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A chilling account: North American and Australasian approaches to fears of over-defensive responses to taxpayer claims against tax officials

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Abstract

Judges frequently deny relief to taxpayers in claims against tax officials because of concerns about the possible adverse motivational effects on tax officials of imposing liability. In particular, there is a concern that the fear of being sued will

1. INTRODUCTION

Taxpayer claims against tax officials for harm caused by tax administration activities give rise to a number of complex public policy concerns which judges need to consider. One of the policy concerns most commonly raised to deny taxpayer recovery is the 'chill-factor' effect.[2] The nub of the chill-factor effect argument is that imposing legal liabilities on tax officials may result in a range of over-defensive responses. For example, in the face of increased risk of liability for incorrect advice provided to taxpayers, a revenue authority may cease providing taxpayers with even the most

chill-factor policy concerns in taxpayer claims against tax officials in the United States, Canada, Australia and New Zealand. Part 4 draws on these contrasting approaches and, mindful of the controversies and complexities discussed in Part 2, proposes a number of specific guidelines to assist policy-makers and judges to deal with chill-factor effect concerns in tax cases in a predictable and principled manner.

2. CHILL-FACTOR CONTROVERSIES AND COMPLEXITIES

The chill-factor effect, as with most public policy concerns, raises a number of complexities and controversies. These include fundamental questions about whether chilling effects are a real and observable phenomenon, and if they are, whether those effects should be feared. Debate also surrounds the appropriate weighing up of chill-factor concerns against any countervailing positive policy effects of imposing liability to taxpayers on tax officials. There are also questions about whether tax officials, in particular, respond in over-defensive ways to adverse judicial determinations and the form any such over-defensiveness might take. Judges need to be mindful of such issues in dealing with chill-factor concerns in tax cases. Hence, each of these complexities and controversies is elaborated below:

2.1 Is the chill-factor a real and observable phenomenon?

Some commentators question whether, despite its inherent logical appeal, the chill-factor effect is a real and observable phenomenon. This scepticism is fuelled by the limited number of empirical studies into the issue and the lack of uniformity in the results of those studies.[7] For example, a United States study by Cordes and Weisbrod into the allocational impact of the imposition of liability on highway authorities found evidence of a 'chill-factor' phenomenon.[8] In contrast, a study by O'Leary into the effect of judicial determinations on activities of the United States Environmental Protection Agency was less conclusive, finding both negative and positive motivational effects.[9] A number of additional United States studies have reached similarly qualified conclusions.[10] The Australasian empirical work is also equivocal. A 2004 Australian study by McMillan and Creyke into the effects of adverse judicial

[7] These facts are lamented by the UK Law Commission in their recent consultation paper on administrative redress for citizens from public bodies. (The Law Commission, United Kingdom, *Administrative Redress: Public Bodies and the Citizen*, Consultation Paper No 187 (2008)). Similar comments were made by the Committee in their earlier report—See The Law Commission, Public Law Team, United Kingdom, *Monetary Remedies in Public Law: A Discussion Paper* (2004), [7.10]–[7.11].

[8] See Joseph Cordes and Burton Weisbrod, 'Government Behaviour in Response to Compensation Requirements' (1979) 11 *Journal of Public Economics* 47.

[9] See Rosemary O'Leary, 'The Impact of Federal Court Decisions on the Policies and Administration of the US Environmental Protection Agency' (1989) 41 *Administrative Law Review* 549.

[10] Other United States studies with similarly qualified conclusions as to whether impact of judicial decisions on public bodies will be positive or negative include: Charles Johnson, 'Judicial Decisions and Organisational Changes: Some Theoretical and Empirical Notes on State Court Decisions and State Administrative Agencies' (1979) 14 *Law and Society Review* 27; and Bradley Canon, 'Studying Bureaucratic Implementation of Judicial Policies in the United States: Conceptual and Methodological Approaches' in Mark Hertogh and Simon Halliday (eds), *Judicial Review and Bureaucratic Impact: International and Interdisciplinary Perspectives* (2004).

review determinations on

the long-run, improvements in administrative decision-making resulting from imposing liability on public authorities outweigh any chilling effects.[16]

2.2 Weighing chill-factor concerns against countervailing policy effects

None of the preceding empirical work or academic commentary examines chill-factor concerns in a tax context. However, tax cases raise their own complexities. For example, where the chill-factor issue is raised in tax cases, judges need to weigh the possible adverse motivational effects of imposing liability on tax officials against possible countervailing positive motivational effects on taxpayers. These effects might offset any observable short-run chill-factor effects and lead to long-run overall improvements in tax administration through fostering voluntary compliance behaviour.

Unfortunately, though, just as there are no tax-specific studies into potential chilling effects on tax officials, there have also been no empirical studies of any possible positive motivational effects of taxpayer success in claims against tax officials. The most closely applicable studies are those

or, alternatively, increase compliance through a greater sense of public confidence in the fairness of procedures".[19]

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threat is of personal liability or liability at an organisational level,[26] the official's level of knowledge and understanding of the ramifications of adverse judicial outcomes, and the degree of legal certainty about the limits of potential liability of tax officials. It is easy to conceive of many more similar considerations which might be material to ascertaining the extent and likelihood of any over-defensive tax official response in any particular case.

There is also the broader philosophical question of whether protecting the Revenue requires taking *extra* care to avoid setting precedents which might generate over-defensive tax official responses. The question arises because any challenge to the activities of a revenue authority indirectly creates vulnerabilities in the funding of the other functions of State and important social initiatives of government. Accordingly, it could be argued that, in the taxation context, judges need to consider not only the direct ramifications of imposing liability on tax officials, but also potential flow-on effects on any of a range of other government activities and initiatives. As Cohen has noted, "[t]he cost may be borne by another department, a bureaucracy independent from the one whose actions are most directly associated with the injury".[27]

Of course, taken to its logical conclusion, such an argument could be used to resist imposing liability on tax officials in any circumstances. And no one seriously advocates endowing tax officials with absolute immunity from liability for all of their wrongs due to chill-factor concerns.[28] A line must, therefore, be drawn. The following Part discloses where that line has been drawn by United States, Canadian, Australian and New Zealand judges.

3. NORTH AMERICAN AND AUSTRALASIAN JUDICIAL APPROACHES TO CHILL-FACTOR CONCERNS

Despite the controversies and complexities surrounding the chill-factor effect outlined in the preceding Part, judges are frequently called upon to adjudicate arguments about potential chill-factor effects of imposing liability on tax officials. This Part examines the contrasting judicial approaches adopted in United States, Canada, Australia and New Zealand.

3.1 United States judicial approaches to chill-factor concerns

The chill-factor effect and the possible adverse effects of it were first judicially noted in the United States in 1788 in *Respublica v Sparhawk*,[29] a case which is widely

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sue that officer personally for damages, even where there is no statutory avenue of relief.[38]

However, courts have struggled with potential chill-factor effects of allowing such claims to proceed against IRS officers.[39] For example, in *Vennes v An Unknown Number of Unidentified Agents of the United States*[40] the majority, referring to the risks of extending the availability of *Bivens* relief to taxpayers, observed:

> Expanding *Bivens* in this fashion would have a chilling effect on law enforcement officers and would flood the federal courts with constitutional damage claims by the many criminal defendants who leave the criminal process convinced that they have been prosecuted and convicted unfairly.[41]

There was a similar result in *National Commodity and Barter Association, National Commodity Exchange v Gibbs*[42] (*Gibbs*). However, in *Gibbs*, the door was left open for a potential *Bivens* action in the tax context with the Court pointing out the need for competing public policy interests to be weighed up in determining whether to allow taxpayer relief:

> … while the comprehensive scheme of the Internal Revenue Code should not be indiscriminately disrupted by the creation of new remedies, certain values, such as those protected by the first and fourth amendments, may be superior to the need to protect the integrity of the internal revenue system.[43]

Premium. Roleau J referred to a number of policy reasons in rejecting the plaintiff's claim including chill-factor concerns:

> Imposing a duty of care in circumstances such as exist in the present case would have a chilling effect ... Once elected, members would be concerned about the representations they made during their election campaigns and would not consider themselves at liberty to act and vote in the public interest on each bill as it came before the legislature. In my view, therefore, it would be unwise to impose a duty of care in such circumstances.[54]

> communications which are a valuable source of wisdom and experience for a person contemplating a course of conduct.[61]

Unfortunately, His Honour did not elaborate on this chill-factor argument. However, Brennan J did elaborate in *Northern Territory v Mengel*[62], confirming that chilling-effect concerns should be afforded less weight in cases where malicious or deliberate intent of a public official is alleged. In situations where liability for public official behaviour falling short of malice (and more akin to negligent behaviour) is sought to be impugned, chill-factor concerns should be given greater consideration.[63] This approach parallels the Canadian approach of Lamer J in *Nelles v Ontario*[64] and in the recent spate of negligence cases against CRA discussed above. However, Australian judges have generally been far less considered in their treatment of chill-factor concerns than their Canadian or United States counterparts.

For example, in the tax context, the Australian High Court directly, but briefly, discussed the issue in *Pape v Federal Commissioner of Taxation*[65] (*Pape*). In that case, the Australian Commissioner of Taxation argued that the taxpayer's argument in seeking to place constitutional limits on the power of appropriation contained in the Australian Constitution 'would cause Parliament constantly to be "looking over its

Again, as in *Pape*, there was no judicial discussion of the merits of any chill-factor concerns. This lack of judicial analysis characterises the Australasian approach to dealing with chill-factor concerns. Troublingly, it has been judicially conceded in Australia that policy concerns such as chill-factor concerns have 'intruded' in some tax cases, heightening the need for guidelines for dealing with such issues in a consistent and principled manner.[71] This is the challenge taken up in Part 4 below.

4. GUIDELINES FOR DEALING WITH CHILL-FACTOR CONCERNS

Conversely, in cases where negligent or innocent mistakes have been made causing taxpayer harm the potential chilling effects of imposing liability should be afforded greater consideration. There is a common thread among the judicial comments in each of the jurisdictions examined to this effect. In particular, we have seen that chilling-effect concerns feature prominently in negligence cases against tax officials in Australasia and Canada.[74]

In summary, therefore, significant evidentiary weight should be afforded to chill-factor fears in those cases where: (1) liability on individual officers is proposed; *and* (2) where that liability is for lower standards of misbehaviour, such as negligent or other unintentional mistakes. This approach would bring together current threads of judicial reasoning evident across the jurisdictions examined. It also would compel judges to expressly recognise that, give

where tax officials can legitimately fear the potential for frequent and indeterminate liability.[78] As Pietruszkiewicz, referring to current uncertainty surrounding the ability of taxpayers to recover damages from tax officials in the United States, has observed:

States the distinction is contained in s421 of the *Federal Tort claims Act of 1948*,[84] legislation which aims to delineate the limits of immunity from suit in tort of Federal officials in that country.[85] A similar distinction has been used in Australia, Canada and New Zealand as an appropriate guide for determining when a public authority owes a tortious duty of care.[86]

Second, the distinction is broad enough to encapsulate distinctions which, as noted in Part 3, have already been recognised in jurisdictions such as the United States and Canada between prosecutorial and judicial functions – which are characteristically discretionary – and other administrative functions.[87] Finally, and perhaps most pertinently, the distinction has been described as specifically aimed at limiting potential chill-factor effects of imposing liability on the State by permitting 'suits for ordinary torts while not chilling government activities...'[88]

4.4 Chill-factor and countervailing policy effects

Potential chill-factor effects should be weighed up against possible countervailing positive effects on tax administration activities of imposing liability on tax officials. As noted in Part 2 of this article the existence and extent of any chilling effect from imposing liability on public officials is far from clear and universally accepted. Hence sound legal analysis demands that judges considering what weight to afford to chill-factor concerns should engage in this weighing-up process.

The preceding three guidelines are essentially examples of this type of weighing-up process. A prime example is the need to weigh possible over-defensive effects against the prospect of providing immunity from suit to tax officials who have acted with dishonesty or malice toward a particular taxpayer. In those circumstances, the likely adverse consequences for taxpayer morale and trust and confidence in tax administrators of leaving the harm caused by such behaviour un-remedied is likely to outweigh any possible wider over-defensive effects of imposing liability on the offending official.

However, a specific guideline is required to emphasise that judges should always engage in some consideration of countervailing possible positive consequences of

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The present situation is aided by terms which have a considerable history of application. They have been used, with varying degrees of consciousness...' Reynolds, above n 13, 129.

[84] *Federal Tort Claims Act of 1948y A5(imm)ousness u'g20any*

> from policy, to the case in hand, is, in my view, to invite uncertainty and judicial diversity. [89]

The proposed guidelines also encourage a more detailed and nuanced approach to dealing with chill-factor concerns. Over time, a body of judicial commentary will develop to aid all tax administration stakeholders in understanding their rights and responsibilities. They may also serve as a primer for future empirical testing of the validity of various chill-factor fears and to assist tax administrators and policy makers in foreseeing possible over-defensive behaviour and minimising the harm of such behaviour.

[89] Stephen J in *Caltex Oil (Australia) Pty Ltd v The Dredge "Willemstad"* (1976) 136 CLR 529, 567.