

10 December 2012

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

Dear Sir,

**Re: Submission Part IVA Draft Amendments**

The following submissions are respectfully made to the Law Design Practice and the Panel of Expert Advisers.

**1. Identifications of taxpayers gaining a tax benefit under a reconstructed alternative postulate**

In the decision in *Peabody Hill J* stated that although a tax benefit may have been found,<sup>1</sup> it could not be attributed to the taxpayer or relevant taxpayer.<sup>2</sup> The scope of the scheme can be defined by the Australian Taxation Office (ATO) as a smaller or wider scheme or schemes including a number of separate steps.<sup>3</sup> The court or the Administrative Appeals Tribunal (AAT) may substitute its identification of a scheme for that of the ATO.<sup>4</sup> If the ATO inaccurately identifies the scheme and if the court or tribunal subsequently specifies the scheme in a way that means the persons receiving the tax benefit have not been correctly identified by the ATO, it means that no taxation will be levied upon persons (the relevant taxpayer or taxpayers) gaining the tax benefit.

In circumstances where the scheme is inaccurately specified by the ATO or where an alternative postulate is assumed, it is suggested that power needs to be given to a court or tribunal to allocate the tax benefit to identified taxpayers and remit it back to the Commissioner under section 177F to make a determination.

<sup>1</sup> *Peabody v FC of T* 93 ATC 4104 p.4111-4114.

<sup>2</sup> *Peabody v FC of T* 93 ATC 4104 p.4116.

<sup>3</sup> *Federal Commissioner of Taxation v Peabody* [1994] HCA 43; (1994) 181 CLR 359; (1994) 123 ALR 451; (1994) 28 ATR 344; (1994) 94 ATC 4663 at para 24-25; *Fletcher v Federal Commissioner of Taxation* 88 ATC 4834.

<sup>4</sup> *Federal Commissioner of Taxation v Peabody* [1994] HCA 43; (1994) 181 CLR 359; (1994) 123 ALR 451; (1994) 28 ATR 344; (1994) 94 ATC 4663 at para 24-25; '...By virtue of sec. 43 of the Administrative Appeals Tribunal Act...' *Fletcher v Federal Commissioner of Taxation* 88 ATC 4834 para 1-3; Explanatory Memorandum Exposure Draft Part IVA Chapter 1 para 1.21- 1.25.

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Failure to enact such a provision may mean that in complicated tax avoidance arrangements, where a scheme may be inadvertently, technically or inaccurately specified by the ATO, the persons receiving the tax benefit will not be assessed for income tax.

## 2. Assumptions to Alternative postulates and the reconstruction provision

Proposed section 177CB states as follows:

### 177CB Assumptions relating to alternative postulates

- (1) In deciding whether paragraph 177C(1)(a), (b), (ba), (bb) or (bc) is satisfied on the basis of a postulate that is an alternative to the entry into or carrying out of a scheme:
  - (a) assume that each person (whether or not a participant in the scheme) would have acted or refrained from acting, as the case requires, without regard to any person's liability (or potential liability) to tax or withholding tax in any year of income; and
  - (b) if the scheme achieves, or would achieve, one or more non-tax effects for the taxpayer—assume that each person (whether or not a participant in the scheme) would have acted or refrained from acting, as the case requires, intending to achieve for the taxpayer:
    - (i) the same non-tax effects as the scheme achieves, or would achieve, for the taxpayer; and
    - (ii) all the other non-tax effects that were achieved, or would be achieved, for the taxpayer in connection with the scheme; and
  - (c) if the scheme does not achieve, or would not achieve, any non-tax effects for the taxpayer—assume that all events or circumstances that actually happened or existed but did not form part of the scheme would still have happened or existed.
- (2) For the purposes of paragraph (1)(b), have regard to the matters to which regard must be had under subsections 177D(1) and (2) in deciding whether this Part applies to the scheme, so far as those matters relate to the taxpayer.
- (3) In this section:

**non-tax effect** means an effect other than:

  - (a) an effect relating to the taxpayer's liability to tax (or withholding tax) in any year of income; or
  - (b) an effect that is incidental to achieving an effect, for the taxpayer, covered by paragraph (a).

The text in 177CB (1) (c) states that ‘...if the scheme does not achieve, or would not achieve, any non-tax effects for the taxpayer—assume that all events or circumstances that actually happened or existed but did not form part of the scheme would still have happened or existed...’. It is submitted that the concept being expressed in this section is the same as that articulated in *Ramsey* and confirmed in *Berry* that a tax arrangement to avoid income tax is ‘...a series of transactions [that] may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will



not...'.<sup>5</sup> The insertion of transactions or elements of transactions that had no commercial purpose were to be disregarded.<sup>6</sup> This is the view expressed by Nicholson LJ in *MacNiven* referring to the formulation by Brightman LJ in *Furniss* in terms of the limitations of the *Ramsay* principle '...that there must be a pre-ordained series of transactions, or a single composite transaction, containing steps inserted which have no business purpose apart from the avoidance of a liability to tax. Where those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes...'.<sup>7</sup>

The *Ramsay* principle was raised in *John*<sup>8</sup> and rejected by the High Court on the grounds that the express words in Part IVA were specific provisions to deal with tax avoidance, implying further limitation on tax minimisation arrangements by a taxpayer were excluded.<sup>9</sup>

In the Explanatory Memorandum (EM) at 1.71 to 1.73 it clearly explains that some schemes will merely require the deletion of the scheme as in *Lenzo*. In *Trail Bros* reconstruction was required because only part of the scheme existed in relation to the tax purpose giving rise to the deduction and resultant tax benefit.

It is respectfully submitted that the EM needs to more clearly state that the legal obligations relating to the scheme remain but that the inserted steps are to be disregarded for fiscal purposes and that the existing legal obligations remain. Further, it is respectfully submitted that it needs to be clearly stated that where a reconstructed alternative postulate is found, the tax benefit is disregarded for fiscal purposes and that the existing legal obligations remain.

Further, it is respectfully submitted that it needs to be clearly stated that there is no other scheme apart from the scheme identified and that schemes existing and continuing legal obligations.

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<sup>5</sup> *Berry v HMRC* [2011] UKUT 81(TCC) para 31; *Ramsey v IRC* [1982] AC300.

<sup>6</sup> *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51 at para 35; *Inland Revenue Commissioners v Burnham Oil Co Ltd* (1981) 54 TC 200; [1982] S.T.C. 30; 1982 S.C. (H.L.) 114; 1982 S.L.T. 348; [1982] T.R. 535; [1980] T.R. 397; HL *Furniss v Dawson* [1984] AC 474; [1984] 2 W.L.R. 226; [1984] 1 All E.R. 530; [1984] S.T.C. 153; 55 T.C. 324; (1984) 15 A.T.R. 255; (1985) 82 L.S.G. 2782; (1984) 81 L.S.G. 739; (1984) 134 N.L.J. 341; (1984) 128 S.J. 132 HL; *Carreras Group Ltd v Stamp Commissioner* [2004] UKPC 16; [2004] S.T.C. 1377; [2004] B.T.C. 8077; [2004] S.T.I. 990; (2004) 148 S.J.L.B. 473;

<sup>7</sup> *MacNiven v. Westmoreland Investments Limited* [2001] UKHL 6; [2001] 1 All ER 865 para 7 citing Brightman LJ in *Furniss v Dawson* [1984] AC 474, 527.

<sup>8</sup> *John v Federal Commissioner of Taxation* [1989] HCA 5; (1989) 166 CLR 417; (1989) 83 ALR 606; (1989) 63 ALJR 166 (8 February 1989).

<sup>9</sup> *John v Federal Commissioner of Taxation* [1989] HCA 5; (1989) 166 CLR 417; (1989) 83 ALR 606; (1989) 63 ALJR 166 (8 February 1989) at para 37-40 per Mason C.J., Wilson, Brennan, Dawson, Toohey and Gaudron JJ; Tretola, John (2006) "The Interpretation of Taxation Legislation by the Courts - A Reflection on the Views of Justice Graham Hill," *Revenue Law Journal*: Vol. 16: Iss. 1, Article 5. P.96' at: <http://epublications.bond.edu.au/rlj/vol16/iss1/5>

Secondly, it is respectfully submitted that, as in the Canadian situation, it be made clear in the EM that the existence of a tax benefit is a factual determination made by the ATO.<sup>10</sup> The obligation is on the taxpayer to refute the ATO's factual assumptions.<sup>11</sup>

In the United Kingdom (UK), a tax benefit is described as a question of fact where it '...refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction...',<sup>12</sup> or as '...[t]he hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such a reduction in his tax liability...'.<sup>13</sup>

A tax benefit occurs where a costless (or near costless) transaction results in a lower taxed transaction than would have occurred in the absence of that transaction.<sup>14</sup>

It is respectfully submitted the EM needs to make clear that the *tax-effect* (as opposed to *non tax-effect*) includes the concept that income tax is reduced without incurring the full economic consequences of commercial gain or loss in attaining the tax benefit.

### **3. An overlay provision exempting specifically legislated transactions that are tax benefited.**

The Australian legislation does not have a general overlay provision.<sup>15</sup> Some transactions are excluded from the operation of Part IVA in section 177C defining tax benefits where there is discussion of non inclusion of assessable income, allowance of a deduction, incurring of a capital loss or a foreign tax offset of the taxpayer as a result of the making of an agreement, choice, declaration, election or selection, giving notice of exercise of an option under the Income Tax Assessment Act 1936 (*ITAA36*) Income Tax Assessment Act 1997 (*ITAA97*).<sup>16</sup>

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<sup>10</sup> *Canada Trustco v The Queen*, 2005 SCC 54 at para 18-20.

<sup>11</sup> *Canada Trustco v The Queen*, 2005 SCC 54 at para 63.

<sup>12</sup> *Berry v HMRC* [2011] UKUT 81(TCC) para 31, viii); *WT Ramsay Ltd v IRC* [1981] STC 174 at 45 182, [1982] AC 300 at 326; *IRC v Burmah Oil Co Ltd* [1982] STC 30 at 38, 54 TC 200 at 221; *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] STC 226 at 238, 240–241, 246, [1992] 1 AC 655 at 673, 676, 683; *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] STC 237 at [5], [32], [2003] 1 AC 311 at [5], [32]; *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [38], [2005] 1 AC 684 at [38].

<sup>13</sup> *IRC v Willoughby* [1997] STC 995 at 1003 per Lord Nolan, cited in Thuronyi V *Comparative Tax Law* Kluwers International, The Hague 2003 P.156.

<sup>14</sup> Edgar T 'Building A Better GAAR' *Virginia Tax Review* Vol 27 833 P. 871-872 and [FN77]; Dept. Of the Treasury, *The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals* pt. VI.B (1999) appendix A.

<sup>15</sup> Edgar T., lecture at Sydney University August 10, 2012.

<sup>16</sup> Section 177C (2), *ITAA36*.



The overlay provision should stipulate specifically those sections of the legislation that the Part IVA does not apply to, so that there cannot be any ambiguity as to whether it is applied to transactions that otherwise might be characterised as tax avoidance.

Alternatively or additionally, the overlay provision could exclude those specific anti avoidance provisions in the *ITAA36* and *ITAA97* that do not need to be considered by the Part IVA.<sup>17</sup>

An overlay provision might give greater certainty to legislation enacted by Parliament to reward certain behaviours adopted by taxpayers with tax benefits that may otherwise be regarded as tax avoidance.

The foregoing is respectfully submitted for your consideration. The erudite efforts of the Law Design Practice and the Panel of Expert Advisers in this difficult and significant task are to be commended.

Yours faithfully,



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<sup>17</sup> Commonwealth of Australia 'Improving the Operation of The Anti Avoidance Provisions in the Income Tax Law' Discussion Paper 18 November 2010.