Muffled Echoes of Old Arguments and Part IVA

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"Muffled echoes of old arguments" seemed an appropriate tag with which to talk about Part IVA to a tax conference seeking to "put our future in focus" in a place called "Bunker Bay". The future of Part IVA is difficult to put into focus with precision. Its terms are the subject of debate. Counsel for the Commissioner, in a recent application for special leave to appeal, contended that the recent construction of Part IVA "distorts the whole operation" of the provisions.[1] The challenge for all who need to consider Part IVA is to make sense of its provisions in a way that produces reasonable and predictable outcomes for the future.

Conclusion about dominant purpose

The trigger to the operation of Part IVA is a conclusion about the purpose of a participant to a scheme. In contrast, s 260 of the *Income Tax Assessment Act 1936* (Cth) was expressed to operate upon the existence of a fact and not upon a conclusion about the purpose of a participant. Section 260 operated on its own terms to render void as against the Commissioner every "contract, agreement or arrangement" which had the purpose or effect of reducing the

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1 Quoted in *Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* [2011] FCAFC 49, [154] (Edmonds J).

tax that would otherwise be payable by a taxpayer. Section 260 presupposed that what had been done through the contract, agreement or arrangement was to have changed the tax that would otherwise have been assessed. Part IVA was intended to do much the same but that it would do so by reference to the purpose to be ascribed to a participant in a scheme rather than to the scheme itself. The purpose upon which Part IVA was to apply was not the actual purpose of anyone, but the purpose to be imputed to a person for the consideration of specified matters. Although different from the way s 260 operated, the similarity between it and Part IVA was clear and intended.

In a recent paper "celebrating" the 30th anniversary of Part IVA, Sir Anthony Mason observed that the High Court "has rejected any attempt to interpret Pt. IVA by reference to arguments based on s.260 and has insisted that the Part be interpreted according to its terms".[2] Sir Anthony cited the passage from *Federal Commissioner of Taxation v Spotless Services Ltd*[3] in which the joint judgment rejected the construction of Part IVA under the influence of "muffled echoes of old arguments" concerning other legislation. Sir Anthony's observations must be read with care. He did not say that the High Court had rejected a construction of Part IVA by reference to the explanatory memorandum[4] or by reference to the mischief it was intended to provide for[5]

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2 Sir Anthony Mason AC KBE, (speech delivered at the PricewaterhouseCoopers Part IVA 30th Anniversary Dinner), 26 May 2011, 8 [16].

3 (1996) 186 CLR 404, 414 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ).

4 See: *Acts Interpretation Act 1901* (Cth) s 15AB.

5 See: *Heydon's Case* (1584) 3 Co Rep 7a; 76 ER 637, 638 (Chief Baron and Sir Roger Manwood); *Pambula District Hospital v Herriman* (1988) 14 NSWLR 387, 410 (Samuels JA); *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 408 (Brennan CJ, Dawson, Toohey, and Gummow JJ); *MLC Limited v FCT*

and, indeed, the High Court made extensive use of the explanatory memorandum accompanying the Bill to enact Part IVA when deciding *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd.*[6]

The relevant passage from *Spotless* rejecting the construction of Part IVA under the influence of muffled echoes of old arguments from other legislation repays re-reading:

> Part IVA is to be construed and applied according to its terms, not under the influence of "muffled echoes of old arguments" concerning other legislation. In this Court, counsel for the taxpayers referred to the repetition by the Privy Council in *Commissioner of Inland Revenue v Challenge Corporation* of the statement by Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* that "[e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be". Lord Tomlin spoke in the course of rejecting a submission that in assessing surtax under the *Income Tax Act 1918* (UK) the Revenue might disregard legal form in favour of "the substance of the matter". His remarks have no significance for the present appeal. Part IVA is as much a part of the statute under which liability to income tax is assessed as any other provision thereof. In circumstances where s 177D applies, regard is to be had to both form and substance (s 177D(b)(ii)).[7]

The “muffled echoes” rejected by the High Court in this passage were not those from the explanatory memorandum accompanying the Bill enacting Part IVA, nor the mischief it was intended to provide for, nor the history leading up

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(2002) 126 FCR 37, [31]-[32] (Hill J).

6 (2001) 207 CLR 235.

7 *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 414 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ) (citations omitted).

to its enactment, nor the predication test in *Newton v Federal Commissioner of Taxation*[8] at least to the extent made relevant by the explanatory memorandum and other admissible aids to the proper construction of Part IVA. The rejected "muffled echoes" were, rather, the more general arguments found in *Inland Revenue Commissioners v Duke of Westmister*[9] called in aid of a submission in *Spotless* that legal form could be disregarded in favour of the substance of a transaction. The High Court in *Spotless* rejected a construction of Part IVA by reference to such arguments about form in preference to substance noting that the terms of s 177D(b)(ii) themselves required that regard be had both to form and to substance. It may be correct to say that "the *Newton* predication test cannot be substituted for the statutory provisions"[10] of Part IVA but the *Newton* test remains relevant to its construction as are the notions of "artificiality" and "contrivance".[11]

Alternative postulates

I focus upon the similarity between s 260 and Part IVA to draw attention to the fundamental question that both provisions required to be answered before either of the tax avoidance provisions could operate. The question in each case is whether something was done which could be said to have avoided what would otherwise have occurred. The question was posed more directly by s 260 than by s 177D, but it is posed no less by s 177D in Part IVA. Relatively recent jurisprudence on the interpretation and application of Part IVA has called for an inquiry into an alternative postulate. This may have

8 (1958) 98 CLR 1.
9 [1936] AC 1, 19 (Lord Tomlin).
10 Sir Anthony Mason AC KBE, above n 2, 8 [16].
11 Cf Ibid.

caused complications and concerns about how to apply Part IVA, but much of the complications and concerns about the "alternative postulate" may disappear if what is kept firmly in mind is that what the anti avoidance provisions were designed to operate upon an hypothesis that something was done to avoid something else. The complication may disappear because enquiries into alternative postulates are enquiries into the question upon which the conclusion required by s 177D depends.

It is worth recalling how the issue of the "alternate postulate" appears to have arisen in *Federal Commissioner of Taxation v Hart.*[12] The issue in *Hart* was not whether or not there was a tax benefit but, rather, whether the deductions obtained by Mr and Mrs Hart in the context in which they were obtained led to the conclusion that s 177D required for Part IVA to operate. The case was, in other words, about how to determine whether the dominant purpose of the scheme by which the tax benefit was obtained was predominantly to obtain the tax benefit.

What was critical for an answer to that question was the implication embedded both in s 260 and in Part IVA. Both provisions carried the implication that what was done by a taxpayer avoided something else that would otherwise have imposed a greater tax liability. Section 260 posed the question by reference to the predication test enunciated in *Federal Commissioner of Taxation v Newton.*[13] The question in *Hart* was how the

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12 (2004) 217 CLR 216.

13 (1958) 98 CLR 1.

same question was to be answered in the context of Part IVA. It, however, just like s 260, presupposes that but for the scheme a tax benefit would not have been obtained. That could be seen from s 177C. Section 177C presupposes that the scheme to which the Part will be subjected is the scheme which, but for it, would have achieved a less favourable tax outcome. It was in that context that the Commissioner had argued in *Hart* that an inquiry into the purpose directed by s 177D required an inquiry into a comparison between the scheme and an alternative. Section 177D required that because s 177C demanded that the scheme to be considered was the scheme which had produced the tax benefit. The combination of s 177C with s 177D was to ensure that the question posed by s 177D required a comparison between what was done with what would have occurred had the scheme not been entered into. How else could the question posed by s 177D be answered?

It was in that context that Gummow and Hayne JJ said:

> In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or carried out, the deductions "might reasonably be expected not to have been allowable". When that is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed. To say, as Hill J did, that "the manner in which the scheme was formulated and thus entered into or carried out is certainly explicable only by the taxation consequences" assumes that there were other ways in which the borrowing of moneys for two purposes (one private and the other income producing) might have been effected. And it further assumes that

> those other ways of borrowing would have had less advantageous taxation consequences.[14]

Their Honours were plainly addressing their observations to answering the question posed by s 177D (being the issue in the case) but the passage has been taken as requiring that something may not be a "tax benefit" within the meaning of Part IVA unless there is *first* a factual inquiry into what the taxpayer might have done had the taxpayer not entered into the scheme.[15] The context of the passage quoted, however, was the posing of the question upon which s 177D is made to depend for the purpose of cancelling the tax benefit and not by way of analysis of whether a tax benefit had been obtained. The conclusion that a particular transaction was entered into for the dominant purpose of enabling the taxpayer to obtain the tax benefit necessarily requires some conception of something else by reference to which the conclusion is to be reached. Indeed, the conclusion in s 177D is required to be reached having regards only to the eight matters stipulated in s 177D(b) and not by reference to facts and circumstances not found within the eight factors in s 177D(b). Their Honours in the passage in *Hart* did not say that the conclusion required by s 177D required or permitted an inquiry into facts and circumstances other than those listed in the eight matters identified in s 177D(b). Rather, the passage explained that to draw a conclusion from those factors carried the implication that what was done could have been done differently. The conclusion about tax avoidance (if any) was to be found in considering what was done with how else the same thing could have been

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14 *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 243-4 [66] (Gummow and Hayne JJ).

15 *Epov v Federal Commissioner of Taxation* (2007) 65 ATR 399, [62] (Edmonds J).

achieved. It is in that difference that the conclusion about tax avoidance is to be found.

Part IVA, like s 260 before it, is premised on a consideration of the scheme and what might reasonably be expected to have occurred otherwise. Part IVA is inapplicable where the result of the statutory inquiry, upon a consideration of the eight factors, viewed objectively, does not point to the conclusion that the transaction was entered into or carried out in that particular way so as to obtain the tax benefit, even though a reduction of tax was a substantial effect of the scheme. But Part IVA will apply if a consideration of the eight factors indicates that the particular scheme was entered into or carried out mainly or solely to obtain the tax benefit, even though the scheme was the means adopted for some further commercial goal. What is necessary, therefore, is to consider the eight matters, listed in s 177D(b), which operate together to direct a structured inquiry extending beyond the effects of the scheme. It is clear from s 177D(b) that the manner in which a scheme is entered into or carried out, and its form and substance, are essential elements of the statutory process for determining the relevant "purpose". Each of these factors directs consideration to how, or the way in which, the effects of the scheme are achieved. Further, as had been observed in *Federal Commissioner of Taxation v Spotless Services Ltd*,[16] the considerations indicated by the sub-paragraphs in s 177D(b) also "throw further light upon the form and substance of the scheme … and the manner in which the

[16] (1996) 186 CLR 404, 420 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ).

scheme was carried out". The other considerations directed by sub-section 177D(b) concern what would have been the taxpayer's position, or what might have been expected to have been the taxpayer's position, but for the scheme. In other words, the effects of the scheme are to be compared with something and not merely considered in isolation to determine whether the s 177D conclusion is to be reached.

Dichotomy between rational commercial decisions and tax planning

The particular facts in *Hart* (like those in *Spotless* and *CPH*) showed a wider commercial objective to have been achieved by what the taxpayer had done than merely the obtaining of the tax benefit. In *Hart* the taxpayers secured funds for their properties; in *Spotless* the taxpayers lent money and received interest income. A wider commercial objective apart from tax, however, would not prevent the operation of Part IVA[17] if the commercial objective was achieved in a particular way which showed that the tax benefit was the main or predominant explanation for the scheme as entered into.

A fundamental consequence of *Spotless* was to have rejected a dichotomy between rational commercial decisions and tax planning.[18] The consequence was to uphold the application of Part IVA in some cases where tax objectives explained the structure of what was otherwise a wholly commercial, and otherwise fiscally permissible, outcome. The fiscal outcome in *Spotless* could

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17 *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235, 264 (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ); *Federal Commissioner of Taxation v Spotless Services Pty Ltd* (1996) 186 CLR 404.

18 *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 415-6 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ).

conceivably have been obtained without structuring and, indeed, the structuring in that case may be seen to be directed to achieve and secure commercial objectives rather than to manufacture artificial or contrived tax outcomes. These considerations have seen Part IVA apply in that difficult area where genuine commercial objectives and tax considerations meet and influence each other in the structure adopted by taxpayers. In that context there is a genuine concern that Part IVA may have come to apply more broadly than intended and, perhaps, more broadly than fiscal policy would require that it should.

The concern that Part IVA may apply more broadly than it should, or perhaps than was intended, may in part be seen by Justice Hill's lament in *Macquarie Finance Ltd v Federal Commissioner of Taxation.*[19] In that case his Honour upheld the application of Part IVA but expressed the view that its application was unlikely to have been what those drafting the provisions had intended. A similar lament was perhaps made by what his Honour had said some years earlier in *CPH Property Pty Ltd v Commissioner of Taxation.*[20] In that case his Honour considered the potential application of Part IVA in the context of a commercial transaction effected in part by the interposition of a company which, had it been successful, would have had the effect of preserving the tax deductibility of interest payments that would otherwise have been quarantined by operation of s 79D. In that context his Honour said:

> It might perhaps be said that one of the problems in the present case lies in artificially dissecting part of a scheme from the totality

[19] (2004) 57 ATR 115.
[20] (1998) 88 FCR 21.

> of the scheme adopted. The arrangement as a whole was directed to a commercial end much more significant than tax. Part of the structure was devised because of tax, but the separating out of the tax and non-tax benefit leaves outside the structure both the borrowing of ACP and the subscription of moneys for shares by CPIL(UK). That, however, is a consequence of the decision of the High Court in *Spotless*.[21]

The remark in the last sentence was a reference to what the High Court had said in *Spotless*, namely that the "fact that the transaction was commercial does not require the conclusion that the dominant purpose would fall outside the part, for there is no true dichotomy between schemes which are commercial and those which are tax driven".[22] Perhaps those drafting the provisions had not subjectively intended the provisions to operate in that way, and perhaps that is why Hill J ascribed the result as "a consequence" of the decision in *Spotless* rather than flowing transparently from the statutory provisions themselves. However interesting it may be to pursue these thoughts, the fact is that it is now well established that the application of Part IVA will not be defeated merely because the scheme entered into was directed to, and in fact achieved, a wider commercial purpose than merely the tax benefit obtained.

It has repeatedly been held since *Spotless* that Part IVA may apply to transactions which have overall commercial objectives. *Spotless* was a case in which a taxpayer sought to derive interest income by a deposit of money at interest. The deposit was commercial; the interest received was real. The taxpayer could have achieved the tax benefit it sought to achieve without the

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21 Ibid 42.

22 Ibid 41 citing *Spotless* at 415-6.

possibility of the application of Part IVA had it done no more than write and post a cheque to the bank in the Cook Islands for derivation of interest income upon that deposit in the Cook Islands. *Hart* is the flipside of the same coin. In *Spotless* the taxpayer lent money to derive real interest income; in *Hart* the taxpayers borrowed money and paid real interest on which they claimed deductions. In that case it is also probable that the taxpayer could have achieved the fiscal consequences had they been able to secure two loans with two different banks, or perhaps two loans even with the same bank, but which were not linked in the way in which they were in that case. In each case there were aspects of the commercial transactions seeking to secure commercial objectives which were only made necessary to ensure the tax benefits would remain available. In each case it was those factors which explained the way in which the transaction (otherwise commercial) was done to secure the tax consequences in fact secured. The elements of "artificiality" in the schemes were the commercial terms necessary to preserve the commercial objectives. The tax benefits could have been achieved easily (and without the anti avoidance provisions applying) but the schemes were undertaken to secure the commercial objectives that obtaining the tax benefit alone might not preserve.

The Predication Test

The Privy Council had made an attempt in *Newton v Federal Commissioner of Taxation*[23] to enunciate a test to determine when a transaction would fall within the ambit of an anti avoidance provision. The test required an objective

[23] (1958) 98 CLR 1.

observer to look at the transactions and to be able to predicate that they were implemented in that particular way so as to avoid tax. The test was put in these terms:

> In order to bring the arrangement within the section you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section. Thus, no one, by looking at a transfer of shares *cum* dividend, can predicate that the transfer was made to avoid tax. Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Div. 7 tax … Nor could anyone, on seeing a declaration of trust made by a father in favour of his wife and daughter, predicate that it was done to avoid tax …[24]

A critical textual comparison of this statement and the statutory provision might prompt the comment that little had been said by their Lordships beyond the words in s 260 themselves. Nonetheless, the dicta served for many years as the basis upon which impermissible tax avoidance was to be recognised and the anti avoidance provisions were to be applied. The Australian legislature appears clearly enough to have intended the enactment of Part IVA to have given legislative effect to the predication test which had been enunciated in *Newton v Federal Commissioner of Taxation*.[25]

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[24] (1958) 98 CLR 1, 8-9 (Lord Denning on behalf of the court).

[25] GT Pagone, *Tax Avoidance in Australia* (2010) 27-8; Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth), 9553; Second Reading Speech, Income Tax Laws Amendment Bill (No 2) 1981 (Cth), 2684; See also *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 408; Michael D'Ascenzo, 'Part IVA and the Common Sense of a Reasonable Person' (Paper presented at the Queensland Taxation Institute Convention, 17 May 2002) www.ato.gov.au/corporate/content.asp?doc=/content/22809.htm; Cf Sir Anthony

The predication test in *Newton* required a consideration of the particular contract, agreement or arrangement which had been identified as an avoidance transaction to determine whether its objectively ascertainable purpose was to avoid tax. The inquiry called for was not into the actual motive or purpose (whether subjective or objective) of the participants to the transaction. It could be assumed that tax avoidance was a motive which any taxpayer may have had without the anti avoidance provisions applying. What the provision was thought to strike at, therefore, was not an intention to avoid tax but, rather, at transactions about which nothing could be said of them except that tax avoidance was their dominant purpose. The distinction is less subtle than it might sound, and in that distinction there may be the only sound and principled criterion by which anti avoidance provisions may sensibly, reliably and defensibly apply.

Amongst the many sound reasons why the anti avoidance provisions should not apply upon proof of a person's actual decision to avoid tax is that sound tax policy should not make the anti avoidance rules depend upon, and to vary as between, identical transactions. A wholly artificial tax avoidance scheme should be struck down whether or not a taxpayer can be shown to have a tax avoidance purpose.[26] The converse is also sound tax policy: tax avoidance rules should not apply where a person takes advantage of a provision in the tax law designed to provide a tax benefit. These considerations might provide

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Mason, paper delivered to PricewaterhouseCoopers Part IVA 30th Anniversary Dinner, 26 May 2011, 8 [16].

[26] *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235, 264 [95] (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ); see also *Federal Commissioner of Taxation v Sleight* (2004) 136 FCR 211; *Vincent v Federal Commissioner of Taxation* (2002) 124 FCR 350.

the basic outlines for how a tax avoidance provision must be applied. A focus upon purely artificial steps and transactions should reliably enable taxpayers, revenue officials, and other decision makers to determine when to apply and when not to apply the anti avoidance rule.

The essence of the predication test was essentially an inquiry into whether something was done which had no function or explanation other than taxation. That, upon a careful consideration, would exclude from the operation of the anti avoidance rule many transactions which were motivated by tax but about which one could not say there was no explanation other than tax. A trustee's decision, for example, to make distributions in a discretionary trust to maximise the tax benefits between the beneficiaries may be motivated wholly, and exclusively, by the tax considerations flowing from the distributions made, but still not be caught by the anti avoidance provisions because, although tax may have been the motivation for the resolution, the resolution produced more than the tax consequences: the beneficiaries gain entitlements flowing from the resolutions which they would not otherwise have had. On such a basis the predication test as enunciated in *Newton* would similarly not apply to conduct motivated by taxation (however entirely motivated by tax considerations that might be) where one looked at the transaction and found that the overt acts did something more than the tax consequence produced. That kind of analysis explains the examples found in the well known passage in *Newton*. No one could say that the private company which had been turned into a non private company in *WP Keighery Pty Ltd v Federal*

Commissioner of Taxation[27] was motivated by anything other than taxation. The beneficial tax consequences may be why the reconstruction occurred, but the reconstruction did occur in fact and that brought with it other commercial and legal consequences apart from tax. That situation was given as an example in *Newton* of one where the anti avoidance provision would not operate for the reason that, whatever the motivation may have been, the conversion of a company from a private company to a non private company did effect more than tax consequences.

Seen in this way an anti avoidance provision provides a valuable adjunct to a taxing statute by ensuring that taxpayers do not embellish their transactions with curlicues that have no purpose beyond taxation without Part IVA becoming a primary source of taxation.[28] Such an approach to the interpretation of the anti avoidance rules also has the highly desirable consequence of confining its operation within predictable bounds. There might still be room for debate in particular cases about how the test is to be applied, but it would confine the debate to a principled one about analysing those elements of a transaction which produced or which secured the tax consequence to determine whether those elements had some function other than tax. The anti avoidance provisions could predictably apply where the

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27 (1957) 100 CLR 66.

28 GT Pagone, 'Taxation by Discretion' (Speech delivered at the Australian Association of Constitutional Law Conference, Sydney, 9 June 2011) <http://www.supremecourt.vic.gov.au/wps/wcm/connect/justlib/Supreme+Court/Home/Library/SUPREME+-+Speech+Taxation+by+Discretion>.

non tax function was non-existent, immaterial or so overwhelmed by the tax purpose that the commerciality of the element is overshadowed.[29]

Objective purpose

The same considerations that arose in *Newton* under the s 260 jurisprudence also arise in application of s 177D in Part IVA in the 1936 Act. Whatever else Part IVA may do, its application depends upon a conclusion about the dominant purpose of a taxpayer entering into the transaction in the particular way that it was entered into. The conclusion required by s 177D is not about the actual purpose of anyone. Section 177D does not call for an inquiry into the actual purpose of anyone. The section could have been made to turn upon a finding that one or more persons connected with a scheme was actuated by a purpose of a taxpayer obtaining a tax benefit. Alternatively, the section could have included the actual purpose of such a person amongst the list of factors required to be considered. The section plainly does neither. Indeed, it expressly contemplates the application of Part IVA to a taxpayer where some person other than the taxpayer (namely one of the many who may have entered into or carried out the scheme) may be concluded to have the relevant purpose without any requirement to link that person's presumed purpose to an actual, or even imputed, state of knowledge of the taxpayer obtaining the benefit.

A reason for making s 177D turn upon "the objective matters listed" in the section "was to avoid the consequence" of Part IVA depending on "the fiscal

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[29] *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 408.

awareness of a taxpayer".[30] In *Federal Commissioner of Taxation v Hart*[31] the Court made clear that an actual purpose of entering into or carrying out a transaction to secure a tax benefit would not trigger the operation of Part IVA.[32] Gummow and Hayne JJ said in a joint judgment:

> In these matters, it is, of course, true that the money was borrowed to finance and refinance the two properties. Of course the loan was structured in the way it was in order to achieve the most desirable taxation result. But those are statements about why *the respondents* acted as they did or about why the lender (or its agent) structured the loan in the way it was. They are not statements which provide an answer to the question posed by s 177D(b). That provision requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any inquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.[33]

The conclusion called for by the inquiry required by s 177D is not whether someone actually entered into or carried out the scheme to enable the taxpayer to obtain the tax benefit, but rather whether a conclusion of that kind would be reached having regard to the particular, specific but limited, matters which s 177D(b) requires to be considered.

Gummow and Hayne JJ in their joint judgment expressed the general inquiry directed by Part IVA as requiring a comparison between the scheme in question and an alternative postulate.[34] To draw a conclusion about purpose

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30 *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235, 264 [95] (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ).

31 (2004) 217 CLR 216.

32 Ibid 222 [3], 227 [15] (Gleeson CJ and McHugh JJ), 243 [65] (Gummow and Hayne JJ).

33 Ibid 243 [65].

34 Ibid 243 [66].

from the eight matters will "require consideration of what other possibilities existed".[35] In particular it will require an inquiry into what was done to determine whether to conclude that the way it was done is to be attributed to the tax benefit secured by that means. An inquiry into whether obtaining a tax benefit for a taxpayer was the dominant purpose of someone participating in a scheme requires an evaluation of the significance of the tax benefit produced by the scheme to the scheme being entered into or carried out. Whether the tax benefit is the explanation to be imputed to the participants to the scheme will depend on a precise identification of the scheme, of the tax benefit and of the connection between the scheme and the taxpayer obtaining the tax benefit.

In *Federal Commissioner of Taxation v Spotless Services Ltd*[36] the High Court considered that the requisite purpose was found in the particular means adopted by the taxpayer to obtain its commercial return.[37] In *Hart* Gummow and Hayne JJ found in the terms of the actual loans entered into matters that "were explicable *only* by the taxation consequences for" the taxpayer.[38] Their Honours did not undertake a factual inquiry about what alternative deal or arrangements might have been done, but about how else the commercial objective which was secured through the scheme would or might reasonably be expected to be achieved without the scheme. Their focus was on whether there was some element of the transaction which could only be explained by

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35 Ibid.

36 (1996) 186 CLR 404.

37 Ibid 423 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ).

38 *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 244 [68], emphasis as per quote.

the tax benefits it secured. Seen in that way, the test in s 177D matches the predication test enunciated by the Privy Council in *Newton* and accords with the mischief, as explained in the Explanatory Memorandum when Part IVA was enacted, of applying to tax avoidance arrangements capable of being described as "blatant, artificial or contrived" and not to transactions of a kind "of a normal business or family kind, *including those of a tax planning nature*" (emphasis added).[39] The test so understood accords with the argument put for the Commissioner in *Federal Commissioner of Taxation v Spotless Services Ltd*[40] that, for the conclusion required by s 177D, the inquiry "must necessarily be whether the scheme is so attended with elements of artificiality or contrivance primarily directed to the obtaining of the tax benefit that any commerciality of the scheme is overshadowed".[41] It accords with the published personal view expressed by the Commissioner of Taxation that the factors chosen for consideration by s 177D were the more exact and positive test to achieve the same purpose as limiting the Part to schemes that are blatant, artificial and contrived.[42] It accords also with acceptance of the proposition that it is only to be expected that the adoption of one particular form over another may permissibly be influenced by revenue considerations.[43]

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39 Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth), 9553; see also PJ Lanigan, 'Interpretational Problems with Part IVA' (Material presented in Melbourne, 15 September 1981) Taxation Institute of Australia Library archive box 638, 13-14, esp at 13 quoting from statement by Second Commissioner in NE Challoner and RJ Richardson, *Tax Avoidance, Implications of 1981 General Provisions (Part IVA)* (CCH Australia Ltd, 1981).

40 (1996) 186 CLR 404.

41 Ibid 408.

42 Michael D'Ascenzo, 'Part IVA and the Common Sense of a Reasonable Person' (Paper presented at the Queensland Taxation Institute Convention, 17 May 2002) <www.ato.gov.au/corporate/content.asp?doc=/content/22809.htm>.

43 *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 416 (Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ); it is consistent with the view expressed by Edmonds J (Sundberg and Stone JJ agreeing) in *Federal Commissioner of Taxation v BHP Billiton Finance Ltd* (2010) 182 FCR 526, [70].

Permissible structuring to secure tax advantages and permissible motivation to achieve a favourable tax outcome may be seen where what secures the tax benefit also secures other outcomes. In such cases what secures the tax benefit will not be explicable *only* by the taxation consequences for the taxpayers.[44] An example was given in the joint judgment of Gleeson CJ and McHugh J in *Hart* of a decision based on a desire to obtain a tax deduction to rent premises rather than to buy them.[45] Another example may be seen in the decision to sell and lease back plant and equipment.[46] In each case the elements of the transaction securing the tax benefit also secure more, or other, outcomes and not only the tax benefit. A lease creates different proprietary interests than ownership with different commercial and legal consequences, irrespective of tax benefits. Similarly the disposal of an income earning asset by gift may result in the non-derivation of assessable income by the donor but it also disposes of ownership by transfer to another. A distribution of income or corpus by a trustee of a discretionary trust may be calculated and wholly motivated by reference to fiscal advantages, but an effective distribution confers economic benefit on the object of the distribution in addition to any tax benefit secured.

Tax Benefit

The area of debate which has emerged concerning the provisions dealing with tax benefit create particular problems both for taxpayers and the Commissioner and may require legislative clarification. On one view s 177C

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44 See the emphasis in *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 244 [68], line 2 (Gummow and Hayne JJ).

45 Ibid 227 [15].

46 *Eastern Nitrogen Ltd v Federal Commissioner of Taxation* (2001) 108 FCR 27.

does no more than require a precise and careful identification of the scheme said to produce the tax benefit. That view does not depend upon a strained reading of the section but can, perhaps, more readily be seen in the GST equivalent to Part IVA in s 165-10(1). It provides:

> (1) An entity gets a ***GST benefit*** from a *scheme if:
>
> (a) an amount that is payable by the entity under this Act apart from this Division is, or could reasonably be expected to be, smaller than it would be apart from the scheme or a part of the scheme; or
>
> (b) an amount that is payable to the entity under this Act apart from this Division is, or could reasonably be expected to be, larger than it would be apart from the scheme or a part of the scheme; or
>
> (c) all or part of an amount that is payable by the entity under this Act apart from this Division is, or could reasonably be expected to be, payable later than it would have been apart from the scheme or a part of the scheme; or
>
> (d) all or part of an amount that is payable to the entity under this Act apart from this Division is, or could reasonably be expected to be, payable earlier than it would have been apart from the scheme or a part of the scheme.[47]

What the section does is to ensure that whatever is cancelled as the tax benefit is that which is directly produced by and from the scheme. The section operates as an analytical tool ensuring a clear logical link between tax benefit and scheme.

Section 165-10 deals with when an entity gets a GST benefit from a scheme. The heading does not describe the section as a definition. Both the heading, and the operative section, use the active verb "get". The heading poses a

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47 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 165-10(1).

question; namely, when does an entity "get a GST benefit from a scheme?". The operative provision begins with identifying when "[a]n entity gets a GST benefit from a scheme". The use of the active verb is important in identifying what the section is directed to. It is directed, not to defining benefits which may come within the ambit of the provision, but rather, to identifying when it may be said that an entity has "got" one. This same form of thinking may readily enough be seen in s 177C by use of the word "obtaining" rather than "get". Lest there be any doubt, I am not suggesting in any way that the GST provision enacted after Part IVA is somehow intended to alter the meaning of Part IVA.[48]

What s 165-10(1) and s 177C were each designed to do was to ensure that the anti avoidance provisions applied in a disciplined manner. The discipline was found by requiring a link between the tax benefit (to be cancelled) and the scheme (which produced it). The analytical link was, in the case of Part IVA, that the tax benefit was "obtained" in connection with the scheme, and in the case of GST, that the tax benefit was "got"[49] from a scheme.

This reading of s 177C and of s 165-10(1) does not require a factual inquiry into any alternative postulate as a precondition to the application of the respective anti avoidance provisions. It is, with respect to those who hold a different view, unsurprising that such an inquiry was not called for by the section because the anti avoidance provisions were supposed to operate on

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[48] See: *Beckwith v R* (1976) 135 CLR 569, 578-83 (Mason J); *Palgo Holdings Pty Ltd v Gowans* (2005) 221 CLR 249, 256-8 (McHugh, Gummow, Hayne and Heydon JJ).

[49] With apologies to grammarians.

objective criteria and were not made to depend upon the fiscal awareness or subjective considerations of individual taxpayers. An anti avoidance provision designed to apply objectively without reference to fiscal awareness or subjective considerations is inconsistent with an inquiry into what a taxpayer might otherwise have done if the particular tax benefit obtained was not obtained through what was done. It is a fortiori inconsistent with an inquiry into what might reasonably be expected by the taxpayer to have done if the taxpayer had not done the scheme actually undertaken through which the tax benefit was in fact obtained.

Recent litigation has adopted an interpretation of s 177C which is different from that which I have just described although it does not appear that the alternative construction was put to the court. The basis for the recent line of authority appears to be the sentence in the decision in *Federal Commissioner of Taxation v Hart*[50] in which Gummow and Hayne JJ considered s 177D (and not s 177C) to which I have already referred. The relevant sentence is that emphasised in the following passage:

> In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or carried out, the deductions "might reasonably be expected not to have been allowable". When that is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed. To say, as Hill J did, that "the manner in which the scheme was formulated and thus entered into or carried

[50] (2004) 217 CLR 216.

> out is certainly explicable only by the taxation consequences" assumes that there were other ways in which the borrowing of moneys for two purposes (one private and the other income producing) might have been effected. And it further assumes that those other ways of borrowing would have had less advantageous taxation consequences (my emphasis).[51]

It is important to read this passage carefully and, perhaps, to read it by reference to the actual submissions put by the Commissioner in that case. Even confining oneself only to the passage, however, it is clear that what their Honours were explaining was how s 177D applied and not how s 177C applied. Their Honours were explaining that in determining whether to draw the conclusion required by s 177D it was necessary to consider what was done with how else it might have been done: it was a guide to how the question posed by the section was to be answered.

The dicta has given rise to other questions and other debates. One such debate is about how and where the "alternative postulate" is to be determined. In the passage quoted above, their Honours referred to a consideration of "what other possibilities existed". An inquiry into "what other possibilities existed" might seem to call for a factual inquiry based upon evidence.[52] Indeed, it might be thought that this factual inquiry (if a factual inquiry was what their Honours intended) was the same as that to be undertaken for the purposes of determining whether a tax benefit had been obtained under section 177C. On that view, presumably, the comparison for 177D purposes is between the scheme which produced the tax benefit and something which

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51 Ibid [66].

52 *Epov v Federal Commissioner of Taxation* (2007) 65 ATR 399.

(somehow) would not. Section 177C contemplates a comparison between the tax effect of the scheme with what "would have" or "might reasonably be expected" to have occurred had the scheme not been entered into or carried out.

The issue has revealed itself to be more complicated for the Commissioner and taxpayers in a series of cases including *Federal Commissioner of Taxation v Lenzo,*[53] *Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd*,[54] *RCI Pty Ltd v Federal Commissioner of Taxation,*[55] *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd*[56] and *Noza Holdings v Federal Commissioner of Taxation.*[57] The critical issue for present purposes in each of these cases is how the courts, encouraged by the parties for particular outcomes irrespective of its impact upon the law or other taxpayers, have interpreted s 177C. In each case the debate has been about whether the fiscal advantage in question was a fiscal advantage coming within s 177C. In each case the provision has been interpreted as requiring that the fiscal advantage obtained be measured as against what, in fact, would otherwise have happened or as against what, in fact, might reasonably otherwise have been expected to happen. In other words, s 177C has been treated as a precondition to enliven the anti avoidance provisions such that the anti avoidance provisions will only be enlivened where, as a matter of fact

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53 (2008) 167 FCR 255.
54 (2010) 186 FCR 410.
55 (2010) 272 ALR 347.
56 (2010) 189 FCR 204 (special leave to appeal to the High Court of Australia refused in *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd* [2011] HCA Trans 63).
57 [2011] ATC 20-241.

and evidence, it is established that the fiscal advantage would otherwise have not been obtained in fact or might not otherwise reasonably be obtained in fact. It is difficult to find a legislative foundation for a reading of the passage in *Hart* as requiring the kind of inquiry it has been taken to have stated. In *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd*[58] Edmonds J said:

> Accepting for present purposes the correctness of what Gummow and Hayne JJ said in *Hart* at [66] extracted […] above, it is difficult to discern its legislative foundation. It certainly does not appear as one of the matters enumerated in s 177D(b) and, as their Honours said (at [47]) in *Hart* (in response to a submission that the term "scheme" had to be understood by reference to criteria outside the statute itself - namely, that the term does not encompass circumstances that are incapable of standing on their own without being "robbed of all practical meaning": *Peabody* at 384):
>
> > "There is no basis to be found in the words used in Pt IVA for the introduction of some criterion additional to those identified in the Act itself."[59]

Such considerations should caution against a reading of the passage which is not compelled by the statute and not compelled by the passage in *Hart* when read in context.

The reading of s 177C, and the potential consequent reading of s 165-10(1), has produced a significant shift in the way in which both the Commissioner and taxpayers analyse and argue about the application of the anti avoidance provisions. Ironically this search for the counterfactual is potentially to the

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58 [2011] ATC 20-255, [163].

59 Cf Sir Anthony Mason, paper delivered to PricewaterhouseCoopers Part IVA 30th Anniversary Dinner, 26 May 2011, 15 [28].

advantage of neither Commissioner nor taxpayer. If the alternative postulate, or the counterfactual, is to be found not in a consideration of what was done by reference to how the same thing could have been done, but rather by reference to what in fact might have been done or what in fact might reasonably expected to have been done, then both taxpayer and Commissioner are directed to undertake very complicated analysis by reference to facts and circumstances which did not occur.[60] It would, curiously, place in centre stage an artificially created hypothesis into something that never happened.[61]

The practical difficulty that such an inquiry occasions may be seen by the facts in *Noza Holdings Pty Ltd v Federal Commissioner of Taxation*[62] where Gordon J was called upon by the parties' submissions to analyse in detail whether the commercial objectives achieved by the actual means adopted by a taxpayer were able to be achieved by the counterfactuals relied upon by the Commissioner. Her Honour concluded in that case that they were not.[63] The conclusion was reached by reference, not to whether the transaction itself exhibited signs of tax avoidance but, rather, to whether what was put as an

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60 "Yesterday, upon the stair,
I met a man who wasn't there
He wasn't there again today
I wish, I wish he'd go away …"
Hughes Mearns, *Antigonish ("The Little Man Who Wasn't There").*

61 Some may recall the Monty Python sketch in which the words "nothing happened" assumed the power of mystery and drama when accompanied by strong dramatic music, mysterious looking figures and a prelude of suspense;
see "The Day Nothing Happened" Monty Python at http://www.wepsite.de/The%20Day%20Nothing%20Happened.htm; "The Adventures of Ralph Mellinsh" in Monty Python *Free Record Given Away with the Monty Python Matching Tie and Handkerchief* (Audio LP Record or CD), 1975.

62 [2011] ATC 20-241.

63 [2011] ATC [20-241], 12,054.

alternative transaction was commercially able to achieve the same commercial outcomes as the one actually adopted by the taxpayer. In *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd*[64] Edmonds and Gordon JJ remarked upon the risk of artificiality occasioned by such enquiries:

> The finding that it *might reasonably be expected* that the alternative postulate was a direct sale to MBF is a further example of the difficulties which now arise in litigation concerning Pt IVA where the focus is on the "scheme" and the "alternative postulate" identified by the parties. Of course, this is a direct result of the adversarial process. The problem is that it does run the risk of creating considerable artificiality often divorced from commercial reality.[65]

The taxpayer was successful in *AXA* and *Noza*, but advisers to taxpayers may not be able to take too much comfort by looking at the outcome. The outcome in both was achieved by complex, and to some extent (if not largely), artificial analysis about necessarily hypothetical circumstances which did not occur. More unsettling, perhaps, for taxpayers might be the role in future litigation which may be played by the legal burden of proof upon the taxpayer to disprove what might reasonably have been expected.

Careful consideration must be given both by the Commissioner and by taxpayers about the consequence of the taxpayer having the burden of proof (including disproof) where one of the matters to be proved (or disproved) is that an alternative postulate might not "reasonably have been expected". What is necessarily contemplated as something which is only "reasonably to

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64 (2010) 189 FCR 204.

65 (2010) 189 FCR 204, 243-4 [147].

be expected" is that it neither happened nor that it would have happened. What may be considered as being a reasonable expectation must therefore exclude and be different from both what did happen and what did not happen but what would have happened. What may reasonably have been expected is a lower order hypothetical than what "would" have occurred in the context of something which did not happen in fact. The ability of the Commissioner to rely upon something which did not happen, would not have happened, but which nonetheless might reasonably be expected to happen is likely in the future to become a more significant Achilles heel for taxpayers because of the legal burden of proof which falls upon the taxpayer. Taxpayers may find decision makers relying more upon the taxpayer not having discharged the burden of proof or disproof rather than concluding affirmatively that something affirmatively comes within the anti avoidance provisions. In that context the role played by intuitive decision making and the need to reconcile competing policy objectives which I mentioned at the start become particularly significant, critically important and frequently disturbingly unpredictable.

Advising

It is difficult for advisers to give confident advice predicting the application of Part IVA in most circumstances in which taxation considerations have an impact in the form or shape of a transaction. Advisers, however, can be confident that a subjective motivation of avoiding tax will not be sufficient to enliven the anti avoidance provisions. A taxpayer who enters into a transaction to avoid tax will not by that circumstance alone come within the operation of the anti avoidance provisions. Thus, for example, a distribution

by a trustee of a discretionary trust to beneficiaries for the purpose of avoiding tax will not be caught by the anti avoidance provisions provided that the resolution is legally and commercially effective upon its terms. That is because although the motivation may have been to avoid tax, the consequence of the resolution is an actual distribution of funds conferring economic benefit to the beneficiary.

A more debateable scenario might be where the taxpayer adopts a tax effective structure through which to undertake income earning activities. Income splitting between spouses is sometimes targeted as tax avoidance. Many people in the community might think so also. I have always doubted that view but must concede that many do not share my doubt. In 2002 the then Commissioner of Taxation announced a series of tax cases designed to test the application of the anti avoidance rules to, amongst other things, income splitting between spouses.[66]

The reason I doubt whether income splitting in its simple form can be regarded as tax avoidance is because of the commercial and economic consequences in typical cases where income splitting occurs and which are revealed upon a careful analysis. Assuming a husband and wife partnership, the splitting of income equally from the labour of the husband is legally, commercially and economically no different from the husband taking an arm's length silent partner or securing a guarantor for the business. The arm's

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[66] Michael Carmody, "Tensions in Tax Administration" (Speech delivered at the ICAA NAB Gala Luncheon, Melbourne, 14 March 2003) at <http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00122124.htm>.

length silent partner may play no active role in the derivation of partnership income beyond the legal liability flowing from the partnership relationship. Both spouses in the typical scenario are similarly exposed legally and commercially for the debts and liabilities incurred by the partner undertaking the income earning activities and services just as the arm's length "silent" partner. The spouse is in no different position from a genuine arm's length silent partner entitled to receive half the profits of a partnership in consideration for the assumption of the potential liability derived from business activity.

In more complex transactions tax advisers feel some need to document counterfactuals and alternative postulates when undertaking a transaction which they fear might be impugned by the Commissioner under the tax avoidance provisions. The wisdom of doing so should be tested carefully. It is conceivable that there may be some benefit in documenting that an alternative would not have been done if that be the fact, however, the wisdom of undertaking any analysis into hypotheticals not actively considered is doubtful. Documentation of what could or might have been done, but which was not done, is inherently artificial, potentially self serving but possibly counter productive. It also assumes a confident prediction of what in the future will be considered to have been relevant in hindsight. It is possible that what is documented as an alternative hypothesis may cause more problems at a factual level for taxpayers. It may engage unforeseen lines of enquiry and cross examination and may expose key people to unwanted criticism about their truthfulness and plausibility.

On the other hand the tax adviser may need to be vigilant to ensure that advice is given not only about the narrow application of the anti avoidance provisions but about risks which a taxpayer may face beyond the narrow question of whether the anti avoidance rules may apply. The occasion to advise upon the potential application of the anti avoidance provisions may arise in the context of ordinary commercial or family dealings. Many apparently simple transactions may have tax consequences that the non-tax expert cannot avoid advising upon, no matter how great the aura of tax law as a specialised area "outside the competence of most lawyers".[67] The adviser will sometimes be obliged to advise about the tax advantages available to a client. At other times the adviser may in doing so be at risk of professional misconduct, penal prosecution or administrative sanction.[68] Neither disavowal of expertise nor disclaimers will necessarily protect an adviser from risk.[69] Registered tax agents may be liable under tax legislation for any negligence causing a taxpayer to be liable to pay a fine, penalty or general interest

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67 GE Dal Pont *Lawyers' Professional Responsibility* (3rd ed, 2006) 124; see also references at footnote 16.

68 Michael McHugh, "Jeopardy of Lawyers and Accountants in Acting on Commercial Transactions" (1989) 5 *Australian Bar Review* 1; Allan Myers, "Tax Advice and Ethical Responsibility" (1990) 19 *Australian Tax Review* 80; D Graham Hill, "The Ethics of Tax Practice" in GS Cooper and RJ Vann (eds), *Decision Making in the Australian Tax System* (1985); RV Gyles, "Criminal Liability of Professional Advisors" (1989) 23 (7) *Taxation in Australia* 480; Ron Merkel, "The Lawyer as Client: Role of the Lawyer as a Professional Adviser" (1987) *Australian Business Lawyer* 11; Vincent Morfuni, "The Civil Liability of Tax Advisors" (2005) 34 *Australian Tax Review* 131; GS Cooper AM, "Promoter Penalties" (2006) 4(2) *eJournal of Tax Research* 117; Jenny Davies "Promoter Penalty Provisions – An Overview of the Provisions including an Analysis of the Key Areas of Risks and Responsibilities" (Conference Paper presented at the Taxation Institute of Australia, 22 May 2007).

69 Kathie Cooper and James Jackson, "The Impact of Section 74 of the *Trade Practices Act 1974* (Cth) on the Use of Disclaimers by Accountants and Other Professionals" (1991) 19 *Australian Business Law Review* 167.

charge.[70] That is in addition to the duties otherwise imposed by the common law and by statute.[71]

An issue in *Walker v Hungerfords*[72] was whether the liability of a taxpayer's accountants was reduced by the conduct of the taxpayer's clerk who had supplied erroneous calculations. The Court rejected the contention that the actions of the taxpayer's clerk reduced the liability of the accountant with King CJ saying:

> The information supplied by [the taxpayer's clerk] was supplied to the respondents who had undertaken responsibility for the preparation of correct tax returns. The very purpose of engaging tax advisers and accountants is to ensure that the returns are prepared upon a correct basis. Any calculation submitted by the taxpayer to his tax expert is necessarily submitted upon the basis that its conformity with tax law and correct tax and accounting practice will be verified by the expert. The taxpayer and his staff, in the absence of agreement to the contrary, do not, by furnishing such information, assume responsibility for its conformity to tax law and practice. If a taxpayer were to be considered to be lacking in reasonable care for his own interests for that reason, much of the advantage of engaging experts would be lost. The taxpayer, as it seems to me, cannot be expected to exercise skill or knowledge in relation to such matters. He is entitled to rely upon the tax expert whom he has engaged to check any calculations submitted by him to ensure their conformity to tax law and practice and in that way to ensure that the tax returns are correct. In my opinion the cross appeal fails.[73]

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70 *Tax Agent Services (Transitional and Consequential Amendments) Act 2009* (Cth) sch 2, pt 6, s 20; *Income Tax Assessment Act 1936* (Cth) s 251M.

71 *Stirling v Poulgrain* [1980] 2 NZLR 402; *Sacca v Adam and R Stuart Nominees Pty Ltd* (1983) 33 SASR 429; *Markham v Lunt* (1983) 15 ATR 136; *Walker v Hungerfords* (1987) 49 SASR 93; *EVBJ Pty Ltd v Greenwood* (1988) 20 ATR 134.

72 (1987) 49 SASR 93.

73 Ibid 96 (Jacobs and Millhouse JJ agreeing).

In *Hurlingham Estates Ltd v Wilde & Partners*[74] a solicitor was found to be negligent for failing to advise about the form in which a transaction might have been entered into to secure a favourable tax result, even though it was discovered during the course of the hearing that the particular conveyancing and commercial partner acting for the taxpayer had little knowledge of tax law and was found to be unqualified to give tax advice or to recognise the adverse tax consequences of the commercial transaction. The standard applied to the adviser in that case was the awareness expected by "any reasonably competent solicitor practising in the field of conveyancing and commercial law".[75]

The scope of the adviser's duty will vary with the circumstances. An important, though not always conclusive, factor will be the terms of the retainer under which any advice is given,[76] and those terms may also include any reasonable or necessary term which is to be implied into the retainer. The adviser's duty will also be governed by obligations in tort, with the scope of the duties under contract and tort often overlapping. In *Tip Top Dry Cleaners Pty Ltd v Mackintosh*[77] Debelle J expressed the duty on the advising lawyer in terms of a duty "to give advice which Tip Top appeared to need regardless of whether or not it had been specifically requested".[78] In that case the relevant adviser had held himself out as an experienced adviser in revenue law and had been expressly retained to advise on whether the taxpayer could engage in a

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74 (1996) 37 ATR 261.
75 Ibid 267 (Lightman J).
76 *Walker v Hungerfords* (1987) 49 SASR 93, 96 (King CJ).
77 [1998] ATC 4346.
78 Ibid 4366 (Debelle J), citing *Carradine Properties Ltd v DJ Freeman & Co* (1982) 126 Sol J 157.

transaction. In those circumstances the adviser was found to have had a duty to advise on all relevant issues arising under tax law and the general law, and to give the taxpayer comprehensive advice which touched upon all relevant matters.[79] In a recent case a trustee of a deceased estate argued that she ought to have been advised when seeking probate that she might become exposed as a partner to the liabilities which arose many years later from a tax effective transaction entered into by a partnership of which the estate was a partner.[80]

In *Hawkins v Clayton*[81] Deane J emphasised the significance to the relationship between lawyer and client in the assumption by the lawyer of the responsibility for the performance of professional work and in the reliance of the client on the lawyer. His Honour said:

> The client relies upon the solicitor to apply his expert knowledge and skill in the performance of that work. In the ordinary case, the only kind of damage which is likely to result from the negligence of the solicitor in the performance of his professional work is pure economic loss. In that context, the elements of assumption of responsibility and of reliance combine with that of the foreseeability of a real risk of economic loss to give the ordinary relationship between a solicitor and his client the character of one of proximity with respect to foreseeable economic loss. …

The content of the duty of care in a particular case is governed by the relationship of proximity from which it springs. It may, in some special categories of case, extend to require the taking of positive steps to avoid

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79 [1998] ATC 4346, 4366 (Debelle J).

80 *Mediterranean Olives Financial Pty Ltd v Lederberger* [2011] VSC 301.

81 (1988) 164 CLR 539.

physical damage or economic loss being sustained by the person or persons to whom the duty is owed.[82]

Much of this will apply equally to other professional relationships in which the client is reliant on the expertise and knowledge of the adviser.[83] The discharge of the duty will vary from case to case, and the sophistication of the client may be a factor relevant to its discharge,[84] but the nature of the relationship of client and adviser will often be such that the client may not know the extent of the advice needed and the lawyer may need to consider what advice the client needs whether or not it had specifically been sought. The client in many instances will be vulnerable to the adviser's skill and knowledge, not only for the specific advice or service sought, but also to be told what else needs to be advised upon or to be provided.

An adviser's duty may not be discharged by advising on how the relevant taxing provisions apply or whether the anti avoidance rules are applicable. In the context of their potential application, the adviser's duty may extend to some testing of the facts on which the application of the anti avoidance provisions may depend or, and at times at least, some warnings about the dangers facing the client in proceeding on a course of conduct. The adviser's duty is also to communicate the advice in a form that the client can

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82 Ibid 578-579 (Deane J) ; see also *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592, 608-609 (Gleeson CJ, Hayne and Heydon JJ).

83 Cf GE Dal Pont, *Lawyers Professional Responsibility* (3rd ed, 2006) 100 and *Frost & Sutcliffe v Tuiara* [2004] 1 NZLR 782, [12].

84 *Hurlingham Estates Ltd v Wilde & Partners* (1996) 37 ATR 261, 267 (Lightman J), citing *Virgin Management Ltd v De Morgan Group* [1996] EGCS 16; *Leda Pty Ltd v Weerden* [2007] ATC 4708.

understand.[85] These duties may require the adviser to warn about any material risk inherent in a transaction[86] perhaps by reference to an evaluation by the adviser of the risks to which a client may attach significance.[87] In that regard, an adviser may find it useful to ask whether the client would attach significance to a particular risk if warned about it. In relation to tax advice, and to the application of the anti avoidance provisions in particular, that may require advice about questions of law and interpretation, questions of fact and evidence, questions of reputation, questions about possible audit or other action which the Commissioner may take, and any other question which may fairly fall within the adviser's expertise and of potential significance to the client.

Melbourne, 8 August 2011

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85 *EVBJ Pty Ltd v Greenwood* (1988) 20 ATR 134.
86 See *Rogers v Whitaker* (1992) 175 CLR 479.
87 Ibid 490; see also *F v R* (1983) 33 SASR 189, 192-193 (King CJ).