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by email: partIVA@treasury.gov.au

ENSURING THE EFFECTIVENESS OF THE INCOME TAX GENERAL ANTI-AVOIDANCE RULE

Dear Ms Roff

This letter comprises my submission in respect of certain technical matters connected with the public consultation launched by Treasury on 16 November 2012 titled *"Ensuring the Effectiveness of the Income Tax General Anti-avoidance Rule"*.

By way of background, I am a post-graduate research student with the School of Taxation and Business Law, Australian School of Business at the University of New South Wales ("ATAX") with a focus on taxation anti-avoidance rules as they apply to international commercial transactions. Prior to my time with ATAX, I worked for many years in European capital markets on cross-border investment and fund-raising transactions and acquired experience of a wide number of OECD tax regimes and the issues which each faces in balancing the operation of local anti-abuse rules with the desire to facilitate in-bound and out-bound foreign investment. I have published material on the present Australian general anti-avoidance rule ("GAAR") and my views on its operation in the context of a topical in-bound investment scenario are set out in "Tax benefits, part IVA and treaty tourism – evaluating the ATO's assault on foreign private equity" (2012) 41 *Australian Tax Review* 62.

My submission does not seek to challenge the policy wisdom which has prompted the proposed revision to Australia's GAAR, although I note that there are strong

arguments to support the claim that the existing rules are already functioning fairly and effectively, albeit in a matter inconsistent with demanding government revenue objectives. Rather, my purpose is to draw your attention to two matters which you may like to take into account when re-drafting the explanatory material to accompany the final set of revisions to Part IVA. Both of these matters surfaced at a seminar hosted by Greenwood & Freehills in Sydney on 27 November 2012 titled *"The Part IVA Reforms"* which was chaired by Professor Graeme Cooper (University of Sydney) and which you also attended as a panel member in the company of Mr Andrew England, Chief Tax Counsel, Australian Tax Office. The two matters arise directly from the questions asked of you and Mr England by participants at the seminar and my suggestions are influenced by the answers which you both gave. In many respects I found the responses from the panel far more illuminating than the opaque syntax of the Exposure Draft and its Explanatory Memorandum – I am of the view that both would benefit from a re-drafting along the lines I set out below.

(1) Interaction of the test for identifying "tax benefits" under ss 177C and 177CB with the test for ascertaining dominant "purpose" under s 177D

Page 16 of the draft Explanatory Memorandum stipulates that under the revised law "[t]he question of whether Part IVA applies to a scheme necessarily involves a single, holistic, inquiry into whether a person participated in the scheme with a sole or dominant purpose of securing for the taxpayer a particular tax benefit in connection with the scheme". In this context Professor Cooper expressed his own puzzlement regarding the operation of proposed s 177CB(2) and the iterative relationship which the draftsperson intended it to bear with the dominant purpose test in s 177D. Members of the audience also seemed confused that the new rules for identifying tax benefits introduced by s 177CB would somehow alter or contaminate the inquiry posed by s 177D as to the purpose of any party to the scheme in obtaining that tax benefit for the taxpayer under scrutiny.

In response to questioning, both you and Mr England emphasised that the amendments were not intended to modify the s 177D inquiry as to purpose but rather were designed to widen the definition of tax benefit, thereby increasing the frequency with which the purpose test would need to be consulted. A participant specifically asked you both whether, had the revised rules been applicable to the facts present in the cases of *Eastern Nitrogen Ltd v FCT*[1] and *FCT v Metal Manufactures*[2], you believed a different outcome would have arisen. These two cases both gave rise to practical issues dealing with the application of the s 177D dominant purpose test and your response was that those results would remain unchanged as the new rules were not designed to affect the purpose test in any way. Mr England agreed with you.

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1 (2001) 108 FCR 27.

2 2001 ATC 4152.

Another participant posited the example of a husband, who having received a large sum of money, decided to make a deposit into a joint bank account with his wife in order to benefit from a lower average rate of taxation on future interest income. Once again you said that the availability of Part IVA was a matter that would be determined by application of the s 177D purpose test, which would remain unchanged and that new s 177CB merely operated to ensure that the s 177D inquiry stage was in fact reached and that s 177C could no longer be construed by a court to operate as a roadblock.

I believe that in order to allay taxpayer fears of legislative and administrative over-reach of the new provisions, any re-drafting of the Explanatory Memorandum would be well served by inclusion of some examples where the new provisions are ***not*** intended to affect the operation of the existing jurisprudence on s 177D. The examples referenced above provide two apposite cases.

A more powerful example which you could cite (that I believe would deliver great comfort to the broader business community) would be the recent judgment of the Full Federal Court in *RCI Pty Ltd v FCT*[3]. Based on your responses in the seminar, it would seem clear to me that if the text of the revised legislation were to have applied on the facts present in *RCI* then the Full Federal Court would have been compelled to find that a tax benefit existed for purposes of s 177C. This result seems to me to be the primary intent of the new legislation.

However it also seems to me to be the case that it would still be valid for that court to have concluded that despite the presence of a tax benefit, the dominant purpose of parties to the scheme was not to obtain that tax benefit for the relevant taxpayer based on an assessment of the eight factors set forth in s 177D. If you were to cite this example in the Explanatory Memorandum and make the concession that there was nothing in the revised law which was intended to alter the ultimate s 177D result produced by the *RCI* court, I believe you will assuage much community concern.

By including the *RCI* example in the Explanatory Memorandum, this would give you the opportunity to distinguish the contrary outcome which the court at first instance would now be obliged to reach in *Futuris Corporation Ltd v FCT*[4] and to highlight the essentiality of the s 177D purpose inquiry which the Full Federal Court was able to side-step in both *FCT v AXA Asia Pacific Holdings Ltd*[5] and *FCT v Futuris Corporation Ltd*[6] but would now be obliged to undertake. If I have understood you correctly, this seems to be the intent of the revised legislation.

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3 2011 ATC 20-275.
4 2010 ATC 20-206.
5 (2010) 189 FCR 204.
6 (2012) 205 FCR 274.

(2) Requirement for consistency of alternative postulates at each of the s 177C and s 177D stages

A related area of concern which manifested itself in the questions directed at you by the seminar participants was whether the new constraints imposed by s 177CB on the identification of so-called "alternative postulates" used to delineate s 177C tax benefits, could also be viewed as limiting the universe of alternative postulates to which a taxpayer might wish to have regard in responding to the statutory question posed by s 177D.

You and Mr England both appeared to acknowledge that no such limitation was intended by the drafting and that a taxpayer could continue to have recourse to its own set of alternatives when seeking to establish that its dominant purpose was to do something other than to obtain the tax benefit identified by s 177C. In particular, you seemed to be saying that the taxpayer can have regard to whichever alternative postulate it likes at the s 177D stage, but, if, measured against the eight factors required to be considered, a court ultimately makes a finding adverse to the taxpayer (such that it is seen to possess the relevant purpose of obtaining a tax benefit) then as a quantification exercise, that tax benefit *must* be measured by reference to the s 177C alternative postulate asserted by the Commissioner and not by reference to any fresh alternatives raised by the taxpayer in the course of the s 177D inquiry.

If this is what you believe the new law is intended to achieve, once again, I think there is much to recommend you explicitly stating this in the Explanatory Memorandum and that you are not seeking to alter the state of affairs reached by the existing jurisprudence on s 177D postulates. In this context, I believe it would be helpful if the Explanatory Memorandum were to cite the unanimous judgment of the High Court in *FCT v Consolidated Press Holdings Ltd*[7] where it was stated "[n]or is there any inconsistency involved, as was submitted, in looking to the wider transaction in order to understand and explain the scheme, and the eight matter listed in s 177D" and to confirm that this passage remains good law under the revised regime.

Taxpayers ought derive substantial comfort if you are able to acknowledge that in defending a s 177D dominant purpose inquiry it remains possible for them to have recourse to the full circumstances of the commercial arrangements entered into by them and that they are not artificially confined by reference to those (limited) integers relevant to the scheme particularised by the Commissioner for s 177A purposes or the postulate called upon by him to validate the existence of a tax benefit for s 177C purposes. By doing so, you would be reinforcing the objective nature of the s 177D inquiry and also reinforcing the paramount character of that

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7 (2001) 207 CLR 235 at [96].

inquiry even though your policy preference now appears to be one of removing objectivity from the s 177C question.

Put another way, it would appear to me that whilst proposed s 177CB prevents taxpayers from having recourse to the so-called "do nothing" alternative postulate such that they cannot use it to defeat the Commissioner from establishing a s 177C tax benefit, there seems to be nothing in the new law which would inhibit a taxpayer from arguing a "do nothing" alternative at the s 177D stage when having regard to the eight factors set forth in s 177D(2) so as to answer the purpose inquiry. Whether or not the taxpayer ultimately wins or loses will be up to the court based on all of the factual material before it. If this is a valid interpretation of how the new law is intended to operate, I believe that such a confirmation is worthy of inclusion in the Explanatory Memorandum.

Yours sincerely

Tim Russell