GREG DAVIES QC
Barrister at Law

Chief Adviser
Law Design Practice
Revenue Group
The Treasury
Langton Crescent
Parks ACT 2600

By email: partIVA@treasury.gov.au

Re: Exposure Draft of the Tax Laws Amendment (2013 Measures No.1) Bill 2013: General Anti-Avoidance Rules

Dear Chief Adviser

1. I make the following comments in relation to the Exposure Draft. The opinions expressed are mine.

2. The language and objective of par 177CB(1)(a) are relatively clear. The amendment appears to be consistent with the goals announced by the Australian Government on 1 March 2012 and is directed at dealing with the perceived deficiency identified in par 1.68 and the third dot point in par 1.89 of the draft Explanatory Memorandum.

3. In contrast to par 177CB(1)(a), pars 177CB(1)(b) and (c) and subsection 177CB(3) are not clear in their language, do not advance and are not supported by any identifiable legislative policy and are not consistent with the objective of certainty announced by the Australian Government on 15 May 2012. In regard to pars 177CB(1)(b) and (c) and subsection 177CB(3) I make five observations.

4. First, the complexities and difficulties of the assumption making processes required by pars 177CB(1)(b) and (c) and subsection 177CB(3) are such that they will hinder and likely frustrate the efficient administration and application of Part IVA. The amendments will require that in all cases each and every "effect" of the scheme is identified and characterised as either a "non-tax effect" or not as a "non-tax effect". That process of identification and characterisation will occur simply as the first step in determining what assumption or assumptions are to be made for the purpose of hypothesising what would or might reasonably be expected to have happened if the scheme had not been entered into or carried out.

5. Each of the concepts of "effect" and "non-tax effect" is redolent with ambiguity and problems of construction. What is an "effect"? Does "effect" comprehend something that relates to the substance of the scheme or the form of the

scheme or, where the substance and form are different, both? What is the material or relevant relationship that will be required between an effect and the taxpayer's liability to tax for the effect to be a "non-tax effect"? Does par 177CB(3)(b) comprehend an effect that is solely incidental to achieving an effect relating to the taxpayer's liability to tax or does it comprehend an effect that is both incidental to achieving an effect relating to the taxpayer's liability to tax and also an effect or other effects that do not relate to the taxpayer's liability to tax? Can an effect that achieves for the taxpayer something that does not relate to its liability to tax be nonetheless an effect that is covered by par 177CB(3) because it is also incidental to achieving an effect relating to the taxpayer's liability to tax?

6. Even ignoring the many ambiguities and difficulties of construction, the decision making process required by pars 177CB(1)(b) and (c) and subsection 177CB(3) is inherently unwieldy and in the more complex cases could prove to be unworkable. In schemes involving a large number of transactions and parties that occur over a significant period of time, such as AXA, the magnitude of carrying out the task of identifying each of the effects of the scheme and characterising those effects as "non-tax effects" or other effects for the sole purpose of making assumptions at the commencement of the inquiry as to what would or might reasonably be expected to have happened if the scheme had not been entered into or carried out will be such that the task is incapable of efficient and timely completion.

7. The inherent ambiguities and complexities involved in the construction and application of pars 177CB(1)(b) and (c) and subsection 177CB(3) will not advance and will likely harm the integrity of Part IVA as an efficient and effective general anti-avoidance provision.

8. Secondly, because of the ambiguities and complexities, pars 177CB(1)(b) and (c) and subsection 177CB(3) will result in a proliferation of disputes and litigation about the proper application of Part IVA. In that context there will be an added burden on all parties, including the Commissioner, to identify what is alleged to be each of the effects of the scheme in question, which of those effects are non-tax effects, and what assumptions are required to be made for the purposes of predicting what would or might reasonably be expected to have happened had the scheme not been entered into.

9. Thirdly, pars 177CB(1)(b) and (c) and subsection 177CB(3) do not advance the goals which the Australian Government announced in relation to the amendment to Part IVA. At the very least their impact will be to introduce substantial uncertainty into the application of Part IVA, contrary to the

government's announcement on 15 May 2012. The policy objectives which the amendments are intended to achieve are not apparent. They are not revealed by the language used, or by the context in which they appear including the recent Federal Court decisions, or by the draft Explanatory Memorandum.

10. Fourthly, the application of pars 177CB(b) and (c) will compromise the efficacy and operation of par 177CB(1)(a). Their application to the facts in *RCI* is an example. If the amendment contemplated in par 177CB(1)(a) alone were applied to those facts, the result would be that the taxpayer obtained a tax benefit in connection with the scheme. However, if the whole of section 177CB were applied to the facts, the finding would likely be that there was no tax benefit obtained by the taxpayer. That is because in ascertaining what would or might reasonably be expected to have occurred if the scheme had not been entered into par 177CB(1)(b) would require the assumption that the relevant persons would have acted with the intention of achieving the repatriation of unrealised profit from the subsidiary with the consequence that the subsequent sale of the subsidiary would not give rise to a capital gain.

11. Fifthly, pars 177CB(1)(b) and (c) and subsection 177CB(3) are likely to operate in such a way as to restrict the existing ambit of section 177C. The application of the amendments to the facts in *Lenzo* is an example. Arguably, the non-tax effects of the scheme in that case included, at the very least, an investment in a project of growing and harvesting sandlewood with a view to profit. The Full Federal Court reversed the judgment of French J and found that the taxpayer obtained a tax benefit in connection with the scheme and that Part IVA applied to permit the Commissioner to cancel the tax benefit. Applied to the same facts section 177CB would seem to require that in ascertaining whether or not the taxpayer obtained a tax benefit the assumption had to be made that the relevant parties would have acted intending to achieve for the taxpayer, at the very least, an investment in a project of growing and harvesting sandlewood with a view to profit. If made, that assumption would compel the conclusion reached by French J that the taxpayer did not obtain a tax benefit.

12. Finally, the draft Explanatory Memorandum will not assist the proper construction of pars 177CB(1)(b) and (c) and subsection 177CB(3). There are at least four reasons.

13. First, the draft Explanatory Memorandum, as expressed, reveals a misunderstanding as to the present state of the law. Pars 1.55-1.65 posit a policy of needing to limit the present "unconstrained inquiry about alternative postulates" in order to achieve the interrelated operation of Part IVA referred to

by Gummow and Hayne JJ in *Hart* (2004) 217 CLR 216 at 232 [36], [37]. However, what Gummow and Hayne JJ stated in *Hart* is the law about the existing Part IVA. The "interrelated operation" is a characteristic of the existing Part IVA that arises in the context of what the draft Explanatory Memorandum refers to as an "unconstrained inquiry about alternative postulates". The draft Explanatory Memorandum suggests that an amendment is needed in order to achieve the interrelated operation to which Gummow and Hayne JJ referred: pars 1.57, 1.65. That is patently incorrect. As found by Gummow and Hayne JJ, that interrelated operation is achieved by the existing terms of Part IVA.

14. There can be no doubt that the Federal Court has applied Part IVA in accordance with the principles laid done in *Hart*, including those articulated by Gummow and Hayne JJ. The High Court refused special leave to appeal in *Lenzo*, *AXA* and *RCI*, amongst others. It rejected submissions that the cases involved errors of principle. On the present state of the law there can be no suggestion that the decisions in those cases are not consistent with the interrelated operation of Part IVA that was referred to by Gummow and Hayne JJ in *Hart.*

15. Accordingly, so far as the draft Explanatory Memorandum identifies a policy of limiting the inquiry about alternative postulates in order to achieve the interrelated operation referred to in *Hart*, it is incorrect: see par 1.89. *Hart* establishes that the existing state of the law achieves that interrelated operation. Whatever else the amendments may be directed at, they will not be seen to be directed at achieving what according to *Hart* is an attribute of the legislation in its present terms.

16. Secondly, there is nothing in the draft Explanatory Memorandum that reveals how limiting the inquiry about alternative postulates by reference to assumptions made upon the basis of non-tax effects and other effects of the scheme in question might advance the aim of achieving an interrelated operation of Part IVA. The amendments can only be explained by reference to some other objective that is both unstated and unidentifiable.

17. Thirdly, there are inherent discrepancies between the aims stated in the draft Explanatory Memorandum and the proposed amendments. The draft Explanatory Memorandum refers to the result in *RCI* as "undesirable": pars 1.64, 1.65. Yet, as I have indicated above, pars 177CB(1)(b) and (c) would likely have the effect of nullifying the impact of par 177CB(1)(a) to the facts in *RCI* and result in the conclusion that the taxpayer in that case did not obtain a tax benefit.

18. The draft Explanatory Memorandum also refers to the result in *AXA*, with apparent criticism: par 1.61. Yet, the alternative postulate which is criticized, being a direct sale of the underlying business by AXA Health to MBF, is the likely conclusion on the application of pars 177CB(1)(b) and (c) (putting aside for the moment the difficulties and complexities of construction and application). That is because the matter of commercial substance that was sought to be achieved by AXA was the disposition of the HBA business. In the circumstances of the case there were only two ways in which that commercial outcome could be achieved, the first being the sale of the subsidiary to MBL and the second being the sale of the business to MBF. Pars 177CB(1)(b) and (c), at least arguably, would seem to require that the assumption be made that if the sale of the subsidiary to MBL had not occurred the parties would have acted with the intention of achieving for AXA the commercial outcome of the disposition of the HBA business. On that assumption, the only alternative postulate would be the sale of the HBA business by MBF, which is the very outcome that appears to be criticised in the draft Explanatory Memorandum.

19. Fourthly, pars 1.69-1.77 of the draft Explanatory Memorandum deal with a matter to which none of the proposed amendments are directed. If there truly be an unacceptable "blurring of the two limbs in section 177C", the amendments do not address that matter. In that context, pars 1.71-1.73 again illustrate misconception by the draftsman about the existing state of the law. Contrary to what is stated in par 1.71, there is no contradiction, apparent or otherwise, between the decision in *Lenzo* and the decision in *Trail Bros*. That is clear from the judgment of Jessup J in *AXA*. His Honour, sitting at first instance, was bound to follow the judgment of *Lenzo*. His Honour found that *Lenzo* did not stand for the proposition that an alternative postulate cannot include some of the integers of the scheme. The Full Court in *Trail Bros* and also in *AXA* agreed. Accordingly, there is no contradiction between *Lenzo* and *Trail Bros* about that matter.

20. The misstatements and misconceptions that arise in the draft Explanatory Memorandum about the existing state of the law will severely compromise its worth as a tool for revealing legislative objective and construing the meaning of the legislation.

Greg Davies

Liability Limited by a Scheme approved under the Professional Standards Legislation