Costs orders against the Commissioner of Taxation

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Abstract: The decision of the Full Court of the Federal Court in *Clark's* case in November 2011 concerned the ability of taxpayers to obtain a costs order, including an indemnity costs order, against the Commissioner of Taxation. This article examines the decision in the context of relevant court rules and existing case law. The court confirmed that the Commissioner is subject to the same rights and obligations that any other participant in commercial litigation. As a result, offers of compromise need to be properly considered by the Commissioner. It is not enough for the Commissioner to claim that a costs order should not be awarded against him on the basis that he was complying with his own policies or procedures, or that indemnity costs should not be ordered against the Commissioner on the basis that he has duties of administration of the taxation regime, and an obligation to pursue questions that have a wider legal significance.

Introduction

On 10 November 2011, the Full Federal Court (the court), comprising of Dowsett, Edmonds and Gordon JJ, handed down its decision in *FCT v Clark (No 2)* (*Clark's* case).[1] The decision concerned the ability of taxpayers to obtain a costs order, including an indemnity costs order, against the Commissioner of Taxation (the Commissioner). The proceedings resulted from a successful challenge by the taxpayers of amended assessments issued by the Commissioner in the Federal Court.

Prior to the resolution of the substantive proceedings, the taxpayers made a number of offers of compromise, both pursuant to the Federal Court Rules (the Rules) and pursuant to the principles established in *Calderbank v Calderbank* (*Calderbank*).[2]

The decision stands for the proposition that considerations such as:

- the Commissioner's duties of administration of taxation legislation,
- his internal practices and procedures, and
- the necessity to litigate in circumstances that involves a matter of public importance,

do not protect the Commissioner against adverse costs orders. Further, once the Commissioner becomes a party to litigation, he is subject to legislation and court rules which relate to practice and procedure in the same way that any other litigant is.

Offers of compromise – the relevant principles

Clark's case concerned the application of O 23, r 11(6) of the Federal Court Rules (Cth) to the Commissioner. The rule provided that:

> "If
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> an offer is made by a respondent and not accepted by the applicant; and
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> the respondent obtains an order or judgement on the claim to which the offer relates as favourable to the respondent, or more favourable to the respondent, than the terms of the offer;
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> then, unless the Court otherwise orders:
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> the respondent is entitled to an order that the applicant pay the respondent's costs in respect of the claim incurred up to 11 am on the day after the day the offer was made, taxed on a party and party basis; and
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> the respondent is entitled to an order that the applicant pay the respondent's costs in respect of the claim incurred after that time, taxed on an indemnity basis."

That is, pursuant to O 23, r 11(6), if an offer of compromise is made by a respondent (in this case the taxpayers) and not accepted by the applicant (in this case the Commissioner), and the respondent obtains judgment on the claim to which the offer relates, which is as favourable as the terms of the offer, then (and unless the court otherwise orders):

- the respondent is entitled to an order against the applicant for the respondent's costs in respect of the claim from 11 am after the day that the offer was made — assessed on an indemnity basis; and
- the respondent is entitled to an order against the applicant before 11 am after the day that the offer was made — assessed on a party and party basis.

As the Federal Court Rules were re-written in 2011, the equivalent order is now contained in O 25.14 of the Federal Court Rules. Further, O 1.35 provides that the court may make an order which is inconsistent with any other rule.

The Commissioner submitted that the court should exercise its discretion to "otherwise order", so that the indemnity costs implications of O 23, r 11 (6). However, the Commissioner argued that, if he rejects an O 23 offer, the presumptive entitlement to indemnity costs under O 23 will be rebutted, and the court should otherwise order in the circumstance where:

- principles of administration of the Acts are in dispute; and
- the Commissioner exercises his general powers of administration in pursuing the resolution of the dispute, for the purposes of such administration.

That is, the Commissioner submitted that indemnity costs should not be awarded if the Commissioner is exercising his statutory powers, especially where the rejection of an offer of compromise is consistent with the proper exercise of the Commissioner's general powers of administration. Further, the Commissioner submitted that he could compromise debts in only limited

circumstances. Those circumstances are provided for in ch 27 of the ATO Receivables Policy (which, from 14 April 2011, is contained in PS LA 2011/3).

The intention behind the "offer of compromise" regime is to oblige a party that receives an offer of compromise to give serious thought to the inherent risks of litigation, including potential costs liability. Dal Pont[3] has explained the reasons behind the rules as follows:

- they encourage the saving of private costs and the avoidance of the inherent risks, delays and uncertainties of litigation by promoting early offers of compromise;
- they promote the saving of expenses incurred in litigation that prove to have been unnecessary, having regard to an early offer of compromise; and
- they give the offeror an indemnity against the costs that it has incurred in action as a result of the offeree having rejected an offer that, had it been accepted, would have been avoided.

General administration of Acts – the Commissioner's authority to compromise proceedings

Pursuant to s 3A of the *Taxation Administration Act 1953* (Cth), s 8 of the *Income Tax Assessment Act 1936* (Cth) and s 1-7 of the *Income Tax Assessment Act 1997* (Cth), the Commissioner has the general administration of those Acts. Spender J in *Precision Pools Pty Ltd v FCT* made the following observation about such a power:[4]

> "I reject the suggestion that there is no power in the Commissioner to agree to receive moneys on the basis that, if it were to be held subsequently that he had no right to be paid them, the Commissioner would repay them. By s 4 of the … [Sales Tax Assessment Act (No. 1)1930] … the Commissioner is given the general administration of that Act. That administration has to be bona fide and for the purposes of the Act, but it is a grant of a wide power and would encompass, for instance, the power to compromise proceedings, in which he was a party or to make agreements or arrangements concerning the efficient management of a dispute in which he was involved."

That is, the Commissioner's power with respect to the general administration of certain taxation legislation allows the Commissioner to compromise proceedings. Further, the court observed that, in discharging his duties, the Commissioner should do so in a transparent and consistent fashion.

Whether the proceedings involved questions of wide legal significance and in the public interest

The Commissioner argued that his obligation to pursue questions of wider legal significance, and in the public interest, meant that the taxpayer should not be awarded indemnity costs.

The court accepted that "… in an appropriate case, the public interest may be better served by having the Court decide a case which has wider ramifications, rather than settling it upon the basis of purely commercial considerations".[5] However, the court found that the Commissioner did not in fact conduct the litigation in the "broader public interest". Indeed, the court referred to the Commissioner's refusal to grant funding to the taxpayer on the basis that the outcome of the substantive litigation would "… not clarify a contentious area of taxation law…".[6] That is, for the same reason that the Commissioner refused the taxpayer's application for litigation funding, the court also rejected the Commissioner's argument against an award of indemnity costs.

Relevance of the Commissioner's practices and procedures

The court rejected the Commissioner's submission that, as the Commissioner had prescribed certain policies and procedures with respect to managing disputes and conducting litigation, the Commissioner had limited his power to compromise litigation — and that, as a result of the Commissioner acting in accordance with his policies and procedures, that was an answer to the taxpayer's application for costs on an indemnity basis.

Although the court considered that the Commissioner's adherence to his policies and procedures is a "relevant circumstance'' that needs to be considered, it was observed that it "… does not follow that the Commissioner may, simply by referring to such policies and procedures, escape the Court's scrutiny of his conduct of litigation, including in refusing to accept offers of settlement".[7] Rather, when the court's jurisdiction is engaged (subject to s 64 of the *Judiciary Act 1903* (Cth)), the Commissioner becomes a litigant and is subject to the relevant legislative regime and court rules.

While the court accepted that it may take into account the Commissioner's policies or procedures when considering the Commissioner's conduct when considering a costs order, the Commissioner had "… not identified any particular aspect of his policies and procedures as relevant for present purposes". Indeed, the court observed that the Commissioner had not given any "real explanation" as to why, according to the Commissioner's policies and procedures, it was inappropriate for the Commissioner to accept any of the taxpayer's offers of compromise.[8]

The court did accept that, in some cases, the public interest may be better served by seeing through litigation to judgment, rather than having a settlement occur on purely commercial grounds. However, the court found that, because the substantive case concerned substantial questions of fact which involved the credibility of witnesses, such considerations should have been taken into account by the Commissioner when considering the offers of compromise: [9]

> "We accept that the Commissioner was obliged to deal with the appeals transparently and in accordance with general practice. It does not follow that he was entitled to preserve in the prosecution of the appeals in the face of reasonable offers of settlement. The decision at first instance involved substantial questions of fact, the resolution of which involved the credibility of witnesses. In those circumstances the Commissioner faced substantial problems in any appeal. He should have taken those problems into account in the course of considering the Taxpayers' offers. There is no evidence he did so."

Whether the offers were "genuine" or "tactical"

The court rejected the Commissioner's submission that any offer to settle, for the purposes of the indemnity costs provisions as contained in the Federal Court Rules, must involve the offer of a substantial amount, having regard to the amounts of the assessment in question.

The court rejected the approach taken in *Sagacious Legal Pty Ltd v Wesfarmers General Insurance Ltd* (*Sagacious*),[10] which considered that, in some circumstances, an offer may be characterised as "… in substance a tactical offer aimed to put pressure on the appellant without offering any true compromise …", and that such offers should not be treated as an offer for

the purposes of the compromise provisions in the relevant court rules or pursuant to the principles in *Calderbank*. In rejecting the approach taken in *Sagacious*, the court observed that:[11]

> "We have difficulty in seeing the validity of … [the approach taken in Sagacious] … By definition, the question only arises where an offer turns out to be more favourable to the offeree than is the eventual litigated outcome. Courts expect that parties will make a realistic assessment of their prospects and act accordingly. Any offer should be based upon such an assessment and assessed by the offeree on the same basis. If one party makes an assessment which turns out to be accurate, that party should generally have the benefit of O 23, unless some factor points to a contrary outcome. Although in the case of a Calderbank offer, the focus may be slightly different, that difference will generally be more apparent than real."

The court did not see the basis for distinguishing between "tactical" and "real" offers. Provided the relevant court rule was satisfied, the taxpayers were not obliged to establish either that:

- the taxpayer's offers were reasonable; or
- the Commissioner ought to have accepted any of the offers.

"Unlike most other forms of litigation, tax litigation may be viewed as even more of a 'high-risk' proposition …"

The court inferred that it was unreasonable for the Commissioner to reject the taxpayer's offers of compromise because the result of the ultimate appeals was less favourable to the Commissioner than any of the offers. Indeed, the court had difficulty in accepting the proposition that an offer may be "tactical".[11]

Application of the Calderbank principle

The court observed that, pursuant to the *Calderbank* principle, when considering the award of costs with respect to a proceeding, a court may take into account an offer to compromise, notwithstanding that the offer is not made in accordance with a specific statutory provision or rule. The court accepted that, as a result of the application of s 67 of the *Judiciary Act 1903* (Cth), the *Calderbank* principle applies to the Commissioner as a litigant.

Comment

The court in *Clark's* case confirmed that, as a result of the application of s 64 of the Judiciary Act, the Commissioner is subject to the same rights and obligations that any other participant in a commercial litigation environment is subject to. As a result, offers of compromise — both in the context of *Calderbank* offers and those made pursuant to Rules of Court — need to be properly considered by the Commissioner. It is not enough for the Commissioner to claim that a costs order should not be awarded against him on the basis that he was complying with his own policies or procedures.

The court rejected the argument that indemnity costs should not be ordered against the Commissioner on the basis that the Commissioner has duties of administration of the taxation regime, rules of practice and procedure dealing with pursuing litigation and compromising claims, and an obligation to pursue questions that have a wider legal significance.

Unlike most other forms of litigation, taxation litigation may be viewed as even more of a "high-risk" proposition, given its "all or nothing" nature. For example, there is no scope for proportionate liability, and discretionary factors rarely come into play in the application of taxing provisions to a given factual scenario. Except for taxation disputes which concern questions of valuation and those that relate to penalties, quantum typically follows the dispute.

Given the Commissioner's approach to settlements — that they should be determined on a principle basis and not necessarily on a commercial basis — the court's approach in *Clark's* case places the Commissioner in a difficult position. Indeed, the court confirmed that the Commissioner cannot simply argue that his practices and procedures limit the availability of a costs order against him.

While taxpayers may not be able to settle a dispute by "cutting a cheque", in the event that a dispute is conducted in a "cost" jurisdiction (ie a court as opposed to the Administrative Appeals Tribunal), regard should be given by taxpayers (and their representatives) of making an offer of compromise so as to preserve the taxpayers' rights with respect to costs in the event that a favourable result is achieved.

Given that the forum of taxation appeals (after the objection stage) is the choice of the taxpayer (and not the Commissioner) pursuant to Pt IVC of the *Taxation Administration Act 1953* (Cth), an issue that needs to be considered is the availability of a costs order in the event that the challenge to a decision of the Commissioner is maintained. Indeed, while the Administrative Appeals Tribunal may offer a cheaper and less formal dispute resolution forum, the inability to obtain a costs order in a taxpayer's favour in the tribunal (as opposed to proceedings in the Federal Court) may be an important factor for a taxpayer when considering the appropriate choice of forum.

A further issue that taxpayers should consider (if they choose to challenge an assessment in the Federal Court, where a costs order may be obtained) is whether they should apply to the Commissioner for litigation funding. If such an application is rejected, then, given the decision in *Clarke*, one may query whether the continuation of litigation by the Commissioner is in the "broader public interest" — with the result that the offer of compromise provisions may be more easily engaged.

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References

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5 *Clark* at [28].
6 *Clark* at [24].
7 *Clark* at [28].
8 *Clark* at [30].
9 *Clark* at [29].
10 [2011] FCAFC 53.
11 *Clark* at [31].