PART IVA PROPOSED AMENDMENTS: SUBMISSION

I am writing to provide my comments and observations on the draft legislation to amend Pt IVA of the *Income Tax assessment Act 1936* (Cth) ('the 1936 Act'), which was released by the Assistant Treasurer, the Hon David Bradbury, on 16 November 2012.

At the outset, I wish to make it clear that what follows are my comments and observations and they do not reflect the views of the Court or any other judicial officer of the Court. Indeed, I do not know whether the Court or any other judicial officer of the Court has views about these matters, although I am aware my colleague, the Hon Justice John Logan, has publicly questioned the need for such amendments. As will be apparent from my early comments, I share his Honour's view.

I have grouped my comments/observations under various headings. The headings are not intended to be discrete. Indeed, many of them overlap, however, I endeavoured to avoid repetition because a point, good or bad, does not get better with repetition. It is something which counsel, indeed senior counsel, whether appearing for a taxpayer or the Commissioner, would do well to observe; it rarely is.

1. The need for amending legislation

1 I am firmly of the view that there is no need for this legislation. It is an unfounded 'knee jerk' reaction to the result in one or two cases – *RCI* being the most notable example – which are exceptional, as is exemplified by the fact that it has taken 20 years into the life of Pt IVA for such a case to come to the surface. I dare say that it will be another 20 years before the courts are confronted with similar factual circumstances, by which I mean circumstances where the alternative postulate relied upon by the Commissioner for assessing the tax benefit can be denigrated by reference to the tax cost of that alternative; voluntary corporate reorganisation aside, it is difficult to conceive of any other circumstances (reference what was said in *Macquarie Bank/Mongoose* at [65] – appeal to the Full Court still reserved).

2 The construction and application of Pt IVA to different factual circumstances has been fixed, if not 'set in concrete', by four High Court cases – *Peabody*, *Spotless*, *Consolidated Press* and *Hart* (I leave aside *Mills* because, in my view, that is a case which the ATO should never have run). *Consolidated Press* and *Hart* were 'high-water marks' for the Commissioner in the outcomes in those cases, but nothing has been said in subsequent cases in the Full Federal Court which would, in any way, provide comfort to a view which would suggest that the tide is on the ebb. Indeed, the reasoning in *RCI* relies almost exclusively on the reasoning

in *Peabody*; and the reasoning in *Citigroup*, both at first instance and on appeal, relies heavily, if not exclusively, on the reasoning in *Spotless*.

3 I am not alone in saying that Pt IVA is operating effectively, efficiently and in the way Parliament intended it to apply when it was first introduced. Indeed, I believe I am but part of a majority of informed opinion which says just that. Some would disagree. The late Justice Hill would disagree having regard to his judgment in the Full Court in *Peabody* (particularly at FCR 548–549), and to his judgment in the Full Court in *Hart*. In his Honour's view, the construction of Pt IVA and its application to genuine commercial transactions was as circumscribed as s 260. On the other hand, those responsible for the promotion of the proposed amending legislation, obviously are of the view that it does not go far enough and, more worrying from my point of view, that the courts have got it wrong.

4 Two observations at this stage: the courts have not got it wrong and any inference in the explanatory material along those lines should be expressly rejected and the inferential words removed. Second, Pt IVA is working effectively, efficiently and in the way Parliament intended it to apply when it was first introduced.

5 My observation, as a judicial officer, is that certain recent cases should never have been run in reliance on Pt IVA. Into that category I put *BHP*, and *Ashwick*. There was no, or insufficient, evidence in either case to support the assessments in reliance on Pt IVA. I do not put *News* into that category, but it is very close. Some argue that *RCI* and *Futuris* fall into the category that they should not have been run. I do not agree. Factually they were arguable but viewed as a whole, the factual content did not support an assessment in reliance on Pt IVA.

6 Like most tax cases, Pt IVA cases are facts cases; the outcome depends on the findings of fact, rather than the construction of the relevant principles of the statute which largely, indeed wholly, have been settled by the jurisprudence in the High Court to which I have already referred. The proposed amendments seek to remove from the factual enquiry, into whether an alternative postulate would have occurred or might reasonably be expected to have occurred, a fundamental matter of fact, namely, the tax cost. That fundamental fact will rarely be sufficient, on its own, to determine the outcome of the factual enquiry. But to remove it, creates a factual context of falsity and artificiality, the very type of schemes to which Pt IVA is directed. As was said by the United States Supreme Court in *Frank Lyon Co*, cited with approval by the High Court in *Spotless* at CLR 416, it could not 'ignore the reality that the tax laws affect the shape of nearly every business transaction'. Indeed, this was at the heart of the High Court's dictum in *Spotless* that it was a false dichotomy to draw a distinction between a 'rational commercial decision' on the one hand and the obtaining of a tax benefit as 'the

dominant purpose of the taxpayer in making the investment' on the other, leading to its conclusion that (CLR 415):

> '*A person may enter into or carry out a scheme, within the meaning of Pt IVA for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business.*'

7 It is equally a falsity to ignore a person's tax liability (or potential tax liability) in making the factual enquiry as to whether the Commissioner's hypothetical postulate is a reasonable expectation as to what might have occurred if the scheme had not been entered into or carried out.

2. Proposed Section 177AA: Object of Part IVA

1 I do not understand the purpose of this proposed provision; nor do I think it is utile. The explanatory material says that it 'confirms that Pt IVA is intended to counter schemes that are entered into with a relevant tax avoidance purpose' and 'confirms that Pt IVA is intended…to include schemes that are merely steps within broader commercial arrangements'.

2 But such confirmations are already manifest in the High Court jurisprudence to which I have referred, in particular in *Consolidated Press*.

3 In my view, the text of the proposed provision, which is the beginning and end of its proper construction – see *Consolidated Media* ([2012] HCA 55 at [39]) – is arguably at odds with s 177D (proposed s 177D(1)). Section 177D makes it clear that Pt IVA is concerned with the objectively ascertained purpose of a person entering into or carrying out a scheme (see too *Hart* at CLR [63] per Gummow and Hayne JJ) not with the purpose of the scheme, cf., s 260. The text of the proposed s 177AA is, arguably, referring to the purpose of the scheme, even though this may not have been intended.

4 Proposed s 177AA is not necessary and should not be enacted.

3. Proposed Section 177CB: Assumptions relating to alternative postulate

1 Subsections (2) and (3) are drafted in aid of the construction of paras (b) and (c) of subs (1). Having regard to my comments and observations on those paragraphs below, subss (2) and (3) require no separate comment. On the other hand, if paras (b) and (c) of subs (1) are enacted in their present or some like form, subss (2) and (3) will not clarify their operation, but will contribute to a 'nightmare' for all of the administrators (the ATO), compliance stakeholders (taxpayers) and judicial officers confronted with the task of

construing and applying the legislation to a given set of facts giving rise to disputation between the first two.

2 I have already outlined my views on para (a) of subs (1) in 1 above and I do not propose to repeat them.

3 I do not understand the policy underlying paras (b) and (c). The explanatory material does not assist and I suspect that, without saying so, these provisions have, as their purpose, an endeavour to produce different results from those which Full Courts come to in *Futuris*, *Traill Bros* and *AXA Asia* (special leave refused). If that is correct, then the explanatory material, if not deceitful, is certainly less than forthright; it should say as much rather than give 'half baked' hypothetical examples (Example 1.1 in [1.108] and Example 1.2 in [1.110]) devoid of comprehensive factual content. I do not regard the references in [1.113] as satisfying the level of forthrightness to which Treasury should aspire. Such examples only lead administrators to seize upon actual facts upon audit to raise erroneous assessments.

4 If these provisions, paras (b) and (c) of subs (1), together with subss (2) and (3) are included in response to the cases to which I have referred, which [1.113] of the explanatory material says they have been, then again this introduces a falsity or artificiality to fact reality which is to be deplored as being part of the tax policy of a country which professes to observe the rule of law. It is nothing more than taxation based on hypotheses which have nothing whatsoever to do with actual facts that might otherwise be found by the courts.

5 Not surprisingly in the face of these comments, I am strongly of the view that paras (b) and (c), and it follows subss (2) and (3) of this proposed provision, should not be enacted in any form. It was not part of the original Ministerial statement back on 1 March this year and should be abandoned.

4. Effective Date

1 The final legislation, if any, should only operate from the date it receives the Royal Assent, and then only after it has been tabled before the Parliament for at least 4 weeks to facilitate constructive parliamentary debate and public comment.

2 The comments in [1] above should not be read as approving the amendment proposed by s 177CB(1)(a).

Richard Edmonds

14 December 2012