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Chief Adviser
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By email: partIVA@treasury.gov.au

Dear Chief Adviser

SUBMISSION: EXPOSURE DRAFT LEGISLATION – TAX LAWS AMENDMENT (2013 MEASURES NO.1) BILL 2013: GENERAL ANTI-AVOIDANCE PROVISIONS

CPA Australia represents the diverse interests of more than 139,000 members in 114 countries throughout the world. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we make this submission in respect of the Exposure Draft legislation 'Tax Laws Amendment (2013 Measures No.1) Bill 2013: General anti-avoidance provisions' (the ED) and its accompanying Explanatory Memorandum (EM) issued by Treasury on 16 November 2012.

General comments

As a general observation CPA Australia recognises the important and enduring role that the provisions of Part IVA of the Income Tax Assessment Act (1936) (the ITAA (1936)) has played in limiting and deterring income tax avoidance activity since its enactment.

However, in our view the provisions of Part IVA do not require amendment.

The fact that the Commissioner of Taxation has recently lost a number of Part IVA cases does not mean that Part IVA no longer works or that its policy objective is not met.

If the outcomes of certain cases are considered unacceptable in terms of revenue outcomes, the appropriate response is not to broaden the general anti-avoidance provisions and create uncertainty that will impede general commercial activity and economic development. Rather, as has been done in the past, the appropriate response is to introduce targeted amendments that deal with the specific issue(s). For example, the Government has announced proposed amendments to deal with related party bad debts and to expand the scope of the limited recourse debt rules following the High Court decision in BHP Finance; and proposed amendments to the existing CGT scrip for scrip integrity rules to address concerns arising from the AXA case.

Alternatively, any amendments to Part IVA should be drafted in such a way as to ensure that they are directed at what is perceived to be the problem in issue. Based on the Assistant Treasurer's Press Release dated 1 March 2012, and subsequent public statements made by the Assistant Treasurer, we understand that the problem is the availability of the 'do nothing' alternative postulate in the context of determining whether there is a tax benefit. Therefore, any amendments to Part IVA should be limited to removing that argument as an alternative postulate. Nothing else should be done that otherwise fetters in any way the broad operation of Part IVA as understood after many years of judicial interpretation.

Moreover, we believe that the proposed amendments in the ED are unworkable in practice. If enacted, the ED will create significant uncertainty that will impede the ability of businesses to make effective commercial decisions and therefore impose further constraints on growing the Australian economy, which will further inhibit productivity which in turn will adversely impact living standards.

The breadth of the proposed amendments under the ED is such that Part IVA could be triggered even on the most basic commercial transactions such as, say, on the selection of a company in lieu of a partnership, or on the inclusion of a private company beneficiary as an object of a discretionary trust.

Furthermore, given this level of uncertainty, company directors trying to meet their corporate governance obligations will have difficulty obtaining sufficient comfort to endorse transactions. This is evident from the fact that it is unclear how the provisions would be applied in the context of the cases that have applied the current Part IVA provisions (e.g. the AXA case).

In addition, the new concepts raised by the ED will require significant judicial interrogation at the cost of taxpayers and the Commissioner. For example,

- what is a 'non-tax effect'?
- what is incidental to a non-tax effect?
- does an alternative postulate need to be reasonable?
- can the tax benefit and purpose tests really be conflated?
- do the amendments taint the purpose test so that it will be more difficult for taxpayers to show that they do not have the requisite dominant purpose?, and
- how do taxpayers argue cases based on fictional circumstances that do not exist and would never have existed?

The draft EM should also be amended to focus on the policy that is meant to apply should the proposed amendments be introduced rather than discuss perceived deficiencies in applying the policy underlying the current provisions. Any discussion as to the policy purpose of the current law can only reflect the views of the author of the draft EM and will always be open to debate and differences of opinion.

Specific comments

We make the following additional specific comments in respect of the ED:

1. No Part IVA Amendment Necessary

The nature of general anti-avoidance provisions such as Part IVA is that there cannot and should not be a 'bright line' that dictates when the provision is triggered. Bright line provisions belong in the specific anti-avoidance provisions of the Income Tax Assessment Acts. Anti-avoidance provisions by their very nature require analysis and testing as to whether there has been an overreaching. A rule that purports to identify specifically when Part IVA is triggered goes too far in favour of either the Commissioner or the taxpayer and is more a specific anti-avoidance provision than a general anti-avoidance provision.

Paragraphs 1.4 and 1.54 of the EM provide that a number of recent Full Federal Court decisions, which the Commissioner has lost, suggests that there are 'technical deficiencies' in the way in which Part IVA operates in determining whether or not a tax benefit has been obtained. This can only be correct if the Commissioner is the sole judge of the role Part IVA should play. That is, if the Commissioner's argument is not successful, there must be an amendment to enable his view to prevail.

As discussed, we submit that Part IVA, as a general anti-avoidance provision, is working properly. As stated in the proposed objects clause, the object of Part IVA is to counter schemes that are entered into with the purpose of reducing the liability of a taxpayer to tax. Thus, a counterbalance against which to assess whether a relevant scheme occurs is required. Putting to one side whether the outcome is desirable or acceptable at a policy level, if the counterbalance is that nothing would have been done, there is no reduction in tax liability. There is not a general anti-avoidance as such. The question then becomes whether that outcome reflects the Federal Government's policy in terms of what is to be taxed and, if the answer is no, to determine the best way to tax the relevant amount without imposing an unnecessary burden on the absolute majority of taxpayers who have nothing to do with the transaction and are unlikely ever to contemplate such transactions.

What is needed instead is an assessment of the cases that have been lost and, if it is determined that the policy is that tax should be paid in the factual context considered, specific amendments should be introduced to enable taxation. Amendments to general anti-avoidance provisions should not be made to address specific uncommon fact patterns.

The 'do nothing' argument has limited potential application. It is not generally available to be relied upon by taxpayers. It is only available if it is the most reasonable alternative postulate. A court cannot make a determination that no alternative was available to a taxpayer if that prediction is unreasonable (see, for

example, Macquarie, in which the Federal Court rejected the do nothing argument). This deals with the concerns raised in the EM. If the outcome of a do nothing argument is considered unacceptable at a policy level, the small number of potential cases it affects should be dealt with through specific amendments focussed on that offence. They do not warrant sweeping changes to provisions that apply to all taxpayers, which will only impede commercial decision making further.

If it is determined that Part IVA should be amended to preclude the do nothing argument, that amendment should specifically target that issue. It does not warrant broad ranging amendments to Part IVA that affect taxpayers that would not and could not have argued the do nothing alternative postulate.

2. Proposed amendments exceed scope announced by Press Release

The ED extends beyond what was formerly contemplated in the Assistant Treasurer's Press Release issued on 1 March 2012. It also introduces foreign concepts that lack clarity and will displace long-established case law and principles of interpretation. If enacted, it would lead to significant uncertainty regarding how Part IVA operates and the type of transactions to which it applies.

The Press Release identified the 'do nothing' alternative postulate as the driver for the amendments. The current Assistant Treasurer endorsed this as the purpose of the amendments in a number of public forums, including his speech 'Tax reform for an economy in transition' to the Tax Institute on 18 May 2012 and his address to the CCH Corporate Tax Managers Network on 13 November 2012. The scope of the ED extends well beyond this stated purpose.

It was expressly stated in the above Press Release that '…the draft amendments do not change the core operation of the 'purpose' test in Part IVA'. The ED provisions do in fact significantly change the core operation of the purpose test for the reasons detailed below.

3. Technical Analysis of the ED

a) Section 177AA:The Objects Clause

An objects clause does not necessarily sit comfortably with the structure of the ITAA (1936).

Consistent with the EM (and the original extraneous materials which accompanied the enactment of Part IVA), it is submitted that the objects clause should refer to the fact that Part IVA will not apply to ordinary commercial arrangements, and that it will be limited in operation to blatant, artificial or contrived arrangements.

It is also recommended that the words in brackets (i.e. the reference to steps within schemes) be deleted as unnecessary.

b) Section 177CB(1): Assumptions

There is no clear understanding as to what is meant by these provisions. Within the tax community there has been much discussion and disagreement as to what they mean and how they could apply. Any draft legislation that cannot deliver clarity as to what it is targeting and how it is to apply should not be enacted.

The sub-section commences with reference to deciding whether certain paragraphs are satisfied on the basis of an alternative postulate. The paragraphs referred to (section 177C(1) (a) – (bc)), do not require satisfaction. Rather, they define the term 'tax benefit'. Accordingly, they do not require 'satisfaction' of an alternative postulate.

Furthermore, section 177C(1) currently requires that an amount would have been, or might reasonably be expected to have been, included in assessable income or disallowed as a deduction, capital loss or foreign income tax offset. By contrast, proposed section 177CB does not require reasonableness in identifying the alternative postulate. It is unclear what will happen when section 177CB throws up an alternative postulate that is meant to be applied to section 177C on the basis that it is reasonable.

The difficulty with this is not only whether a court will require the alternative postulate to in fact be reasonable whilst also meeting the proposed section 177CB requirements. It will also impede the effectiveness with which taxpayers can argue their positions. They will be arguing against alternative postulates posed by the Commissioner but be hampered in so far as it is possible that they will have to argue for an alternative postulate that was not a commercial reality or even under remote consideration as discussed below.

c) Section 177CB(1)(a): Disregard Potential Tax Costs

Proposed section 177CB(1)(a) requires that the tax liability of any parties be disregarded when considering constructing an alternate postulate. The inference from this is that a company's Board of Directors that factors tax costs into its decision making is doing something wrong. That must be incorrect – a Board that does not factor tax costs into the decision making process is doing something wrong.

Further, the tax consequences of anyone remotely connected (whether or not a participant) is ignored and those tax consequences apply indefinitely.

This assumption will lead to alternative postulates that are not commercially feasible or 'reasonable'. Tax will often be a relevant commercial cost that influences decisions and there is no reason why it should be excluded. For example, the Commissioner could argue for an alternative postulate that would impose an excessive amount of tax on a person other than the taxpayer, even though it would otherwise not be reasonable to expect that that other person would be willing to bear such a burden. That third party would not be required to bear the tax. However, that liability would clearly indicate that it was not a commercially feasible alternative postulate

Thus, a vendor who secures a tax benefit after restructuring at the request of a purchaser will be disadvantaged as it will be irrelevant that the restructuring occurred for the tax benefit of the purchaser and that the purchaser would not have proceeded with the sale but for the restructuring.

Further, as discussed below, it appears that the dominant purpose test is applied by reference to the tax benefit determined in accordance with section 177CB. This means an assessment as to whether the restructure was done to avoid tax is constrained. It will not be relevant that the restructure was for the tax benefit of the purchaser.

d) Section 177CB(1)(b): Same non-tax effects

Proposed section 177CB(1)(b) applies where the scheme achieves non-tax effects for the taxpayer. It is premised on all parties acting without regard to any person's tax liability. If enacted, there will need to be a significant body of judicial consideration as to what the term 'non-tax effects' means.

Example 1.1 of the EM concerns an investment of $1m made by way of deposit for 12 months for a return of $50,000 payable in arrears. It is stated that the alternative postulate would involve the investment of the same amount, for the same period at comparable risk and return and that an investment in ordinary shares is not a viable alternative postulate.

The commercial reality is that the most viable commercial alternative to debt may be a form of equity. There is no reason why this should be excluded for the absolute majority, if not all, cases. Further, there are many equity investments that fall between what is traditionally considered to be equity and what is traditionally considered to be debt. How will it be determined what the non-tax effect is in such cases?

If the purpose of Part IVA is to tax what would have been taxed if the scheme had not been entered into, this limitation makes no sense.

Furthermore, it is not just taxpayers that will be constrained by this provision. What will happen when there is not a 'same' non-tax effect? Also, if the term tax effect is interpreted literally, the Commissioner could be limited in terms of taxpayer and alternative postulates. For example, assume a group was going to sell Business A. It could sell certain assets of Company A or it could move those assets of Company A to Newco and then sell Newco. If the Newco option was pursued and the Commissioner considered there was a Part IVA scheme, the non-tax effect would be the sale of shares in Newco by the shareholder of Newco. The Commissioner could not argue that there would have been a share sale.

e) Section 177CB(1)(c): No non-tax effects

Effectively, this provision says that if the scheme did not achieve a non-tax effect, assume 'that all events or circumstances that actually happened or existed' but did not form part of the scheme still happened or existed.

There is no guidance as to how to determine what 'events or circumstances' are included or excluded.

f) Section 177CB(3): Non-tax effect

Non-tax effects are defined to be any effects other than effects relating to the taxpayer's liability to tax or effects incidental to the tax liability.

It is submitted that there are no transactions that would have no non-tax effects. There might be some minor non-tax effects, but generally some forms of obligations arise. An example is given of depositing money with little prospect of return. If the sole reason for depositing money is to secure a tax deduction and the prospect of return is irrelevant, why do it? It would be easier to make a donation and get the deduction. The fact that the investment is made suggests that there is more to it than the tax outcome. The financial return might be remote, but it is a relevant prospect.

Reference could be made to forestry scheme cases to rebut this argument. However, those cases did not consider the meaning of 'non-tax benefit'. These words change the inquiry. Similarly, it might have been said in Futuris that certain steps had no commercial reason, but that does not mean that they did not have a non-tax effect. They did achieve results in the movement of assets.

It might be argued that Futuris is an example of a non-tax effect because the non-tax effect is incidental to the taxpayer's liability to tax. The debate then moves to what is meant by 'incidental' in this context. For example, in RCI, was the payment of the dividend a non-tax benefit because it was a dividend under the Corporations Law and all of the relevant obligations flowed from that? Or was it incidental to the tax benefit secured? It will be interesting to see what the courts say in due course if the provisions of the ED are enacted.

g) Section 177CB(2) Conflating the inquiry

It is unclear how section 177CB(2) can or will operate. The calculation of tax benefit and the assessment of the benefit's dominant purpose have always been separate modes of inquiry. It is not readily apparent how Part IVA can be applied without first determining the tax benefit and then applying the purpose test to that tax benefit.

Contrary to the statement in paragraph 1.65 of the EM, Hart's case does not endorse the proposed holistic approach.

h) Applying the section 177D factors

The dominant purpose test is affected by the proposals as:

- there is an issue as to whether the alternative postulate that is used in the dominant purpose test is the true commercial alternative postulate or the alternative postulate determined under the proposed section 177CB assumptions (the section 177CB alternative postulate);
- if it is necessary to apply the section 177D factors to a determination of tax benefit, there is a significant risk that this will influence a subsequent application of the factors to the dominant purpose test; and
- is it possible for a person to have a dominant purpose of obtaining a tax benefit that they never contemplated (i.e. because the alternative postulate on which the tax benefit is based is not an alternative postulate that would have been entered too for commercial reasons)?

There is no suggestion that the dominant purpose test is not working. It is an effective tool and it should not be affected by any amendments.

The alternative postulate is relevant to the identification of the tax benefit and the evaluation as to dominant purpose in section 177D. What is not clear is whether the dominant purpose test is to be applied against the real alternative postulate or the proposed section 177CB alternative postulate (i.e. whether the section 177CB constraints apply only for the purpose of determining the tax benefit).

It is submitted that a proper application of the dominant purpose test would require that it be made against the true alternative postulate (i.e. not the alternative postulate determined by reference to the proposed section 177CB assumptions). How can you test whether someone had a dominant purpose of avoiding a tax benefit that they were never going to have because they did not commercially limit themselves to the section 177CB assumptions?

The consequence is that two separate alternative postulates need to be identified:

- one for the purpose of quantifying the tax benefit in section 177C(1), which applies the assumptions in section 177CB(1); and
- one for the purpose of identifying the dominant purpose of the parties who entered into or carried out the scheme, which does not take account of the assumptions in section 177CB(1).

However, the need for two alternative postulates would clearly be complex and confusing (and potentially require two sets of evidence in relation to what reasonably would be expected to have occurred). This is another reason why the amendments proposed should not be enacted.

If you have any questions regarding the above, please contact Mark Morris, Senior Tax Counsel, on (03) 9606 9860 or via email at mark.morris@cpaaustralia.com.au.

Yours faithfully

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