Comments and Notes

Pathological Precedents: *Hepples v FCT (No 2)*

Hepples v FCT[1] provided the first opportunity for the High Court to consider Part IIIA of the *Income Tax Assessment Act* 1936 (Cth) ("the Act"). In *Hepples v FCT* (No 2),[2] the Court faced the difficulty of settling the order to be made as a result of the earlier judgment. The difficulty arose because, although a majority of the Court had found in favour of the Commissioner, that majority had so found for divergent reasons each of which was rejected by a majority. The traditional approach to such a situation would have been to make an order in favour of the Commissioner. This approach results in a precedent of problematic value in that the reasons for the decision are inconsistent with the decision itself.[3] The High Court did not follow this approach, but made an order in favour of the taxpayer. This note examines the reasons propounded by the Court in favour of this order and argues that these reasons are convincing and, in fact, suggest that the limits which the Court placed on the new approach may be arbitrary.

It is necessary briefly to recapitulate the operation of Part IIIA of the Act and the facts of *Hepples*. Part IIIA contains the capital gains tax provisions. Where a person receives a payment without having alienated an asset, consideration needs to be given to the "extraordinarily complex"[4] provisions of ss160M(6) and 160M(7). If a gain is taxable under either of those sections it will enter the taxpayer's assessable income by virtue of s160ZO(1).[5] The dispute in *Hepples* related to such a capital gain, a $40,000 payment made to Hepples by his employer in return for his entry into a restraint of trade deed. The Commissioner asserted that Hepples was liable to tax on the payment. Hepples appealed to the Administrative Appeals Tribunal ("the AAT"), which referred this question to the Full Federal Court:

> Was there ... included in the assessable income of the Applicant ... (a) an amount of $40,000 ... pursuant to subsection 160ZO(1) of the *Income Tax Assessment Act*, 1936?[6]

The Full Federal Court (by majority) found for the Commissioner[7] and Hepples appealed to the High Court. There, Brennan J held that the payment fell within s160M(6) and Dawson and Gaudron JJ concurred. The balance of the Court disagreed. Dawson and Toohey JJ held that the payment fell within s160M(7) and Gaudron J concurred with Dawson J.[8] Again, the balance of the

1 (1991) 65 ALJR 650.
2 (1992) 66 ALJR 231.
3 Cf Montrose, J L, "*Ratio Decidendi* and the House of Lords" (1957) 20 *ModLR* 124 at 129 (n26); and the note by Honoré (1955) 71 *LQR* 196 at 201.
4 *Hepples*, above n1 at 651 per Mason CJ.
5 Assuming that no other capital gains or losses are made in the relevant tax year and that no losses are brought forward.
6 *Hepples* (No 2), above n2 at 2.
7 (1990) 22 FCR 1.
8 Section 160M(7) is expressed to be "subject to the other Provisions of this Part". Dawson J in *Hepples* (above n1 at 660) held that, as the payment in his view fell within s160M(6), it

Court disagreed. Thus, there was no majority in favour of liability under s160M(6) nor under s160M(7). Yet there was a majority in favour of liability on one or other of these grounds.[9]

In ruling in *Hepples* (No 2) that Hepples was not liable to tax, the High Court drew a distinction between a decision which will conclude the rights of the parties and a decision on a referred question of law. In the former case, there is authority that that order will be made which is favoured by the majority of the court. Thus, to use Lord Simonds' example,[10] it would be possible for an appellant to appear before a court of five judges with five arguments, have those arguments emphatically rejected by a majority of four to one, yet win a unanimous victory, provided that each judge accepts a different argument.[11] The High Court ruled that this approach is not to be adopted in a decision on a referred question of law, when the task of the court is to "declare the majority opinion as to the issue of law".[12] Implicit in this distinction seems to be an acceptance of the "English" view[13] that a decision concluding the rights of the parties is essentially the resolution of a dispute. That such a resolution produces "law" is, as it were, agreeable but fortuitous. Thus it is no criticism of a decision to say that the principles of law established are inconsistent with the order made. On the other hand, when giving a decision on a referred question of law, the court's primary function is to state the law; to make an order inconsistent with this statement would be to fail to fulfil the very task set the court.

Much of this was not made explicit in the judgment and this argument was not the primary one advanced. However, it allowed the Court to distinguish the approach described by Lord Simonds and, thus, to clear the ground. Having done so, the Court outlined two reasons for its order. The first was the assertion that the question stated by the AAT was ill-posed, since it conflated two alternative bases of assessability which should have been kept separate. The second, which will be dealt with first, was the "miscarriage of justice" argument.

The "miscarriage of justice"

This argument appears in the following passage:

> It would work a miscarriage of justice to answer the question referred according to its terms for the answer would bind the Tribunal, by force of s45(3) of its Act, to hold that there was a disposal when majorities of this

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could not fall within s160M(7). His view on s160M(7) was given on the assumption that s160M(6) did not apply. Gaudron J (above n1 at 664) substantially concurred with this reasoning.

9 Dawson and Gaudron JJ under s160M(6) or (if s160M(6) was inapplicable) under s160M(7); Brennan J under s160M(6) and Toohey J under s160M(7).

10 Given in argument in the *Commonwealth of Australia v Bank of NSW* (1949) 79 CLR 497; see the notes in (1949) 23 *ALJ* 355 and (1950) 66 *LQR* 298; these notes are cited in *Hepples [No2]* above n2 at 1.

11 The majority in favour of the appellant in such a case will be termed a "composite" majority.

12 Above n2 at 1.

13 Cf Paton, G W and Sawer, G, "*Ratio Decidendi* and *Obiter Dictum* in Appellate Courts" (1947) 63 *LQR* 461 at 477.

> Court have decided that there was no disposal within s160M(6) and no disposal within s160M(7). In a future case though the facts be indistinguishable, the Tribunal would be constrained to hold that there was no disposal.[14]

Three points should be made about this argument. First, it assumes the ratio of *Hepples* will compel the AAT if it ever has to deal with an identical case, to rule that the identical payment is non-assessable. This is not an inevitable view. There are a number of ways in which an inferior court may deal with a decision such as that in *Hepples*. First, it may be said that the case contains no ratio, and is therefore not binding. This was the approach of the Court of Appeal of Northern Ireland in *Walsh v Curry*[15] when that Court had to deal with the House of Lords decision in *George Wimpey v British Overseas Airways Co.*[16] Secondly, the decision may be treated as authority for the orders made, so that if the identical facts were before the inferior court, the same order would be made. This seems to be one implication from Lord Halsbury's rather inscrutable dictum that "[a] case is only authority for what it decides"[17] and accords with the view of Goodhart[18] and of Megarry.[19] The approach assumed by the High Court — that a decision made on the strength of a composite majority is authority against each argument which is consistent with the order — stands in opposition to these views. It is, however, supported by the treatment by the same Court in *R v Murray ex parte Proctor*[20] of its earlier decision in *R v Drake-Brockman ex parte Northern Colliery Proprietors' Association.*[21] In the earlier case, the High Court had found for the prosecutors for two reasons, each of which was rejected by a majority. In *Murray*, only one of those reasons was relevant. Dixon J, in holding for the prosecutors, treated *Drake-Brockman* as authority against that reason and thus found it necessary to distinguish the earlier case.[22] The assumption made in *Hepples* [No2] is consistent with this approach. It is also consistent with the "classical" theory of precedent,[23] by which the *ratio* of a case is the principle of law propounded by the court as the basis for its decision. This view was given its most vigorous Australian exposition by Griffith CJ in *Deakin v Webb*[24] and, whilst the treatment of precedent is

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14 Above n2 at 3.

15 [1955] NI 112; at 125 per Lord MacDermott LCJ; at 135 per Black LJ; discussed by Montrose, above n3.

16 [1955] AC 169.

17 *Quinn v Leathem* [1901] AC 459 at 506; see Cross, R and Harris, J W, *Precedent in English Law* (4th edn, 1991) at 57-58.

18 *Essays in Jurisprudence and the Common Law* (1931) at 1-26; "The *Ratio Decidendi* of a Case" (1959) 22 *ModLR* 117.

19 (1950) 66 *LQR* 298. This note is cited in *Hepples* (No 2), above n2 at 1, but the Court does not advert to the difference between its approach and Megarry's. The Megarry approach seems to have been taken by United States Courts of Appeals (the Ninth Circuit in *Siegmund v General Commodities Co*, 175 F 2d 952 (1949) and the Seventh Circuit in *Detres v Lions Building Corporation*, 234 F 2d 596 (1956)) to the decision of the Supreme Court in *National Mutual Insurance v Tidewater Transfer*, 337 US 582 (1948); discussed by Stone, J in *Legal System and Lawyers' Reasonings* (1968) at 255 (n132).

20 (1949) 77 CLR 387.

21 (1946) 52 ALR 106; discussed by Paton and Sawer, above n13 at 463-64.

22 At 400-01.

23 Montrose, above n3 at 124-25; cf Simpson, A W B, "The *Ratio Decidendi* of a Case" (1957) 20 *ModLR* 413.

marked by much flexibility making generalisation difficult, this view seems to accord with judicial practice.[25]

Secondly, the "miscarriage of justice" argument offers little assistance to referring bodies attempting to formulate the question to be referred. This is because it will often be impossible for a body referring a question of law to predict whether that question will give rise to a miscarriage of justice. Indeed, even the question as reformulated by the High Court[26] could have given rise to such a miscarriage. The s160M(7) point, for example, involved two major issues. First, does the word "asset" when first appearing in that section refer to an asset of the taxpayer; if so, is there such an asset? Secondly, is there the required connection between the payment and the "asset"? Deane J held that the "asset" had to be an asset of the taxpayer; a majority of the Court disagreed.[27] Deane J did not express a view on the connection requirement; of the other six justices, three held that there was the required connection;[28] three held that there was not.[29] Thus, if Deane J had expressed a view on the connection requirement and found that the relevant connection was present, the payment to Hepples would have escaped s160M(7) for two reasons — first, the absence of an asset of the taxpayer and secondly, the absence of the requisite connection — even though both of these reasons would have been rejected by a majority of the Court.

Thirdly, the "miscarriage of justice" argument proves too much. It is equally applicable to the situation described by Lord Simonds, where a litigant succeeds where any subsequent identical litigant would fail.[30] It is, for example, impossible to see any grounds for distinguishing between the injustice suffered by a taxpayer appealing to the High Court from the AAT on a question of law and the injustice suffered by an identical taxpayer who appears before the High Court in an appeal that will conclude his or her tax liability. Indeed, the High Court's "miscarriage of justice" argument seems directed at preventing just this sort of unfair discrimination between identical litigants.

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24 (1904) 1 CLR 585 at 604-05.

25 See Cross and Harris, above n17 at 41-43.

26 See text accompanying n31.

27 Dawson, Toohey, Gaudron and McHugh JJ; Brennan J, with whom Mason CJ concurred, declined to decide this point.

28 Dawson, Toohey and Gaudron JJ.

29 Mason CJ; Brennan and McHugh JJ.

30 This is not the case if the assumption which the High Court makes regarding the *ratio* of *Hepples* is not applicable to decisions which conclude the rights of the parties. Yet *Drake-Brockman* is authority that, at least where the subsequent litigation is not identical to the precedent litigation, the Court's assumption will extend to such decisions. It would be odd if it were said that the assumption applies to decisions which conclude the rights of the parties where the subsequent litigation is non-identical, but not where the subsequent litigation is identical since the only reason for such a distinction would be to avoid the "miscarriage of justice" and if the distinction can be made in relation to decisions which conclude the rights of the parties, why can it not be made in relation to a decision on a referred question of law?

The "ill-posed question"

The first justification for the orders in *Hepples* [No2] was the assertion that the question referred was ill-posed. The AAT, it was said, should have asked itself two questions *seriatim*: first, was the payment to Hepples assessable under s160M(6); and, secondly, was the payment assessable under s160M(7)?[31] It is somewhat difficult to give content to this reasoning. Sections 160M(6) and 160M(7) do not operate, of themselves, to bring capital gains to tax.[32] Rather, a gain made as a result of a disposal under s160M(6) or s160M(7) is deemed to be a "capital gain" by s160Z(1) and will enter into the calculation of the "net capital gain" (if any) made in a tax year under s160ZC(1). Section 160ZO(1) operates to include this "net capital gain" in the assessable income of the taxpayer.

The AAT, then, posed the main question, to which a number of other questions were subsidiary. It is true that many of these questions were distinct, but it is difficult to know which of the distinct questions were "separate questions of law". It may be tempting to amalgamate the two grounds for the decision and define an ill-posed question as one that leads to a composite majority (and thereby to a miscarriage of justice), but this is to avoid the issue, because there will only be a composite majority if a sufficient number of justices examine the subsidiary questions. In *Hepples*, for example, if Brennan J had found for the Commissioner on s160M(6) and had not considered s160M(7) and if Toohey J had found for the Commissioner on s160M(7) and had not considered s160M(6), there would have been no composite majority. Thus, the definition of an ill-posed question as one that leads to a composite majority is an illusory solution since it offers no criteria by which to decide which questions must be considered by the whole court.[33]

If there is a weakness in the *Hepples* (No 2) judgment, it is this failure to specify what distinguishes a separate question of law. If it seems sensible to treat the s160M(6) and s160M(7) questions as separate, the High Court itself parenthetically acknowledges that there may be additional questions.[34] If so, why were these questions not stated? It may be that, with respect to s160M(7), the asset issue and the connection requirement were separate issues of law. If so, why did Deane J not state his view on the connection requirement? However, it is probably unreasonable to expect the courts to develop a failsafe procedure for identifying separate questions of law. Obviously, where distinct questions of legal importance are at issue they will be treated thoroughly by the Court. At the same time, some questions will not require separate consideration. In *FCT v Whitfords Beach Pty Ltd*,[35] for example, Gibbs CJ remarked that in practice it was generally found unnecessary to determine whether profits were assessable to tax under s25(1) of the Act or under the

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31 Above n2 at 3.

32 Cf per Deane J in *Hepples* above n1 at 658.

33 Or by a sufficient number of justices so as to result in one view with majority support. This is the same reason why the "miscarriage of justice" approach offers little assistance to a referring body attempting to formulate the question to be referred.

34 *Hepples* (No 2), above n2 at 3: "the question referred contains not a single question of law but (*at least*) two questions of law" (emphasis added).

35 (1982) 150 CLR 355.

predecessor of s25A; "it was enough to decide whether or not they were taxable".[36]

It would be wrong to think that *Hepples* (No 2) requires that such questions now be considered separately. This is because s25(1) and s25A may have an overlapping operation and the interpretation of one will have an impact on the interpretation of the other.[37] It is for this reason that flexibility is necessary.[38]

Conclusion

The High Court's clear distinction between a decision on a question of law and a decision concluding the rights of the parties would seem to militate against an extension of the *Hepples (No 2)* approach. However, there seems to be no reason why the decision should have been different if Hepples had appealed from his assessment direct to the Federal Court and from there to the High Court. It is to be hoped that the miscarriage of justice argument, which tends to stultify this distinction, will be seen as authorising such an extension. In any case, the "English" assumption[39] which underlies the distinction is open to question. Paton and Sawer suggest that the function of a court is not only to give judgment, but also "to lay down a principle consistent with that judgment".[40] The *Hepples* (No 2) approach supplies this *desideratum*.

It is for this reason, indeed, that the approach should be welcomed. The position of a decision of a court in which all arguments with majority support are inconsistent with the orders made has been an *aporia* in traditional theories of precedent. The High Court has demonstrated that the problem is susceptible to sensible resolution. The Court could, of course, have avoided the problem which it faced in the *Hepples* litigation if the justices who had found for the Commissioner on one ground had not considered the other ground.[41] Yet this solution would have been purchased at the price of continued uncertainty in the interpretation of ss160M(6) and 160M(7). The *Hepples* (No 2) principle provides a solution which involves no such compromise, and which thus promotes certainty, and which is fair to litigants. It is to be hoped that its operation is not restricted.

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36 At 364.

37 See the discussion of "parallel" and "central" provisions analysis in Woellner, Vella, Burns and Chippindale, *Australian Taxation Law* (3rd edn, 1990) at [6-070].

38 To return briefly to the "miscarriage of justice" argument; the *ratio* of *Hepples* was relatively perspicuous. Where this is not so, it seems unlikely that a court would be prepared to hear argument as to the *ratio* of the judgments just handed down, for the purposes of deciding whether the "miscarriage of justice" argument is attracted. In such a case, there would probably be no "separate questions of law".

39 See above n13.

40 Id at 464.

41 Specifically Brennan and Toohey JJ.

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