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OF AUSTRALIA

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Dear Chief Adviser

**Exposure Draft of the *Tax Laws Amendment (2013 Measures No. 1) Bill 2013:*  
*General anti-avoidance rules***

Thank you for the opportunity to provide a Submission in relation to the Exposure Draft.

The Taxation Committee of the Business Law Section of the Law Council of Australia (the Committee) values the opportunity to contribute to the legislative process.

The Committee's comments addressing particular aspects of concern are set out below.

The following Submission has had the benefit of input from a wide group of practitioners with a broad range of views.

**Executive Summary**

1. Part IVA operates in the manner as intended by the legislature when enacted. It has been given that effect by decisions of the Courts. Any amendments to it represent the implementation of new policy. There are various statements in the draft Explanatory Memorandum that do not accurately reflect the role of the judiciary in the Australian constitutional and legal framework. As a proposed explanation for the initiatives being advanced, coming from the executive arm of government, the draft Explanatory Memorandum should be more accurate. It is inappropriate to refer to these amendments as correcting deficiencies arising from interpretation of the current law. For example, the statement in paragraph 1.1 of the Explanatory Memorandum that the amendments operate to 'restore [Part IVA's] effective operation' should be removed.

2. The proposed amendments seek to address circumstances that the Courts have determined ought not to be covered by the current law and that the Government has decided to address on a policy basis.
3. It likely that the form of the amendments proposed would not achieve what appears to be sought. Assuming the courts adopt consistent approaches to statutory construction into the future, the outcomes in the cases the Commissioner lost may not alter if re-litigated under the proposed amended laws and the outcome in one of the more recent cases in which the Commissioner succeeded would probably be reversed.
4. The proposed amendments will effect a fundamental change to the manner in which Part IVA applies to all arrangements. Amending a threshold provision in the proposed manner will introduce unnecessary uncertainty into the manner in which Part IVA applies generally. That will, in turn, mean that the understanding of the operation of the law developed by the substantial body of jurisprudence over the last 18 years, starting with the High Court's decision in *Peabody* in 1994, on the affected provisions will be lost.<sup>1</sup>
5. The proposed 'tax benefit' changes are difficult to understand (e.g. s177CB(2) and (3)) and their intended operation is obscure. The difficulty in applying the provisions in straightforward scenarios (see paragraphs 26-30 below) suggests that applying the provisions to complex arrangements will be extremely difficult.
6. The uncertainty that flows from these difficulties is amplified by the unreality of fixing liability to tax by reference not only to circumstances that do not exist, but also to artificial circumstances that never would have existed (see s177CB(1)(a), (b) and (c)).
7. Importantly, it is wrong to assume that the proposed amendments will not materially impact on the operation of other provisions in Part IVA,<sup>2</sup> specifically the question of dominant purpose under s177D. The 'purpose' test in s177D is assessed by reference to the alternate postulate developed for the purpose of s177C.<sup>3</sup> Changing the parameters by which the alternate postulate is identified inevitably changes the application of the dominant purpose test, even if the words of s177D are not altered. This outcome, while said not to be an intended consequence, will logically follow. Therefore, the existing jurisprudence in relation to the dominant purpose test will largely cease to be relevant, as will the jurisprudence on the question of obtaining a 'tax benefit' under existing s177C.
8. These matters are adversely affecting business investment decisions now (for the amendments will have retrospective effect – the justification for which is provided in the vaguest of terms: '*the obtaining of unintended tax advantages*'<sup>4</sup>).
9. Further consultation is required to enable the policy initiative the Government is seeking to advance with these proposed amendments to be clarified and clearly enunciated in legislation that is effective, unambiguous and does not result in

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<sup>1</sup> Compare Draft Explanatory Memorandum, [1.86]-[1.89].

<sup>2</sup> Compare Draft Explanatory Memorandum, [1.86]-[1.89].

<sup>3</sup> *FCT v Hart* (2004) 217 CLR 216 at [66] per Gummow and Hayne JJ.

<sup>4</sup> Draft Explanatory Memorandum, [1.127].

unintended consequences. In particular, if the Government's policy is to address particular scenarios, that should be able to be achieved without impacting on the overall structure of the provisions. Clearer enunciation of the policy objectives would assist with identifying a more appropriate legislative response.

10. More detailed comments on each of the proposed principal amendments are set out below. Comments on particular paragraphs of the Explanatory Memorandum (EM) are set out in the Schedule to this Submission.

### **The current operation of Part IVA**

11. The principal provisions of Part IVA have been in effect for over 30 years. They have achieved their intended purposes and that has been acknowledged in robust terms:

*'Part IVA has worked and safeguards the integrity of the Australian income tax system.'*<sup>5</sup>

12. A substantial body of jurisprudence commencing with the High Court's decision in *Peabody* in 1994 means that the principles relevant to their application are understood. That different views may be taken as to whether Part IVA applies in a particular circumstance reflects its nature as a 'general' anti-avoidance provision, rather than any deficiency.
13. Subject to ensuring taxpayer's costs in the process are accommodated, the Commissioner's role in administering the tax law at times calls for litigating cases that assist to clarify the law. That necessarily involves litigating cases in which the outcome is uncertain and in which he has a realistic prospect of not succeeding. It does not follow that, because the Commissioner of Taxation's view of Part IVA has not prevailed before the Courts in particular cases, amendment is required to 'restore its effective operation' (EM, [1.1]), or that the Courts' decisions are wrong. Rather, it suggests that the Commissioner's submissions were inconsistent with the jurisprudence that has developed.

### **Policy to be advanced**

14. Whilst the Government need not provide a rationale for policy implementation, where it chooses to enunciate a policy objective, that objective should be clear and accurate. In the case of identifying areas in which the Courts have indicated that current law does not apply, on a considered interpretation of the existing law, there should be a clearly outlined policy objective for introducing new laws to address what are extensions of the current law. This will assist taxpayers, advisers, the Commissioner and, if the words of the legislation require it, the Courts, to interpret and apply the amending legislation in the future.
15. A clear policy statement should be provided for the amendments proposed.

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<sup>5</sup> Trevor Boucher, former Commissioner of Taxation, 'Blatant, artificial and contrived, Tax schemes of the 70s and 80s' (Australian Taxation Office, 2010), p381.

## Tax benefit matters

16. As a package, proposed s177CB is convoluted, difficult to understand, prospectively unworkable, not assisted by the proposed EM and likely to lead to further rounds of extended litigation. Further, as noted at paragraph 2 above, the form of the amendments proposed may not achieve what is intended, the outcomes in the cases the Commissioner lost may not alter if re-litigated under the proposed amended laws and the outcome in one of the more recent cases in which the Commissioner succeeded would be likely to be reversed.

### Section 177CB(1)(a) – liability to tax be disregarded

17. Part IVA is concerned with artificial and contrived means to avoid tax. It presently does so by setting up objective tests which are based in, and on, real world phenomena from which conclusions as to obtaining tax benefits and as to relevant purposes are to be drawn. Further, Part IVA does this in a context of accepted wisdom that it is not for the Commissioner, or Tribunal or Courts on review, to tell a taxpayer how to conduct his, her or its affairs; rather, the Commissioner and the Tribunal and Courts on review are merely to look at what transpired and to determine the reflex of the Assessment Acts on what has transpired. The proposed amendments introduce, in the Committee's view inappropriately, artificiality into the analysis to determine whether someone has obtained a tax benefit. The current law requires a comparison of arrangements that did take place, the scheme, with alternate postulates to determine whether a taxpayer has obtained a tax benefit as part of arrangements that are artificial and contrived to avoid tax. Under the current rules the bench mark against which comparisons are made is an alternate postulate, i.e. a state of affairs or set of transactions, which can be predicated with sufficient reliability to be regarded as reasonable. This approach compares what did happen with what might reasonably have happened as part of a process to identify artificial and contrived avoidances of tax. Comparisons with reasonable alternatives are likely to be helpful in such a process. In a world where tax is a significant impost on net profits and net income, it is only to be expected that tax will affect commercial and financial considerations and planning. Courts have recognised this reality of life. Accordingly, it is appropriate to have regard to taxation matters in the bench marking process.
18. Mandating the comparison of what happened, the scheme, to something that may have happened *ignoring taxation considerations* is to mandate a comparison with an artificial benchmark so as to assist in identifying something artificial. That benchmark is simply inappropriate.
19. Further, if these amendments are enacted in their current form, they will cause grave difficulties for directors and executives of businesses who are charged with making commercial judgments (which necessarily take account of tax consequences of available courses of action) because they will in effect be required to make commercial judgments without regard to potentially material tax consequences (see observations in *Hart's case* referred to in EM at [1.14]-[1.15]).

20. The amendments will pose similar difficulties for trustees who are required by statute to take tax consequences into account when exercising powers of investment<sup>6</sup> and who may be held liable as fiduciaries for failing to do so.<sup>7</sup>
21. If this proposed amendment does proceed, the Committee considers that, first, allowance ought to be made for potential exposure to 'double taxation'.<sup>8</sup> Second, it ought to be made clear that the reference to 'tax' is a reference to that term as defined in s995-1, being in effect a reference to *Australian* tax only.

### **Sections 177CB(1)(b)-(c), (2) and (3) – 'non-tax effect'**

22. The proposed amendments to s177CB(1)(b)-(c), (2) and (3) concerning 'non-tax effects' are convoluted, difficult to understand, unworkable and likely to lead to further rounds of extended litigation. If a new policy initiative is to be enacted, the drafting needs to be reworked.
23. The range of meanings that may be attributed to the non-specific language employed in the definition of 'non-tax benefit' in s177CB(3) ('an effect relating to the taxpayer's liability' or 'an effect incidental to achieving [such] an effect') are so varied that it will be very difficult to determine what are, and are not, non-tax effects (see EM, [1.115]). That difficulty infects the operation of s177CB(1)(b), which is intended to confine the inquiry in relation to the alternative postulate.
24. For example, a taxpayer who may decide to rent, rather than buy, business premises, enjoys a deduction for the rent outgoing as a potential tax benefit.<sup>9</sup> If a question arose as to whether Part IVA applied to cancel the rent deduction, would the grant of the lease be a 'non-tax effect'? The answer depends on whether the phrases 'relate to' and 'incidental to' are given their broadest meanings (in which case the answer is no), or whether they are given a narrower meaning requiring a more direct causal relationship than that between the granting of the lease and the rental deduction (in which case the answer is yes).
25. If the phrases are given their broadest meaning, it is difficult to fathom in what circumstances an effect of a scheme could be a 'non-tax effect'. That would mean that s177CB(1)(b) effectively has no scope to operate.
26. There is therefore a valid argument that the phrases ought not to be given their broadest meaning. Even if that is correct, that does not, however, resolve the issue – there remains the question of the nature of the connection that is required for an effect to be 'related to' a taxpayer's liability or 'incidental to' such an effect?
27. Reasonable minds can (and do) differ on the answer to that question. Certainty will not be achieved until this is litigated to finality, which will take many years.

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<sup>6</sup> See *Trustee Act 1925* (NSW), s14C(1); *Trustee Act 1958* (Vic), s8(1).

<sup>7</sup> See *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028.

<sup>8</sup> See *FCT v Futuris Corporation Limited* [2012] FCAFC 32, [42].

<sup>9</sup> See *Hart's case* at [15] per Gleeson CJ and McHugh J.

28. In the interim, the inability of s177CB(3) to yield a certain answer to that straightforward example suggests that the application of ss177CB(1)(b)-(c) and (3) to complex arrangements will be extremely difficult.

### **Suggested consequential amendment to s177F (cancellation of tax benefit)**

29. The Committee suggests that, if the amendments referred to above are made as proposed, given the wholly artificial nature of the inquiry, then s177F ought to be amended to clarify that it is only the tax benefit that was the object of the dominant purpose that may be cancelled rather than *any* tax benefit obtained in connection with the scheme.<sup>10</sup>

### **Principal comments on the EM**

30. Detailed comments on the EM are set out in the schedule to this Submission. There are two points of general principle that the Committee wishes to bring to your attention.
31. First, as referred to in paragraph 1 above, the draft EM suggests that the Courts have not properly applied Part IVA (see also items 5, 6 and 10 of the Schedule).
32. The Judiciary interpret the legislation as enacted and that interpretation defines the scope and meaning of existing legislation. The EM should not include any criticism of previous decisions, but should clearly identify areas that the Government seeks to amend as a result of the amending legislation.
33. Second, contrary to the EM, nothing in Part IVA as it stands, nor in the amendments, suggests as a matter of legislative intent or logic that one should do other than start with the question of whether someone has obtained a tax benefit (c.f EM, [1.89]).
34. To suggest that a 'holistic' approach to Part IVA is required and that this involves first considering whether there is a dominant purpose of obtaining an unidentified (and potentially non-existent) tax benefit, and that this is the fulcrum about which the application of Part IVA turns, is to misconstrue Part IVA (c.f EM, [1.65]). Indeed, the passage from the judgment of Callinan J in *Hart's* case ([92]) to which the EM refers as authority for this novel proposition provides no support at all. Rather, in that case, his Honour first asked and answered the question of whether there was a tax benefit (see [91]) and only then, having answered that question in the affirmative, did his Honour turn to the question of dominant purpose. The latter question is logically irrelevant if the answer to the former question is negative (c.f EM, [1.63]-[1.65]).

### **Further Contact**

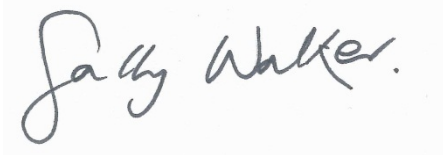
35. The Committee trusts these comments are of assistance. If you have any questions, please contact the incoming Chair, Mark Friezer, on (02) 9353 4227 or via email: [mfriezer@claytonutz.com](mailto:mfriezer@claytonutz.com).

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<sup>10</sup> Relevantly, section C9-1-220 of the Consolidation Reference manual includes the following statement: '*The Commissioner has power under s. 177F to cancel all tax benefits obtained by taxpayers in connexion with the scheme, and not merely the tax benefit that it was the dominant purpose of some person to obtain.*'

36. This Submission has been lodged by the authority delegated by the Directors to the Secretary-General, but does not necessarily reflect the personal views of each Director of the Law Council of Australia.

Yours sincerely

A handwritten signature in black ink that reads "Sally Walker." The signature is written in a cursive style with a period at the end.

**Professor Sally Walker**  
**Secretary-General**

Enc.

## SCHEDULE

No.	EM Para	EM Statement	BLS Tax Committee Comments
1.	1.1	'Bill amends Part IVA ... to restore its effective operation as the income tax general anti-avoidance provision.'	In a book commissioned and published by the ATO in 2010 (available on the ATO website), former Commissioner of Taxation Trevor Boucher concluded that: <i>'Part IVA has worked and safeguards the integrity of Australia's income tax system.'</i> The Committee agrees.



No.	EM Para	EM Statement	BLS Tax Committee Comments
2.	1.4	Recent Court decisions have 'revealed technical deficiencies in ... Part IVA ... These deficiencies undermine the effective operation of Part IVA.'	<p>See comments in paragraph 7 of the Submission. Further, as the Hon. Justice Logan of the Federal Court recently stated:</p> <p><i>'Adverse outcomes for the Commissioner in Part IVA cases are not just a victory for a taxpayer. They are also an independent, external assessment of the efficacy of the process that led to the making of the determination and the related assessment. Those adverse outcomes may serve as an indication not of a deficiency in Part IVA but rather of a deficiency in particular public administration practices which led to the use of Part IVA or the pressing of a case in which it was used.. Whether or not [to amend Part IVA] is a matter for the value judgment of Parliament. It would be unfortunate if that value judgment were based on the flawed premise that cases in which the Commissioner's use of Part IVA failed inevitably point to a deficiency in the legislation, as opposed, perhaps, to a deficiency in case selection'<sup>11</sup></i></p> <p>In plain terms, his Honour's comments are an injunction against assuming that a legislative 'fix' is required if the Commissioner of Taxation is unsuccessful.</p>

<sup>11</sup> Hon. Justice Logan, 'Mission Accomplished? A perspective on Part IVA of the Income Tax Assessment Act 1936', Tax Institution of Australia, 2012 Queensland Corporate Tax Retreat, 6 September 2012.

No.	EM Para	EM Statement	BLS Tax Committee Comments
3.	1.23 – 1.25	<p>‘In determining whether a scheme is one to which Part IVA applies, the critical question – indeed the fulcrum upon which Part IVA turns is [the dominant purpose test]’: see <i>Hart</i>, [92] per Callinan J. Part IVA requires a ‘singly inquiry’.</p>	<p>In <i>Hart’s</i> case, Callinan J identified the ‘first step’ as working out whether there was a ‘scheme’ as defined ([89]), then whether there was a ‘tax benefit’ ([91]).</p> <p>His Honour then stated that (at [92]):</p> <p><i>‘The next question, which is of purpose, is whether under s 177D the scheme is one to which Pt IVA applies. This will, in my view, in most cases be the critical question. The answer to it, both as a matter of statutory interpretation and as the Explanatory Memorandum indicates, was intended to be the fulcrum upon which most Pt IVA cases will turn, because the definition of a scheme, being as wide as it is, will relatively easily be satisfied, and the presence or absence of a tax advantage will also usually be readily apparent.’</i></p> <p>Rather than suggesting that the ‘dominant purpose’ test is the first and critical issue, Callinan J expressly endorsed the proposition that the identification of a scheme and ascertainment of a tax benefit are necessary anterior steps to the application of s177D.</p> <p>Nor do Gummow and Hayne JJ in <i>Hart</i> suggest otherwise (c.f. EM, [1.24]). Indeed, at [34], Gummow and Hayne JJ state that identification of a tax benefit and a scheme is the ‘first element’ that must be satisfied for Part IVA to apply.</p>

No.	EM Para	EM Statement	BLS Tax Committee Comments
4.	1.29	It 'would be expected' that the alternative postulate to work out whether there was a tax benefit would be consistent with the alternative postulate relevant to the application of the dominant purpose test ('form and substance').	No reason is provided for this conclusion. Nothing in the text of Part IVA suggests that this ought to be the case. Indeed, the absence of symmetry of language in ss177C and 177D suggests that Parliament intended that the inquiries would be undertaken differently. The first (pursuant to s177C) having regard to what would have or might reasonably be expected to have occurred – which need not have had the same economic effect. The second (pursuant to s177D) by reference to whether the same economic effect (i.e. the substance) could be achieved by different means (i.e. form): see EM, [1.17]. There is a risk that this proposed amendment will diminish rather than enhance the effectiveness of Part IVA.
5.	1.39-1.53; 1.69-1.77	<p>[1.43] The EM states that interpreting s177C(1)(a) as providing for a two limb test is the 'conventional' approach</p> <p>[1.69] The approach of the courts in recent decisions is described in the heading as '<u>Blurring</u> of the two limbs ...'</p> <p>In [1.73], apparently as a point in favour of interpreting s177C(1)(a) as providing for a 'two limb test', the EM states 'that different circumstances may demand different approaches to identification of a tax benefit.'</p> <p>In [1.74], the EM states that the two limb test 'is consistent with the legislative history' and supported by a '<b>a reasonable reading</b>'.</p>	<p>The passages from the EM referred to suggest both that: (a) courts have impermissibly 'blurred' the text of s177C(1)(a) to achieve a result other than intended by Parliament; and (b) by inference, the courts' interpretation is <b>unreasonable</b>.</p> <p>These comments are incorrect and they should be excised from the EM.</p>

No.	EM Para	EM Statement	BLS Tax Committee Comments
6.	1.39-1.53; 1.69-1.77 (Cont.)	<p>The syntax (i.e. text) of s177C(1)(a) 'supports' the view expressed in the EM (i.e. s177C provides for a two limb test) ([1.74]).</p> <p>At [1.76], the EM states: <b>'The plain language of the section does not therefore support the conclusion'</b> arrived at by the Courts in the recent cases referred to and that the <b>'better view'</b> is the one advanced in the EM.</p>	<p>These paragraphs suggest that the courts have misinterpreted the 'plain language' of s177C. They have not. They also suggest that the view supported by the EM is the 'better view'. This is an unnecessarily controversial comment to make in an EM and a comment more appropriately made in a formal legal opinion on a fact scenario.</p> <p>These paragraphs should be excised.</p>
7.	1.62 – 1.65	<p>Recent decisions suggest that s177C ('tax benefit') has replaced the s177D 'dominant purpose' test as the 'fulcrum upon which Part IVA turns' (EM, [1.62]). It is <b>'undesirable'</b> to begin the inquiry by seeking to ascertain whether the taxpayer has obtained a tax benefit. Rather, the 'inquiry into Part IVA should be a <b>single, holistic</b> inquiry': referring to <i>Hart's case</i> at [66] per Gummow and Hayne JJ (EM, [1.65]).</p>	<p>See comments in paragraph 23 of the Submission above.</p> <p>In summary, s177D has never been the 'fulcrum' on which Part IVA turns in the sense that it is appropriate to consider it prior to identification of a 'tax benefit'. As Gummow and Hayne stated in <i>Hart's case</i> at [33]:</p> <p><i>'The schemes to which Pt IVA applies are identified in s 177D. ... [T]here are two elements that must be satisfied. First, it must be shown that the relevant taxpayer has obtained, or would but for s 177F obtain, a tax benefit in connection with the scheme. Secondly, it must be shown that ... the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme ...'</i></p> <p>The approach advocated in the EM is inconsistent with the authority incorrectly cited in the EM as support for the EM's approach.</p>

No.	EM Para	EM Statement	BLS Tax Committee Comments
8.	1.66-168	Rejection of an alternate postulate as unreasonable on the ground of tax costs involved 'is to defeat the role Part IVA was intended to play in the scheme of the income tax laws. ... It can be no answer to Part IVA.'	See the comments in paragraph 16 of the Submission.
9.	1.89 and 1.93-1.96	The amendments will restore dominant purpose test as (a) the first test to be applied and (b) as the 'fulcrum' on which Part IVA pivots - and result in s177C being interpreted in the manner envisaged by Gummow and Hayne JJ in <i>Hart</i> .	<p>The proposed amendments do not give effect to the statements in (a) and (b). Ascertainment of whether a tax benefit has been obtained will remain a logically anterior step to the application of the dominant purpose test.</p> <p>Further, the Federal Court's approach (i.e. first identifying the scheme and ascertaining whether there is a tax benefit) is consistent with the interpretation of s177C adopted by Gummow and Hayne JJ in <i>Hart's</i> case (see item 7 above).</p> <p>This comment should be removed from the EM. The suggestion to the contrary in the EM is wrong.</p>
10.	1.97-1.124	Paragraphs dealing with assumptions in relation to alternative postulates.	See comments in paragraphs 8-16 of the Submission above.

No.	EM Para	EM Statement	BLS Tax Committee Comments
11.	1.125-1.127	Commencement date: 16 November 2012.	<p>The Committee welcomes the reduction in the retrospective period of application of the proposed provisions.</p> <p>The preferable approach however remains that the provisions only have prospective effect as provided for in the <i>Acts Interpretation Act 1901</i> (Cth), s3A(2), being the 28<sup>th</sup> day after the legislation receives Royal assent.</p> <p>The vagueness of the reasons referred to in [1.127] (minimisation of 'potential for taxpayers to obtain <b>unintended tax advantages</b>') is inadequate justification for retrospective application of provisions yet to be enacted.</p>