GENERAL ANTI TAX AVOIDANCE PROVISIONS IN AUSTRALIA AND NEW ZEALAND[1]

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The role of anti avoidance rules continues to be in discussion in New Zealand, Australia and the United Kingdom. The need for anti avoidance rules is to bolster the integrity of the tax system but they are frequently criticised as introducing uncertainty into the tax system. An ordered society depends upon certainty of laws and predictability in their application. It is the ability to predict the application of the law that enables people to arrange their personal affairs, transactions and their dealings with government. Certainty in the law is fundamental to the rule of law which "should be clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable".[2] Certainty, however, cannot always be achieved in part because it is an inevitable feature of language.[3] It is also a feature of the frequent mismatch between the lawyer's tools and the underlying concepts which legislation

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2 Melissa Castan and Sarah Joseph*, Federal Constitutional Law*, *a Contemporary View* (2nd ed, 2006) 5; J Raz, "The Rule of Law and its Virtue" (1977) 93 *Law Quarterly Review* 195, 198-202; A V Dicey, *Introduction to the Study of the Law of the Constitution* (1st ed, 1885; 10th ed, MacMillan, 1960); Butterworths, *Halsbury's Laws of Australia*, vol 4 (at 18 August 2009) 80 Civil and Political Rights, 'Use of International Covenant on Civil and Political Rights' [80-25].

3 *Bourne v Norwich Crematorium Limited* [1967] 1 WLR 691; Roland Barthes, *Criticism and Truth* (Continuum, 2007) 25-28; Umberto Eco, *The Limits of Interpretation* (1990).

seeks to enact.[4] It arises from different views about what legislation is intended to achieve or about how it should be applied in a given case.[5]

Some uncertainty may also be intended and thought to be desirable. There are many examples of tax laws drafted with embedded uncertainty as a means of discouraging behaviour. Tax liability is sometimes made to depend upon the formation by the Commissioner of an opinion about whether the application of some provision is unreasonable, with a discretion to take into account such "matters, if any, as he thinks fit" in forming the opinion.[6] There are many reasons for discretions to be given in tax legislation notwithstanding the desirability for clarity, certainty and predictability.[7] One reason may be to have a tax outcome depend upon commercial, business or economic considerations that non discretionary rules might not allow. The Australian government and legislative response to the social evil of tax avoidance was in part the enactment of taxing provisions dependent upon discretionary considerations.[8] Intentional uncertainty plays a part in commerce and social decision making,[9] and its adoption through taxation by discretionary powers is

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4 G.T. Pagone, 'Tax Uncertainty' [2009] 33 *Melbourne University Law Review*, 886.

5 See, for example, *Hepples v Federal Commissioner of Taxation* (1992) 173 CLR 492.

6 *Giris Pty Ltd v Commissioner of Taxation* (1969) 119 CLR 365.

7 Prof G.S.A. Wheatcroft, "Taxation by Administrative Discretion", *Papers, First National Convention, Taxation Institute of Australia* (TIA, 1969) 1-11; see also K.C. Davis, *Discretionary Justice* (1979, Illinois), Ch 1.

8 PJ Lanigan, "Technical Problems Relating to the Objectives and Consequences of Taxation", in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 29, 32-3, 38; see also Professor R Parsons "Commentary" in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 46, 47.

9 Philip D Straffin, 'The Prisoner's Dilemma' in Eric Rasmusen (ed), *Readings in Games and Information* (2001); John von Neumann and Oskar Morgenstern, *Theory of Games and Economic Behaviour* (2004).

in part a means of combating tax avoidance.[10]

Avoidance and Abuse of Legislation

Measures to prevent tax avoidance are interlinked with the need to preserve the integrity of legislation when the words themselves, and their purposive construction and application, are found to have failed to achieve their intended effect. In the United States decision of *Helvering v Gregory*[11] Judge Learned Hand refused to apply a literal reading of a statute which he considered to be contrary to the statutory intention saying:

> … Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes … Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition … [T]he meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create.[12]

A purposive, or non literal, construction to taxing statutes may, however, be made more difficult as the statute increases in specificity.[13]

The courts in the United Kingdom have also relied upon principles of statutory interpretation in developing the doctrine sometimes referred to as the doctrine of fiscal nullity to counter tax avoidance. The doctrine articulated first in *W.T.*

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10 PJ Lanigan, 'Technical Problems Relating to the Objectives and Consequences of Taxation', in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 27, 29, 32-3, 38; Ross Parsons, 'Commentary' in Taxation Institute of Australia (ed), *Taxation Now and in the Future: Papers and Commentaries Presented at the First National Convention of the Taxation Institute of Australia* (1969) 45, 47.

11 69 F. 2d 809 (2nd Cir, 1934), aff'd 293 U.S. 465 (1935).

12 69 F. 2d 809 (2nd Cir, 1934) 810-11; see also Marvin A Chirelstein, 'Learned Hand's Contribution to the Law of Tax Avoidance' (1968) 77 *Yale Law Journal* 440.

13 69 F. 2d 809 (2nd Cir, 1934) 810; aff'd 293 U.S. 465 (1935).

Ramsay v Inland Revenue Commissioners[14] was said by Lord Wilberforce to be within the function of the courts to apply strictly and correctly the legislation enacted by parliament. In that context, his Lordship said:

> To force the courts to adopt, in relation to closely interpreted situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process.[15]

The question at issue in *Ramsay* was whether there had been a disposal giving rise to a loss under a taxing statute. The issue of construction was whether the particular transaction came within the intended terms of the statute where the disposal was effected by a series of steps, each of which the parties necessarily intended to be effective according to their terms, but the partial legal effect of which had been intentionally undone by some other parts of the transaction. The principle adopted in that case was subsequently formulated by Lord Brightman in *Furniss v Dawson*[16] in these terms:

> First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. The composite transaction does, in the instant case; it achieved a sale of the shares in the operating companies by the Dawsons to Wood Bastow. It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax … not "no business effect". If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The Court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.[17]

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14 [1982] AC 300.

15 Ibid 326C-D; cited with approval in *Tower MCashback LLP 1 v Revenue and Customs Commissioners* [2011] 2 WLR 1131, 1144.

16 [1984] AC 474.

17 Ibid 527.

The importance, and limitations, of the statutory construction at play as the foundation and extent of the principle enunciated has been remarked upon in subsequent cases[18] and by commentators.[19] In *Tower MCashback LLP 1 v Revenue and Customs Commissioners*[20] the formulation of the principle was criticised as obscuring and imposing a "fairly inflexible prescription" on the force of the earlier view expressed by Lord Wilberforce.

A purposive interpretation of taxing provisions does not alone give revenue authorities the ability to "reconstruct" transactions to determine liability. A criticism of provisions like Australia's s 260[21] and New Zealand's s 108[22] that they failed to impose tax in some cases.[23]

General Anti Avoidance Legislation

The means adopted to deal with tax avoidance in Australia, New Zealand and Canada has been the enactment of special statutory provisions of general application. The general anti avoidance rule in Australia was for many years that found in s 260 of the *Income Tax Assessment Act 1936* (Cth) in much the same terms as existed in s 108 of the *Land and Income Tax Act 1954 (*NZ). An important feature of those provisions was that they did not themselves impose taxation. They operated principally as a deeming provision or as some such provision to that effect. The avoidance rule did not create a

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18 See especially *IRC v McGuckian* [1997] 1 WLR 991, 999-1000 (Lord Stein) and 1005 (Lord Cooke), *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311 per Lord Hoffman.

19 See Lord Walker, 'Ramsay 25 Years On: Some Reflections on Tax Avoidance' (2004) 120 *Law Quarterly Review* 412, 416.

20 [2011] 2 WLR 1131, 1148.

21 *Income Tax Assessment Act 1936* (Cth).

22 *Land and Income Tax Act 1954* (NZ).

23 *Mangin v Inland Revenue Commissioner* [1971] AC 739.

separate head or subject matter of taxation apart from or independent of the provision said to be avoided. The rule applied as an adjunct to, or facilitator of, the other taxing provisions and specifically of the provision said to be avoided. It sought only to negate (that is, to render void as against the revenue authorities) the avoidance arrangement so that the "avoided" taxing provision would operate as intended.

Section 260, like the provision in New Zealand, provided that every contract, agreement or arrangement was absolutely void as against the Commissioner[24] in so far as it had or purported to have the purpose or effect of:

(a) altering the incidents of any income tax;

(b) relieving any person from liability to pay income tax or making any return;

(c) defeating, evading or avoiding any duty or liability imposed on any person by the Act; or

(d) preventing the operation of the Act in any respect.

The words of s 260, like its equivalent in New Zealand, were wide and simple but carried the risk of a greater ambit of application than intended or desirable. That led to criticism of the section and to various attempts to give it a meaning that would have a reasonable and predictable application. In 1921,

[24] The words "as against the Commissioner" appeared for the first time in 1936. The earlier provisions affected private rights and could be relied on by individuals against others in affecting private rights where a contract, agreement or arrangement differed the incidence of tax: *De Romero v Read* (1932) 48 CLR 649. The Privy Council described this as an "unexpected effect" in *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1, 7 (Lord Denning on behalf of the court).

Knox CJ in *Deputy Federal Commissioner of Taxation v Purcell*[25] said of the precursor to s 260 in s 53 of the *1916 Act*:

> The section, if construed literally, would extend to every transaction whether voluntary or for value which had the effect of reducing the income of any taxpayer …

For this reason, his Honour sought to construe the terms of the section to curb unintended excesses. His Honour said:

> [B]ut, in my opinion, its provisions are intended to and do extend to cover cases in which the transaction in question, if recognised as valid, would enable the taxpayer to avoid payment of income tax on what is really and in truth *his* income. It does not extend to the case of a *bona fide* disposition by virtue of which the right to receive income arising from a source which theretofore belonged to the taxpayer is transferred to and vested in some other person. The section is intended to protect the revenue against any attempted evasions of the liability to income tax imposed by the Act … and the *bona fide* gift or sale by a taxpayer of assets producing income is therefore in no sense an attempt to evade his liability to income tax.[26]

The case before his Honour, and subsequently on appeal to the Full High Court, concerned the owner of certain income producing property who had declared himself a trustee of the property for himself, his wife and his daughter equally. His Honour found that the declaration of trust created by the taxpayer was not affected by the anti avoidance provisions in the the *1916 Act*. The members of the Full Court essentially agreed with the decision of the Chief Justice at first instance.

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25 (1921) 29 CLR 464, 466.

26 Ibid.

Criticism of the terms in which the anti avoidance provisions were expressed was sometimes strident. In *Federal Commissioner of Taxation v Newton*[27] Kitto J said:

> Section 260 is a difficult provision, inherited from earlier legislation, and long overdue for reform by someone who will take the trouble to analyse his ideas and define his intentions with precision before putting pen to paper.

In the same case Fullagar J said:

> [T]he 'purposes' or 'effects' which will attract its operation are stated very vaguely. If we interpret it very literally, it will seem to apply to cases which it is hardly conceivable that the legislature should have had in mind.[28]

These doubts and uncertainties saw limitations emerge on s 260 that ultimately led to its replacement with Part IVA.[29] The New Zealand anti avoidance provisions similarly came in for strident criticism. Lord Wilberforce in his dissenting judgment in *Mangin v Inland Revenue Commissioner* [30] questioned the ability of the provision to confront the problems of modern tax avoidance. In *Commissioner of Inland Revenue v Gerard*[31] McCarthy P described the provision as "notoriously difficult",[32] echoing laments which had been expressed about the equivalent Australian provision.[33]

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27 (1956) 96 CLR 577, 596.

28 Ibid 646.

29 See *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66; *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290; *Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314; *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330; *Clarke v Federal Commissioner of Taxation* (1932) 48 CLR 56; *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548; *Rowdell Pty Ltd v Federal Commissioner of Taxation* (1963) 111 CLR 106; Razeen Sappideen, 'Judicial Legislation and the Rationalisation of Section 260 of the Income Tax Assessment Act 1936' (1977) 8 *Federal Law Review* 319.

30 [1971] AC 739.

31 [1974] 2 NZLR 279.

32 Ibid 280.

33 Ibid 281-3; *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188, 23206-7; see also James Coleman, *Tax Avoidance Law in New Zealand* (CCH, 2009), 15-16.

The Predication Test

The Privy Council had made an attempt in *Newton v Federal Commissioner of Taxation*[34] to enunciate a test to determine when a transaction would fall within the ambit of an anti avoidance provision. The test required an objective observer to look at the impugned arrangement 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 dealings, 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 …[35]

This dicta served for some years as the basis upon which impermissible tax avoidance was to be determined and the anti avoidance provision 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 Commissioner of Taxation*.[36]

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34 (1958) 98 CLR 1.

35 (1958) 98 CLR 1, 8-9 (Lord Denning on behalf of the court).

36 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>.

The predication test required a consideration of the particular contract, agreement or arrangement which had been impugned as an avoidance transaction to determine whether its objectively ascertainable purpose was to avoid tax. The enquiry called for was not into the actual motive or purpose (whether subjective or objective) of the participants to the transaction. What the provision was thought to strike at, therefore, was not an intention to avoid tax but, rather, at arrangements about which nothing could be said of them except that tax avoidance was their predominant purpose or effect. The distinction is less subtle than it might sound, and in that distinction there might 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 to a person's actual intention to avoid tax is that sound tax policy should not make the anti avoidance rules depend upon, and to vary as between, the particular circumstances of 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.[37] 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 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 the

[37] *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.

courts to determine when to apply and when not to apply an anti avoidance rule.

The essence of the predication test was an enquiry into whether something was done which had no substantial objective function or objective explanation other than tax avoidance. That would exclude from the operation of the anti avoidance rule many transactions which were motivated to reduce tax but about which one could not say there was no explanation other than tax. A trustee's resolution to make distributions in a discretionary trust along lines which maximise the tax benefits between the beneficiaries may be motivated wholly, and exclusively, by the tax considerations flowing from the distributions made, but may not be caught by the anti avoidance provisions because the resolution will produce more the achievement of the tax motivation. At the very least the beneficiaries gain entitlements from the resolutions which they would not otherwise have had. On such a basis the predication test as enunciated in *Newton* would not apply to conduct motivated by taxation (however entirely motivated by tax considerations the conduct may have been) where one looked at the transaction and found that the overt acts did more than secure taxation advantages which may have been its motivation. Indeed, that kind of analysis explains the examples found in *Newton* of transactions which would not be caught by the avoidance provisions notwithstanding that avoidance may have been their motivation. No one could sensibly say that the private company which had been turned into a non private company in *WP Keighery Pty Ltd v Federal Commissioner*

[38] was motivated by anything other than the favourable taxation consequences produced. The beneficial tax consequences may be the reason why the reconstruction occurred, but the reconstruction did occur in fact and that brought with it other commercial and legal consequences apart from the tax benefits. 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 the tax consequences which had motivated the transactions.

Seen in this way an anti avoidance provision provides a valuable adjunct to a taxing statute. 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 identifying those elements of a transaction which produced tax consequences and analysing whether those elements had a function other than tax. The anti avoidance provisions could then predictably apply where the non tax function was non-existent, immaterial or so overwhelmed by the tax purpose that the commerciality of the element was overshadowed.[39]

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[38] (1957) 100 CLR 66.

[39] *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 408 (argument by Counsel for the Commissioner).

The Statutory Solution in Australia: Part IVA

In the late 70s early 80s in Australia it was thought both that s 260 was ineffective to achieve its purpose and that it was possible to enact an alternative that would be effective. The theoretical problem was how to make taxable something which, on either a literal or a purposive construction of the provisions, and on their application to the facts of a particular case was otherwise not taxable. The legislation could have made the avoidance provision depend upon a finding of fact, or on some constructive conclusion, about the primary provisions being abused. That had been the basis of the jurisprudence in the US and appears to have been adopted by the legislation in Canada and to have found judicial favour recently in New Zealand in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*.[40]

The Australian legislature in 1981, however, chose to make the anti avoidance provision depend not upon a view that the provisions were being abused but, rather, upon a constructive conclusion that a person to a scheme (where the word "scheme" is not used pejoratively) participated in the scheme for the purpose of enabling a taxpayer to obtain a tax benefit. The critical criterion for application of the anti avoidance provision was the purpose to be attributed to a person.[41] It was a "constructive" conclusion because it did not depend upon a finding of the actual purpose of someone but, rather, was to be drawn from the objective consideration of specified facts and circumstances.

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40 (2009) 24 NZTC 23,188.

41 *Income Tax Assessment Act 1936* (Cth) s 177D.

The statutory test adopted in Part IVA owed much to the predication test in *Federal Commissioner of Taxation v Newton.*[42] That was clearly stated in the extrinsic materials including the treasurer's second reading speech and explanatory memorandum.[43] It is not surprising that the predication test in *Newton* is at the heart of Part IVA because the problem with s 260 had been thought to be in the way in which the so called choice principle had come to make the application of s 260 fail in certain cases and rather than any widespread dissatisfaction with what the Privy Council had enunciated as the test to determine its application. The provisions, therefore, show much concern to deal with how choices might be made without application of the anti avoidance rule, but with making its provisions depend ultimately upon what was thought to be a statutory formulation of the predication test.

Peabody, "may" and Part of a Scheme

The enactment of the legislative provisions in Part IVA, however, gave rise to their own and novel interpretative debates which have grown, have modified, have varied, but continue to this day and which some consider threaten the viability of the provision. The first serious debate concerning the operation of Part IVA concerned the role of the scheme identified by the Commissioner. Central to the litigation was the meaning and effect of the three letter word

42 (1958) 98 CLR 1.

43 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>.

"may" in s 177F. A fundamental issue in *Peabody*[44] was the role of the scheme as identified by the Commissioner in the application of Part IVA. The High Court rejected the view that Part IVA depended upon the Commissioner's correct identification of a scheme holding that Part IVA presupposed the obtaining of a tax benefit in connection with a scheme as an objective fact.[45] The court did not say that the identification of a scheme did not matter but only that the operation of the provisions were not made to depend upon the Commissioner's correct identification of the scheme.

An unexpected consequence for the subsequent application of Part IVA arose from observations made by the court in addressing an argument put by the Commissioner. The Commissioner had argued that the relevant dominant purpose could be found in part of what might have been identified as the scheme. The Commissioner's argument is recorded as having been put in the context of submissions that assumed that the only scheme able to be considered was one which had as its dominant purpose a commercial nature rather than to enable a taxpayer to obtain a tax benefit. It was in that context that the Commissioner had argued that the provisions of Part IVA permitted the requisite conclusion to be drawn from "part of a scheme

It was in answer to that argument that the court said that Part IVA could not apply to something as if it were a scheme where the circumstances were incapable of standing on their own as a scheme without being robbed of all

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44 *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359.

45 Ibid 382 (Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron, McHugh JJ).

practical meaning.[46] That passage subsequently became the basis of arguments that circumstances identified by the Commissioner as schemes could not be within the contemplation of Part IVA if they were incapable of standing on their own without being robbed of all practical meaning. It was not for another ten years before the High Court could reconsider that observation. In the joint judgment of Gummow and Hayne JJ in *Federal Commissioner of Taxation v Hart*[47] their Honours explained the error in treating the earlier observations in *Peabody* as "a criterion which must be applied in deciding whether there is a scheme to which Part IVA applies".[48] Their Honours pointed out that what had been said in *Peabody* had been addressed to a particular argument on which the Commissioner had sought to rely and went on to say:

> Thirdly, and most importantly, 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. There is no reference to a scheme having some commercial or other coherence. Far from the Part requiring reference only to the purpose of those who carry out *all* of whatever is identified as the scheme, s 177D(b) specifically refers to it being concluded "that the person, or one of the persons, who entered into or carried out ... *any part of the scheme*" did so for the purpose of enabling the relevant taxpayer (alone or with others) to obtain a tax benefit in connection with the scheme …[49]

It would seem now that the identification by the Commissioner of a scheme has lost some of the significance it had in earlier litigation after *Peabody* but the effect of *Peabody* was not without cost and uncertainty.

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46 Ibid 383–4 (Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron, McHugh JJ).
47 (2004) 217 CLR 216.
48 Ibid 237.
49 Ibid 238 (emphasis in original).

The importance of what is identified as the scheme to the application of Part IVA should not, however, be ignored. Part IVA only applies where a tax benefit has been obtained "in connection with [a] scheme".[50] That requirement is only satisfied where it is the scheme which gives rise to, or produces, the tax benefit which the Commissioner has cancelled. Indeed, the role played by s 177C(1) is to ensure that Part IVA is limited in its application to those schemes which produce the tax benefits. Section 177C(1) statutorily compels that there be a clear and discernable link between the tax benefit obtained and the scheme by which it is obtained. It may be that the link can be satisfied by reference to reasonable expectations but the need for the link is important both analytically and as a safeguard for taxpayers.

Dichotomy Between Rational Commercial Decisions and Tax Planning

A fundamental concern for the application of any anti avoidance provision is the extent to which it is applied in the face of commercial 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 other than obtaining 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[51] if the commercial objective was achieved in a particular way which showed that the tax benefit was the dominant explanation for the scheme as entered into.

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50 *Income Tax Assessment Act 1936* (Cth) s 177D(a); *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2004) 57 ATR 115, [76] (Hill J).

51 *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.

A fundamental consequence of *Spotless* was to have rejected a dichotomy between rational commercial decisions and tax planning.[52] 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 conceivably have been obtained without structuring. 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.*[53] 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 concern was perhaps made by what his Honour had said some years earlier in *CPH Property Pty Ltd v Commissioner of Taxation.*[54] In that case his Honour considered the potential application of Part IVA in the context of a

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

53 (2004) 57 ATR 115.

54 (1998) 88 FCR 21.

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 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*.[55]

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".[56] 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. It is, however, 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.

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55 Ibid 42.

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

Tax Benefit

Another area of debate has emerged around the application of s 177C. That section is headed "Tax Benefits" and is often treated as a definition of the tax benefits to which Part IVA may be applied or as identifying a factual precondition to be established before application of Part IVA rather than in its application. There appear to be at least two rather different ways of reading s 177C. One way is that it requires the precise identification of what gave rise to the tax benefit. On that view satisfying s 177C does no more than require the precise and careful identification of the scheme which produces the tax benefit.[57] The purpose of the section by that construction is to provide analytical rigour to the application of Part IVA and to ensure that any tax benefit cancelled by the Commissioner is a tax benefit which is analytically, and therefore in fact, produced by the scheme. This reading of the section does not require a consideration of any counterfactual or of any alternative postulate. It simply asks that there be identified that which analytically, and therefore in fact, the scheme either would, or might reasonably be expected, to produce. The point of such an identification would be to ensure that the conclusion about purpose is linked clearly and specifically to the tax benefit obtained in connection with the scheme.

A different construction has been adopted in a series of cases which appears to require a different and more complex enquiry. That construction assumes that s 177C excludes from the operation of Part IVA any tax benefit which would have been obtained had the scheme not been entered into. The idea

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[57] Compare *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 165-10.

behind this construction may be that Part IVA should not apply where the tax benefit obtained by the taxpayer through the scheme would have been obtained had the scheme not been entered into or carried out. This view has been said to require a consideration of what the scheme produced and its comparison with an alternative postulate.

In *Lenzo v Federal Commissioner of Taxation*[58] the taxpayer submitted at first instance that if Mr Lenzo had not invested in the plantation project on which the Commissioner had applied Part IVA, he would have obtained a similar tax benefit by putting money into his self-managed superannuation fund.[59] The answer given to this at first instance by French J was that s 177C(1)(b) sought to identify whether "that deduction", namely the deduction referable to the identified scheme, would not be, or might not reasonably be, allowable if the scheme had not been entered into or carried out.[60] His Honour therefore considered the superannuation "counterfactual" which had been contended for by the taxpayer to be extraneous to the statutory alternatives contemplated by the section.[61] His Honour went on to say, however, that a relevant "counterfactual" was that the taxpayer might have invested in the plantation project using either an alternative source of funds or his own funds.[62] These counterfactuals were challenged on appeal on the basis that they amounted to an erroneous finding at first instance that Mr Lenzo would still have invested in the plantation scheme. The basis of that contention was that the task required by s 177C(1) was to be undertaken by comparing what the

58 (2007) 68 ATR 381; *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255.
59 (2007) 68 ATR 381, 407 [116] (French J).
60 Ibid 407 [118].
61 Ibid.
62 Ibid 407 [119].

scheme produced with what else a taxpayer might have done in the absence of the scheme.

On appeal, the Full Federal Court held that, in assessing the counterfactual, s 177C(1)(b) requires the "entirety" of the scheme identified for application by Part IVA to be ignored.[63] In reaching that conclusion no distinction was to be made between a scheme and its factual components, and the counterfactuals used by the trial judge were criticised on the basis that they dispensed with part of the scheme but left the balance intact.[64] In *AXA Asia Pacific Holdings Ltd v Federal Commissioner of Taxation*[65] Jessup J, at first instance, sought to explain the decision of the Full Court in *Lenzo* by saying:

> In my view, *Lenzo* is authority for the proposition that the starting point under s 177C(1)(a) is one which the whole scheme identified by the Commissioner must be assumed out of existence. The question then arises: what then might reasonably have been expected to have been included in the assessable income of the taxpayer? Here the court is engaged in a "prediction as to events which would have taken place" in the absence of the scheme: *Commissioner of Taxation v Peabody* (1994) 181 CLR 359, 385. The exercise thus postulated, in my view, is wholly one of fact-finding. A fact is not disqualified, *a priori* as it were, from consideration merely by reason of it having been an element of the scheme which was in place. To the contrary: what the taxpayer and his or her associates in fact did in the commercial circumstances which existed is likely to shed much light on what they would have done in the absence of the scheme, and in some cases to be, as a matter of prediction, elements of that counterfactual. Nothing in *Lenzo* requires me to hold otherwise. Indeed, the way Sackville J approached the task of prediction was entirely consistent with the counterfactual in any particular case involving elements of the presumptively discarded scheme, assuming always that the facts of the case indicated such an outcome.[66]

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63 *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255, 281 [136] (Sackville J), 263 [42] (Heerey J agreeing), 286 [159] (Siopis J agreeing).

64 Ibid 280 [130] (Sackville J).

65 [2009] FCA 1427.

66 Ibid [118].

The view adopted by Jessup J drew a distinction between the scheme and any facts which may constitute its elements. It is the former, but not the latter, which the authority of *Lenzo* was seen to require to be entirely "ignored"[67] or "assumed out of existence".[68] Whether that is what had been intended by the Full Federal Court in *Lenzo* may be doubted in view of the observation by the Full Court in *Lenzo* that the difficulty with the counterfactuals adopted by French J at first instance had been "that they apparently dispense[d] with part of the scheme (as found by his Honour), yet leave the balance of the scheme intact".[69]

The approach to *Lenzo* adopted in *AXA* at first instance was endorsed in *Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd.*[70] On appeal to the Full Court in *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd*[71] their Honours[72] set out the relevant legal principles concerning the application of s 177C and said:

> In the case of an amount being included in the assessable income of a taxpayer, s 177C(1)(a) provides that it is an objective inquiry as to what would have been included or might *reasonably* be expected to have been included in the assessable income had the "scheme" not been entered into or carried out: *Epov v Federal Commissioner of Taxation* (2007) 65 ATR 399 at [62] and *Peabody* 181 CLR 359 at 385-6.

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67 *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255, 281 [136] (Sackville J).

68 *AXA Asia Pacific Holdings Ltd v Federal Commissioner of Taxation* [2009] FCA 1427, [118] (Jessup J).

69 *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255, 280 [130] (Sackville J).

70 (2010) 186 FCR 410; Ibid 418-9 [28] – [31] (Dowsett and Gordon JJ).

71 [2010] FCAFC 134.

72 Edmonds and Gordon JJ with Dowsett J agreeing.

> The legislation requires a comparison between the relevant scheme and an alternative postulate, or counterfactual: *Hart* 217 CLR 216 at [66].
>
> The alternative postulate requires a "prediction as to events which would have taken place *if the relevant scheme had not been entered into or carried out* and that prediction must be sufficiently reliable for it to be regarded as reasonable" (emphasis added). "A reasonable expectation requires more than a possibility": *Lenzo* 167 FCR 255 at [122] citing *Peabody* 181 CLR 359 at 385. The question posed by s 177C(1) is answered on the assumption that *the scheme* had not been entered into or carried out: *Lenzo* 167 FCR 255 at [121].[73]

In answering the question posed by s 177C(1) on that construction of the provision their Honours reasoned that the exclusion of particular integers from a prediction is contrary to the express words of s 177C, its context and its purpose.[74] The Full Court in *AXA*, like the trial Judge, sought to apply *Lenzo* in reaching its conclusion.

The Onus and its Discharge

The prevailing reading of s 177C has had a substantial effect upon the way in which both the Commissioner and taxpayers analyse and argue about the application of the anti avoidance provisions. The search for alternative postulates is potentially to the advantage of neither Commissioner nor taxpayer. If the alternative postulate, 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 a very complicated analysis by reference to facts and circumstances which did not occur. It would, curiously,

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73 *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd* [2010] FCAFC 134, [126] – [129].

74 Ibid [132] – [133].

place in centre stage an artificially created hypothesis into something that never happened.

The practical difficulty occasioned by an inquiry into counterfactuals may be seen in the facts in *Noza Holdings Pty Ltd v Federal Commissioner of Taxation*[75] 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.[76] The conclusion was reached by reference, not to whether the transaction itself exhibited signs of tax avoidance but, rather, by reference to whether what was put as an 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*[77] 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.[78]

The taxpayer was successful in *AXA* and *Noza*, but advisers to taxpayers may not be able to take much comfort from the outcome. The outcome in both

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75 [2011] ATC 20-241.
76 [2011] ATC [20-241], 12,054.
77 (2010) 189 FCR 204.
78 (2010) 189 FCR 204, 243-4 [147].

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 postulated might not "reasonably have been expected". What is necessarily contemplated as something which is only "reasonably to 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 may be 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

become particularly significant, critically important and frequently unpredictable.[79]

The complexity and difficulty of the inquiry was considered by the Full Federal Court decision in *RCI Pty Ltd v Federal Commissioner of Taxation.*[80] In that case the court considered whether it was sufficient to find as a tax benefit that the counterfactual contended by the Commissioner was reasonable. In concluding that it was not their Honours said:

> It has been said in the past, and the learned primary judge at [88] of her Honour's reasons said below, that the taxpayer carries the onus of establishing that the Commissioner's counterfactual is unreasonable; and that if the taxpayer does not establish that the Commissioner's counterfactual is unreasonable, then the taxpayer fails to prove that the assessment is excessive on that ground. (Of course, the taxpayer may establish that the assessment is excessive on some other ground, such as that the conclusion required to be drawn as to the dominant purpose of a party to the scheme under s 177D(b) cannot be drawn, but that is another matter.)
>
> Such an articulation of the onus is erroneous, but if not, certainly unhelpful because it can lead one into error. Even if a taxpayer establishes that the Commissioner's counterfactual is unreasonable, it will not necessarily follow that he has established that the assessment is excessive. *That is because the issue is not whether the Commissioner puts forward a reasonable counterfactual or not; it is a question of the Court determining objectively, and on all of the evidence, including inferences open on the evidence, as well as the apparent logic of events, what would have or might reasonably be expected to have occurred if the scheme had not been entered into.* Thus, even if a taxpayer establishes that the Commissioner's counterfactual is unreasonable, that will not discharge the onus the taxpayer carries if the Court determines that the taxpayer would have or might reasonably be expected to have done something which gave rise to the same tax benefit.
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> That such an articulation of the onus is at worst erroneous and at best unhelpful, can also be illustrated from the other side of the coin, because it implies that if the Commissioner's counterfactual

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79 GT Pagone, 'Centipedes, Liars and Unconscious Bias' (2009) 83 *Australian Law Journal* 255..

80 [2011] ATC 20-275.

> is reasonable that is the end of the matter; even if the Court were to conclude, on all the evidence, inferences and logic referred to, that if the scheme had not been entered into the taxpayer would have or might reasonably be expected to have done something which did not give rise to a tax benefit, or which gave rise to a tax benefit less than that thrown up by the Commissioner's counterfactual. In our view, that cannot be correct.[81]

It may readily enough be accepted that a counterfactual is not reasonable merely because the Commissioner says so. However, a judicial conclusion that the counterfactual propounded by the Commissioner is reasonable may enliven the provision. In *RCI* the court held that the taxpayer did not obtain a tax benefit within the meaning of s 177C because the taxpayers either would have abandoned the transaction actually entered into or would have done something else which, in effect, would not have produced the tax consequence by the means actually secured.[82] The basis for that conclusion was the court's analysis of the "underlying or foundation material" before the court.[83] The court did not exclude the potential relevance of other evidence but concluded that in the vast majority of cases it was the court's view about the "underlying or foundational material" which would answer the inquiry called for by s 177C. In that regard the court observed:

> That this may be a recipe for uncertainty of outcome in any given case is to be regretted, but if it is to be criticised as too dependent on the judgment of the Court, that is a criticism to be directed at the architecture of the legislation and not the process of the Court.[84]

Such defects make the provisions difficult to predict in many cases until finally adjudicated upon by court decision.

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81 Ibid [129] – [131] (Edmonds, Gilmour and Logan JJ).
82 Ibid [150], 12,728.
83 Ibid [140], 12,726.
84 Ibid [140], 12,726.

Cautious observation on recent New Zealand developments

It is not surprising to see debates in New Zealand about the proper role and proper approach to anti avoidance provisions. The two cases from the New Zealand Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[85] and *Penny and Hooper v Commissioner of Inland Revenue*[86] are illustrations of two aspects of recurrent debates which are also seen in other jurisdictions. *Ben Nevis* illustrates concerns about the misuse of a statutory provision and the difficulties in the application of those concerns as seen in the US, UK and Canadian cases. *Penny and Hooper* illustrates concerns about non commercial dealings to achieve a favourable tax outcome. Each case carries with it complex issues and each decision gives rise to difficult questions for their future application.

Ben Nevis: "Parliamentary Contemplation"

The approach taken in New Zealand in *Ben Nevis* would seem, on one view, to have the anti avoidance provisions operate more broadly than may have been contemplated in *Newton*. In *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[87] the New Zealand Supreme Court adopted a test requiring a consideration of the purpose contemplated by parliament when enacting the provision which a transaction is said to have avoided. In the joint judgment of Tipping, McGrath and Gault JJ their Honours said:

> When, as here, a case involves reliance by the taxpayer on specific provisions, the first inquiry concerns the application of those provisions. The taxpayer must satisfy the Court that the use

85 (2009) 24 NZTC 23,188.
86 (2011) 25 NZTC 25,635.
87 (2009) 24 NZTC 23,188.

> made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement.[88]

It is understandable that regulators, courts and the community alike will not be eager in the modern world to condone what appears to be the manipulation of the law in a way that was not intended by parliament. It is therefore not surprising to find courts unwilling to endorse a "use" of statutory provisions that was not what the court perceives to have been the use intended by parliament. A difficulty for the courts, however, is how to express a principled test with predictive force that is jurisprudentially more than a final court's expression of disapproval of one given set of facts.

The enquiry called for in *Ben Nevis* is about the underlying policy through which the specific provision is reflected. Taxpayers and revenue authorities may be expected to have different views about what a specific provision means and how it is to be applied. In the field of tax there may still be something to be said in favour of the need for precision in legislative drafting.[89] On one view the "parliamentary contemplation" test may confine the application of the general anti avoidance provisions in New Zealand to those situations where it may reliably be said that the application of the anti avoidance rule is to give effect to the policy underlying a specific provision. In

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88 (2009) 24 NZTC 23,188, 23211-2.

89 *BP Refinery (Westernport) Pty Ltd v Hastings Shire* (1977) 16 ALR 363; *Western Australian Trustee Executor and Agency Co Ltd v Commissioner of State Taxation (WA)* (1980) 147 CLR 119, 126 (Gibbs J).

that way, the need to link the impugned arrangement with something found to be within the contemplation of parliament in another provision may reveal in *Ben Nevis* the echoes of the abuse of statute jurisprudence developed in the United States and the enactment of the general anti avoidance rule in Canada. However, both taxpayers and the revenue authorities are likely to find different "angles" to the decision in *Ben Nevis*, and each is likely to rely, and to distinguish, the decision for their own ends.

The majority judgment in *Ben Nevis* said that the enquiry into whether a tax avoidance arrangement exists is broad and not confined. Their Honours said:

> The general anti-avoidance provision does not confine the Court as to the matters which may be taken into account when considering whether a tax avoidance arrangement exists. Hence the Commissioner and the courts may address a number of relevant factors, the significance of which will depend on the particular facts. The manner in which the arrangement is carried out will often be an important consideration. So will the role of all relevant parties and any relationship they may have with the taxpayer. The economic and commercial effect of documents and transactions may also be significant. Other features that may be relevant include the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer. As indicated, it will often be the combination of various elements in the arrangement which is significant. A classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.
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> In considering these matters, the courts are not limited to purely legal considerations. They should also consider the use made of the specific provision in the light of the commercial reality and the economic effect of that use. The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond Parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.[90]

[90] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC

Those who must apply these principles may not find it easy to do so. The category of those who must apply the provision includes taxpayers, advisers, revenue officials and the courts. A difficulty with the parliamentary contemplation test is whether the subject of inquiry is what parliament intended or whether the transaction impugned could ever have been what was contemplated. The ambiguity of the exercise may, I think, be seen from the Inland Revenue Draft Interpretation Statement issued 16 December 2011.[91] It sets out over several pages how one is to ascertain parliament's purpose[92] but concludes that the approach to identify parliament's purpose is to ask whether the impugned transaction would have been within its purpose.[93] It is clear that the New Zealand Revenue see that parliament's purpose is to be ascertained from the impugned transaction. At one point in the Draft Interpretation Statement it is said without irony "that how Parliament's purpose is ascertained for any arrangement will depend on how the Act is used or circumvented by the arrangement".[94] It may be accepted that parliament can be presumed to have contemplated that the benefit of its specific provisions would not be gained by an artificial or contrived way, but the application of the decision in future cases or occasions may need to take care to ensure that the passages from *Ben Nevis* are not applied as tautologies. Whether an avoidance arrangement exists cannot depend upon whether it is an avoidance arrangement (since that would be tautologous) but, rather, whether the arrangement can reliably be seen to have been outside

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23,188, [108]-[109] (Tipping, McGrath and Gault JJ).

91 Inland Revenue, *Draft Interpretation Statement Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007*, 16 December 2011.

92 Ibid, see especially paras [329] – [357].

93 Ibid [358].

94 Ibid [349].

what parliament contemplated. It is the latter to which attention is likely to be drawn, and about which there is likely to be debate. The "parliamentary contemplation" test may conceivably be relied upon by taxpayers to narrow the application of the anti avoidance rules by arguing, with some force, that what was in the contemplation of parliament when enacting the specific provision was, and stopped with, the ambit of its actual terms (purposively interpreted, of course).[95] The revenue might rely upon the "parliamentary contemplation" rule to focus upon some broader fiscal policy effected by the language in the specific provision which in terms may not go as far as the revenue would like. No doubt, in an appropriate case, each will adopt the opposite stance to achieve opposite conclusions. The broader the assumed contemplation of parliament, the broader the reach of the anti avoidance rule; the narrower the assumed contemplation of parliament, the narrower the reach of the anti avoidance rule.

An allied, but fundamental jurisprudential concern about the approach of the New Zealand avoidance provision found in *Ben Nevis*, is that it may result in the imposition of unlegislated taxation. It is implicit from *Ben Nevis* that tax will be imposed under the provision which would not otherwise arise. In other words that the primary provisions, purposively construed and purposively applied, did not go as far as parliament is to be presumed to have contemplated but failed to go. An ability to extend the reach of taxing provisions through the anti avoidance provisions may encourage the application of the anti avoidance provisions by the New Zealand revenue

95 *Scott v Cawsey* [1907] 5 CLR 132, 154-5 (Isaacs J).

authorities significantly beyond the reach of the primary taxing provisions. *Ben Nevis*, and its application, may also lead to criticism of the courts namely, that in giving legal effect to the Commissioner's assessments, through the anti avoidance provisions, to something which parliament is presumed to have contemplated but failed to enact in the primary provisions (given a purposive interpretation) involves the courts in making law something that was not enacted.

In evaluating such concerns it is important to recall that the issue of the application of the anti avoidance rule only arises after the primary taxing provisions have been given a purposive interpretation. In other words the question posed in *Ben Nevis* of parliament's contemplation is a second purposive interpretation which needs to be considered only after the primary provisions are given a purposive interpretation but found not to apply. A practical consequence may be that the anti avoidance provision becomes a mechanism for filling the actual gaps in tax legislation rather than striking only at what is undoubtedly tax avoidance.

A mechanism which "fills in gaps" may be indistinguishable from a delegation of legislative powers. In the task of applying the principle, however it may be described, it will be difficult for a court (let alone the many taxpayers called upon to make decisions upon the law as it is stated without the benefit of a court decision) to know with sufficient confidence how to go about determining what parliament contemplated. It may be accepted that the inquiry is not into

an actual purpose, but rather, into a hypothetical purpose[96] but the hypothetical parliamentary contemplation must be measured against something. The commercial reality and economic effects[97] of the impugned arrangement need to be measured against the commercial realities and economic effect parliament must be presumed to have contemplated or not to have contemplated. The complex modelling and economic assumptions which form the basis of fiscal provisions will not be easy for a court to ascertain. In one instance in Australia fiscal benefits were introduced in one context upon an unstated assumption that some of the benefits would be wasted.[98] The market which developed to make use of credits by trading in them was subsequently countered in Australia by specific legislative provisions.[99] In New Zealand they might have been met in the first instance by a departmental invocation of *Ben Nevis* followed by courts having to decide whether the parliamentary contemplation principle applied. The application of the principle may be difficult where the legislative provisions in issue are detailed or complicated.[100]

Penny and Hooper: An "uncommercial" artificial step

In *Penny and Hooper v Commissioner of Inland Revenue*[101] the issue in dispute was the fixing of a low salary by orthopaedic surgeons with their employers who were companies owned by the surgeons' family trust. A consequence of fixing low salaries was that the company employers derived

96 Inland Revenue, *Draft Interpretation Statement Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007*, 16 December 2011, [358].
97 Ibid [18].
98 GT Pagone, *Tax Avoidance in Australia* (2010) 112-4.
99 Ibid.
100 *Helvering v Gregory* 69 F 2d 809, 810 (2nd Cir 1934), aff'd 293 US 465 (1935).
101 (2011) 25 NZTC 25,635.

substantial income through the work undertaken by the surgeons with the economic consequence of the companies (and not the surgeons) deriving the income otherwise referable to the services of the surgeons.

Applying tax avoidance provisions to transactions, or aspects of transactions, which are thought to be uncommercial is not without difficulty. An uncommercial dealing judged by one aspect may appear to be sound commercial judgment by another. It has long been held that it is not for the revenue authorities to determine how a taxpayer is to conduct business or what or how much a taxpayer should incur in doing so.[102] An uncommercially low salary to the principal income earner might permit higher superannuation benefits to that earner's spouse without falling foul of anti avoidance rules in Australia.[103] An uncommercial dealing may be sufficient to enable the conclusion that some part of a loss or outgoing was not sufficiently incurred in the gaining of assessable income to deny a deduction.[104] On the other hand an uncommercial rate of interest as between companies may be explained by a broader commercial objective of a holding company[105] or of group activities and group necessities.[106]

The court in *Penny and Hooper*[107] was mindful of such complications and posed the relevant question and inquiry as follows:

> The question to be asked is therefore why the salary was fixed as

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102 *Ronpibon Tin NL v Federal Commissioner of Taxation* (1949) 78 CLR 47.
103 *Ryan v Federal Commissioner of Taxation* (2004) 56 ATR 1122.
104 *Fletcher v Federal Commissioner of Taxation* (1991) 173 CLR 1.
105 *Federal Commissioner of Taxation v Total Holdings (Aust) Pty Ltd* (1979) 79 ATC 4279.
106 *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* (2009) 77 ATR 92.
107 (2011) 25 NZTC 25,635 [34], 25,645.

> it was on a particular occasion. Whether that involved tax avoidance can be answered by looking at the effect produced by the fixing of the level of the salary in combination with the operation of the other features of the structure.[108]

In that case the court concluded against the taxpayers holding that the "taxation advantage produced" by the fixing the salaries of a low level "can fairly be seen as the predominant purpose".[109]

The decision in *Penny and Hooper* will no doubt give rise to lively discussion for some time. Its circumstances are at least about 50 years old as seen from the facts and decision in *Peate v Federal Commission of Taxation.*[110] Critical to its application in the future will be the role of evaluation and judgment in the conclusions fairly to be seen from what arrangements produce. Much will turn upon the evidence and the impression which that evidence will have upon a decision maker. In that context there may still be much room for significant differences of opinions and that raises a significant policy question for the law about the extent to which anti avoidance rules should apply to cases in which there is genuine room for doubt. One such area of difference may be in the application of the anti avoidance rules to husband and wife partnerships where one is the effective income generator but the two share income equally. In that context it may be interesting to see how revenue authorities (and ultimately the courts) distinguish domestic arrangements of that kind from those in which income is shared with an arm's length third party silent partner whose only contribution (typical also in the domestic arrangements) is liability as a guarantor or joint partner if sued. And, if domestic arrangements of that

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108 Ibid [34], 25,645.
109 Ibid [36], 25,646.
110 (1964) 111 CLR 443.

kind are thought exempt from the anti avoidance net (whether on principle or on policy grounds) it will be interesting to see why or how similar considerations should not apply to arrangements such as those challenged in *Penny and Hooper*.

One feature in the decision in *Penny and Hooper* that may cause lively debate is whether the question as enunciated by the court calls for a subjective inquiry into the taxpayer's actual reason for doing what was done. The answer to the question as posed by the court was said to lie in looking at the "effect" produced by the arrangements, but that is not to exclude looking at other matters in other cases if the inquiry is one into the subjective intention of the taxpayers. It will also be interesting to see how far the "effect" will govern the outcome of the application of the anti avoidance rules. Plainly there are some effects which reduce tax that a taxpayer may legitimately choose to take.

The GAAR Panel

The application of Part IVA in Australia occurs in the context of a panel. Its charter was initially described in *Practice Statement Law Administration 2000/10*, now withdrawn, as having been designed to assist tax officers who were contemplating the application of the anti-avoidance provision found in Part IVA of the *Income Tax Assessment Act 1936* (Cth) (the "*1936 Act*").[111] The GAAR Panel was then known as the Part IVA Panel and was described as having been established to advise the tax office on general anti-avoidance issues rather than as a measure to safeguard the central ground of

[111] PS LA 2000/10 (Withdrawn), [1].

responsible tax planning. It is, however, an important aspect in the responsible application of the GAARs in Australia. Its focus may not be in form as a safeguard for tax planning, but it has a key role in providing oversight by senior public officials of the application of the GAARs, in giving a measure of public confidence that the application of the GAARs is overseen to an extent by tax practitioners from outside the Australian Tax Office, and in providing discipline to decisions before the GAARs are applied.[112]

Charter of the GAAR Panel

The 2000 Practice Statement was in the form of a direction by the Commissioner to tax officials but it was publicly available and found on the ATO website.[113] The direction given by the Practice Statement to tax officers explained the charter of the Panel as follows:

> 8. The Panel considers the use and development of the general anti-avoidance provisions as a whole, rather than being necessarily "driven" by individual cases….
>
> […]
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> 10. The charter of the Panel is therefore to ensure that, in cases which come before it, proper consideration has been given to the primary tax liability questions so that Part IVA is only used as a measure of last resort and is only used where it is clearly appropriate. In doing this, the Panel looks at the use and development of the general anti-avoidance provisions as a whole.
>
> 11. The Panel also helps to settle, maintain and develop the ATO position on Part IVA, monitors consistency and helps identify trends. It serves the purpose of providing guidance to the ATO on general questions surrounding Part IVA such as on practice and procedure and on applying Part IVA to emerging risks.
>
> 12. The Panel provides a forum in which avoidance issues can be workshopped. This is encouraged where risks of a significant type have come to the attention of Business Lines.

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112 Ibid Attachment 3: Escalation of Part IVA issues, [6].

113 Australian Tax Office, PS LA 2000/10 (Withdrawn) (2000) <http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS200010/NAT/ATO/00001> accessed at 30 January 2012.

> 13. It should be borne in mind that the Panel is not in a position to evaluate the evidence that supports a proposal to exercise Part IVA. Rather the Panel relies upon assurances from tax counsel and senior officers in the Business Lines that any proposal to make a determination under Part IVA can be supported on the basis of legally admissible evidence available to the Commissioner.[114]

The main elements of this description of the charter of the Part IVA Panel were restated in the replacement Practice Statement issued in 2005 applicable to the GAARs generally.[115]

Part IVA of the *1936 Act* is not the only general anti-avoidance rule administered by the Commissioner of Taxation in Australia. Part IVA applies to the provisions taxing income (including capital gains), but there are similar general anti-avoidance rules dealing with other taxing statutes administered by the Commissioner. The most prominent are those statutes taxing fringe benefits[116] and the supply of goods and services.[117] The 2005 Practice Statement replaced that issued in 2000 and was expressed to apply to the other GAARs administered by the Commissioner generally.[118] It too was expressed as being designed to assist tax officers contemplating the application of a general anti-avoidance rule. The role of the GAAR Panel was described in the 2005 Practice Statement in the broader context beyond Part IVA to much the same effect as the earlier Practice Statement:

> **Role of the Panel**

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114 Ibid [8], [10] – [13].

115 Australian Tax Office, PS LA 2005/24, [23] – [25] (under review) (2005) <http://law.ato.gov.au/atolaw/view.htm?DocID=PSR/PS200524/NAT/ATO/00001> accessed at 30 January 2012.

116 *Fringe Benefits Tax Act 1986* (Cth) s 67.

117 *A New Tax System* (*Goods and Services Tax*) *Act 1999* (Cth) div 165.

118 PS LA 2005/24, [1].

23. The primary purpose of the Panel is to assist the Tax Office in its administration of the GAARs in the sense that decisions made on the application of GAARs are objectively based and there is a consistency in approach to various issues that arise from time to time in the application of the GAARs. The Panel does this by providing independent advice to a GAAR decision-maker in those matters which are referred to it. This includes advice regarding the appropriate imposition of penalties. The Panel is made up of business and professional people chosen for their ability to provide expert and informed advice, with the other members of the Panel being senior Tax officers. The Chair of the Panel is a senior Tax officer.

24. The Panel has no statutory basis; its role is purely consultative. The relevant decision under a GAAR is that of the decision-maker; the Panel does not make a decision but its advice is taken into account by the Tax Office decision maker. The Panel does not investigate or find facts, or arbitrate disputed contentions. Rather, the Panel provides its advice on the basis of the contentions of fact which have been put forward by the officers of the Tax Office and by the taxpayer. In providing advice the Panel is able to advise on any differences between the Tax Office and taxpayer on conclusions or inferences to be drawn from the facts. If there is a dispute as to the facts, the Panel may suggest that the Tax officers make additional enquiries or may indicate whether the difference would, in its opinion, change its advice. Where a matter referred to the Panel arises from an application for a private ruling, the Panel has regard to the arrangement in relation to which the Commissioner is asked to rule.

25. Upon a matter being referred to the Panel, a decision-maker will not (other than in exceptional circumstances) make a decision before receiving advice from the Panel. Where exceptional circumstances are considered to exist, any decision is not to be made without first discussing the matter with the Chair of the Panel. A decision-maker is not obliged to follow the advice of the Panel one way or the other; the decision to apply or not to apply the GAAR is that of the decision-maker. However, a decision to apply a GAAR contrary to the advice of the Panel is not to be made without first escalating the matter to the Chair of the Panel or the CTC.[119]

The main focus of the GAAR Panel remained the same as that of the Part IVA Panel: internal consistency, internal accountability, and compliance with policy.

[119] PS LA 2005/24, [23] – [25].

Internal Safeguard

The function of the GAAR Panel as an internal safeguard should not be underestimated. The GAAR Panel provides an internal tax office safeguard by providing a high level review of individual decision makers who apply, or seek to apply, a GAAR. There are many tax officials who are authorised to apply, or to propose the application of, a GAAR to a taxpayer. The authorised officers are not only significant in number but are located in many offices spread across Australia and throughout the many cities and regional centres in which the Australian Tax Office has staff. A high level centralised GAAR Panel promotes consistency of approach, promotes the application of consistent policy, reduces the risk of misapplication of the provisions, or of maladministration or abuse, and provides a mechanism for the sharing of information within the tax office of developments in tax practice.

The desirability for consistency may be self evident but it may be worth mentioning that the need for consistency arises in different ways. It arises, of course, in the context of applying the same provision to different taxpayers but on similar facts and circumstances.[120] However, questions of consistency also arise in the context of the relationship between the GAAR and specific anti-avoidance provisions in any one of the various taxing regimes, as well as the context of the relationship between the provisions of different GAARs with similar provisions or complimentary or overlapping operation. The taxing provisions in which the GAARs are found also frequently contain specific anti-avoidance rules which need to be reconciled with the GAAR and which need

[120] *Aktiebolaget Hassle v Alphapharm Pty Ltd* (2002) 212 CLR 411, 445 (McHugh J); *Breen v Williams* (1996) 186 CLR 71, 115 (Gaudron and McHugh JJ).

to be made to operate consistently within their respective intended spheres of operation.[121] In addition, there will be times when the differing taxing regimes, including their respective GAARs, may either overlap[122] or may be intended to have complimentary operation.[123] In such cases the GAAR Panel is able to provide a forum for the taxing authorities to resolve potential internal inconsistency of application and to advise the office generally on the resolution of conflict that may arise concerning operation or interpretation.

External Member Participation

Internal mechanisms of this kind promote better administration and, therefore, public confidence. Public confidence is also promoted by the presence of external members on the GAAR Panel. It is composed both of senior tax officials and of "business and professional people chosen for their ability to provide expert and informed advice".[124] The presence on the GAAR Panel of reputable external members exposes a critical aspect of tax administration to some measure of direct external review and accountability. It may be a small measure of accountability and it may be difficult to evaluate the effectiveness of that accountability because the work of the GAAR Panel must necessarily preserve the confidentiality of the taxpayers,[125] but the significance of some direct external participation on a key aspect of tax administration should not be minimised. The mere fact of having to explain the proposed application of the anti-avoidance provisions to an "outsider" capable of adverse advice or

121 See, for example, *Income Tax Assessment Act 1936* (Cth) s 73B(31).

122 An example of a differing taxing statute applying independently to the same events may be seen in *Walstern v Commissioner of Taxation* (2003) 138 FCR 1.

123 An example of differing taxing statutes having complimentary operation may be seen in *Cameron Brae v Commissioner of Taxation* (2007) 161 FCR 468.

124 PS LA 2005/24, [23].

125 *Taxation Administration Act 1953* (Cth) div 355.

comment is likely to encourage self discipline in the tax official proposing the application of the provision.

The role of the external members on the GAAR Panel, and of their identity, selection and term of service, are all matters that should be reviewed and could be improved. The external members of the Australian GAAR Panel are selected by the Commissioner and serve for unspecified terms. These aspects of its composition, in my view, detract from the confidence the public will have in the working of the GAAR Panel. It would be preferable for the selection process to be more transparent, more accountable and more defensible against robust challenge. The same is true about the terms of service. It would be desirable for those selected and the term of service both to be less linked to the Commissioner's ability to choose without restriction and to terminate service at will. That said, those on the GAAR Panel have tended to enjoy professional respect and have done much to improve the administration of the GAARs. Indeed, it may even be that the Commissioner has felt more concerned to select demonstrably independent outsiders because of the lack of formal criteria and process. It is, in any event, fair to say that the Commissioner has been keen to ensure that the process is fair and seen to be fair.

Legal Foundation of Panel

The establishment of the GAAR Panel in Australia was a wholly administrative decision made by the Commissioner of Taxation. The basis of the decision is

probably section 8 of the *1936 Act*.[126] That is a provision conferring wide power upon the Commissioner,[127] albeit a power to be exercised with procedural fairness.[128] The Commissioner explained his decision to establish the Panel as being for it "to advise on the application of GAARs to particular arrangements".[129] The GAAR Panel established by the Commissioner in Australia has no other independent legal foundation. Its existence derives from the Commissioner's decision that it be established.[130] The role of the GAAR Panel as "purely consultative" may not, however, make it immune from an obligation to afford persons affected by its advice with procedural fairness, including a right to be heard.[131]

Extent of Advisory Function

The role of the GAAR Panel in Australia is wide as can be seen from the description of the role set out in the Practice Statement. An illustration may be seen from the litigation in *Commissioner of Taxation v Futuris Corporation Ltd*[132] which concerned not only whether the transaction was one to which the GAAR applied but also both the mechanism for raising any assessment and the quantum of the assessment. In that matter an issue had arisen before assessment about whether the impact of an earlier court decision required that an assessment on the facts in *Futuris* be raised for an amount greater

126 See also *Taxation Administration Act 1953* (Cth) s 3.

127 *Industrial Equity Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 649; *Precision Pools Pty Ltd v Federal Commissioner of Taxation* (1992) 92 ATC 4549; *Grofam Pty Ltd* v *Commissioner of Taxation* (1997) 97 ATC 4656.

128 *David Jones Finance & Investments Pty Ltd & Adsteam Finance & Inv Pty Ltd v Federal Commissioner of Taxation* [1990] 90 ATC 4730, 4734 (O'Loughlin J).

129 PS LA 2005/24, [17].

130 Ibid, [24]: "The panel has no statutory basis; its role is purely consultative."

131 *Annetts v McCann* (1990) 170 CLR 596; *Ainsworth v Criminal Justice Commission* (1992) 175 CLR 564.

132 (2008) 237 CLR 146.

than the Commissioner would ever seek to recover. The Panel's recommendation to the relevant officer was to raise an assessment by adding each of the alternative amounts claimed under the alternative bases thereby creating a tax debt in an aggregate amount that was greater than that which would be recovered.[133]

The core aspect of the GAAR Panel's role in any given case, however, is to advise the relevant case officers on the exigible application of the GAAR in that case. The advice given may vary significantly from case to case. On occasion it may be that further audit work needs to be undertaken. On other occasions it may be to alter the analysis or proposed application of the GAAR. The various GAARs typically depend upon the identification of a tax benefit which, in complex transactions, may not be easy to identify with confidence. In some cases there may be a number of fiscal advantages potentially able to qualify as *the relevant tax benefit in respect of* which the GAARs application may be made to operate.[134] A tax officer's identification of a tax benefit from amongst the available benefits may prove not to be the one most likely to withstand curial proceedings and the Panel may advise the officer to pursue a different tax benefit from that originally chosen.

Relevant Considerations

The members of the GAAR Panel have no restriction upon what they may take into account in considering what advice they may give the tax officer.

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133 Ibid 160 (Gummow, Hayne, Heydon and Crennan JJ).

134 See, for example, the facts in *McCutcheon v Federal Commissioner of Taxation* [2008] FCA 318.

They doubtlessly bring to bear their own experiences of commercial and business affairs, but their charter is not restricted in considering whether the attempt to cancel a tax benefit was reasonable. To the extent that they may consider the reasonableness of such a step, the members are not directed, or guided, by what they should take into account.

Reliance by Individual Taxpayers

The value and benefit of the GAAR Panel to public administration can be assumed to extend to all taxpayers to whom the GAAR is, or might, be applied, but that does not necessarily mean that individual taxpayers will see advantage in appearing or having their matter reviewed by the GAAR Panel. The Commissioner sometimes makes available quantitative figures about the number of cases to which the GAAR is applied or which either come before the GAAR Panel or are not pursued after consideration by the GAAR Panel. Quantitative figures have their use and place but the conclusions to be drawn from them may sometimes be debatable. A high rejection rate by the GAAR Panel may be consistent equally with either bad administration or with effectiveness of checks and balances. A low rejection rate may similarly be equally consistent with a futility in seeking review by the GAAR Panel as with an efficient administration applying the GAAR only where truly appropriate.

There are no publicly available studies about the utility of the GAAR Panel to individual taxpayers and qualitative assessments of the utility and effectiveness of the GAAR Panel in individual cases are rarely published. Practitioners vary in their advice to clients about whether, and if so how

diligently, to pursue a review by the GAAR Panel. Some practitioners embrace the prospect of recourse to the GAAR Panel with enthusiasm whilst others dismiss it as a waste of time, money, resources and a potential forensic disadvantage. At least one senior tax advisor in Australia would routinely advise clients not to waste time and resources in GAAR Panel hearings because of a perception that the Panel lacked power to determine a matter independently of the members of the tax office propounding the application of the GAAR. The strength and value of such advice is best measured, not by quantitative figures about the work of the Panel, but by qualitative assessments based upon breadth of individual experience and a consideration of the detail and importance of the matter in question.

Taxpayer Decision to Pursue a GAAR Hearing

Many factors are relevant to whether a taxpayer will want to appear before the GAAR Panel and the extent to which the appearance is pursued with vigour. Some taxpayers regard it as important to participate in the process for their own governance requirements irrespective of their confidence of success or their confidence in the process. Accountability to boards, shareholders, financiers, the market, or others may often encourage taking advantage of the GAAR Panel process to air differences irrespective of an assessment of whether it is likely to result in a favourable outcome. Sometimes the sensitivity of the issue, or the sensitivity of the taxpayer, will make it more desirable for all avenues to be pursued that might resolve a tax dispute in private rather than in public tribunals or before it may need to be reported to shareholders, the public, financiers or others.

The fact that the GAAR Panel is not an independent forum and has no power to bind the Commissioner is a factor which every taxpayer will necessarily take into account when deciding what stand to take on a matter before the GAAR Panel. The hearing does provide an opportunity which some may see as potentially valuable although not necessarily as the critical forum to resolve a dispute. The use made of the opportunity varies from case to case by reference to the many complex considerations affecting such decisions. Some may view a Panel hearing as a means to test the Commissioner's case without completely revealing the taxpayer's best evidence or best arguments.

Referral to the GAAR Panel

The process for the referral of matters to the GAAR Panel varies from case to case. Generally, however, a matter will be referred to the GAAR Panel after the tax office has prepared a position paper informing the taxpayer, usually amongst other matters, that the tax office is considering the application of a GAAR.[135] A tax officer may seek advice from the GAAR Panel before then and is not required to inform the taxpayer that preliminary advice is being sought.[136] In general, however, where a position paper has been issued, the taxpayer will be invited to respond to the position paper and the GAAR Panel will ordinarily give the taxpayer an opportunity to make oral submissions to the GAAR Panel.

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135 PS LA 2005/24, [28].

136 Ibid.

Materials and Deliberations Before Hearing

The members of the GAAR Panel will therefore usually have a position paper prepared by the tax office and the taxpayer's response to the position paper before any appearance. Neither document is prescribed by regulation as to its form, content or length, and they may vary significantly from case to case. Each may contain documents and annexures. Each will usually address the facts and will usually provide a detailed analysis of the law and its application to the facts. The documents are circulated amongst the members of the Panel before any hearing and the Panel members frequently exchange views amongst themselves before the hearing. On occasion a Panel member may not be able to participate on a matter where the member (or a professional partner of the member) may previously have advised the taxpayer, or a related party, or on a related matter, or where there may be either a conflict or some perception of conflict.

Panel Hearings

A typical hearing at the GAAR Panel will commence by a meeting of the members of the GAAR Panel with the tax officers involved in the audit or the proposed application of the GAAR in the particular case. The members of the GAAR Panel will usually have read all of the written materials before then and meet with the relevant case officers to discuss any matters arising from the papers in the absence, and before hearing orally from, the taxpayers. The taxpayers will next be invited to attend at the meeting and to make submissions in the presence of the tax officers responsible for the matter. This will usually involve oral submissions and detailed questioning and

discussions between members of the Panel and the taxpayer. The questions from the Panel members are sometimes posed by the Panel chairman but it is common for the members to ask questions freely about matters on which they seek clarification whether it be about the facts, the analysis, or the law. Taxpayers are often represented by lawyers or professional tax advisors who do not have a legal right of appearance but who are usually permitted to make submissions on behalf of taxpayers without the need for leave or other formal requirement.

The hearing of the taxpayer is not conducted as an adversarial proceeding. The Panel does not sit in a formal sense as an independent body and is not able to hear evidence or make findings upon contested facts. It receives the submissions from the taxpayer and takes the opportunity to ask questions of the taxpayer's representatives to explore matters that may concern its members. The case officers proposing the application of the GAAR are usually present during the submissions made by the taxpayer but do not usually participate at that stage of the hearing. The tax officers frequently remain with the members of the GAAR Panel after the conclusion of the taxpayer's submissions and after they have left. This provides the Panel with a further opportunity to explore matters with the relevant tax officers after having heard from the taxpayers or their representatives.

GAAR Panel and Disputed Facts

The GAAR Panel is not a fact finding tribunal and this may be both a strength and a weakness. Cases involving the application of a GAAR will often

depend upon contested facts[137] but the Panel is neither equipped to find facts nor is it the appropriate forum for such an exercise. Its primary focus often becomes that of testing the application of the GAAR upon the assumption that the facts are as the relevant case officers contend them to be. Taxpayers are not prevented from contesting the facts as they are maintained to be by the Commissioner, and frequently do contest them, but they often face the tactical dilemma of whether to withhold a challenge to the Commissioner's evidence until trial and confine any challenge before the GAAR Panel to the Commissioner's analysis and reasoning. The GAAR Panel, however, is not restricted in its inquiries by what the "parties" have submitted and are free to inquire into the facts[138] and frequently explore the facts at large. The Panel itself does not, however, have investigatory powers under statute. The information given to the Panel is no doubt covered by the statutory provisions which requires taxpayers and advisors not to mislead or make statements that are not true or correct,[139] but (unlike the Commissioner generally)[140] the Panel itself has no statutory power to compel the provision of information or the production of documents.

Panel Deliberations and Minutes

The GAAR Panel has a person to act as a minute secretary to note the decisions and recommendations in each case. The recommendations are made available to the taxpayer but the Panel's deliberations and minutes more generally are not otherwise made available to the taxpayer. The GAAR

137 See: *Ashwick (Qld) No 127 Pty Ltd v Federal Comissioner of Taxation* [2009] FCA 1388; *Commissioner of Taxation v BHP Billiton Finance Ltd* (2010) 182 FCR 526.

138 *Clough v Leahy* (1904) 2 CLR 139, 156–7 (Griffith CJ).

139 *Income Tax Assessment Act 1936* (Cth) pt III, div 2, sub-div B.

140 *Income Tax Assessment Act 1936* (Cth) ss 263, 264.

Panel's documents have sometimes been the subject of requests for access by taxpayers. The internal documents of the GAAR Panel may be accessible under the Freedom of Information legislation although most would come within one of the various exceptions.[141] Usually the internal documents of the GAAR Panel will not be discoverable in court action because the GAAR is made to operate upon objective facts rather than any exercise by the Commissioner of a discretion or the formation by the Commissioner of an opinion.[142] There had been attempts in some cases to challenge the application of Part IVA on the basis that the provisions did depend upon the exercise by the Commissioner of a discretion or the formation by the Commissioner of an opinion or of a state of satisfaction. The argument in those challenges depended upon the power to make a determination to cancel a tax benefit under section 177F. It was rejected in *Federal Commissioner of Taxation v Peabody*[143] in which the High Court held that Part IVA presupposed the obtaining of a tax benefit in connection with a scheme as an objective fact rather than being dependent upon the Commissioner's correct identification of a scheme. There may, nevertheless, be some circumstances where an integer in the process of assessment leading to the application of a GAAR may require the Commissioner to reach a subjective opinion or to form a view,[144] and in such cases access to the internal documents of the GAAR Panel may become relevant.

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141 *Freedom of Information Act 1982* (Cth).

142 *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, 382 (Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ).

143 (1994) 181 CLR 359.

144 *W R Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation* (2007) 66 ATR 336.

Advance Rulings

The existence of the Panel may potentially be of particular benefit in transactions before they are entered into. Australian tax law provides for legally binding rulings[145] which modifies the position at law that the conduct of the Commissioner cannot prevent the operation of the statute if inconsistent with a ruling or view of the Commissioner.[146] Rulings given by the Commissioner under those statutory provisions modify the law applicable to a taxpayer who comes within the terms of the ruling.[147] The GAAR Panel provides a significant vehicle through which a taxpayer seeking certainty before entering a transaction may seek to obtain some measure of comfort. On the other hand, observations have been made that the terms of the GAAR may not sit conformably with the ruling provisions.[148]

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145 *Taxation Administration Act 1953* (Cth) sch 1, ss 359, 105-60 (repealed by No 74 of 2010, s 3 and sch 2 item 23), 356-5.

146 *Federal Commissioner of Taxation v Wade* (1951) 84 CLR 105; *AGC (Investments) Ltd v Federal Commissioner of Taxation* (1991) 91 ATC 4180.

147 *Taxation Administration Act 1953* (Cth) sch 1, s 357-60.

148 *Bellinz v Federal Commissioner of Taxation* (1998) 84 FCR 154, 170 (Hill, Sundberg and Goldberg JJ).