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Retrospective tax law: Has Pandora's Box opened never to be shut again?

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Abstract

The recent *Chevron* case¹ raised the issue of retrospectivity of legislation. While this issue is not new, it has been argued in the past that there are limits on when governments can resort to enacting retrospective laws. These limits centre on the ability of government to protect the revenue in the public interest. This paper explores the history of retrospective taxation legislation in Australia, and analyses whether such legislation was justified in the circumstances to achieve this goal. The authors argue that the *Chevron* case not only entrenches the right of governments to enact retrospectively with respect to taxation laws, but unjustifiably extends that right in the name of 'protecting the revenue'. This will have serious implications for taxation practitioners and their clients. The authors contend that retrospective legislation should only be considered in the most egregious circumstances, and that it is incumbent upon governments to acknowledge deficiencies in legislation promptly, and amend such legislation quickly, in order to provide certainty and maintain public confidence in the taxation system.

Key words: Retrospective laws; taxation; *Chevron* case

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¹ *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [No 4]* [2015] FCA 1092 ('*Chevron*'). See also below n 7.

1. INTRODUCTION

James Popple, in his article 'The Right to Protection from Retroactive Criminal Law',² considered that the right to protection from retroactive criminal law has been accepted without argument although literature to justify this is scarce. The principle has been enunciated in various declarations of human rights from 1789 until the present.³ His article discusses retroactive criminal laws — the Nuremburg trials and Australia's own 'Bottom of the Harbour' legislation.⁴ The paper discusses both sides of the argument regarding when retroactive legislation is appropriate. Although the paper concentrates on criminal law, two maxims arise which bear consideration. The first is that there can be a penalty with a law imposing that penalty and secondly that a person cannot be prosecuted for doing something which is not prohibited by law.

He goes on to discuss two further principles — that penal laws should be accessible and intelligible and that ignorance of the law is no excuse because the laws are accessible and intelligible:⁵

Retrospectivity means that even a person well-informed about the law will be ignorant of the illegality of her or his acts because those acts are not deemed illegal until the retroactive law is made. So, it can be seen that retroactive laws are at odds with the principle that ignorance of the law is no excuse.⁶

Senator Don Chipp commented on retrospective tax law in the debates on legislation following the Bottom of the Harbour schemes:

Good heavens; give politicians the chance to legislate retrospectively and we will open a Pandora's Box. I find that quite frightening. On this occasion a Pandora's Box is opened in the excuse of catching the filthy people who cheat on tax. It is done for a noble purpose, one might say, and I agree. But I have never been one to subscribe to the view that the end justifies the means. That sort of proposition leads one down a track which is fraught with disaster. That is the track that every tyrant in history has gone down; that is, to make illegal today something which was legal last year.⁷

The Federal Court issued its much anticipated decision in *Chevron* on 23 October 2015.⁸ The case was extremely complex involving multiple facets of tax law, in particular, transfer pricing. However, one of the matters discussed in *Chevron* was the

² James Popple, 'The Right to Protection from Retroactive Criminal Law' (1989) 13(4) *Criminal Law Journal* 251 <<http://users.cecs.anu.edu.au/~James.Popple/publications/articles/retroactive/>>.

³ *Ibid* 251.

⁴ *Ibid* 256 to 257; 259 to 260.

⁵ *Ibid*.

⁶ *Ibid*.

⁷ Commonwealth, *Parliamentary Debates*, Senate, 1982, Vol S96 2594.

⁸ The focus of this paper is the decision of the Federal Court of Australia in *Chevron* at first instance. The authors note here that the taxpayer appealed that decision to the Full Federal Court, which dismissed the appeal on 21 April 2017 (*Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62). The issue raised in the appeal did not concern the retrospectivity aspect of the first instance judgment, but rather the transfer pricing provisions of pt III div 13 of the *Income Tax Assessment Act 1936* (Cth) ('ITAA 1936') and sub-div 815-A of the *Income Tax Assessment Act 1997* (Cth) ('ITAA 1997'). Chevron Australia has since advised it will seek special leave to appeal the decision of the Full Federal Court to the High Court of Australia (<http://www.theaustralian.com.au/business/chevron-to-appeal-340m-ato-bill/news-story/40879c8cc9bf0514644377efecd96fea>).

validity of retrospective taxation legislation. It is in light of this aspect of the judgment that the focus of this paper is directed towards a discussion of the principle of retrospectivity and governments' ability to enact retrospectively in order to 'protect the revenue'. This article is structured in three sections. First, a general overview of the principle of retrospectivity will be presented. Second, the history of retrospectivity in relation to taxation will be discussed and analysed against the requirement that the revenue be protected. As part of this analysis, consideration will be given to the possibility that the same practical outcome could have been achieved without enacting legislation with a retrospective operation. Third, the decision in *Chevron* will be analysed with a view to summarising its impact on the ability of governments to enact retrospective tax legislation. With reference to Senator Chipp's Pandora's Box the authors consider that the Box has been opened never to be shut again, much to the dismay of tax practitioners and taxpayers. On this basis, the ability for governments to enact retrospectively should be reconsidered and limited to circumstances in which the threat to the revenue is so blatant or egregious that there is no other alternative than retrospective action in the public interest.

2. RETROSPECTIVITY OF LEGISLATION — GENERAL OVERVIEW

The principle underlying retrospectivity of legislation is that the common law presumes that legislation acts *prospectively* but not *retrospectively*.⁹ As noted by Pearce and Geddes, the courts have frequently declared that, in the absence of some clear statement to the contrary, an Act will be assumed not to have retrospective operation.¹⁰ The leading case on this question in Australia is *Maxwell v Murphy* where Dixon CJ summarised the approach of the courts thus:

The general rule of the common law is that a statute changing the law, ought not, unless the intention appears with reasonable certainty, to be understood as applying to facts or events that have already occurred in such a way as to confer or impose or otherwise affect rights or liabilities which the law had defined by reference to the past events.¹¹

Another frequently cited statement of the principle is from Fullagar J in *Fisher v Hebburn Ltd*:

There can be no doubt that the general rule is that an amending enactment — or, for that matter, any enactment — is *prima facie* to be construed as having a prospective operation only. That is to say, it is *prima facie* to be construed

⁹ As noted by Susan Franks <www.charteredaccountants.com.au>, in his *Commentaries on the Laws of England* (Book 1) first published in 1765, Sir William Blackstone describes retrospective legislation as unreasonable since it is impossible for a person, at the time of taking an action, to foresee that his or her action would become illegal by a subsequent law. Blackstone states: 'There is still a more unreasonable method than this, which is called making of laws *ex post facto*; when after an action (indifferent in itself) is committed, the legislator then for the first time declares it to have been a crime, and inflicts a punishment upon the person who has committed it. Here it is impossible that the party could foresee that an action, innocent when it was done, should be afterwards converted to guilt by a subsequent law; he had therefore no cause to abstain from it; and all punishment for not abstaining must of consequence be cruel and unjust. All laws should be therefore made to commence *in futuro*, and be notified before their commencement.' Lon Fuller, in his *Morality of Law* (1964), laid down eight fundamental requirements for a purported law to be genuine, one of which was that it be prospective.

¹⁰ Dennis Pearce and Robert Geddes, *Statutory Interpretation in Australia* (LexisNexis, 2011) 322.

¹¹ (1957) 96 CLR 261, 267.

as not attaching new legal consequences to facts, or events which occurred before its commencement.¹²

As discussed in *Attorney-General of New South Wales v World Best Holdings Ltd*,¹³ the presumption is strongest if 'palpable injustice' will result from retrospective operation, for example, legislation creating retrospective criminal offences. By contrast, the presumption will be weaker if the retrospective operation of legislation actually has a beneficial operation, or causes some injustice to one party but rectifies injustice to others.

Naturally, the operation of the presumption does not mean that Parliament is forbidden from passing legislation that has a retrospective operation. Parliament *can* legislate retrospectively and may do so for a variety of reasons, for example, to:

- overcome court decisions (including interpretations which Parliament does not like); or
- close loopholes in tax or other legislation; or
- validate past actions.

As noted by the Australian Law Reform Commission, the general justification for laws that interfere with vested property interests is that the interference is necessary and in the public interest.¹⁴ However, if government of free individuals is justified upon the basis that protection of private property can only be achieved by public authority,¹⁵ then retrospectivity presents a challenge. Yet, as alluded to by Higgins J in *R v Kidman*,¹⁶ while there are plenty of passages that can be cited showing the inexpediency, and the injustice, in most cases, of legislating for the past, of interfering with vested rights, and of making acts unlawful which were lawful when done, such passages do not raise any doubt as to the power of the legislature to pass retrospective legislation, if it sees fit. In such cases, the presumption against retrospectivity should be excluded by a direct statement to the contrary in the relevant Act.¹⁷ This requires a statement of 'necessary intendment' that the Act is to operate retrospectively. As Pearce and Geddes point out,¹⁸ the closest one can perhaps come to a working rule is provided by *Worrall v Commercial Banking Co of Sydney Ltd*:

Necessary intendment only means that the force of the language in its surroundings carries such strength of impression in one direction, that to entertain the opposite view appears wholly unreasonable.¹⁹

It is important when considering the question of retrospectivity to draw a distinction between legislation having a prior effect on past events and legislation basing future action on past events. The presumption is against having a prior effect on past events, it is not against having a future effect based on those same past events. Jordan CJ contrasted these circumstances in *Coleman v Shell Co of Australia Ltd*:

¹² (1960) 105 CLR 188, 194.

¹³ (2005) 63 NSWLR 557, 568 to 574.

¹⁴ Australian Law Reform Commission, *Traditional Rights and Freedoms — Encroachments by Commonwealth Law*, Interim Report 127, 7.136.

¹⁵ See John Locke, *Two Treatises of Government* (Cambridge University Press, 2nd ed, 1967) 289.

¹⁶ (1915) 20 CLR 425, 451.

¹⁷ Pearce and Geddes, above n 10, 330.

¹⁸ *Ibid* 330.

¹⁹ (1917) 24 CLR 28, 32 (Barton J).

[A]s regards any matter or transaction, if events have occurred prior to the passing of the Act which have brought into existence particular rights or liabilities in respect of that matter or transaction, it would be giving a retrospective operation to the Act to treat it as intended to alter those rights or liabilities, but it would not be giving it a retrospective operation to treat it as governing the future operation of the matter or transaction as regards the creation of further particular rights or liabilities.²⁰

An illustration of the operation of this distinction can be found in *La Macchia v Minister for Primary Industry*.²¹ In that case the holder of a fisherman's licence was convicted of an offence that at the time of conviction could not result in the cancellation of his licence. Subsequently, the relevant Act was amended to permit licence cancellation on the basis of such offences and his licence was cancelled. The Full Federal Court upheld the validity of a cancellation based on the conviction before the Act was amended, on the basis that this was held *not* to infringe the presumption, since the new law only operated into the future, in that it permitted licence cancellation in the future on the basis of past events. In other words, it did not create a new offence but created a new penalty that operated into the future.

The presumption against retrospectivity only arises where so to read the legislation would impinge on a person's accrued rights or duties.²² It does not apply to legislation that merely regulates procedure.²³ For example, in a criminal trial, the law to be applied at trial will be that at the time of the offence, however, the procedure for the trial (eg, rules of evidence) will be governed by the law of procedure, evidence etc, at the time of the trial.²⁴ In other words, rules which are directed to governing or regulating the mode or conduct of court proceedings are procedural and all other provisions or rules are to be classified as substantive.²⁵

3. RETROSPECTIVITY OF TAX LEGISLATION

As noted by Pearce and Geddes, there is, in general, no reason why any different approach should be followed in determining whether a tax Act is to operate retrospectively than is applicable to other legislation.²⁶ However, the fact that taxpayers will have organised their affairs to comply with existing legislation strengthens the argument that the legislative intention to remove existing rights should appear clearly: *Commissioner of Stamps (Qld) v Weinholt*,²⁷ followed in *Perpetual Trustees (Australia) Ltd v Valuer-General*.²⁸ In fact, the introduction of retrospective tax legislation is not done lightly. It is generally only done where there is a significant risk to revenue that is inconsistent with the Parliament's intention.²⁹ However, as we will see, there is now a significant history in Australia of governments acting retrospectively in the name of countering risks to their revenue base. Yet, the

²⁰ (1943) 45 SR (NSW) 27, 31.

²¹ (1986) 72 ALR 23.

²² Pearce and Geddes, above n 10, 326.

²³ *Maxwell v Murphy* (1957) 96 CLR 261.

²⁴ *Rodway v R* (1990) 169 CLR 515.

²⁵ Pearce and Geddes, above n 10, 337.

²⁶ *Ibid* 316.

²⁷ (1915) 20 CLR 531, 541.

²⁸ (1999) 102 LGERA 324, 337.

²⁹ Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012.

operation of such legislation, in fact, appears to go beyond the 'noble purpose',³⁰ as Senator Chipp put it, of punishing tax cheats and seems to be becoming, as one commentator has noted, a 'fact of life'.³¹

As noted by the Australian Law Reform Commission, concerns about the scope of retrospective taxation laws have been widely expressed.³² For example, in 2012, the Tax Institute of Australia made a submission to Treasury in which it noted an 'extremely concerning trend in recent months of the government announcing retrospective changes to the tax law'.³³ The Tax Institute warned that retrospective changes in tax law are likely to 'interfere with bargains struck between taxpayers who have made every effort to comply with the prevailing law at the time of their agreement'.³⁴ The Tax Institute accepted that retrospective tax laws are justified in the case of:

1. concessional announcements, where it is proposed that a person should have a benefit from a given date but the legislative programme does not allow for immediate enactment; and
2. strengthening of tax laws, where an issue has come to the attention of the Commissioner requiring prompt attention (subject again to the legislative programme).

Therefore, it appears that some retrospective legislation is necessary, yet the question then becomes in what circumstances. The above cases cited by the Tax Institute could be considered as a broad guide as to the appropriateness of retrospective legislation, yet in this paper we are engaging in a more specific analysis. In other words, would it be possible for the legislature to achieve the same result (for example, strengthening the tax laws) without acting retrospectively? Which situations would pose a 'significant risk to the revenue'³⁵ so as to render retrospective legislation appropriate? Is the retrospective action warranted in the public interest? We now turn our analysis to various instances in the past in which retrospective legislation has been applied and assess whether that application was warranted in the circumstances, taking into account these considerations.

4. HISTORY OF RETROSPECTIVE TAX LAWS

4.1 Bottom of the Harbour schemes

As recounted by Lidia Xynas in her article³⁶ the 1970s and 1980s were decades in which the tax avoidance industry in Australia evolved and flourished. While prices rose by 54.6 per cent and wages by 116.6 per cent, income tax collections rose by

³⁰ Commonwealth, *Parliamentary Debates*, Senate, 1982, Vol S96 2594.

³¹ See John Eager, 'CGT, Retrospectivity and All That ... Some Hard Lessons Learned!' 33 *Butterworths Weekly Tax Bulletin*, 605.

³² Australian Law Reform Commission, above n 14, 9.76.

³³ Tax Institute, 2012–13 Federal Budget Submission, 2012, 2.

³⁴ *Ibid* 2.

³⁵ Above n 29.

³⁶ Lidia Xynas, 'Tax Planning, Avoidance and Evasion in Australia 1970–2010: The Regulatory Responses and Taxpayer Compliance' (2011) 20(1) *Revenue Law Journal* who cited these figures from the Asprey Report: W Asprey and R Parsons, 'Taxation Review Committee' (University of Sydney Library, 1975) ch 11, [11.1].

332.14 per cent.³⁷ It was the disproportionate increase in tax collections which drove the tax avoidance industry at the time.

One method used to avoid tax was to strip a company of its assets and accumulated profits before tax was payable and transfer those assets to another company which would continue the business operations. The stripped company would be sent 'to the bottom of Sydney Harbour'³⁸ often with its records. This meant that the company was transferred to the ownership of someone who did not have the means to pay the tax and was also disinterested in the activities of the company.

At the time there was no consensus as to the legality of these schemes. There was debate as to whether they constituted tax avoidance which was legal or tax evasion which was illegal. Without a decision as to the interpretation of these schemes many taxpayers who had faced significant increases in taxation liabilities engaged in these schemes. It was estimated that this engagement in these schemes cost the Australian economy dearly. Grabosky and Braithwaite quoted from Treasury's 1985 Draft White Paper which estimated revenue losses of \$3 billion per year from tax fraud.³⁹ Section 260 of the *ITAA 1936*, the general anti-avoidance section was found to be ineffective. Taxpayers continued to use schemes which saved them tax while the Commissioner had no effective method of countering them.

A number of reviews and reports at the time highlighted the growing inequality between taxpayers who could and couldn't access these schemes and the effect that this was having on the collection of tax.⁴⁰ By this time the Australian public was aware that many hundreds of companies had paid no tax because they had taken part in these schemes.⁴¹ The government finally had to take action due to the loss to the revenue and the effect on the taxpaying public which could not benefit from such schemes. It took action in two ways — firstly to criminalise participation in those schemes and secondly to allow the retrospective collection of tax which had been avoided under the schemes from 1 January 1972 – 4 December 1980.

The *Crimes (Taxation Offences) Act 1980* was enacted in 1980 and made it a criminal act to have taken part in the schemes in the 1970s. It was in the debate on this legislation that Senator Don Chipp made the comments quoted at the start of this paper. There was considerable reluctance to pass this legislation, however, the damage which had been done to the collection of revenue eventually persuaded members to vote in favour of it.

The second piece of legislation was the *Taxation (Unpaid Company Tax) Assessment Act 1982* ('*TUCT*'). It applied to schemes entered into on or after 1 January 1972 and before 4 December 1980. At that date the *Crimes (Taxation Offences) Act 1980* became operative. The *TUCT* legislation allowed the Commissioner to recover the tax which had been avoided using the schemes. Some additional legislation was also introduced at this time to make some actions criminal and to confiscate 'tainted' property. The large scale use of schemes and the huge effect on the revenue allowed

³⁷ Xynas, above n 36.

³⁸ Above n 2, 259.

³⁹ Peter Grabosky and John Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (Oxford University Press, 1986).

⁴⁰ See, eg, the Asprey Review (1975), McCabe-La Franchi Report (1979–83), and Costigan Royal Commission (1984).

⁴¹ Grabosky and Braithwaite, above n 39.

the retrospective nature of this legislation to pass. In the circumstances, the retrospectivity here was warranted in the public interest, given the threat to the revenue and the ineffectiveness of the legislation at the time to combat these schemes.⁴² It could be argued that the scale of the mischief was such that it warranted and almost required the retrospective change to the legislation.

The following two areas we will discuss have shown the willingness of governments to enact retrospectively not solely to protect the revenue or to give better effect to Parliament's legislative intent. In other words, the ability of governments to enact retrospectively is being extended beyond what could be considered to be in the public interest, thus seeing an 'opening up' of the Pandora's Box that those such as Senator Chipp feared would occur.

4.2 Capital gains tax

Prior to the introduction of capital gains tax (CGT) many comments were made that it would only operate on capital gains arising after its introduction. These included comments made by the then Treasurer, Mr Paul Keating. Yet, the legislation taxed the gain which arose on the giving of a lease on a property which a taxpayer had owned prior to the introduction of the tax. The matter was raised in *Gray v FCT*⁴³ and effectively endorsed the taxation of such lease premiums and the grant of an easement. While the Treasurer made a statement to Parliament on 19 September 1985 and in the second reading speech on 22 May 1986 the Court held that it was the legislation as enacted which must be interpreted.

The need for retrospective legislation in the aftermath of the Bottom of the Harbour schemes was obvious to Parliament and approved by the public, notwithstanding the reservation of Senator Chipp, among others. However, this cannot be said of the 'retrospective' operation of the CGT provisions to properties which had been owned prior to the introduction of the tax, but attracted CGT when lease premiums were received when such properties were leased. John Eager commented after the *Gray* case that 'retrospectivity appears to be a fact of life and not just to put down tax avoidance schemes or to punish "tax cheats"'.⁴⁴ We should not accept this as de rigueur. Taxpayers and their advisors need certainty when engaging in business or investment activities. Legislators must write sound and clear legislation on which taxpayers can rely. Legislation which does not achieve its aims or contains provisions which are easily avoided must be amended in order to protect the revenue. The government must move quickly to overcome these deficiencies but will have to bear the cost of inadequate legislation, rather than impose retrospective legislation on law-abiding taxpayers.

4.3 Transfer pricing

Transfer pricing legislation is the area which has seen recently the deliberate use of retrospective legislation to ensure that the government's intention in respect of the legislation was made possible; and this was the subject of the *Chevron* case.

⁴² As discussed by Xynas, above n 36, Grabosky and Braithwaite, above n 39 and the reports cited in above n 40.

⁴³ (1989) 20 ATR 649 ('*Gray*').

⁴⁴ Eager, above n 31.

The initial legislation was introduced in 1982 in div 13 of the *ITAA 1936*. Division 13 was introduced to address emerging concerns about cross-border profit shifting. Each of Australia's tax treaties also contains articles that deal with transfer pricing. The Commissioner of Taxation has long held and publicly expressed a view that the treaty transfer pricing rules, as enacted, provide an alternate basis to div 13 for transfer pricing adjustments.⁴⁵ It was tested in *Commissioner of Taxation v SNF (Australia) Pty Ltd*⁴⁶ and as a consequence of the decision it was decided that the legislation required amendment and strengthening. Consequently sub-div 815-A of the *ITAA 1997* was enacted to operate retrospectively so as to ensure that treaty rules in relation to transfer pricing have separate application to div 13. This subdivision applies to transactions entered into on or after 1 July 2004 but was enacted on 8 September 2012. While it was observed in the Explanatory Memorandum that this retrospective application of the legislation had not been entered into lightly, there was a perceived significant risk to the revenue which could only be protected with retrospective legislation. In fact, the *SNF* case was considered on the basis on div 13 alone and no reference was made to the relevant treaty. It was considered, however, that div 13 'may not adequately reflect the contributions of the Australian operations to multinational groups, and as such in some income cases treaty transfer pricing rules may produce a more robust outcome'.⁴⁷ This reflects inadequacy or errors in the drafting rather than the intention of the Parliament.⁴⁸

The Australian Law Reform Commission in its Interim Report 127 *Traditional Rights and Freedoms — Encroachments by Commonwealth Law* commented as follows in respect of the proposed changes to transfer pricing laws as a consequence of this case:

In introducing the legislation, it was explained that this would 'ensure the Parliament's view as to the way in which treaty transfer pricing rules operate is effective, that the Australian revenue is not compromised, and that International consistency is maintained with our tax treaty partners'.⁴⁹

Further, the Explanatory Memorandum stated:

There are strong arguments ... for concluding that under the current income tax law, treaty transfer pricing rules apply alternatively to Division 13. If this is the case, these amendments constitute a mere rewrite of those rules. To the extent that some deficiency exists in the current law, these amendments ensure the law can operate as the Parliament intended.⁵⁰

This analysis has been criticised. The Law Council, for example, submitted to the Senate Economics Legislation Committee that the provisions of the Bill cannot be regarded as merely 'clarifying' the law:

To the contrary, the Bill introduces a new test for interpretation. This test requires taxpayers and the Court to read relevant provisions of the tax

⁴⁵ Ibid.

⁴⁶ [2011] FCAFC 74; 193 FCR 149 ('*SNF*').

⁴⁷ Above n 29, 7.

⁴⁸ Australian Law Reform Commission, above n 14.

⁴⁹ Ibid 9.71–9.74.

⁵⁰ Above n 29, 7.

treaties 'consistently' with OECD guidance, fundamentally changing the interpretation and application of the law.⁵¹

In a submission to this Australian Law Reform Commission inquiry, the Law Council argued that these retrospective laws were not justified for two reasons. First, it could not be said that the amendments merely restored a prior understanding of the law, as differing views and questions had been raised by the courts. Second, there was no evidence of avoidance behaviour.⁵² Again, there were no egregious circumstances existing to justify enactment of retrospective laws. The arguments advanced by the Law Council, as outlined above, formed the basis of one of the key issues raised in the *Chevron* case.

5. THE *CHEVRON* DECISION⁵³

This case involved the application of the transfer pricing provisions to some loans between Chevron Australian Holdings Pty Ltd (CAHPL) and Chevron Texaco Funding Corporation (CFC). The two entities were related by having a common parent — Chevron Corporation (CVX). Whilst the case is significant for many reasons, given its significance in the context of transfer pricing legislation both in Australia and internationally, and the OECD's current BEPS work, it was also the first case to consider the validity of the transfer pricing rules in sub-div 815-A of the *ITAA 1997* because of their retrospective nature. These rules operated concurrently with existing transfer pricing rules in div 13 of the *ITAA 1936*. From 1 July 2013, both div 13 and sub-div 815-A were replaced with sub-div 815-B of the *ITAA 1997*.

Amended assessments were issued on 20 May 2010 for each of the years ended 31 December 2003–07. These were made as a result of earlier determinations made against the taxpayer on the basis of s 136AD of the *ITAA 1936*. On 24 October 2012 the Commissioner made determinations under s 815-30 of the *ITAA 1997* for the years ended 31 December 2005–07 (ie the 2006–08 tax years). On 26 October 2012 amended assessments were issued for those years. The determinations were based on sub-div 815-30.

One of the grounds of the taxpayer's appeal was that the retrospective nature of sub-div 815-A made it invalid. In addition to other claims, the taxpayer claimed that

the provisions applied to taxpayers over a period during which the criteria for liability were neither specified nor ascertainable, in view of both the terms of the provisions and the reasoning in decisions of the Federal Court to the effect that relevant double taxation treaties did not by themselves confer a power of taxation ...⁵⁴

Further, the taxpayer submitted that sub-div 815-A was retroactive and, as applied by s 815-1 of the *Income Tax (Transitional Provisions) Act 1997* to the income years commencing on or after 1 July 2004, ss 815-10–815-30 of the *ITAA 1997* were invalid because they imposed an arbitrary exaction and therefore did not answer the

⁵¹ Law Council of Australia, Submission to Senate Economics Legislation Committee, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012, 2.

⁵² Australian Law Reform Commission, above n 14.

⁵³ *Chevron* [2015] FCA 1092.

⁵⁴ *Ibid* [531].

description of a law with respect to taxation for the purposes of s 51(ii) of the *Constitution*. Chevron's primary submission was that the arbitrariness of the exaction imposed by the retroactive operation of sub-div 815-A flowed from the absence of ascertainable criteria with sufficiently general application as to whether an entity had received a transfer pricing benefit. Alternatively, Chevron submitted, an unduly retrospective exaction could, in the circumstances of its imposition, be arbitrary in character and thus beyond legislative power. Informing its arbitrariness was the inability of a taxpayer to comply with its criteria because they remained unknown during the course of ordinary commercial discourse: they could not be pointed to at the time when the events, which subsequently gave rise to purported liability, were entered into. Nor could they be identified when a tax return was prepared by a taxpayer. Subdivision 815-A was unduly retrospective and thus arbitrary.⁵⁵

One of the Commissioner's responses was that 'a law was not retrospective ... merely because it attached new consequences to past events'.⁵⁶ The Commissioner at paragraph 552 argued that Chevron's argument proceeded from a misapprehension of the relationship between taxing Acts and assessment Acts. The amount payable by force of s 4-10 of the *ITAA 1997* for each tax year was assessed by the Commissioner, subject to appeal or review, under relevant provisions of the *ITAA 1936* which defined 'this Act' to include, amongst others, the *ITAA 1997*: see s 6(1) of the *ITAA 1936*. The insertion of a new taxing provision into the *ITAA 1997*, expressed to apply in respect of a particular tax year, changed the amount of income tax payable under s 4-10 for that year and income tax in that amount was imposed by the *Income Tax Act 1936* (Cth). That Act operated in an ambulatory fashion but it did not impose tax for a particular year only during the course of that year and in accordance with the assessment Acts as they stood during that year. There was no need, in the case of a new taxing provision applicable to past tax years, for an additional provision retrospectively incorporating the assessment Act as amended into the *Income Tax Act*. Any additional liability created by the insertion of a new taxing provision became 'due and payable' in accordance with the former s 204 of the *ITAA 1936* and s 5-5(7) of the *ITAA 1997*.⁵⁷

The Court found for the Commissioner. For the purposes of the subject at hand, Robertson J dismissed Chevron's position that the retrospective transfer pricing rules in sub-div 815-A (introduced in 2012) are not constitutionally valid, although it was held that art 9 of the *Double Taxation Agreement* between Australia and the USA does not provide a separate taxing right independently from the domestic transfer pricing rules. Specifically, Robertson J opined:

In my opinion, the contentions on behalf of the applicant in this respect misconceived the nature of the amendments made by s 815-1 of the *Income Tax (Transitional Provisions) Act*. The provision had the effect, according to its terms, that Subdiv 815-A of the *ITAA 1997* applied to income years starting on or after 1 July 2004. I accept the respondent's submission that the *Income Tax Act* did not impose tax only for the particular year in which it was enacted and did not impose tax limited to the form of the Assessment Act as it stood at the time the *Income Tax Act* was enacted. Section 7 of the *Income Tax Act* provided that the tax imposed by s 5(1) 'is levied, and shall

⁵⁵ Ibid [529].

⁵⁶ Ibid [537].

⁵⁷ Ibid [552].

be paid, for the financial year commencing on 1 July 1986 and for all subsequent financial years until the Parliament otherwise provides'.⁵⁸

From this, it appears quite clear that the ability of Parliament to legislate retrospectively in matters of taxation was confirmed by the Court. The general principle against retrospectivity advanced by *Chevron*, namely, the inability of a taxpayer to comply with a law that did not exist at the time of a particular transaction, was dismissed by the Court. It appears that, maybe, as Senator Chipp feared, the end of protecting the revenue does justify the means of the enacting of retrospective laws, irrespective of the actual purpose of those laws.

6. HOW TO AVOID OR LIMIT THE NEED FOR RETROSPECTIVE LEGISLATION

In light of the discussion in the previous sections of our paper, this section will consider action that could be taken by government to:

1. reduce the need for retrospective legislation; and
2. explain why retrospective legislation is necessary in some circumstances.

Good interaction between the ATO and practitioners will go a long way to ensuring that legislation is better drafted to prevent deficiencies in legislation arising in the first place, so as to avoid the reliance, so to speak, on retrospective action by governments. It is incumbent upon the ATO and Treasury to engage with the public in explaining the above public interest test and to work with practitioners before legislation is provided in draft form for comment and during the public consultation period.

The government and the ATO also need to explain more clearly when retrospective legislation is justified. The recent reaction to the proposed changes to non-concessional superannuation contributions announced in the 2016–17 Federal Budget, offers a useful contemporary case study. While the proposed changes were not overtly retrospective, they appeared to have a retrospective element with regard to non-concessional contributions.⁵⁹ Was this approach necessary in the circumstances? In other words, was the law on these contributions, as it stood, posing a serious threat to the revenue? The view of the Treasury was that the changes would only adversely affect around 1 per cent of fund members.⁶⁰ Further, a Tax Institute submission on the proposed changes noted that a similar outcome could have been achieved without the implied retrospective nature of the changes.⁶¹ These considerations suggest that the retrospective approach was not justified in the circumstances, and, in fact, will no longer be introduced into law.

The government and the ATO must show the public generally that both tax avoidance and evasion are in fact stealing from the public. Such practices go beyond the realm of intelligent tax planning, but it disadvantages the public at large, thus eroding public confidence in the taxation system. It also encourages smaller taxpayers to take measures to avoid or reduce their tax liabilities. Currently about 95 per cent of

⁵⁸ Ibid [553].

⁵⁹ Commonwealth of Australia, *Budget 2016–17* <http://budget.gov.au/2016-17/content/glossies/tax_super/html/>.

⁶⁰ Commonwealth of Australia, *The Treasury* <<https://treasury.gov.au/superannuation-reforms/#lifetime>>.

⁶¹ Tax Institute, 2016–17 Federal Budget Submission.

taxpayers pay their tax voluntarily. Significant actions by large or sophisticated taxpayers to reduce their tax payable with 'artificial' measures or misuse of existing law will eventually see a reduction in this level of voluntary payment.

Perhaps more importantly, the issue of retrospectivity should be specifically addressed during the legislative process itself, from policy consideration and approval through to the drafting stage. Presently, the *Legislation Handbook* (the Handbook), published by the Department of the Prime Minister and Cabinet,⁶² provides guidance on the requirements of the legislation process. With regard to retrospective legislation, paragraphs 5.19 and 5.20 of the Handbook provide, relevantly:

5.19 Provisions that have a retrospective operation adversely affecting rights or imposing liabilities are to be included only in exceptional circumstances and on explicit policy authority (see paragraphs 3.7(i) and 3.19(b) and also paragraphs 3.26 to 3.29 concerning announcement of legislation to operate from the date of announcement).

5.20 Departments need to be aware that the Senate Standing Committee for the Scrutiny of Bills and the Parliamentary Joint Committee on Human Rights, which scrutinise all bills, expect that an explanation and justification for any retrospective provisions will be included in the explanatory memorandum and statement of compatibility with human rights (see paragraphs 7.20 and 7.29(c) to 7.29(d)).

Paragraphs 3.7 and 3.19 provide, in summary, that a justification for retrospective legislation must be included in any policy approval as well as an explanation of any adverse impact.

Paragraph 7.29(c) states that an explanatory memorandum '*must set out whether, and why, retrospective application of the Act would adversely affect any person other than the Commonwealth and, if applicable, include an assurance that no person would be disadvantaged by the retrospective application of the Act*' (emphasis added).

Whilst the government may still enact retrospective legislation, the only 'safeguard' here, as it were, is that the proposed legislation does not adversely affect any person and no person must be disadvantaged by it. This appears to be a quite broad, almost ambiguous, statement. The Handbook does not specifically prescribe that any retrospective legislative proposal must demonstrate that it is in the public interest, and, as far as taxation legislation is concerned, whether the proposal is designed to counter a real and serious threat to the revenue, the nature of that threat, and therefore a justification for retrospective action in the circumstances. If, as Lon Fuller suggests, a genuine law is one that operates prospectively, an 'explanation and justification for any retrospective provisions'⁶³ should include a 'statement of compatibility with the public interest' (similar to the 'statement of compatibility with human rights'⁶⁴), outlining that, in the circumstances, the retrospective approach is warranted, given the threat to the revenue and the ineffectiveness of the legislation presently in force to combat the threat. Such a requirement may render more credible and transparent any claims of the necessity of retrospective action on the part of the government of the day.

⁶² Commonwealth of Australia, *Department of the Prime Minister and Cabinet* (February 2017) <<https://www.dpmc.gov.au/resource-centre/government/legislation-handbook>>.

⁶³ Ibid.

⁶⁴ Ibid.

7. CONCLUSION

Having started with the premise in 1789 that laws should not be retrospective as it does not allow taxpayers to fully appreciate the implications of their actions, the decision in *Chevron* relating to the retrospective nature of the transfer pricing legislation appears to have finally put to rest this premise. In fact the previously long held view, as enunciated in cases such as *Commissioner of Stamps (Qld) v Weinholt*⁶⁵ and *Perpetual Trustees (Australia) Ltd v Valuer-General*⁶⁶ that taxpayers will have organised their affairs to comply with existing legislation no longer appears to hold sway. Indeed, retrospective legislation now seems to be 'a fact of life'. This should cause practitioners great concern particularly at a time when the government is proposing new legislation concerning transparency and international transactions, not to mention the proposed changes to superannuation contributions announced in the 2016–17 Federal Budget, which appear to have a retrospective element with regard to non-concessional contributions.⁶⁷

Practitioners should not accept retrospective legislation as a 'fact of life', and must resist this trend — we should insist on governments responding with alacrity and effectively to perceived deficiencies in legislation. Retrospective legislation should only be countenanced in the most egregious circumstances in order to truly protect the revenue in the public interest, rather than simply to render past events no longer legitimate, which is now the trend in this area. This could be addressed via amendments to the Handbook, wherein it should be prescribed that any retrospective legislative proposal (and ensuing explanatory memorandum) must demonstrate that it is in the public interest, and, as far as taxation legislation is concerned, whether the proposed legislation is designed to counter a real and serious threat to the revenue, the nature of that threat, and therefore a justification for retrospective action in the circumstances, rather than an assurance that the proposed legislation does not adversely affect any person. Such an approach would enhance the transparency of the process.

The question now is, how do we provide advice to our clients, secure in the knowledge that we have adhered to the law as it exists at the time they enter into transactions when we don't have a functioning 'crystal ball' to tell the client that the advice we provide currently may be illegal or even criminal, in the future? If this is the case, not only should clients be concerned but also practitioners, in that they may face the Pandora's Box governments have opened and will have to explain and defend this new view to their law-breaking or indeed criminal clients.

⁶⁵ (1915) 20 CLR 531.

⁶⁶ (1999) 102 LGERA 324.

⁶⁷ Commonwealth of Australia, 'Budget 2016–17', above n 59.