disagreeable" thing to be avoided is "payment." That is, the person "intentionally avoids payment" in fact of a sum which in law is payable. But whether the "intention" extends so as to make belief in facts constituting liability to pay, or, still further, belief in actual liability to pay, the criterion of the offence is another question and a serious one both for Commonwealth and individual. [sic]

His Honour then went on to outline the possibilities, given the different constructions, and then said at pages 143-144:

> We begin with the intrinsic neutral meaning of evade as intentional avoidance. Then, by a process of elimination, we can see what the Legislature intended the word to connote. Being erected into an offence …, it is manifest that the evasion contemplated is more than mere omission to pay *instanter*. … On the other hand, the evasion penalised by sec. 234 clearly does not connote intent to defraud the revenue. That is shown by sec. 241, which doubles the maximum penalty where that intent is charged and proved. The position so far is that "evasion" is more serious than mere omission to pay and less serious than attempting to defraud the revenue. At this point one observation is material. Defrauding the revenue is not confined to escaping payment forever. Escaping for a time with an intention to pay when convenient and in the meantime depriving the Customs of its security is defrauding the revenue, though the moral tint is a shade lighter …

Finally we get to the nub of it at page 144:

> Any trick or artifice or force which results in obtaining dutiable goods without payment of duty is a fraud on the revenue, and is, therefore, outside simple "evasion." Bringing to the solution what should in a doubtful case always be assumed, a presumption of just intention consistent with safeguarding the Customs revenue, the test must be whether the Crown debtor has acted honestly and reasonably in relation to his public obligation. … If, legally owing the duty, the importer has not merely omitted to pay, but has omitted without any reasonable grounds for withholding payment, he has "evaded" payment. If, however, he can show any reasonable excuse for omitting to pay, he does not evade payment. He may genuinely and without negligence be unaware of the facts constituting liability; he may have misunderstood a regulation or a law; he may, though perfectly cognizant of all necessary facts, be strongly advised that either on construction or constitutionally the law does not reach him. Such a man does not, in my opinion, "evade" payment. On the other hand, if his ignorance of facts arises through his own unbusinesslike conduct, so as to be unreasonable in his case want of knowledge is no reasonable excuse.

Higgin J said at page 148:

> To say the least, "evade" would seem to connote the exercise of will in avoiding; whereas a mere failure to pay may be by accident or mistake.

His Honour rejected the gloss on the offence proposed by Isaacs J, the use of the words "without reasonable excuse". He thought it dangerous to attempt to frame a definition, or to interpose a formula given that the facts might vary in each case.

Rich J at page 149 agreed that there had been no evasion but thought it inexpedient to attempt exhaustive definition.

Starke J at page 151 said:

> Clearly, in my opinion, the word "evade" in the Act does not necessarily involve any device or underhand dealing for the purpose of escaping duty; but on the other hand it involves something more than a mere omission or neglect to pay the duty. It involves, in my opinion, the intentional avoidance of payment in circumstances indicating to the party that he is or may be under some obligation to pay duty. The circumstances may consist of knowledge, or neglect of available means of knowledge, that the omission to pay is or may be in contravention of the Customs law.

The result was that the paint was found to have been imported. The consignee had failed to enter the imported goods as required by the Act and had failed to pay duty required. But the consignee had not "evaded" payment of duty.

4 Early Australian Income Tax Statute

The *Income Tax Assessment Act 1915* (Cth) did not by section 33 impose a time limit for amendment to assessments.

The Explanatory Memorandum to the *Income Tax Assessment Bill 1922*[2] shows at clause 37 that:

> This section now places a limit of three years upon the Department within which it may alter assessments, unless the Commissioner has reason to believe the existence of fraud or attempted evasion.
>
> It is obvious that any other limitation on the Department to recover tax which has been evaded would seriously prejudice the revenue. Any express of limitation on the Department, except in cases where fraud or attempted evasion exists, would not assist the Department owing to the difficulty in demonstrating fraud to the satisfaction of a court.

Thus, as enacted, section 37(1) contained a second proviso as follows:

> Provided further an alteration or addition shall not be made in or to an assessment after the expiration of three years from the date when the tax payable on the assessment was originally due and payable, unless the Commissioner has reason to believe that there has been an avoidance of tax owing to fraud or attempted evasion.

Moreau v Federal Commissioner of Taxation (1926) 39 CLR 65 was the first opportunity for the provision to be tested, given the date of commencement of the 1922 income tax legislation.

The matter came before Isaacs J at trial in the High Court of Australia. The question which arose was whether "the Commissioner had power to make the increase alterations absolutely notwithstanding the expiration of the three years mentioned, or whether he had that power only if he had "reason to believe" that there had been an avoidance of tax owing to fraud or an attempted evasion": page 67.

Unfortunately Isaacs J did not find it necessary to reach a conclusion on that point. Instead his Honour was satisfied that the Commissioner "had reason to believe" there was an avoidance of tax owing to an attempted evasion.

Isaacs J decided that the task of deciding if the Commissioner had reason to believe there had been fraud or an attempted evasion lay with the Commissioner: pages 67-68.

The Commissioner's conclusion is not a judicial decision, Isaacs J said, but an administrative decision. The decision "is not to be preceded by any judicial or quasi-judicial inquiry; it is not, and could not be, subject to any appeal."

His "reason" could be "the result of official information, or his own investigation, or may come from any source he considers reliable."

The Commissioner could if he thought right, ask the taxpayer for explanation. He might on the other hand think it unnecessary, inadvisable or useless. "Fair play would, of course, usually induce him to give the taxpayer the fullest opportunity to explain, but that is not legally inexorable."

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[2] 1 TLA 110.

In this case the taxpayer was not given an opportunity to explain.

The Commissioner was called to give evidence in his case, and he asserted that he had "reason to believe", and "did believe, the necessary fact". In fact, he gave particulars of the circumstances inducing the belief. Isaacs J considered that the evidence was not sacrosanct, and was open to cross-examination. But the cross-examination had to be directed to "ascertaining whether the alleged reason really existed, and, if it did, whether it was so irrational as to be outside the limits of administrative discretion … and as to be really in disregard of the statutory condition": page 69.

The facts can be best gleaned from another report of the case, Ratcliffe & McGrath *Income Tax Decisions (Australasia)* (1928), from page 84 in the Federal Cases:

> The appellant carried on business as an importer, dealing in goods produced in France. He also sold goods on commission for French principals. The purchases of goods on the taxpayer's own account were always made at a price agreed upon in francs, and such price was accordingly payable in francs, irrespective of the rate of exchange.
>
> The taxpayer's books were kept on a sterling basis. When the goods arrived, the actual cost price in francs was entered in one column, and alongside it a price was entered in sterling. This latter price was estimated on the basis of 25 francs to the pound. It happened that before the price became payable the value of the franc fell so that fewer pounds were required to provide for the necessary number of francs. As a result, at the end of one year, there were surpluses in various purchases accounts which were transferred to the credit of a foreign exchange account. The taxpayer treated the amount at the credit of this account as income arising from a source outside Australia, and omitted it from his return … He contended that the price at which the purchases were entered, viz, 25 francs to the pound, being the rate ruling at the date of purchase was correct. The Commissioner ignored the foreign exchange account, and reduced the amount charged for purchases to the amount of sterling eventually and actually used to pay for the goods.
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> As regards commissions, the amounts due to the taxpayer were credited to him half-yearly, and in the ordinary course were available to him within two months of the end of each half-year. The taxpayer however, allowed the commissions to which he was entitled for the two half-years … to remain at his credit until [a later date], when they were used for the purchase of goods. At this date the franc had depreciated to 36 francs to the pound, whereas the rate ruling [earlier], at which date the taxpayer was entitled to draw the commissions … was 26.50. Practically the whole of the commissions for the year … were earned in the first half-year, but in making up the return, all the commissions were converted on the basis of 36 francs to the pound, thus disclosing a lower income.
>
> … [The] business was converted into a company. The taxpayer became the governing director, and was the controlling shareholder. … [The] whole of the amount … at the credit of the company's foreign exchange account, was by resolution at a general meeting of the company appropriated as a bonus to the taxpayer who contended that it was non-taxable.

Isaacs J found for the Commissioner in terms of date of conversion of the foreign exchange. His Honour also found against the taxpayer in terms of taxability of the distribution by the company of the alleged bonus.

Unfortunately no report gives us details of the further dealings between the taxpayer and the Commissioner which might have gone to fraud or evasion. However, Isaacs J found at page 67 that the taxpayer and his representative were honest men. This did not, however, deal with whether the Commissioner could not have formed the view that the avoidance of tax was due to fraud and evasion.

The case is thus remarkable in result, in that an honest trader nevertheless had his income tax assessments upset outside the usual (then) three year period, on the basis that the Commissioner had not been shown to have improperly formed the view that the avoidance of tax was due to fraud or evasion.

5 A Second Case in the High Court About the 1922 Act

A peculiar case came before the Victorian Supreme Court (Mann J) and then on appeal to the High Court of Australia, called *Federal Commissioner of Taxation v Clarke* (1927) 40 CLR 246.[3]

The matter seemed to involve confusion about the ownership of shares, and the facts are very lengthy. But suffice to say that there was a deal of remarkable events, and I am unsurprised that the Commissioner formed a view that there had been an avoidance of tax due to fraud or evasion. The interesting point in issue was whether the "attempted evasion" had to occur during the then three years allowed for amendment, or not.

Isaacs ACJ said at page 276:

> The attempted evasion might take place at any during the three years, thus misleading the Commissioner during any part of the period open to him to assess unconditionally.

Rich J at page 304 also considered, though not conclusively, that the wording and structure of the then section 37 of the 1922 Act directed attention to a fraud or attempted evasion during some particular period of time. His Honour's reasoning is more elaborate, and really does show how it depends upon the construction of particular provisions. However, it seems that his Honour would have required the fraud or attempted evasion to have occurred during the period leading up to assessment, or perhaps during the period then of three years after that assessment was payable.

The other remarkable thing, looking back on *Clarke*, was that the Commissioner again got in the box and stated that he held the relevant belief, giving some elaboration on that. Rich J commented that:

> The process of calling the Commissioner as a witness as to his secret beliefs and reasons unexpressed and not communicated to the taxpayer seems a curious proceeding; and I cannot help thinking that the Legislature intended that the assessment itself should state what reason the Commissioner had for his belief, leaving the taxpayer to attack its sufficiency if he thought he could do so. (Page 306)

In light of current authority, that would be a useful suggestion. It is not the current law.

Finally, the case is notable for the things that lead the Commissioner to apparently take his view about fraud or attempted evasion. (Page 290):

- Omission of all stock-jobbing profits from the original return
- Conversations of the taxpayers with the Commissioner's officers
- Acquiescence of the taxpayer in a reassessment (which, although the facts are somewhat confused, seems to have been a reassessment of relatives in an attempt to misdirect the Commissioner to those people)
- The evidence which the taxpayer himself gave before the High Court of Australia in a previous appeal by one of those relatives

[3] There is a brief report of Mann J's decision in Ratcliffe &McGrath *Income Tax Decisions (Australasia)* (1928), page 115 of the Federal Cases.

- Statements made in the cases for opinion submitted to counsel for the taxpayer

6 Walters – The need for Caution in Relation to Early Cases

The case of *Clarke*, immediately above, seems to emphasise the particularity required in construing different taxing provisions over the years. For example, whether the fraud or evasion had to occur during the period leading up to the end of the usual amendment period depended peculiarly on an analysis of a complex, but short, provision in the 1922 Act.

Likewise, the law has developed a good deal, and practice has also developed.

Thus I mention, only to dismiss immediately, the last of the cases in the series before the 1936 Act.

Walters v Commissioner of Taxation (NSW) (1936) 3 ATD 338 states that the onus of establishing that there had been avoidance of tax due to fraud or evasion was upon the Crown.

Apart from the fact that the then New South Wales income tax legislation may have been considerably different from that presently in force in the Commonwealth, it would seem invariably the case nowadays that the Commissioner will tender the assessment in evidence. Once tendered, it is evidence under section 350-10 *Taxation Administration Act 1953* as to the following:

- Conclusive evidence that the assessment was properly made; and
- Except in appeal proceedings - conclusive evidence that the amounts and particulars of the assessment are correct.

The predecessor provision in the 1936 Act was section 177. Section 175 remains in the *Income Tax Assessment Act 1936*, and provides that the validity of an assessment is not affected by reason that a provision of that Act had not been complied with.

As we shall see, even in the AAT nowadays the taxpayer bears the onus of showing that such opinion was not justified. And the taxpayer is not entitled to particulars of the opinion.

7 Barripp

This case is about the New South Wales income tax, but it is plain that the New South Wales Legislature had adopted the Federal initiative of permitting amendment outside a time limit in case of fraud or attempted evasion, after the decision of the High Court of Australia in *Moreau*.

In the New South Wales Full Court,[4] Jordan CJ strongly expressed doubt about the result in *Moreau*. If the matter had been free of authority, his Honour may well have found differently: pages 19-20. Particularly strong are the following passages

> When liability of the subject to taxation is made to depend upon the volition or the opinion of an official, or of a bureaucratic tribunal, I am of opinion that if the Legislature, in express terms, gives a right of appeal to a Court of Justice in unrestricted terms, the Court should not be astute to find reasons for holding that the Legislature, notwithstanding the generality of its language, intended that same general class of rulings should be sheltered from appeal.
>
> …
>
> If the matter were free from authority, I should find considerable difficulty in discovering any implication of intention to exclude from the general provision for appeal a provision that the Commissioner may amend an assessment, whatever the lapse of time, if he is of opinion that there has been an avoidance of tax and that the avoidance is due to fraud or evasion. Fraud and evasion are matters which constantly arise for adjudication in Courts of Justice; and the subject matter is not specially and peculiarly administrative, nor is it necessarily involved with matters that are highly technical.

Nevertheless, in light of *Moreau*, and what had followed, Jordan CJ felt constrained to follow the High Court of Australia, albeit in the context of New South Wales income tax. There were different constitutional considerations in relation to New South Wales, but the adoption of Commonwealth provisions by New South Wales pointed strongly to that conclusion.

As with Isaacs J in *Moreau*, Jordan CJ in *Barripp* would not, himself, have found fraud or evasion proved. But the Full Court, on appeal from a decision of the New South Wales tribunal, was not at liberty simply to substitute its own view. His Honour said at page 26:

> I have examined and considered the findings and reasons of the Board, and am of opinion that they contain nothing which indicates or suggests that, in arriving at their decision, they acted capriciously or fancifully or upon legally irrelevant or inadmissible grounds. In these circumstances, the fact that I personally should have arrived at a different conclusion is immaterial …

The other two members of the Full Court gave varying reasons. Bavin J would, if it were for himself to decide, have found fraud or evasion (page 21). His Honour nevertheless concurred with the Chief Justice's opinion that the Court should not be "astute to find reasons for holding that the Legislature, notwithstanding the generality of the language in which it has granted a right of appeal, intended some general class of ruling should be sheltered from appeal": page 22. His Honour did not find it necessary to come to any conclusion.

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[4] *Barripp v Commissioner of Taxation* (1940) 41 SR (NSW) 16.

Roper J followed what we would now regard as a more conventional approach, finding that the Court was restricted to the question of whether the Commissioner was "actually of the opinion", which extended to determining whether the "facts on which he formed his opinion, or the grounds on which he holds it," were only material "for the purpose of showing that he could not have formed the opinion at all, or that it is 'so irrational as not to be worthy of being called an opinion by an honest man'". (Page 24)

Barripp went on appeal to the High Court of Australia.[5] There is a reason why this is not in the authorised reports. As a matter of fact, all four High Court of Australia judges came to the conclusion that the Board had correctly concluded that the avoidance of tax was due to fraud or evasion, making it unnecessary to express a view about the limits of any appeal to a Court.

However, finally, we do get some details of the evidence which justified, at least the Board, in coming to the view that there had been fraud or evasion. This is in the judgment of Starke J at pages 70-71:

> It is conceded in the present case that the appellant was assessable to tax in respect of the sum of £3,924 for the year of income which ended on 30 June 1927. The sum was shown in the revenue account in his books for the six months ended 30 June 1927, as a profit on sale. It was never returned as income, and tax was avoided. The excuse put forward was that the sum represented a balance of purchase money which had not been paid or received by the appellant but had been secured by mortgage. The Commissioner may not have heard, but the Board heard the confused account of the appellant and his accountant in relation to the matter, but did not accept the view that the appellant omitted the sum from his return for the reason assigned. The Commissioner and the Board had no doubt, I think, nor have I, that the sum was knowingly omitted from the appellant's return and was concealed from the tax authorities for many years. … Moreover, the evidence establishes that in other years the appellant had not made the mistake now suggested but had returned his profits on the sale of land when he ascertained them.

[5] (1941) 6 ATD 69. It is not in the authorised reports except as a note at 65 CLR 661 and 41 SR (NSW) 325.

8 Denver Chemical

8.1 High Court

The decision is best remembered for a passage in Dixon J's reasons:[6]

> I think it is unwise to attempt to define the word "evasion". The context … shows that it means more than avoid and also more than a mere withholding of information or the mere furnishing of misleading information. It is probably safe to say that some blameworthy act or omission on the part of the taxpayer or those for whom he is responsible is contemplated an intention to withhold information lest the commissioner should consider the taxpayer liable to a greater extent than the taxpayer is prepared to concede, is conduct which if the result is to avoid tax would justify finding evasion.

The decision is again about New South Wales income tax law. It appears that the New South Wales Full Court's decision of *Barripp*, above, had not quelled dispute concerning the powers of the Court on appeal from the New South Wales tribunal (which was called the "Income Tax Board of Appeal" or "Board of Appeal").

Thus *Denver Chemical* is significant in confirming Jordan CJ's view of the limited role of a Court on appeal from the New South Wales Board of Appeal. It is somewhat unsatisfactory, in a Federal context, since Jordan CJ in *Barripp* had pointed out that the Board of Appeal had judicial features, as opposed the Commonwealth's Board of Review. Nevertheless, *Denver Chemical* has been influential. Dixon J said that: (page 311-312)

- The amendment provision gave to the Commissioner a discretionary power to say whether there had been, in his opinion, an avoidance due to fraud or evasion.
- The provisions concerning objections and appeals gave to only the Board of Appeal the authority to re-examine that discretion on the merits.
- The New South Wales legislation was based on Federal legislation. While another view of the scope of appeal might be possible, authority lay the other way.
- "long experience of the matter in which discretionary decisions of the Federal Commissioner and Board of Review are dealt with in this Court would be quite enough to convince one that [the contrary argument] … was doomed to failure".

Thus Dixon J said at page 312:

> If the Board has stated that there has been an avoidance due to evasion it is for the Supreme Court to examine processes by which the Board arrived at that conclusion in order to see whether there has been any error in law or misconception of the Board's duty or any such miscarriage as will show that it cannot stand.

McTiernan J and Webb J briefly concurred. Williams J agreed, giving somewhat lengthier reasons but to the same end.

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[6] *Denver Chemical Manufacturing Company v The Commissioner of Taxation (New South Wales)* (1949) 79 CLR 296, 313. We will come to the decision below, again of a strong New South Wales Full Court, which is reported at (1949) 49 SR (NSW) 195.

8.2 NSW Full Court

I will refer briefly to the Full Court's reasons, only to mention what was found by the Board of Appeal to constitute fraud or evasion.

The commodity in question is apparently still made.[7] The product is rubbed into the skin, producing dilation of the capillaries and increased blood circulation. This product is apparently still popular in Canada for treatment of some muscle and other pains.

The taxpayer was incorporated in New York. It carried on business selling this commodity. It appointed Mr Woodward as its branch manager in New South Wales, and sold the commodity in Australia from that base.

When he arrived in Australia in 1906, he found that New South Wales income tax was being assessed and paid on a particular basis. A return was made to the New South Wales Commissioner on the gross amount received each year in respect of sales made in Australia, and the New South Wales income tax was assessed on the basis of a certain percentage of this gross amount. An expert, Mr Molesworth, whose advice Mr Woodward obtained on arrival, made returns on this basis on the company's behalf and continued to do so until 1913 when Mr Woodward (or his staff) continued the process of making estimates to save the expert's fee.

There was a change in 1917. Until that point, the product was made up in the USA and sent out to Australia in finished form for sale. In 1917, the company started sending to New South Wales only part of the ingredients of the commodity. The rest was obtained in New South Wales. The finished article was manufactured in New South Wales and sold in New South Wales and other States.

Mr Duncan, then Mr Woodward's employee who was making up income tax returns, and acting under Mr Woodward's instructions, had an interview with an officer of the New South Wales Income Tax Department. He explained that Mr Woodward, on the company's behalf, was no longer simply selling the commodity in New South Wales. It was first manufacturing it here, and then selling it here. He was told by the officer that, until the Department instructed otherwise, the return should be made up on the same basis as previously.

That continued until 1923. In 1923, Mr Woodward had a conversation with his neighbour, Mr Wrigley. Mr Wrigley was employed by a company engaged in selling chemical products. Mr Wrigley told Mr Woodward that in his opinion the appellant company was liable for New South Wales income tax only on the gross amount of sales made to New South Wales customers, not of sales made to persons residing in other States.

Relying on Mr Wrigley's expression of opinion, Mr Woodward, in the returns for New South Wales income tax from 1923 to 1934 inclusive, omitted from total gross sales all sales made to customers outside New South Wales.

[7] The entry at Wikipedia is at https://en.wikipedia.org/wiki/RUB_A535

In his Commonwealth income tax returns, he included all sales made to persons anywhere in Australia. The New South Wales Commissioner continued to assess the company for New South Wales income tax on the basis of a percentage upon gross sales.

In 1938, Mr Woodward sent to the New South Wales Commissioner a return intended for the Federal Commissioner. This return showed gross sales for the whole of Australia. This aroused the New South Wale Commissioner's suspicions. An investigation was made. Amended assessments were made in 1941 for the years ended 1923-1934 inclusive. These amended assessments were made not on the basis of a percentage of the gross sales in Australia but on the basis of the tax payable according to the results of an ordinary profit and loss account.

The question for the Commissioner, and then for the Board of Appeal, was whether there had been an avoidance of tax due to fraud or evasion.[8]

Jordan CJ at page 199 dealt with what might amount to evasion. His Honour approved the following passage from the decision of the Board of Appeal:

> Without attempting any definition of evasion, we think it undoubtedly connotes underhand dealing and is usually associated with acts or omissions which are designed to obtain an unwarranted advantage. Even where a taxpayer is firmly of the opinion that his view is the correct one, he may be guilty of evasion by seeking to prevent the Commission from applying his mind some debatable question, eg, whether a particular item of income should be assessed: the evasion in such a case consists in the attempt to preclude the presentation of any opposing view or to exclude its application.

It will be appreciated immediately that the practical system of administration in those days is quite different from the present. There is reference to interviews between the New South Wales manager and the revenue authority and to practical and comfortable arrangements being reached between them. Also, the way in which the Board of Appeal casts its view assumes that there is some way of seeking the Commissioner's opinion in the context of a return.

Presently, with self-assessment (either full or *de facto*) there is no way for a very large number of taxpayers practically to access the view of the Commissioner on a disputable item. The suggestion that the taxpayer should apply for a private ruling is becoming increasingly problematic, in light of the Commissioner's difficulties in that regard.[9] For small business and tax agents, the idea of dealing with someone who is a non-specialist at the other end of a telephone line in a call centre is more than a waste of resources.

There is no way of personally engaging with the Commissioner's officers by walking into the ATO and meeting someone. You may end up dealing with a specialist located in another State, potentially on the other side of the country. Theoretical possibilities abound, but the opportunity in a practical sense to have a discussion with the Commissioner, in the way that Denver Chemicals did in the 1900s is now a thing of the past.

Nevertheless, we have this law from that bygone era.

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[8] Section 210(2)(a) *Income Tax (Management) Act 1936* (NSW).

[9] See my article, "Proceeding in certainty: tax rulings" (2017) 89 AIAL Forum 91-101.

After dealing with one further High Court of Australia case, below, I will bring this discussion to a close by highlighting the very recent decisions of the courts about what to do about a finding of fraud or evasion; and will close my oral presentation with some brief examples from Tribunals where facts are instructive.

9 Australasian Jam Company

This matter concerned valuation of trading stock.

It came on for trial before Fullagar J in 1953. The history goes back to 1914.

From 1914 onward, the company adopted the practice in its own accounts and for income tax returns of valuing stocks of jams, canned fruits and tinplate at certain "standard" values. These values had originally been based on cost. However they remained unchanged from 1914 to 1947. The evidence showed there had been very wide fluctuations in the stock on hand from year to year, also. Thus, it might be expected by us that trading stock would be material to income tax calculations.

Up until the end of the 1938 year, no basis of valuation of stock was stated either in the company's own accounts or in its income tax returns.

Subsequent accounting periods saw the company, both in its own accounts and income tax returns, stating the valuation of its stocks as having been made "at cost or under".

An investigation of the company's accounts concerning stock values led to amended assessments for each of 11 income years, in 1950. Eight of the 11 years showed a taxable income higher than that which had been returned.

The Commissioner used the company's own opening stock figure for the first of those years, and then attempted (using the company's own figures) to arrive at closing stock figures representing as nearly as possible actual cost.

The case is important also for the application of the trading stock provisions, but I will leave that to one side. The case is interesting as a decision of the High Court of Australia, albeit sitting at trial, upon the direct precursors to the modern provisions about amendment of assessments.

Fullagar J at page 34, first, distinguishes the concept of an avoidance of tax from evasion. The former does not "involve any notion of active or passive fault on the part of the taxpayer".

Fullagar J then held that the burden of proving that the Commissioner held the relevant opinion at the relevant time was borne by the Commissioner (page 34). The way that this burden was attempted to be fulfilled was by tender of a certificate under the then Regulation 43. This made tender of such a certificate conclusive evidence that the Commissioner had formed the opinion that the avoidance of tax was due to fraud or evasion. I will come back to that.

Because of a ruling made by Fullagar J that that certificate was not evidence, a Second Commissioner was called as a witness. He said that he had, before the amended assessments were made, former the relevant opinion. He was cross-examined on that.

As we have come to expect, Fullagar J said at page 37 that it was not for the Court to decide whether there had been such fraud or evasion, but rather it was a question of whether the opinion was not in fact entertained, or that it was based upon a misconception of the word "evasion", or that it was arrived at "capriciously, or fancifully, or upon irrelevant or inadmissible grounds".

Fullagar J rejected a passage from *Moreau*, which I have not quoted above, in which Isaacs J had said that it would be necessary to show that the Commissioner's belief was "found to be so irrational

as not to be worthy of being called a reason by any honest man". This was said to be putting the position "somewhat too strongly": page 37.

Finally, the Court held that the taxpayer could, instead, obtain an actual review of an opinion or discretion of the Commissioner by the Board of Review, though not by the Court. We shall see below that this may not be the case nowadays in effect.

The case is also interesting because the evidence of the Second Commissioner in chief exposes the reasons why the opinion was formed.

The company, over a period of time, began to bring stock to account at a unit value which proved to be considerably below cost, and only a minor proportion was at cost price. Over a period of time this led to "a very substantial hidden reserve of £160,000 odd": page 38.

As a result the total tax escaped was in the vicinity of £56,000.

It was a big company and well advised. The Second Commissioner considered that the company officers were supposed to know the law, and they would have known the provisions of the then section 31 which required selection of one of three valuations. They made no effort to deny that the unit value used was not "cost", and they made the claim that it may have been "market selling value" which was rejected and which was later not pursued in the investigation. The company was given an opportunity to identify units which were "below cost" and to submit a market selling value. They did not do so. The unit value did not in any way answer any of the required descriptions. (Refer pages 38-40)

The Commissioner formed the view that there was no deliberate attempt to deceive, and thus it was said not to be a case of fraud. It was only pursued as evasion.

Fullagar J considered that, had it been for him to decide, his Honour would also have concluded that there had been an evasion. Despite some unsatisfactory aspects of the evidence given in the Commissioner's case, Fullagar J was content that the Commissioner did entertain a view that there had been an avoidance of tax due to evasion. It was not an unreasonable view. It was certainly not one which was capricious, fanciful, or arrived at upon irrelevant or inadmissible grounds.

It is interesting to note that the following was regarded by the Commissioner as relevant:

- The size of the company and the fact that it would have been well advised.
- The fact that it can be assumed that this company's officials would have known the three methods permissible under the trading stock rules for valuation.
- The failure to come up with better information during the audit, despite opportunity.
- The size of the "hidden reserve" and the amount of the tax evaded.
- An initial representation that the unit price actually was closest to "market selling" value, a contention not then pursued during the audit.

I now return to the certificate under Regulation 43. Recall that the regulation provided that such a certificate was conclusive evidence that the relevant opinion was held. Fullagar J considered at pages 35-36 that the purported effect of such a certificate was to preclude the court from deciding questions which, by the provisions of the Act, relating to objections and appeals, were committed to the court for decision. This meant that the certificate was not authorised by the regulation making power, as it then stood in the *Income Tax Assessment Act 1936*.

I recall that the regulation was remade, and that the new Regulation 43 simply made the certificate *prima facie* evidence. That overcame the problem. I cannot find such a regulation nowadays, however.

10 Modern Controversies

My research folder has about 60 cases in it, dealing in one way or another with questions of fraud or evasion. We will come to some of those examples during the oral presentation, to test the evolution of thinking about fraud or evasion, in the context of older findings.

For the present, there are real and practical problems about contesting findings of fraud or of evasion under section 170 *Income Tax Assessment Act 1936*. One matter where there was an appeal to the Full Federal Court (since discontinued) is of particular interest.

This case is *Nguyen* 2018 ATC ¶20-667, an appeal from the AAT reported at 2016 ATC ¶10-442.

Recall that a particular difficulty of calling the Commissioner's decision that there has been an avoidance of tax owing to fraud or evasion, in a Court, is that the review can only be on administrative law grounds. It is not the Court's function to substitute its own decision for that of the Commissioner.[10]

So the logical thing to do might seem to be to go to the AAT, which is suggested by one of the authorities dealt with above.

The difficulty there is that *Nguyen*, and before it *Binetter* 2016 ATC ¶20-593, require that the taxpayer bear the onus of proving that the conditions for the exercise of the amendment power did not exist: *Nguyen* 2018 ATC ¶20-667, [114]. The former Taxation Board of Review performed a different task, apparently, of forming its own view as to whether there had been fraud or evasion,[11]

Worse, the Commissioner had refused to provide particulars of the basis upon which he had concluded that there had been fraud and evasion in *Binetter*. He had refused to do so on the basis that if he had done so, it would be contrary to the function of the Tribunal.[12] In effect, since the Commissioner did not have the onus of proof on the point, the provision of particulars indicating how he would go about proving it was a "redundant exercise".

Thus we now have a situation where, in the forum which should give merits review of exercises of discretion, the Commissioner's opinion is effectively unexaminable. The taxpayer is expected to go to trial without particulars of how an opinion was formed.

The taxpayer cannot discharge its onus simply by chipping away at parts of, for example, a default assessment done on an asset betterment basis or by showing only that some monies treated as income are not in fact income.[13]

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[10] If the finding were against the Commissioner on that limited basis, query if the Court could then proceed to decide the matter on the merits. Refer *Harding v Commissioner of Taxation* 2019 ATC ¶20-685, [4]. The other members of the Full Court do not appear to have dealt with this issue.

[11] *Krew v FCT* (1971) 45 ALJR 324, 327 col. IIE (Walsh J)

[12] Refer the summary in *Nguyen*, above, 2018 ATC ¶20-667, [104].

[13] *Hourigan* [2018] AATA 3369, [11].

It is little wonder that Ms Nguyen appealed to the Full Court. Whilst it appears that appeal was discontinued on about 18 February 2019[14] the grounds of appeal may indicate further controversy in this area. In short, issues raised by that notice of appeal include:

- Whether the AAT in fact is purportedly required to exercise judicial power in review of an objection decision in such a case, contrary to the Constitution. The path to that conclusion lies in the purported change in the AAT's role, as against that of the old Board of Review which stood in the shoes of the Commissioner and was merely to do over again what the Commissioner did in making the assessment within the limits of the taxpayer's objection. If the AAT, as opposed to the Board of Review, had a more limited role, this was said to lead to purported conferral on the AAT of judicial power.
- It was also said that the construction favoured by *Binetter* meant that the Tribunal was required to start with a statutory presumption of wrongdoing, and that instead the Tribunal should have been found to be required to ignore the Commissioner's assertions and opinions of fact that underlay his assessments of the liability of the taxpayer.
- There was also a ground to do with whether, because you could not judicially review a finding of fraud or evasion, the appeal to the Federal Court from the AAT should be construed as permitting effective review instead. Where this ground actually leads was to calling into question the decision of the Court in *Chhua* [2018] FCAFC 86.
- There was also said to be a constructive failure to exercise jurisdiction to review the question of fraud or evasion.

These are difficult questions to be examined in the long run. The practical difficulties being thrown up for taxpayers, particularly taxpayers who might have expected to get merits review in a sensible way in the Tribunal (including notice of the Commissioner's basis of formation of his opinion) will, I think, lead to continued litigation in this area. Something has to give.

[14] See the Federal Court's record for proceeding number VID1299/2018.

11 Commissioner's Response

The Commissioner does have some publications dealing with fraud or evasion. There are fraud and evasion guidelines, and also PSLA 2008/6 on fraud or evasion. The latter is more satisfactory in terms of the content.

Further, the Commissioner is said to be referring questions of determination of fraud or evasion to the National Fraud or Evasion Advisory Panel, in accordance with revised PSLA 2008/6 paragraph 7. This panel is also known as the "FE Panel".

There has been a deal of discussion about this panel. The ATO's own material indicates that it will comprise "at least three senior ATO staff" at EL2 level or above. Some discussion has focused on the lack of any outside member on the panel. There has also been discussion about the fact that the taxpayer or its representative will not be in attendance at meetings.

As an assurance mechanism, have such a formalised procedure seems worthwhile.

On the other hand, the lack of outside representation on the panel, and the lack of representation by or for the taxpayer at meetings of the panel may send the wrong message in terms of transparency of the process.

12 Taxpayer's Options

My simple prescription, in light of the above, is -

- engage early. Since a decision that there has been fraud or evasion will be hard to shift, act to prevent that conclusion being formed.
- use the process recently introduced, if at all possible, by getting your client's views before the FE Panel.
- be aware of the distress your client will be suffering, in being accused of this. You are the cool, rational voice in the room. Use that position.
- since it may be difficult to obtain in litigation - FOI documents outlining the Commissioner's case on fraud or evasion. Address this in preparation of objections and beyond.
- if left with no other reasonable option - litigate. But the foregoing recognises that practical remedy is hard to find there. The AAT seems only little better than the Court on this point, if recent cases are correct.

It can be hard to find cases which assist in making the argument against fraud or evasion. Because the cases are more likely to turn up where merits review is available, the cases tend to have less authority. And it can always be said against you that all cases in the area are "facts cases". That said, during the oral presentation we will discuss several Taxation Board of Review cases which may assist.[15]

David W Marks QC, CTA
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1 March 2019

[15] 8 CTBR Case 1; 8 CTBR Case 2; 8 CTBR Case 3; 8 CTBR Case 4; 8 CTBR Case 5; 9 CTBR Case 1; 10 CTBR Case 1; 11 CTBR Case 1; 12 CTBR (NS) Case 99; and compare *SRBBB v FCT* 2001 ATC 2194; *Parry v FCT* (2004) 57 ATR 1343; *Lam v FCT* (2005) 58 ATR 1317; *Case 4/2006* 2006 ATC 133, etc

