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Chief Adviser
Law Design Practice
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The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

Submission on exposure draft legislation on income tax general anti-avoidance regime

BP Australia Pty Ltd (**BP**) welcomes the opportunity to make this submission on the exposure draft legislation and accompanying explanatory materials[1] concerning proposed amendments to the general anti-avoidance regime (**GAAR**) in the income tax legislation[2].

Before turning to specific aspects of the exposure draft legislation, our view, as outlined in our letter of 23 February 2011, is that no substantive change is required to the GAAR. Substantive change of the kind proposed will invite uncertainty and disturb the benefit of 30 years of consideration of the operation of the GAAR by taxpayers, the ATO and the Courts. This is not justified in the absence of identifying a "tax gap" from aggressive tax planning under the current law.

In fact, we submit the high level of voluntary compliance by large business and the steps taken in recent years to develop cooperative practices and real time engagement with the ATO mean substantive change to the GAAR is unwarranted. Evidence to support high levels of voluntary compliance by large business is the very low number of taxpayers in the Commissioner's Quadrant 1 Risk Differentiation Framework compared to the overwhelming numbers in the key or lower risk quadrants.

We believe any perceived "tax gap" from tax planning would be better addressed by gathering empirical evidence to develop principled, long-term reforms of the tax system. That is, the failure of the tax system to generate sufficient revenue is not in substance driven by taxpayer behaviour but the tax system framework itself. The proposed Tax Studies Institute[3] would be ideally placed to do this work.

We are concerned that the current proposals are an over-reaction to recent Court cases that the Commissioner has lost and would cause major uncertainty to business and complicate corporate governance processes on legitimate well thought through transactions. Moreover, we believe substantive changes of the nature proposed will increase the complexity and tax risk associated

[1] Released on 16 November 2012 as part of the Assistant Treasurer's press release number 143.
[2] Contained in Part IVA of the Income Tax Assessment Act 1936.
[3] Referred to most recently in the "Asian Century" White paper. As indicated in our letter to the Treasurer of 19 November 2012, BP is a strong supporter of establishing such a body.

with doing business in Australia and will not drive continuous improvement in administration of the law.

Legitimate tax planning does not fall within the ambit of the GAAR

Critically, if any changes are made to the GAAR, it is imperative that amendments respect the fact that legitimate tax planning does not fall within the ambit of the GAAR. We submit that the proposed amendments must be very clear on this point, that the GAAR does not extend to legitimate tax planning in the ordinary course of business.

To elaborate on this point we note the recommendations made by Graham Aaronson QC in his study to consider whether a general anti-avoidance rule should be introduced into the UK tax system (a copy of his report is attached. John Bartlett, BP's Group Head of Tax, was the only business representative on the Advisory Committee to the study). Whilst the study group were conscious of the need not to discourage multinationals investing in the UK at a time of economic uncertainty, which perhaps isn't the same concern in Australia although our economic position appears to be changing, he concluded that introducing a broad spectrum general anti avoidance rule would **not** be beneficial for the UK tax system because it would carry the real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning.

"Such tax planning is an entirely appropriate response to the complexities of a tax system such as the UK's".

The study group also concluded that a broad spectrum rule would have to be accompanied by a comprehensive system of obtaining advance clearance which would impose very substantial resource burdens on taxpayers and HMRC. We submit the current draft proposals to amend the GAAR in Australia would do just that - stalling legitimate business, increasing costs and creating unnecessary uncertainty for taxpayers and the ATO.

Further, we believe the current proposals in Australia would be a missed opportunity if the explanatory materials accompanying the proposed changes did not provide clear guidance, by way of 'real world' examples, on the dividing line between legitimate tax planning and transactions that fall within the ambit of the GAAR. We submit it is in the best interests of all Australians for there to be clarity on where that line is and how it will be administered. The current drafting does not achieve this. In fact, the current drafting would throw up considerable corporate governance challenges as Boards would be required to understand tax risks associated with transaction proposals against hypothetical transactions that might never have been contemplated.

Substantive changes proposed

The main substantive change proposed to the GAAR is the inclusion of a new provision, section 177CB. That new provision is intended to enable one to determine what would have happened in the absence of the actual transaction and therefore to determine the offending "tax benefit" obtained by the taxpayer. We submit that the drafting of the proposed section is unclear and requires further work and consultation.

First, the drafting goes beyond what was contemplated by the Assistant Treasurer's press release of 1 March 2012. The intention was to prevent an argument that taxpayers "did not get a 'tax benefit' because, without the scheme, they would not have entered into an arrangement that attracted tax," "For example, they could have entered into another scheme that also avoided tax, deferred their arrangements indefinitely or done nothing at all". Accordingly, we submit all that is required in respect of an amendment to the definition of tax benefit is to essentially replicate the Assistant Treasurer's words into the legislation rather than the extensive changes proposed. An amendment to the definition of tax benefit in section 177C could require one to determine the amount by reference to an assumption that the taxpayer would **not** have done nothing at all, or deferred their arrangements, or entered into a transaction that did not attract tax. Such an amendment would not destroy the body of understanding that exists on how Part IVA ought to apply and would be a step forward in continuously improving the existing legislation rather than a revolutionary change.

Second, as mentioned, the current proposed drafting[4] is too complex to provide certainty. Specifically, how one constructs transaction/s that would have happened with the same "non-tax effects" to that of the offending transaction is unclear. For example, what occurs if all of the "non-tax effects" are not able to be achieved by an alternative? Are minor non-tax effects to be ignored in constructing such a transaction? In practice, how are the "eight factors"[5] intended to work on a hypothetical transaction that has not occurred? Would an alternate transaction also motivated by tax be allowed as an alternative postulate?[6] To borrow from transfer pricing concepts, it is difficult to discern what the "comparable" transaction would be in many cases. Consequently, for transfer pricing, determination of an arms length price can be determined via a number of alternative methodologies not one alternative postulate.

Third, the current explanatory materials are particularly impenetrable in parts[7]. In many passages, the materials read as commentary on Court decisions or views of what the Courts have not ruled on.[8] A summary of the key decisions on the GAAR would be welcomed. However, if there is doubt about the operation of the law (eg where matters are yet to be tested) then it would be more helpful for the provisions to be clarified and the explanatory materials reflect what is changed and why.

Conclusion

The current drafting of the proposed amendments needs amendment. The current changes will invite uncertainty and future disputes and drive up compliance costs. Moreover, the amendments would waste the body of precedent developed over the last 30 years on existing provisions and throw up significant corporate governance issues for Boards contemplating alternative efficient options for achieving commercial arrangements.

Recommendation

We urge Treasury to further consult with industry, the tax profession and ATO after taking on board this and other submissions and not rush amendments. We include as an example of consultation, the "Summary of Responses" to the UK's GAAR proposals as which capture the key concerns and responses. Such a process in Australia is important if substantial amendments occur.

Furthermore, we believe consideration should also be given to the proposals being developed in the UK to have an independent Advisory Panel to inform judgement on cases that should go to Court. The model appropriate for Australia might be to strengthen the existing GAAR panel by making it. Issues with the existing GAAR panel process might reflect the issues with the type of cases being brought to the Courts. Surely, before the law is substantially amended, consideration should be given to processes that underpin its application. Debate on the makeup of the panel, its independence, responsibilities and power should occur to provide the necessary safeguards to taxpayers and ATO on the appropriate cases to pursue where disputes arise.

Start date of proposed amendments

The Assistant Treasurer's press release of 16 November 2012 indicates that the proposed "amendments will apply from today rather than from the original date of announcement, in recognition of the unique role that Part IVA plays in the income tax laws...". Given the very important current consultation process on the exposure draft and the further amendments required to it, we submit that the more appropriate start date for amendments to the GAAR should be the

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[4] Proposed paragraph 177CB(1)(b).
[5] Section 177D.
[6] Example 1.5 in the explanatory materials does not assist because it is not clear what the hypothetical transaction would be on the facts and how one constructs it.
[7] Paragraph 1.75 for example.
[8] Proposed paragraph 1.71.

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date at which a Bill receives Royal Assent unless amendments are restricted to reflect the Assistant Treasurer's original press release.

We would welcome the opportunity to participate further in the consultation process eg, via workshopping 'real world' examples to agree what legitimate tax planning is and what would be within the ambit of Part IVA potentially. We also offer the opportunity for the Law Design team to discuss with John Bartlett the UK's experience in developing their GAAR proposals.

Please contact me or Enzo Coia on (03) 9268 4111 if you would like to discuss our submission in more detail.

Yours faithfully,
BP Australia Pty Ltd

John Condon
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