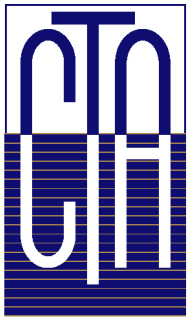

CORPORATE TAX ASSOCIATION
of Australia Incorporated

Submission

Exposure Draft

Tax Laws Amendment (2013 Measures No. 1) Bill 2013: General anti-avoidance rules

Corporate Tax Association

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The Corporate Tax Association is pleased to provide the following comments in relation to the recent Exposure Draft for *Tax Laws Amendment (2013 Measures No. 1) Bill: General anti-avoidance rules*.

By way of background and context, we reiterate that the CTA is of the view that the courts have for the most part been getting Part IVA right, and we remain unconvinced about the need for major change. Nevertheless, we do accept that the government has made a decision to make certain limited changes as announced by former Minister Arbib on 1 March 2012, and we are committed to contributing to the law design process in a constructive way so as to give effect to those announced policy changes.

However, we are firmly of the view that the Exposure Draft is not the right approach – it exceeds the scope of the government's announcement in some respects and creates unnecessary uncertainty by making sweeping changes to the architecture of Part IVA. We note also the reassurances given by Assistant Treasurer David Bradbury on two separate occasions (CCH Tax Manager forums in September and October 2012) that the amendments will be limited to the matters covered by the 1 March 2012 announcement.

SUMMARY COMMENTS

- The proposed amendments seek to target the "do nothing" and "steps within a scheme" outcomes. In our view four pages of proposed amendments (accompanied by 24 pages of explanatory memoranda) is excessive, and by drafting multiple amendments to sections of Part IVA runs a strong risk of removing the relative certainty of case law precedent of the operation of Part IVA. Further, the uncertainty likely to arise from the current proposed amendments has been described as a "barrister's picnic". Rather, the changes to Part IVA should be kept to a minimum to solely address the two targeted areas.

- We support the inclusion of an Objects clause. However the Objects clause should include a statement that Part IVA is intended to target "tax avoidance arrangements that are blatant, artificial or contrived" – refer the 1981 Explanatory Memorandum that introduced Part IVA, and para 1.10 of the proposed Explanatory Memorandum.

- The assumption that tax was disregarded by the relevant persons is unnecessary and would give the Commissioner the power to make determinations that impose maximum tax.

- The assumption that the relevant persons would have sought to achieve the same non-tax effects as the scheme is appropriate, but should be expressed in more general language.

- The law should clarify that there may be more than a single alternative postulate.

- The explanatory material should refrain from arguing for a single holistic enquiry into the alternative postulate. This is a highly theoretical construct that is not supported by any case law and there is simply no need to depart from the tried and proven three step approach of identifying the scheme and the tax benefit before moving on to purpose. Nothing useful (to taxpayers or the Commissioner) comes from conflating tax benefit with purpose, as is done in draft sec 177CB(2).

ANALYSIS

The principal part of the new law is draft sec 177CB, which modifies the way in which a tax benefit in connection with a scheme is determined under sec 177C. It does this in two ways. Firstly it assumes, in draft para 177CB(1)(a), that in relation to the alternative postulate under sec 177C that each person would have acted or refrained from acting without having any regard to tax. Secondly, draft para 177CB(1)(b) assumes that persons would have sought to achieve the same "non-tax effects" as the scheme achieves.

The "disregard tax" assumption

We consider the first assumption risks giving the Commissioner the power to assess taxpayers on the basis of "maximum tax" – that is to say, an amount of tax than most fair minded people would regard as being excessive. This is perhaps best illustrated by way of a simple example:

Say a taxpayer is considering selling an asset to an unrelated third party to realise a profit of $100. After obtaining tax advice, the transaction is structured in such a way as to trigger a tax liability of only $5. The structure adopted involves a number of artificial steps which, when considered objectively, can only be explained by the taxpayer's desire to minimise his tax liability.

The Commissioner determines there is a scheme for the purposes of Part IVA and assesses the taxpayer on an alternative postulate that results in a tax liability of $60. There are no legal or commercial impediments to the Commissioner's alternative postulate – the acquirer would have been indifferent and it does not breach any statutory or regulatory rules.

The taxpayer in this case might wish to argue that the Commissioner's alternative postulate is not one that he would reasonably have contemplated. Rather than pay 60 per cent of the realised gain in tax, he would instead have retained the asset and obtained a return from it. Under draft sec 177CB(1)(a), however, he would be prevented from making that argument because he is assumed to be indifferent to tax.

It has been suggested in the course of the consultation process that proceeding on the basis of an unreasonable or excessive alternative postulate would make the Commissioner less likely to succeed on purpose under the factors that have to be weighed up under sec 177D. It is far from clear why this would necessarily be so. Were such a scenario to be litigated, a court would be in the position of having to compare the scheme that was actually entered into (which was one that clearly involved avoidance) with the Commissioner's alternative postulate that is protected by statute.

The reality is that business and individuals operate in an after-tax world, and from a practical and corporate governance perspective, it would be highly problematical to ask board members to put their minds to what the company would have done in the highly artificial world where tax is assumed not to matter. Tax always matters to some degree, and the High Court has made it clear in *Hart's* case that some tax planning is permissible without triggering the application of Part IVA.

The government should also note that Part IVA lay largely idle for the first few decades of its existence, and it has not been until relatively recently that the Commissioner has sought to apply the GAAR in a number of cases that taxpayers and advisers would previously have thought were beyond the scope of these provisions. It would be very negative for business (and ultimately for levels of future investment) if this attempt to overcome what the Government has been advised is a technical problem around the alternative postulate resulted in a major shift in the overall balance of a provision that most tax specialists consider has been working quite well.

While we do not suggest the Commissioner would deliberately abuse the power to maximize tax in an unreasonable way, it would be wrong to make such an outcome even theoretically possible. Importantly, we consider the objectives expressed in the 1 March 2012 announcement can be achieved without this statutory assumption, although not with para 177CB(1)(b) in its current form.

Para 177CB(1)(b) creates unwarranted uncertainty

It is clear from the consultation process, the draft legislation and the explanatory material that the aim of this draft provision is to foreclose on both the "do nothing" argument and the "do something materially different" argument. The former is clearly covered by the 1 March 2012 announcement, although the latter is not, strictly speaking:

> "For example, they could have entered into another scheme that also avoided tax, deferred their arrangements indefinitely or done nothing at all. Such an outcome can potentially undermine the overall effectiveness of Part IVA and so the Government will act to ensure such arguments will no longer be successful."

We see little point in engaging in unproductive hair splitting over the language used in the announcement, and we accept that preventing taxpayers from arguing they would have done something else entirely is not inconsistent with the stated aim of preventing them from arguing they would have done nothing at all or deferred the arrangement indefinitely.

We don't regard the concerns about taxpayers arguing they would have done something that would itself have been susceptible to Part IVA (e.g. selling the asset in the above example using different steps and resulting in a tax liability of $6 instead of $5) as being soundly based. We are not aware of all the cases that come before the ATO's GAAR Panel, but there are no reported cases of litigation where such an argument has ever been advanced. If it were, we would expect the Courts would not seriously entertain them under the existing law.

The CTA's main concern centers on the uncertainty which would potentially be created by the language used to give effect to a principle that seems clear enough from the policy announcement. Taxpayers, the Commissioner and eventually the Courts would need to put their mind to when something achieved by a scheme is a "non-tax effect", which is defined in draft sec 177CB(3) by what it isn't – something relating to the taxpayer's liability to tax or something that is incidental to that.

The difficulty here is that many acts, steps, and transactions can have both a tax effect and a non-tax effect and the risk is that the complexity around Part IVA will shift from the alternative postulate being "at large" to an uncertain analysis of non-tax effects. The extent of the proposed change in language is likely to create unnecessary uncertainty for both taxpayers and the ATO for many years to come.

As a matter of detail, we believe that the wording of the definition of "non-tax effect" is too vague, centering on a taxpayer's "liability to tax or withholding tax". This definition could potentially include the likes of tax offsets (such as for Film Tax Offsets) which themselves cannot constitute a "tax benefit" under sec 177C. The definition of "non-tax effect", if thought to be necessary at all, should only reference effects other than those that could potentially give rise to a tax benefit under sec 177C(1)(a), (b), (ba), (bb) or (bc).

Part IVA appears to be working well enough in relation to purpose, and whatever is currently wrong about the alternative postulate does not, in our view, warrant the sort of upheaval that would result from the introduction of new and uncertain language. Instead, we offer the following suggestions about the path that should be followed.

Draft a "do something" assumption

While there may be some who have understandable reservations about the use of principle based drafting in most areas of the tax law, having seen the Exposure Draft we consider that a case could be made for its application in conveying the idea that in framing the alternative postulate, the broader commercial (or family) dealing that the taxpayer actually entered into would still have happened. For example, if the scheme identified by the Commissioner is part of a broader commercial arrangement, the essence of which was the disposal of an asset to a third party, the alternative postulate would assume that the taxpayer would have disposed of the asset to the third party in some other way. We are confident that the Courts would in the large majority of cases reach the right decision about what broader transaction or event would have happened in some other way.

We don't profess to have any special skills in drafting tax legislation and won't try to suggest an appropriate form of words in this submission. However, we hope this part of the submission adequately describes the approach we would prefer the legislation to take. It may be useful for the explanatory material to include examples to illustrate the way such a provision is expected to apply. The CTA would be pleased to assist with developing such examples if required.

More than one Alternative Postulate

Consideration should also be given to including a provision which makes it clear that in some situations there may be more than one alternative postulate, and that the Commissioner is not required to identify the most reasonably likely alternative postulate. There is a view that *RCI* may suggest otherwise.

We agree that where there is a range of possible alternative ways of achieving a particular commercial or family outcome, it would be unduly onerous to require the Commissioner to identify the one reasonable possibility among many other reasonable ones that is the most likely (perhaps sometimes by only a narrow margin). From a policy perspective it should be sufficient that the alternative postulate identified by the Commissioner is reasonable in all respects (other than for the "do something" assumption).

Steps within a scheme

It isn't entirely clear why it was considered necessary to include the "steps within a broader commercial scheme" point in the 1 March 2012 announcement.

> "The Government amendments will confirm that Part IVA always intended to apply to commercial arrangements which have been implemented in a particular way to avoid tax. This also includes steps within broader commercial arrangements."

There are many who think this argument was settled as far back as *Spotless*, and certainly since *Hart*. We acknowledge there was some debate in *RCI* about whether the dividend that was paid out of the revaluation reserve was part of the broader restructuring of the James Hardie group; however we do not think much turned on that in the final analysis. We note that the draft objects clause 177AA refers to steps within or towards other schemes, and have no objection to this clarification being included.

The "disregard tax" assumption is not needed

While it might seem counterintuitive to suggest this assumption is not needed, we advance this argument in the context of the concerns we have already expressed about the Commissioner potentially being empowered to raise assessments that are unreasonable and excessive.

But even putting those concerns to one side, it is submitted that an appropriately worded "do something" assumption (using high level principles), combined with the suggested clarification about the potential for there being more than one alternative postulate, should effectively overcome the "at large" concerns about the alternative postulate and foreclose on the "do nothing" (or "do something else") argument.

If there is a statutory assumption that the underlying transaction of which the scheme is a part would have occurred in one way or another and the Commissioner identifies an alternative postulate that is reasonable in all other respects (including its tax cost), it would not be open to the taxpayer to argue that he would adopted some other course of action that involves a tax outcome that is more advantageous to him.

Again using the example of the disposal of an asset to a third party for a $100 gain, if the Commissioner's alternative postulate resulted in a tax cost of $30 in the case of a corporate taxpayer (or, say, $28 or $32), and there are no non-tax factors the taxpayer can point to that would stand in the way of the Commissioner's alternative postulate, then we are confident that a Court would regard that as being reasonable. On the other hand, if the Commissioner over-reaches, and identifies an alternative postulate that is unreasonable (say, involving a tax cost of $60 by paying tax twice on the one gain) then his determination should not be allowed to stand as a matter of good public policy. If that raises issues about his powers to amend to give effect to an alternative postulate that is reasonable, then that should be addressed as a separate matter.

We appreciate there could well be some instances where it might be impossible on the facts to identify any alternative course of action other than what the taxpayer actually did. We don't expect that would be a common outcome, but it is one that might be an inevitable consequence on insisting on a "do something" rule. It may just be something the Courts would have to deal with if and when it occurs.

Start date

Finally, we applaud the government's decision regarding the later start date for any new law. However, should the Exposure Draft that was released on 16 November 2012 be amended substantially (as we suggest it should be), then consideration should be given to having a later date of effect.

Next steps

Rather than rush to meet some self-imposed deadline, we would also recommend having at least one further iteration of the public consultation process. It is important to get these amendments right and, in our view that means keeping any changes to a minimum. The debate around these changes has thus far been highly legalistic, which is perhaps inevitable. However, such an approach poses the risk that some of the more practical issues may not be fully explored. The CTA would be pleased to facilitate input from experienced corporate tax practitioners to assist in identifying and addressing such issues.

Thank you for the opportunity to comment, and also for the roundtable process that the writer participated in.

(Frank Drenth)

Executive Director
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