WHEN IS THE COMMISSIONER EMPOWERED OR REQUIRED TO NEGATE A GST BENEFIT?

CYRUS THISTLETON*

I. INTRODUCTION

Competently structured tax legislation tends to minimise tax avoidance by putting in place provisions, which may include specific anti-avoidance provisions, to stop the abuse of the intent of each provision in the tax legislation, even when a scheme is devised to enable avoidance. Even though the policy intent of the legislation may be reflected in the wording of the legislation to a greater or lesser degree, it can be open to different interpretations or can be manipulated to suit the taxpayer's preferred outcome. It is impossible for the legislature to foresee all possible tax avoidance arrangements and to enact a tax provision which has no loopholes for an indefinite period. Despite the existence of some specific anti-avoidance provisions[1] to address particular schemes, general anti-avoidance provisions are put in place to prevent artificial schemes which are designed, solely or principally, for the purpose of obtaining tax benefits by using these loopholes in a manner which is inconsistent with the intent of the legislature.

The leading and the most influential High Court decisions on the general anti-avoidance rules in FCT v Unit Trend Services Pty Ltd[2] (Unit Trend), FCT v Spotless[3] (Spotless), FCT v Consolidated Press Holdings[4] (Consolidated Press), FCT v Peabody[5] (Peabody) and FCT v

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1 Specific anti-avoidance provisions of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA) such as s 9-75(1)(b) (the value of taxable supplies not expressed in money), s 29-25 (Commissioner may determine particular attribution rule for particular taxable supplies and creditable acquisitions), s 66-10 (amounts of input tax credit for creditable acquisitions of second-hand goods) and s 72-70 (the value of taxable supplies foe inadequate consideration between associated persons).

2 *FCT v Unit Trend Services Pty Ltd* (2013) 250 CLR 523.

3 *FCT v Spotless Services Ltd* (1996) 186 CLR 404.

4 *FCT v Consolidated Press Holdings Ltd* (2001) 207 CLR 235.

5 *FCT v Peabody* (1994) 181 CLR 359.

Hart[6] (Hart) have acknowledged the importance of the general anti-avoidance provisions. In this regard, Sackville J stated that 'it is becoming increasingly apparent that the general anti-avoidance provisions are central to the operation of the Australian tax system'.[7]

Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA) contains the general anti-avoidance rules for the GST, the wine equalisation tax and the luxury car tax. The general anti-avoidance provisions in the GSTA give the Commissioner the power under s 165-40 of the GSTA to negate the GST benefit obtained from an artificial or contrived scheme when the GST provisions fail to achieve the result intended by the legislature. Division 165 can be applied to an arrangement when an entity, being the avoider, got or gets a GST benefit from a scheme which has the sole or dominant purpose of getting a GST benefit or, alternatively, the principal effect of the scheme is that the avoider gets the GST benefit from the scheme, directly or indirectly. However, the third element (determining the purpose and the principal effect) is controversial and subject to different interpretations. The principal effect test is an extension of the test in Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936). Once these requirements are satisfied, the Commissioner is empowered to make a declaration negating the GST benefit.

Although the focus of this article is on Division 165, the author refers, in particular, to Pt IVA court decisions because: (1) Division 165 is based on Pt IVA in many aspects, such as structure and purpose;[8] (2) there is a paucity of judicial guidance on Division 165; and (3) there are many more income tax avoidance court cases than there are GST avoidance cases.

Despite being a derivative of Pt IVA, Division 165 was written to address the transactional nature of GST, as well as rectifying Pt IVA deficiencies. In this respect, Gyles J in *McDonald's Australia Ltd v FCT*[9] stated that, Division 165 is 'broadly similar to Pt IVA of the *Income Tax Assessment Act 1936* (Cth), the subject of much litigation, but there are important differences … both from the different terms of the provisions themselves and from the differences between GST and income tax'.

It should be noted that Division 165 should be considered after specific anti-avoidance provisions fail to prevent the GST benefit as the result of the scheme. Accordingly, in this paper, an example is provided which shows how the specific anti-avoidance provisions are considered prior to application of Division 165.

Since Division 165 does not deal with tax evasion, it is important to distinguish between tax avoidance and tax evasion. In this regard, the author explains, in passing, what constitutes tax evasion and what constitutes tax avoidance.

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6 *FCT v Hart* (2004) 217 CLR 216.

7 Justice R Sackville, 'Avoiding tax avoidance: the primacy of Part IVA' (FCA) [2004] *FedJSchol* 11.

8 See Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.313]

9 *McDonald's Australia Ltd v Commissioner of Taxation* [2008] FCA 37 at [16].

The author then provides a detailed examination of the application of Division 165 and takes into consideration the policy intent of the GSTA to examine the circumstances in which the Commissioner should negate the GST benefit. The author writes this article from both a legal and a tax administrator's perspective.

II. SPECIFIC ANTI-AVOIDANCE PROVISIONS

Specific anti-avoidance provisions are to address possible tax avoidance schemes. However, it is impossible for the legislature to foresee all possible tax avoidance arrangements and to enact a tax provision which has no loopholes for an indefinite period. When considering application of Division 165, it is always considered necessary to consider the specific anti-avoidance provisions prior to considering general anti-avoidance provisions.

The following example describes an arrangement, entered into by an entity, which attempts to increases its entitlement to input tax credit (ITC), however, it triggers the specific provisions that stops the rise of the GST benefit. In the absence of such specific provisions, it is considered appropriate to apply Division 165 to negate the GST benefit.

When looking at the GST chain, some businesses are end users where the GST is, in part, an expense to the business, such as acquisitions that attract reduced input tax credit (RITC) under s 70-5 of the GSTA. This may include entities which provide input taxed supplies, such as authorised deposit-taking institutions like banks. The financial supplies are input taxed and therefore, the bank cannot claim ITC for acquisitions it makes in making those supplies. However, there is provision for a special 75 percent ITC entitlement for certain types of services acquired by financial supply providers such as banks. These are called 'reduced credit acquisitions'.

The example is a hypothetical scenario for the purposes of demonstrating how specific anti-avoidance provisions work, as follows:

1. Ultimate Head Entity (UHE) is a bank which is a financial supply provider.
2. Company A is a member of the broader economic group; however, it is not a member of UHE GST group at the initial stage of the arrangement.
3. Company A is a service provider which is not carrying on an enterprise for the purposes of making financial supplies. This entitles the company to 100 percent of the input tax credit for its acquisitions.
4. Company A, while sitting outside the GST group, buys a business which has the necessary requirements for providing services to UHE, by utilising going concerns provisions and treating the acquisitions as GST free. These acquisitions are intended to be used exclusively by UHE.
5. Immediately afterwards (or some time later), the UHE's GST group representative groups Company A for GST purposes. Subsequently, Company A provides goods and/or services to UHE which is an intra-group transaction. Under the grouping provisions of

GSTA, the supplies and acquisitions made wholly within the group are effectively ignored and not treated as taxable supplies or creditable acquisitions.

6 While UHE attempted to increase its entitlement to ITC from 75 percent to 100 percent by entering into this arrangement, it triggers GST specific anti-avoidance provisions to prevent the bank from getting the GST benefit.

In the above scenario, the GST benefit is the loss of revenue resulting from the intra-group transaction. Had the Company A been outside of the GST group when it supplied UHE with the services, then the GST liability of the UHE Group representative would exceed the RITC entitlement of the UHE such that the Commissioner would be in a revenue positive position.

Prior to considering the application of Division 165, it is important to consider specific anti-avoidance provisions to see if the GST benefit resulting from this arrangement could result in an increasing adjustment.

This arrangement gives rise to an increasing adjustment under s 48-55, Division 135 and 129 of the GSTA. An increasing adjustment, for purposes of GSTA, means that the GST liability of UHE GST group is increased due to the fact that the bank acquired a business GST-free as a going concern but intends to use it wholly or partly in making input taxed supplies. These provisions are specific anti-avoidance provisions.

Section 48-55 of the GSTA requires that GST groups be treated as a single entity for the purposes of working out whether the representative member has any adjustments, in particular:

(1A) If:

*(a) while you were not a * member of any * GST group, you acquired or imported a thing; and*

(b) you become a member of a GST group at a time when you still hold the thing;

*Then, when the * representative member of the GST group applies section 129-40 for the first time after you became a member of the GST group, the * intended or former application of the thing is the extent of * creditable purpose last used to work out: (c) the amount of the input tax credit to which you were entitled for the acquisition or importation; or (d) the amount of any * adjustment you had under Division 129 in relation to the thing.*

Division 129 of the GSTA requires an increasing adjustment because of changes in the extent of creditable purpose.

Division 135 of the GSTA applies in relation to any supply of a going concern. Division 135 states that you have an increasing adjustment if you are the recipient of a sale of a going concern and intend that some or all of the supplies, made through the enterprise to which the supply of the going concern relates, will be input taxed supplies. The GST group representative may have an increasing adjustment when the going concern becomes part of the GST group if its use was to make supplies that were neither taxable nor GST free, on the basis that the GST group is now a single entity.

Therefore, the UHE GST group, as the recipient of a supply of a going concern, has an increasing adjustment to take into account the proportion (if any) of supplies that will be

made in running the concern and that will not be taxable supplies or GST-free supplies. Later adjustments are needed if this proportion changes over time. The amount of the increasing adjustment is as follows:

$$\frac{1}{10} \text{ x Supply price x Proportion of noncreditable use}$$

The above specific anti-avoidance provisions are in place to address such schemes. However, when such provisions fail, the general anti-avoidance provisions are available to prevent artificial schemes which are designed, solely or principally, for the purpose of obtaining tax benefits by using such loopholes in a manner which is inconsistent with the intent of the legislature.

III. EVASION AND AVOIDANCE

General anti-avoidance provisions of Division 165 are not generally directed at tax evasion. The distinction between evasion and avoidance can sometimes be a little unclear and may be difficult to recognise in practice. While both result in tax revenue leakage, one, avoidance, is done lawfully through artificial but legitimate activity and the other, evasion, classically carries a factor of clear illegality or fraud. As they say 'the difference between avoidance and evasion is the thickness of a prison wall'.[10] Although fraud can mean different things in branches of the law, for the purposes of Australian taxation law as a whole, it is common law fraud and not criminal law fraud or equitable fraud. The court in *Kajewski v FCT*[11] held that:

> *Fraud within s 170(2)(a) involves something in the nature of fraud at common law, ie, the making of a statement to the Commissioner relevant to the taxpayer's liability to tax which the maker believes to be false or is recklessly careless whether it be true or false.*

It can therefore be extrapolated that this concept also applies equally to GST law. A good description of fraud in taxation matters was given by Enderby J in *Masterman v FCT; MacFarlane v FCT*.[12] In this case, the taxpayer lodged income tax returns, for a few income years, claiming deductions in respect of employees that did not exist. Enderby J stated that the statements made in these tax returns 'can only be described as frauds on the Commissioner of Taxation'. Taking this approach, in the context of GST, producing invoices for goods which do not exist or claiming GST that was never paid, in order to maximise GST refunds, constitutes fraud and thus evasion.

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10 Former British Chancellor Denis Healey.

11 *Kajewski v FCT* [2003] FCA 258 at [111].

12 *Masterman v FCT; MacFarlane v FCT* (1984) 16 ATR 77.

Evasion also includes conduct which is more than avoidance but less than fraud. In this respect, Lord Hobhouse in *Simms v Registrar of Probate*[13] described evasion as 'nothing more than intentional avoidance of something disagreeable but less than fraud'.

Evasion is best explained by reference to the judgment of Dixon J in *Denver Chemical Manufacturing v FCT*[14] in which his Honour described evasion as a 'blameworthy act or omission on the part of the taxpayer'.

Williams J in *Barripp v FCT (NSW)*[15] explained tax evasion in the following way:

> *Where a taxpayer makes a profit which he knows to be taxable income and wilfully omits this profit from his income tax return, he would be guilty of evasion in the absence of some satisfactory explanation for the omission.*

Accordingly, tax evasion requires the presence of two elements: (1) the act itself such as a false statement or deliberate omission; and (2) the 'guilty' mind of the taxpayer who knows he is doing something wrong and recklessly ignores the true position.

Gleeson CJ in *R v Meares*[16] distinguished between 'avoidance' and 'evasion', in the following way:

'Tax avoidance involves using, or attempting to use, lawful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful … It is sometimes said that the difference may be difficult to recognise in practice. I would suggest that in most cases there is a simple and practical test that can be applied. If the parties to a scheme believe that its possibility of success is entirely dependent upon the revenue authorities never finding out the true facts, it is likely to be a scheme of tax evasion, not tax avoidance.'

Tax avoidance was defined by the *Review of Business Taxation*:[17]

> *Tax avoidance may be characterised as a misuse or abuse of the law rather than a disregard for it. It is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by the Parliament but also includes manipulation of the law and a focus on form and legal effect rather than substance. The way things are done in order to take advantage of structural loopholes, or to dress up something to satisfy form but not substance can also stamp an arrangement as avoidance.*

Characteristics of a tax avoidance scheme would be qualities such as 'artificiality', 'undue complexity' and 'circularity', or 'lack of business reality'.[18]

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13 *Simms v Registrar of Probate* (1900) AC 332 at [334].

14 *Denver Chemical Manufacturing v FCT* (1949) 79 CLR 296 at [313].

15 *Barripp v FCT (NSW)* (1941) 6 ATD 69 at [72].

16 *R v Meares* (1997) 37 ATR 321 at [323].

17 *Review of Business Taxation*, A tax system redesigned, July 1999, at [243].

18 *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [24], citing Park J in the High Court.

It should be noted that tax avoidance is different from legitimate tax planning or tax mitigation. Legitimate tax planning is a way in which a taxpayer structures his or her business and taxation affairs, in compliance with taxation laws, to arrive at the lowest possible tax cost. This is not against the intent of the legislature. Lord Templeman, in *CIR (NZ) v Challenge Corporation*, stated that there is a difference between acceptable tax mitigation to which the general anti-avoidance rules do not apply and unacceptable tax avoidance to which the general anti-avoidance rules applies.[19]

There is also a situation where taxpayers avoid paying GST liability or other tax liabilities to the Commissioner by phoenixing where the tax liability becomes no longer accessible by means of the systematic liquidation of related entities. The aim of phoenixing is simply to avoid payment of a tax liability, employee entitlements and creditors.

In phoenixing, the directors of the company leave the debts with the old company and place the company into liquidation, leaving no assets to pay creditors. In the meantime, another company is registered and operated by the same 'controlling mind' and continues the same business under a new structure.

For tax purposes, a phoenixing arrangement is concerned with the stripping of assets of companies and trusts before tax liability is due or collected; and schemes under which a tax liability falls on a company or trust that is never intended to have sufficient assets to meet its tax liability. This is neither avoidance nor evasion. It is not avoidance because the GST liability already exists. It is not fraud or evasion as the liquidation is not illegal and it would be difficult to establish the fraudulent intention of the directors to lift the corporate veil. However, director's penalty notices and *Crimes (Taxation Offences) Act 1980* (Cth) could restrict phoenixing. There are cases where the Commissioner has sought to apply the provisions of this Act such as in *R v Ditford*.[20]

GST avoidance could also be in the way of altering the timing of payments of GST or refunds as was decided in *VCE v FCT*.[21] *VCE* concerned an arbitrage opportunity through a transaction exploiting differences in the timing for payment and accounting for GST differently, one on cash and the other on accrual. VCE claimed an input tax credit when it entered into an agreement to purchase a medical centre payable over an approximately 15-year period, while the vendor was only paying GST when consideration was received. The Commissioner disallowed VCE's claim under Division 165. The Administrative Appeals Tribunal (AAT) found that the taxpayer got a GST benefit and Division 165 was applied to negate the benefit.

In the absence of fraud or evasion, GST anti-avoidance provisions, unlike Pt IVA, have a time limit in which they may be applied. The effective time limit for the Commissioner to make a

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19 *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155 at [167]-[168]. See also the decision of the New Zealand Court of Appeal in *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 at [39], where the majority drew the line between legitimate tax planning and improper tax avoidance.

20 *R v Ditford* 87 ATC 4678 and 91 ATC 4423.

21 *VCE and FCT* [2006] AATA 821.

declaration under s 165-40 is within four years after the time GST became payable by an entity.[22]

GST is highly susceptible to evasion and not quite so easily susceptible to avoidance. The obvious situation is where a transaction is a sham with fraudulent GST refund claims or where GST is simply not paid, in respect of a taxable supply, by deliberate underreporting of taxable supplies. Legislation can deal with evasion by criminalising it. It can impose penalties on those who are caught in the act. However, detection and prosecution are the problems.

Since the general anti-avoidance provisions are not generally directed at tax evasion, the act of GST minimisation, for the purposes of Division 165, should fall within the scope of tax avoidance.

IV. APPLICATION OF DIVISION 165

Division 165 is aimed at artificial and contrived transactions that are, in themselves, real and lawful but which nonetheless breach the normal or expected operation of the GSTA. Its object is to deter schemes that would produce GST benefits, such as reducing GST, increasing refunds, or altering the timing of payment of GST or refunds where the dominant purpose or principal effect is to get GST benefits.[23] Not all of the GST benefits obtained by taxpayers constitute GST avoidance.[24] An outcome of reduction in GST would hardly seem to be GST avoidance if it comes about accidently as part of ordinary commercial transaction. Although there is no carve-out for commercial transactions, commercial explanation does not negate Division 165. While the legality and commercial reasoning behind the transaction needs to be considered carefully, it should not prevent the application of Division 165 when some provisions are utilised in a manner not intended by the legislature. In this respect, the New Zealand High Court in *Miller v Commissioner of Inland Revenue*[25] held that:

> *It is the very nature of tax avoiders to manoeuvre skilfully around the express rules of the general law and the tax legislation and end with the innocent submission - as I have not infringed them I have succeeded. That is the very reason for generally expressed anti-avoidance provisions which begin their operation when other provisions have had their effect.*

The AAT in *Unit Trend* acknowledged that the fact that a transaction is genuinely commercial does not exclude the application of Division 165:[26]

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22 See *Taxation Administration Act* 1953 (Cth), ss 105-5 and 105-50 in Schedule 1.

23 Explanatory Statement to GSTA, s 165-1. The explanatory statement is quite important. Although they do not have operative force in themselves, they may be considered in determining the purpose or object underlying the legislation (s 182-10 of the GSTA).

24 GSTA, 165-5(1)(b).

25 *Miller v Commissioner of Inland Revenue* (1996) 17 NZTC 13,001.

26 *The Taxpayer and FCT* [2010] AATA 497 at [114].

> *... even if the ultimate objective of the transaction is genuinely commercial or the transaction producing the GST benefit also delivers a desired non tax commercial outcome, Division 165 may still operate. Division 165 might apply if there is enough in the way in which a transaction is entered into or carried out, viewed through the prism of the matters listed in s 165-15(1) of the GSTA, that the purpose of obtaining the GST tax benefit outweighs the commercial objectives. The greater the degree of artificiality or contrivance in the transaction directed to obtaining the GST benefit the greater the prospect that the commercial pursuits of the transaction will not be dominant.*

V. UNIT TREND

Unit Trend, a property developer, was the representative member of a GST group of companies which, at the relevant time, included Simnat Pty Ltd, Blesford Pty Ltd and Mooreville Investments Pty Ltd. Different members of the Unit Trend GST group were allocated different roles in the property development. In this case, when construction of the project was at an advanced stage, Simnat sold the project as going concern to Blesford and Mooreville, which completed the project and sold the completed individual residential units to buyers.

The group members used grouping and going concerns provisions and applied margin scheme which resulted in reducing the amount of GST payable by GST group on the ultimate sales of individual residential apartments. The choices and elections that the GST group made which were specifically allowed under GSTA are:

- The choice to form the GST group;
- The choice of intra-group transactions;
- The choice to treat the sales as a supply of a going concern; and
- The choice to apply margin scheme to final sales of the individual residential apartments which means the GST was payable on the difference between the purchase and sale price, rather than on the sale price alone).

The Commissioner issued a declaration to Unit Trend under the anti-avoidance provisions in Division 165 negating the GST benefit. This declaration was contested by Unit Trend in the AAT which found in favour of the Commissioner. The AAT's decision was subsequently overruled by the Full Court in favour of Unit Trend. The Full Court held that the GST benefit obtained by Unit Trend was attributable to the making of a choice, election, application or agreement expressly provided for by the GSTA and, therefore, Division 165 did not apply. On appeal by special leave to the High Court, the issue before the Court was whether the GST benefit obtained by Unit Trend was not attributable to the making of a choice, election, application or agreement that was expressly provided for by the GST Act.

The High Court in *Unit Trend* considered the purpose of Division 165, and took into account the legislative intent of the supplementary explanatory memorandum to *A New Tax System*

(Goods and Services Tax) Bill 1998.[27] Further, the High Court in *Unit Trend* considered the 'election exclusion' contained in s 165-5(1)(b) GSTA. This saving provision can only be applied to protect the taxpayer where the arrangement is not artificial. The High Court confirmed that Division 165 can still be applied when an entity is taking advantage of an election, which was found in the GSTA, in a way that is not consistent with the policy and object of the provision that grants the choice.

The High Court decision in *Unit Trend* also supports the view that Division 165 is focused on the objective purpose or effect of the arrangement and not the motive or subjective purpose of the taxpayer.[28]

The decision of High Court in *Unit Trend* is important in the application of Division 165 because the High Court acknowledged that the High Court cases such as *Spotless, Consolidated Press, Hart* and *Peabody* that dealt with Pt IVA are important authorities in dealing with Division 165 in relation to identifying the scheme, the tax benefit as well as the dominant purpose of the scheme and should also be applied in the context of Division 165. Moreover the importance of *Unit Trend* is the clarification of the exclusion in 165-5(1)(b). This is the first time that the application of the exclusion has been tested in the High Court.

A. *The elements of Division 165*

(a) GST benefit

A 'GST benefit' is defined in s 165-10(1) of the GSTA. An entity gets a GST benefit by (Any of these effects are a GST benefit):

- reducing GST liability, either by not paying or by paying less;[29]
- obtaining or increasing GST refunds;[30] or
- timing benefits, such as altering the timing of GST payment (eg pays GST later) or GST refunds (e.g. gets a refund earlier).[31]

A taxpayer may obtain a variety of tax benefits from the same scheme. However, for the purposes of Division 165, the dominant target of the scheme should be a GST benefit. The definition of 'GST benefit' for the purposes of Division 165 is different from the definition of 'tax benefits' in Pt IVA. This is because the nature of GST and income tax are different as they have different bases.

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27 *FCT v Unit Trend Services Pty Ltd* (2013) 250 CLR 523 at [53].

28 Michael Evans, 'GST — It's Not a Matter of Choice: *Commissioner of Taxation v Unit Trend Services Pty Ltd*' on Opinions on High (5 July 2013) http://blogs.unimelb.edu.au/opinionsonhigh/2013/07/05/evans-unittrend/.

29 GSTA, s 165-10(1)(a).

30 GSTA, s 165-10(1)(b).

31 GSTA, ss 165-10(1)(c) and (d).

An obvious example of what constitutes a GST benefit is an inordinate deferred settlement arrangement while claiming an input tax credit today for the expected future value of the property to be paid in future.[32]

There may be situations where the GST benefit obtained does not attract anti-avoidance provisions:

- offering delivery-inclusive prices rather than charging delivery separately for GST-free goods. In this case, delivery is incidental to the supply of those GST-free goods and, thus, there is no GST payable on the value of the portion attributed to delivery costs as the delivery is not contractually separate from the sale of the GST-free goods. This is a common commercial arrangement and accepted internationally;
- formulating a product to bring the supply of that product within the GST-free category, such as increasing the fruit juice content of a beverage from 85 percent (subject to GST) to 90 percent (GST-free) in order to achieve GST-free status;
- an exporter electing to have monthly tax periods in order to bring forward the entitlement to input tax credits; or
- a supplier of child care applying to register under the *Childcare Rebate Act 1993* (Cth), which makes the supplies of child care GST-free.

Identifying the GST benefit requires an examination of what could reasonably have been expected to be the position when viewed independently from the scheme; a reasonable counterfactual which involves a reasonable expectation test.

(b) What is a 'reasonable expectation'?

The enquiry directed by Division 165 requires comparison between the scheme in question and an alternative hypothesis based on the reasonable expectation test in the context of the definition of tax benefit.

The High Court in *Peabody* explained reasonable expectation as follows:[33]

> *A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.*

When identifying the GST benefit raised from a scheme, ss 165-10(1)(a), (b), (c) and (d) of the GSTA refers to 'could reasonably be expected'. In other words, what could reasonably be expected to have happened if the scheme had not been entered into or carried out? The use of the word 'could' rather than 'would' appears to set a lower degree of satisfaction.

There are many factors to consider when applying the reasonable expectation test, but a few of them are more reasonable and, in the author's opinion, give more weight to a reasonable counterfactual scenario:

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32 See cases such as *VCE and FCT* [2006] AATA 821 and *Ch'elle Properties (NZ) Ltd v Commissioner of Inland Revenue* [2007] NZCA 256.

33 *FCT v Peabody* (1994) 181 CLR 359 at [42].

- the most straightforward and usual way of achieving the commercial and practical outcome of the scheme (disregarding the tax benefit);
- commercial norms, for example, standard industry behaviour; and
- the behaviour of relevant parties before/after the scheme compared with during the period of operation of the scheme.

If the scheme includes some significant commercial effect (ignoring the GST benefit), then it is important to see if another counterfactual scenario can achieve the same result but without the GST benefit. When comparing different counterfactuals, it is possible for different conclusions to be reached as to what could reasonably be expected to have happened if the particular scheme had not been entered into or carried out. According to the explanatory memorandum,[34] 'enquiry will be in relation to the most economically equivalent transaction to the scheme or part of the scheme actually entered into or carried out'.

While it may be difficult to find the most reasonable transaction, the one that creates the most economically equivalent transaction to the scheme and which generates the same commercial result and practical outcome without the GST benefit would be the most reasonable one to choose. Interestingly, unlike Pt IVA, even where there is no other alternative scenario, s 165-10(3) provides that a GST benefit can still arise 'even if there is no economic alternative'. In this respect, the explanatory memorandum states that:[35]

> *'An entity that gets a GST benefit from a scheme, even if the entity claims it would not have entered into any type of transaction had the actual scheme not been entered into can still have that GST benefit negated.'*

Accordingly, s 165-10(3) empowers the Commissioner to apply Division 165 in circumstances where the taxpayer claims that no GST benefit arises from the scheme because in its absence, nothing would have happened.

In the author's opinion, it is reasonable to conclude that it only needs to be found that there is a GST benefit, as the result of the scheme, when the scheme was artificial and had no commercial benefit or outcome other than the obtaining of the GST benefit or perhaps other tax benefits.

(c) What constitutes 'an amount'?

Section 165-10(1)(a), (b), (c) and (d) refers to 'an amount' or 'part of an amount' which is a particular quantum of money, whether cash or equivalent, either payable to or payable by the entity. Amount includes a nil amount.[36]

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34 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.334].

35 Ibid [6.335].

36 GSTA, s 195-1.

(d) Which amount constitutes the GST benefit?

Section 165-10(1)(a) deals with that part of the GST benefit involving the actual amount payable by the entity to the Commissioner (including nil amount) being reduced from the amount that should have been paid.[37] An obvious scenario is where the taxable supply is converted to GST-free supplies, as the result of the scheme, so the liability of the entity to the Commissioner in respect of that transaction is reduced to nil amount. The amount equal to the reduction in GST for that transaction is the GST benefit. It is irrelevant to say that the GST is paid by one entity (third party) and claimed back as a creditable acquisition and therefore there is no GST benefit since it is revenue neutral. But, in fact, when applying s 165-10(1)(a) to calculate the GST benefit, you consider the liability of the avoider, rather than trading it off against the third party input tax credit to the transaction if the acquisition is a creditable acquisition.

Section 165-10(1)(b) deals with that part of the GST benefit involving the actual amount payable by the Commissioner to the entity being increased from the amount that should have been paid.[38] An obvious scenario is where input taxed supplies are converted to GST-free supplies as the result of the scheme so the entity can have a full refund for the GST paid on the acquisitions. The GST benefit in this situation is the increase in the claim for input tax credit.

Section 165-10(1)(c) and (d) deals with the timing benefit which arises from the payment of GST, either in delaying the payment or in claiming it. The GST benefit in these situations will be the time value of the money irrespective of how small it is.

(e) What is the 'net amount'?

According to the explanatory memorandum, the net amount refers to the combined effect of s 165-10(1)(a) and (b) where a net amount payable by an entity to the Commissioner is reduced to nil or converted into a refund payable by the Commissioner to the entity.[38]

(f) Is it important for the GST benefit not to be attributable to the taxpayer making an election that is expressly provided for by the GSTA?

When an entity obtains a GST benefit, following the choices and elections that the entity makes, which is specifically allowed under the GSTA, the question is, can the anti-avoidance provisions apply in this situation? This issue concerns s 165-5(1)(b) and (3) GSTA. The election exclusion rule in s 165-5(1)(b) sets the following conditions, for the Commissioner, in negating a GST benefit:[39]

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37 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.331]

38 Ibid.

39 GSTA, s 165-5(1)(b).

> *(b) the GST benefit is not attributable to the making, by any entity, of a choice, election, application or agreement that is expressly provided for by the GST law, the wine tax law or the luxury car tax law.*

This section was included in the GSTA, when the GSTA was introduced, to ensure that the exercise of an express choice, allowed under the GSTA, would not trigger Division 165.

The High Court in *Unit Trend* examined the election exclusion contained in s 165-5(1)(b). In this case, the High Court emphasised that the real test in s 165-5(1)(b) is not whether a GST benefit is attributable to a statutory choice but, rather, whether the GST benefit was not attributable to a statutory choice. Their Honours took the view that the Federal Court mistakenly focused on the word 'attributable' rather than the phrase 'not attributable to'.[40]

However, this created problems in regard to arrangements which were specifically allowed under the GSTA but where the abuse of these provisions created a situation where the taxpayer may argue that the benefit was received and is attributable to the choice which is specifically allowed under the GST law. The language in s 165-5(1)(b) contrasts with the language in the income tax anti-avoidance rule: s 177C(2)(a)(i) of the ITAA36. This rule provides that a tax benefit that 'is attributable' to the making of the choice is not a tax benefit obtained by a taxpayer in connection with a scheme.

Greenwood J in *Walters v FCT* stated that:[41]

> *The phrase in s 177C(2)(a)(i) 'attributable to' the particular election, choice or event means that there must be a direct relationship between the non-inclusion of the relevant amount and the choice or election made by the taxpayer.*

Despite the 'not attributable to' issue, s 165-5(3) (creating circumstances or states of affairs) was inserted by the *Tax Laws Amendment (2008 Measures No. 5) Act 2008* (Cth) with effect to choices and elections made after 9 December 2008. The insertion of s 165-5(3) was intended to overcome the problems faced by the Commissioner when considering artificial schemes, even though the explanatory memorandum accompanying the amending legislation stated that this is to confirm the existing law. Section 165-5(3) states that:[42]

> *(3) A GST benefit that the avoider gets or got from a scheme is not taken, for the purposes of paragraph (1)(b), to be attributable to a choice, election, application or agreement of a kind referred to in that paragraph if:*
>
> *(a) the scheme, or part of the scheme, was entered into or carried out for the sole or dominant purpose of creating a circumstance or state of affairs; and*
>
> *(b) the existence of the circumstance or state of affairs is necessary to enable the choice, election, application or agreement to be made.*

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40 *FCT v Unit Trend Services Pty Ltd* (2013) 250 CLR 523 at [33].

41 *Walters v FCT* (2007) 67 ATR 156 at [83].

42 GSTA, s 165-5(3).

Therefore, if the taxpayer creates circumstances and a state of artificial affairs, which ultimately provides the GST benefit, then the scheme is not taken, for the purposes of Division 165, to be attributable to a choice, election, application or agreement of a kind referred to in that provision. The High Court in *Unit Trend* acknowledged that when applying the election exclusion in s 165-5(1)(b), you do not need to find a causal link between the relevant choice or election and the GST benefit.

It is considered by some GST pundits that Division 165 will not apply to a situation where GST benefit is obtained through grouping provisions in Division 48. It should be noted that certain choices such as the choice to group may be necessary for a scheme to work. Where the grouping is artificial, and mainly for the purposes of tax benefits, it is irrelevant to say that the non-payment of GST is attributable to the making of a choice expressly provided for under the GSTA. In the author's opinion, Division 165 should apply in cases where grouping provisions are used in a scheme to get the GST benefit directly or which enable the entity to also get other GST-related benefits indirectly.

B. *GST wash transactions*

A GST 'wash' transaction is one where a supplier who is registered for GST fails to include GST in the price of a taxable supply and remit it to the ATO; the supply in question is then made to a recipient who is registered for GST, and would have been a creditable acquisition with the entitlement to claim back, from the ATO, a full input tax credit if the transaction had been correctly treated as taxable by the supplier. The term 'wash' refers to the fact that the effect is revenue neutral.

This could, however, be achieved as a result of a scheme in which a supply made by a GST-registered entity, that would otherwise be a taxable supply, is treated as either a GST-free supply or not a taxable supply.[43] The GST-free supply is made to another GST-registered entity. Based on the classification of the transaction, there is no GST liability for the supplier and no ITC entitlement for the recipient. From an ATO perspective, this is a wash transaction as it is revenue neutral. The question arises as to whether the general anti-avoidance rule can be applied in this situation.

It is important to note that Division 165 can still be applied to a GST wash transaction, described above, as you consider the liability of the avoider rather than trading it off against the potential ITCs claimable by the acquirer. That means the GST position of each entity is considered separately to the transaction. It is irrelevant to say that there is no net GST loss to the ATO on the overall net GST position of both entities. However, if this interpretation is

[43] For example, under Division 48 of the GSTA (grouping provisions), the supplies and acquisitions made wholly within the group are effectively ignored and not treated as taxable supplies or creditable acquisitions.

taken, then there will be compensating adjustments under 165-45 on the 'losers' net amount.[44]

The application of a wash transaction only has an impact when considering the application of, or remission to, shortfall penalties and/or general interest charges.

C. *The GST benefit must arise 'from' a 'scheme'*

(a) What is a 'scheme'?

'Scheme' is defined broadly in s 165-10(2) to include any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise. In establishing whether there is a scheme, the purpose of the scheme is irrelevant. 'The focus of the enquiry is on the purpose of the persons who entered into or carried out the scheme. It is not an enquiry into any purpose of the scheme.'[45] The term 'from' in Division 165 suggests that the benefits must flow from the scheme, that is, the scheme must result in the tax benefit.

Due to the wide definition of scheme in the context of GST, it would be easy to establish, under any circumstances, that a scheme exists. Obviously, the scheme cannot be a mere proposal. It should include both actions and courses of conduct. Scheme is an essential part of Division 165, as any GST benefit identified must be related to the scheme and flow from the scheme, as must any conclusion of sole, dominant purpose or the principal effect.[46]

(b) What is 'part of a scheme'?

Unlike the Pt IVA provisions, the GST benefit can arise from a single transaction which is part of the scheme. This reflects the nature of GST as being a transaction-based tax.[47] This does not mean that part of the scheme is a scheme itself, but it appears that Division 165 can be applied to part of a scheme and not necessarily to the full scheme. The scheme can be found in individual steps or, more often, in a combination of steps. In *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*,[48] the New Zealand Supreme Court held that:

> *Parliament must have envisaged that the way a specific provision was deployed would, in some circumstances, cross the line and turn what might otherwise be a permissible arrangement into a tax avoidance arrangement … Thus tax avoidance can be found in individual steps or, more often, in a combination of steps. Indeed, even if all the steps of an arrangement are unobjectionable in themselves, their combination may give rise to a tax avoidance arrangement … [The GAAR's] function is to prevent uses of the specific provisions which fall outside their*

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44 Section 165-45 of the GSTA provides that where an entity gets a GST disadvantage due to another entity getting a GST benefit, the Commissioner may make an adjustment to compensate the disadvantaged entity.

45 *FCT v Spotless Services Ltd* (1996) 186 CLR 404 at [423]; Hart (2004) 217 CLR 216 at [63] per Gummow and Hayne JJ.

46 *FCT v Unit Trend Services Pty Ltd* (2004) 217 CLR 216 at [41] per Hill J.

47 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.336].

48 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115 at [104].

intended scope in the overall scheme of the Act. Such uses give rise to an impermissible tax advantage which the Commissioner may counteract.

(c) Territorial application

A scheme may involve international dealings. This does not preclude the operation of Division 165. Section 165-5(2) provides that 'it does not matter whether the scheme, or any part of the scheme, was entered into or carried out inside or outside Australia'.

D. *Sole or dominant purpose, principal effect*

Section 165-5(1)(c) requires the existence of one of the following:

> (i) an entity that (whether alone or with others) entered into or carried out the scheme, or part of the scheme, did so with the sole or dominant purpose of that entity or another entity getting a GST benefit from the scheme; or
>
> (ii) *the principal effect of the scheme, or of part of the scheme, is that the avoider gets the GST benefit from the scheme directly or indirectly*; (emphasis added)

The way in which the sole or dominant purpose is pinpointed has similarities to the way in which the principal effect is pinpointed, albeit with some slight differences.

The inquiry under s 165-5(1)(c) is as to the purpose of the person or persons who entered into or carried out the scheme and it is not to the purpose of the scheme itself.[49] The AAT in *VCE* confirmed this and stated that it is not the purpose of the scheme that should be the focus of the enquiry, but rather the purpose of those who entered into or carried out the scheme. The person or persons may be, but need not be, the taxpayer.[50]

Sole purpose is too narrow in scope and can be hard to quantify. But this is what the law says. If there is more than one purpose, the sole purpose test cannot, by definition, apply. If the scheme has a number of purposes, then all purposes are examined and decide which one is dominant. Each purpose must be tested by reference to the specified factors. But what is important to consider is the fact that what is planned and done should be for the purpose of getting GST tax benefits, providing the GST benefit can be identified and the purpose/effect tested against it. It should be noted that some schemes which may produce a GST benefit may also produce other tax benefits. The taxpayer usually takes actions that have advantageous tax consequences and which are entered into deliberately with a view to gaining those advantages. This can be tested against what is dominant. When the scheme is found to have two or more purposes, or effects, the effect or purpose can be considered in relativity to other purposes or effects, or to a purpose with more than 50 percent dominance. Dominant purpose or principal effect indicates the purpose or effect which is the 'ruling,

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49 *FCT v Spotless Services Ltd* (1996) 186 CLR 404 at [417]; *FCT v Hart* (2004) 217 CLR 216 at [63]; *FCT v Sleight* [2004] FCAFC 94 at [67] per Hill J (with whom Hely J agreed).

50 *FCT v Hart* (2004) 217 CLR 216 at [35].

prevailing or most influential purpose', as was held in *Spotless*[51] by the High Court. If the scheme results in multiple tax benefits and if the GST benefit obtained by the scheme is not the dominant purpose or the principal effect of the scheme, then Division 165 cannot not be applied.

In respect of sole or dominant purpose, where the taxpayer argues that the purpose of the scheme is commercial, a question arises as to what extent the scheme actually achieved the desired commercial outcomes.

The difference between purpose and the effect of a scheme is at times lacking in clarity. The purpose of a scheme can be described as 'the effect which it is sought to achieve'.[52] The ATO in Practice Statement PS LA 2005/24 stated that the effect test focuses on the results of the scheme, rather than the purpose of the participants.[53] The net result is that the focus is on the scheme itself, rather than on the participants.

The Explanatory Memorandum to s 165-5(1)(c) clarifies this state of affairs by saying that 'it applies specifically to the avoider and the GST benefit obtained by the avoider'[54] and it is necessary for the effect to be 'an important effect, as opposed to merely an incidental effect'.[55] The revised explanatory memorandum provides further clarification:[56]

> The principle [sic] effect test only applies to the entity and does not look at the effect on other entities. For this test, principal effect means an important effect, as opposed to merely an incidental effect. This is in contrast to the dominant purpose which is concerned about the prevailing or most influential purpose of the scheme.

Therefore, the purpose test focuses on the participants in the scheme, while the effects test focuses on the result of the scheme.

Where the scheme has a number of purposes or effects, the question will be which appears to be the dominant one or the principal one, that is, to say the one that is most significant. Many schemes which may produce a GST benefit may also produce a tax benefit for income tax purposes.

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51 *FCT v Spotless Services Ltd* [1996] 186 CLR 404 at [416].

52 *Newton v FCT* (1958) 98 CLR 1 at [2]; see also *Insomnia (No. 2) Pty Ltd and Insomnia (No. 3) Pty Ltd v FCT* (1986) 84 FLR 278 at [290] per Murphy J; and Justice G Hill, 'Scheme New Zealand or an example of the operation of Div 165' (2003) 1 *eJournal of Tax Research* 147 at [156].

53 Practice Statement PS LA 2005/24: Application of General Anti-Avoidance Rules, [215]. This Practice Statement provides instruction and practical guidance to the ATO officers on the application of General Anti-Avoidance Rules (GAARs). Officers proposing to make a determination under section 165-40 GSTA should follow this practice statement. This practice statement also outlines the role and operation of the GAAR Panel of the ATO.

54 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.344]; see *The Taxpayer and FCT* [2010] AATA 497.

55 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill* 1998, [6.345].

56 Explanatory Memorandum to the *A New Tax System (Tax Administration) Bill (No. 2)* 2000, [1.95].

Multiple purpose schemes are usually aimed at a few types of tax and there are usually no rational commercial grounds to enter into such a scheme. A good example of a multiple purpose scheme can be seen in transactions involving property. Transfer of property attracts three types of tax, these being stamp duty, GST and income tax. In a property transaction, taxes such as stamp duty would be applicable to the GST-inclusive value of the property transaction making the application of GST more important. To the best of the author's knowledge, there has not yet been an anti-avoidance case that considers this scenario.

Section 165-15(1) GSTA lists a range of matters which are to be taken into account in determining the entity's purpose in entering into or carrying out the scheme. The factors listed in s 165-15(1) need to be considered objectively. The inquiry into the purpose is not the actual purpose of the relevant person. It is an objective one having regard to, and only to, the 12 matters identified in s 165-15(1).[57]

There are 12 factors that must be objectively considered by the Commissioner. The objective enquiry is not about the purpose of entering into the transaction, but a conclusion based on the application of objective facts into the 12 factors.

Some of the matters may point one way, others may point in the opposite direction and some may be neutral. Each of the 12 factors must be taken into account to make a conclusion concerning dominant purpose.[58]

(a) The manner in which the scheme was entered into or carried out (s 165-15(1)(a))

In *Spotless*, the joint judgment of six of the Justices of the High Court stated that:[59]

''Manner' includes consideration of the way in which and method or procedure by which the particular scheme in question was established.'

The manner in which the scheme is carried out, for avoidance purposes, usually demonstrates some level of unnecessary complexity which is unusual in the ordinary commercial sense.

The transactions may be carried out for commercial purposes; however, the structured way that the scheme is entered into and carried out usually suggests careful planning and should be justifiable mainly for taxation consequences. Where a simple transaction is carried out with a high level of complexity, it is little wonder that questions should be asked regarding why it should be so.

In *Hart*, the High Court held that consideration of the manner in which the scheme was entered into or carried out is important; this involves unusual features designed to confer a tax benefit not otherwise available.
In *Consolidated Press*, the court concluded that the interposed company lacked any reason for being, other

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57 *FCT v Hart* (2004) 217 CLR 216 at [65]; *FCT v Sleight* [2004] FCAFC 94 at [67]; *FCT v Zoffanies Pty Ltd* (2003) 132 FCR 523 at [53]-[54].

58 *FCT v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at [94].

59 *FCT v Spotless Services Ltd* (1996) 186 CLR 404 at [420].

than to create a tax benefit.

The arrangement is usually structured by some tax experts or based on the advice of tax advisers promoting the arrangements.

While this factor in isolation would not be determinative, the Commissioner will give this factor a great weight.

(b) The form and substance of the scheme (s 165-15(1)(b))

Form and substance are probably the most usual indicia of tax avoidance and can include:

- the legal rights and obligations involved in the scheme; and
- the economic and commercial substance of the scheme.

The desired effect of tax planning is to manipulate the form of business transactions in order to maximise the taxpayer's profit. A difference between the commercial and practical effect of a scheme, on the one hand, and its legal form on the other may indicate the scheme has been implemented in a particular form to obtain the GST benefit.

The Full Federal Court's decision in *FCT v Sleight*[60] and *Pridecraft Pty Ltd v FCT*[61] shows the importance of looking at the substance of arrangements, in particular the commercial and financial substance of arrangements, when making a conclusion concerning dominant purpose.

The period over which the scheme was carried out also impacts on form. Generally, the more short-lived the scheme, the more likely it is to lead to the conclusion of avoidance. It can be presupposed that the form of any tax avoidance transaction will be that which results in the desired GST effect.

(c) The purpose or object of the GSTA and any relevant provision of the GSTA whether expressly stated or not (s 165-15(1)(c))

It is necessary to assess the purpose and intent of the relevant legislative provisions in the GSTA which were used by the scheme. It is, therefore, important to consider the legislative purpose of any act. Division 165 is aimed at artificial and contrived schemes that are, in themselves, real and lawful but which nonetheless breach the normal or expected operation of the GSTA and, therefore, that purpose of the Act is, to some extent, frustrated. The policy intent of the Act and the provisions can be manipulated to suit the taxpayer's preferred outcome by entering into an artificial and contrived scheme. In arriving at an appropriate conclusion, the overall intent of the GSTA policy objectives should be considered. This is where the Commissioner should look at the policy intent of the relevant provision to see whether it has been defeated.

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60 *FCT v Sleight* [2004] FCAFC 94 at [33]-[36].

61 *Pridecraft Pty Ltd v FCT* [2004] FCAFC 339.

It is contrary to the legislative purposes of the GSTA for an entity to obtain a GST benefit where GST on the transaction is avoided or reduced.

(d) The timing of the scheme (s 165-15(1)(d))

The reference to timing is directed at the question of when the particular scheme is entered into or carried out, as well as considering the GST law at the time.[62]

Consideration of the timing of the occurrence of key steps in the scheme (e.g. immediately or shortly after one another) is also important.

The fact that a scheme is entered into shortly before the end of a tax sensitive date such as the date of a change in the rate of GST (e.g. a future change from 10 percent to 15 percent) and carried out for a brief period may point to the purpose of obtaining a tax benefit.

(e) The period over which the scheme was entered into and carried out (s 165-15(1)(e))

The period over which the scheme is entered into and carried out is an important factor. The more short-lived the scheme, the more likely it is to give rise to the conclusion of avoidance.[63] In *Futuris*, the court considers whether the steps were carried out in a 'flurry of activity'.[64] In this case, the transactions were carried out and completed within minutes of each other leading to a conclusion of a dominant tax purpose.

In *Sleight* and *Vincent v FCT*,[65] the courts considered whether there was a connection between the timing and the flow of funds by the scheme. It was recognised that if the timing and flow of funds of the scheme are needed for a tax benefit to be produced, then the conclusion of a dominant purpose is more likely to be ascertained.

It should be noted that some schemes are carried out over a long period and not a short period. In this situation, this factor has less weight in the anti-avoidance conclusion.

(f) The effect that the GSTA would have in relation to the scheme apart from Division 165 (s 165-15(1)(f))

This factor deals with the effect of the scheme without considering Division 165; whether a GST benefit exists. The GST liability under the arrangement is almost inevitably reduced or nullified.

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62 *The Taxpayer and FCT* [2010] AATA 497 at [115], with reference to *FCT v Mochkin* (2003) 52 ATR 198 at [45]; *Vincent v FCT* (2002) 193 ALR 686 at [93]; *CPH Property Pty Ltd v FCT* (1998) 40 ATR 151 at [42].

63 *FCT v Sleight* [2004] FCAFC 94 at [83].

64 *Futuris Corporation Ltd v FCT* (2010) 80 ATR 330 at [156], and *FCT v Sleight* [2004] FCAFC 94 at [83].

65 *Vincent v FCT* (2002) 193 ALR 686 at [91]-[95].

(g) Any change in the avoider's financial position that has resulted, or may reasonably be expected to result, from the scheme (s 165-15(1)(g))

There is usually no rational commercial benefit, such as any effect on the market value of company's shares or any movement in the net financial position of the company, in a scheme which is structured mainly for GST benefit and, perhaps, for income tax and stamp duty benefits as well. A scheme with no commercial benefit, merely a tax benefit, will often produce no real change in the financial position of the entity except for the tax benefit component. For the purposes of Division 165, the main measurable financial benefit is the saving of GST. In this case, it is more likely that a finding of tax avoidance will be concluded.[66] In *Hart*, the High Court established that the beneficial change in the taxpayer's financial position was wholly dependent on the tax benefit that was obtained.

(h) Any change that has resulted, or may reasonably be expected to result, from the scheme in the financial position of the entity (or a connected entity) that has or had a connection or dealing with the avoider, whether the connection or dealing is or was of a family, business or other nature (s 165-15(1)(h))

The GST benefits, obtained from the scheme, by the related parties, also point to the scheme being entered into for the dominant purpose or principal effect of getting a GST benefit.

The GST benefit, as the result of the scheme, can impact other persons and this falls within the form and substance factor. There are occasions where the scheme may be financially neutral but, in general, a change in the financial position of the entity, or of a connected entity such as an economic group or family, as a result of tax benefits will be sufficient indication of avoidance.

When considering this factor, *The Taxpayer and FCT*[67] identified that there is an overlap with the considerations and conclusions reached in relation to the change in the taxpayer's financial position.

(i) Any other consequences for the avoider or connected entity of the scheme having been entered into or carried out (s 165-15(1)(i))

This is not always relevant and should be considered in each case separately as was held in *The Taxpayer and FCT*.[68] Each case is capable of a broad meaning and can include the subjective purposes, motives and intentions of the participating entities. It is important to check whether the entity has skipped commercial profits by entering into the scheme.

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66 See also *The Taxpayer and FCT* [2010] AATA 497 at [115] and [143]; *Futuris Corporation Ltd v FCT* (2010) 80 ATR 330 at [165]-[169].

67 *The Taxpayer and FCT* [2010] AATA 497 at [159].

68 Ibid at [145].

It seems that the fiscal awareness of the taxpayer was of no account when the legislature considered GST anti-avoidance provisions.[69]

(j) The nature of the connection between the avoider and a connected entity, including the question whether the dealing is or was at arm's length (s 165-15(1)(j))

Arm's length dealing has, over time, been discussed in depth in relation to income tax and, more particularly, in relation to capital gains tax. It should be noted that an arm's length dealing between entities which may, or may not, be connected, should be considered and not an arm's length relationship.

In the concept of income tax, Davies J in *Barnsdall v FCT*[70] stated that 'term should not be read as if the words 'dealing with' were not present. The Commissioner is required to be satisfied not merely of a connection between a taxpayer and the person to whom the taxpayer transferred, but also of the fact that they were not dealing with each other at arm's length. A finding as to a connection between the parties is simply a step in the course of reasoning and will not be determinative unless it leads to the ultimate conclusion'.

In *The Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT*,[71] Hill J said:

> *What is required in determining whether parties dealt with each other in respect of a particular dealing at arm's length is an assessment whether in respect of that dealing they dealt with each other as arm's length parties would normally do, so that the outcome of their dealing is a matter of real bargaining.*

It is important to note that unrelated parties may interact in a non-arm's length manner. Even so, this may lead to the conclusion that their motivation is to avoid GST.

(k) The circumstances surrounding the scheme (s 165-15(1)(k)) and any other relevant circumstances (s 165-15(1)(l))

When considering these two factors, a broad range of enquiries can be considered including, but not restricted to, the prevailing economic conditions, industry practices that are relevant to the scheme,[72] or the nature of the tax advice received by the taxpayer in relation to the scheme.

Deputy President Forgie in *VCE* stated that these two factors may potentially include the subjective purposes, motives and intentions of the participating entities.[73] The same observation was expressed by the court in *FCT v News Australia Holdings Pty Ltd*.[74]

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69 *VCE v FCT* (2006) 63 ATR 1249 at [86]-[90] per Deputy President Forgie.

70 *Barnsdall v FCT* (1988) 81 ALR 173 at [176].

71 *The Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT* 21 ATR 1123 at [1133].

72 PS LA 2005/24, above n 53, [225].

73 *VCE v FCT* (2006) 63 ATR 1249 at [137] per Deputy President Forgie.

74 *FCT v News Australia Holdings Pty Ltd* (2010) 79 ATR 461, at [472].

E. *Reasonable conclusion after considering the above 12 matters*

Having considered these 12 factors, the application of Division 165 requires a reasonable conclusion as to whether the purpose of an entity in entering into or carrying out the scheme, or the principal effect of the scheme, is to obtain a GST benefit.

In *Peabody*[75], in a passage, Hill J stated that:

> *In arriving at his conclusion, the Commissioner must have regard to each and every one of the matters referred to in s 177D. This does not mean that each of those matters must point to the necessary purpose referred to in s 177D. Some of the matters may point in one direction and others may point in another direction. It is the evaluation of these matters, alone or in combination, some for, some against, that s 177D requires in order to reach the conclusion to which s 177D refers.*

The 12 factors in Division 165 are, more or less, similar to s 177D(2) of the ITAA 1936. However, there are also some important differences which reflect the transaction-based nature of the GST including s 165-15(1)(c), s 165-15(1)(d) and s 165-15(1)(f). Some of these factors provide obvious indicia of avoidance, others less so, and there has not been much discussion on the weight or relevance of any of these factors in a GST context. It is the evaluation of these matters in combination which is critical.

F. *What is the decision-making process?*

Step 1

Once the ATO officer has reached a conclusion of GST avoidance, Aggressive Tax Planning (ATP) and Tax Counsel Network (TCN) are engaged.[76] If the conclusion is supported, in particular, by TCN, the ATO will issue the taxpayer with a position paper setting out its preliminary view.

Step 2

The ATO considers the taxpayer's response (if any) to the position paper.

Step 3

If the ATO officer still considers that Division 165 applies, the case is referred to TCN. If the officer's view is supported (by a submission signed off by TCN), the case is then referred to the General Anti Avoidance Rules Panel (the GAAR Panel).

Step 4

The GAAR Panel, as an independent internal review body, assesses the proposal to apply Division 165 before the formal declaration is made and served.[77] The GAAR Panel has a

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75 *Peabody v FCT* (1993) 25 ATR 32, at [42].

76 See PS LA 2005/24, above n 53, [11]. The ATO officer should disclose to the taxpayer that Division 165 may be in contemplation when requesting additional information from the taxpayer to determine whether Division 165 may apply to the arrangement or an associated arrangement.

77 See PS LA 2005/24, above n 53, [18]-[41].

consultative role and does not make the relevant decision but its advice is taken into account. The GAAR Panel provides its advice on the basis of contentions of fact which have been put forward by ATO officer and by the taxpayer.

The taxpayer has the opportunity to make submissions to the panel. Once the Panel has assessed the applicability of Division 165, the Commissioner may make a Division 165 declaration. Although this is, ordinarily, the course of events, the proposal to apply Division 165 is not always reviewed by GAAR Panel and there are exceptional circumstances where the Commissioner makes a declaration without having the decision assessed by GAAR Panel. This can be due to time constraints or other reasons. However, the application of the GAAR must still be cleared by a Deputy Chief Tax Counsel.

Step 5

A declaration under s 165-40 is required if the Commissioner decides to apply Division 165. The purpose of the declaration by the Commissioner is to negate the GST benefit which has been obtained from the scheme by the avoider. The Division 165 declaration may specify an amount that becomes the net amount for the relevant business activity period.[78] One declaration can relate to net amounts for several tax periods and importations. Under s 165-65, the Commissioner must give copy of the declaration to the entity affected. A failure to comply with this does not affect the validity of the declaration.[79]

Step 6

The Commissioner will issue the taxpayer with an amended assessment for the relevant tax period to reflect the negation of the GST benefit and the applicable penalties and interest charges.

G. *Penalties*

Like Part IVA, the same penalty regime applies to Division 165. The taxpayer is liable to pay an administrative penalty of 50 percent of the scheme shortfall amount.[80]

H. *Objection and Review*

The Division 165 declaration and the subsequent assessment is a reviewable decision.[81] Formal objection must first be made to the Commissioner requesting that he revisit his original decision. The taxpayer may take the objection decision to the Administrative

78 Net amount: the GST liability less the input tax credits attributable to a relevant tax period.

79 GSTA, s 165-65(2).

80 *Taxation Administration Act* 1953 (Cth), s 284-160 of Schedule 1 for *base penalty amount*: scheme. See PS LA 2005/24, above n 53, [179]-[184].

81 *Taxation Administration Act* 1953 (Cth), s 14ZZ. .

Appeals Tribunal or appeal to the Federal Court followed by the Full Federal Court, then, with special leave to the High Court.[82]

The Tribunal may, standing in the shoes of the Commissioner, make a determination including making a new Division 165 declaration and refer the matter back to the Commissioner if AAT or Court thinks the objection decision wrong on some technical point/s, but justified subject to reconsideration in compliance with Division 165. The Court can set the Division 165 declaration aside and can send it back to the Commissioner to reconsider.[83]

In a review under Pt IVC, the onus is on the taxpayer to prove, on the balance of probabilities, that the assessment is excessive.[84] In a Division 165 case, this could be done by establishing that the conclusion to invoke the Division by the Commissioner was not supportable.

A Division 165 case will always be based on a set of facts. However, the taxpayer has to satisfy the Tribunal or court, on a review of an objection decision, that the Commissioner's conclusion that there had been tax avoidance as defined by Division 165 is excessive and the Commissioner's action to negate the GST benefit is objectively wrong.[85]

I. *Taxpayer Alerts, Public Rulings and Tax Determinations on Division 165*

There are 17 Taxpayer Alerts[86] (some covering multiple arrangements) and 12 ATO view products[87] (Public Rulings and Tax Determinations) issued to date on the application of Division 165 by the Commissioner, as follows:

(I) Taxpayer Alerts (TA)

TA 2013/2 – *Wine equalisation tax (WET) producer rebate schemes*. This Taxpayer Alert describes two contrived arrangements that are designed to create additional Wine Equalisation Tax (WET) rebates through non-commercial dealings between entities.

TA 2012/5 – GST – *Acquisition of intangible right for inflated consideration which is financed by supplier.* This Taxpayer Alert describes an arrangement where an entity claims an input tax credit on a purported acquisition (on non-commercial terms) of an intangible right from

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82 See *Taxation Administration Act 1953* (Cth), Pt IVC, *Taxation objections, reviews and appeals*.

83 *Fletcher v FCT* [1988] FCA 362.

84 *Taxation Administration Act 1953* (Cth), s 14ZZK(b)(i).

85 *Bai v FCT* [2015] FCA 973 at [34].

86 A Taxpayer Alert is a warning to the community about an emerging aggressive tax planning where the ATO believes taxpayers may not be complying with the law. Practice Statement PS LA 2008/15 provides guidance for initiating and issuing a Taxpayer Alert.

87 The ATO makes known its views about the application of relevant provisions in a number of ways. For example, the ATO issues formal rulings, grouped in different series, on the application of relevant provisions at a general level, in the sense that they do not address particular entity's affairs.

a GST-registered supplier, with the provision of vendor finance under which payments are contingent on a future event.

TA 2010/7 – GST – *Retirement Village operators who on-sell services to residents in an attempt to claim greater input tax credits.* This Taxpayer Alert describes an arrangement in which a retirement village operator ('RVO') increases its claims for input tax credits (or for decreasing adjustments) by assuming the role of a service supplier, such as an electricity retailer. By buying services and on-supplying them to retirement village residents living in independent living units ('ILUs'), the RVO contends that it is making a taxable supply, separate from its input taxed supply of residential accommodation.

TA 2010/1 – GST - *Interposing an associated 'financial supply facilitator' to enhance claims for reduced input tax credits for expenses incurred in the course of a company takeover.* This Taxpayer Alert describes an arrangement that attempts to create or increase an entitlement to a reduced input tax credit (RITC) for an entity that makes a financial supply of acquiring shares in a company as part of a takeover.

TA 2009/7 – *Uncommercial contract manufacture arrangements to claim the wine equalisation tax (WET) producer rebate.* This Taxpayer Alert describes uncommercial and collusive arrangements where one or more growers use a contract winemaker, so each such grower can attempt to claim the WET producer rebate by retaining title to their produce, until a pre-arranged sale to the winemaker.

TA 2009/6 – *Use of uncommercial indirect marketing arrangements to reduce wine equalisation tax (WET).* This Taxpayer Alert describes uncommercial and collusive arrangements that seek to reduce WET liability by using an interposed entity and an agency relationship to shift the point where WET liability is determined and to manipulate which methodology is used in determining it.

TA 2009/5 – *Use of an associate to obtain Goods and Services Tax (GST) benefits on construction of residential premises for lease.* This Taxpayer Alert describes an arrangement where an entity uses an associate in an attempt to secure input tax credits on the construction of residential premises for lease and defers the corresponding GST liability, in some cases indefinitely.

TA 2009/4 – *Land owner's use of a registered associate to maximise input tax credit entitlements and reduce Goods and Services Tax (GST) payable under the margin scheme.* This Taxpayer Alert describes an arrangement that purportedly allows a land owner to register for GST as late as possible to minimise its GST payable under the margin scheme, but still claim a full input tax credit on its acquisition of construction services from its associate.

TA 2008/17 – *Claims for GST refunds beyond four years arising from the reclassification of a previously taxable supply as GST free.* This Taxpayer Alert describes a situation where a taxpayer seeks to claim a refund four years or more after the end of a tax period on the basis that they incorrectly classified a supply as a taxable supply and they now contend it is GST free. In this situation the Commissioner may not be able to recover the input tax credits

previously claimed on what are contended to be incorrectly classified supplies. This could lead to a situation where either the supplier or the recipient of the supply obtains a windfall gain.

TA 2007/1 – *Lease by a charitable institution to an associated endorsed charitable institution designed to gain input tax credits.* This Taxpayer Alert describes arrangements designed to gain entitlement to input tax credits by treating otherwise input taxed supplies of residential accommodation as GST-free. These arrangements involve charitable institutions leasing land and buildings to associated endorsed charitable institutions in an attempt to increase the cost of making supplies of accommodation to residents and thereby satisfying a concessional GST provision.

TA 2005/4 – *Creation of Goods and Service Tax (GST) input tax credits by barter exchanges.* This Taxpayer Alert describes arrangements where a barter exchange buys and sells in its own right, effectively acting as a member with its own trading account. The barter exchange has access to unlimited trade dollars to spend on the acquisition of goods and services, often at commercially unrealistic prices, from its members. Consequently, large GST refunds are claimed by ensuring that its acquisitions continually exceed its supplies by significant amounts within the barter operation.

TA 2004/9 – *Exploitation of the second-hand goods provisions to obtain Goods and Services Tax (GST) input tax credits.* This Taxpayer Alert describes arrangements apparently designed in an attempt to exploit the GST second-hand goods provisions resulting in claims for GST input tax credits in relation to second-hand goods sold to an interposed associated entity. A GST registered entity acquires goods (usually of high value) through a non-taxable supply. The acquiring entity sells the goods to an associated entity, thus creating a claim for an input tax credit on its acquisition of the goods under the second-hand goods provisions.

TA 2004/8 – *Use of the Going Concern provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax (GST) on the sale of new residential premises.* This Taxpayer Alert describes an arrangement involving an entity which makes a sale of substantially completed residential units/houses to another entity as a GST-free going concern. The acquiring entity completes the residential units/houses and sells them as a taxable supply to third parties, paying GST only on the margin between this sale price and its acquisition cost, which is designed to set the price to reduce or eliminate the margin for GST.

TA 2004/7 – *Use of the Grouping provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax (GST) on the sale of new residential premises.* This Taxpayer Alert describes an arrangement that uses the grouping provisions and the margin scheme in an attempt to avoid or reduce GST on the sale of new residential premises. Relying on a concession within the grouping provisions, substantially completed residential units/houses are sold within a group and not treated as a taxable supply. The acquiring group member completes the residential units/houses and sells them as a taxable supply to third parties, paying GST only on the margin between this sale price and the intra-group sale

price. The effect of the intra-group sale is to avoid or reduce the margin for GST on the sale to the third party.

TA 2004/6 – *Use of the Grouping provisions of the GST Act to avoid Goods and Services Tax (GST) on the sale of new residential premises.* This Taxpayer Alert describes an arrangement that uses the grouping provisions in an attempt to avoid GST on the sale of new residential premises. The parties to the arrangement use a GST group structure for the purposes of creating an 'internal sale' of new home units/houses between GST group members. This is to support a claim that the units/houses are no longer 'new residential premises'. On this basis, any subsequent sale of the residential units/houses is claimed to be input taxed and not subject to GST.

TA 2004/2 – *Avoidance of Goods and Services Tax (GST) on the sale of new residential premises.* This Taxpayer Alert describes an arrangement using the joint venture provisions to attempt to avoid GST on the sale of new residential premises. The parties to the arrangement purportedly form a joint venture for the purpose of creating an 'internal sale' of new home units/houses by the joint venture operator to a participant in the joint venture. This is to support a claim that the units/houses are no longer 'new residential premises'. On this basis, any subsequent sale of the residential units/houses is claimed to be input taxed and not subject to GST.

TA 2004/1 – *Non-arm's length arrangements using Goods and Services Tax (GST) cash/non-cash accounting methods to obtain a GST benefit.* This Taxpayer Alert describes non-arm's length arrangements where an entity makes acquisitions from another entity at commercially unrealistic prices to obtain an inflated input tax credit. The arrangements seek to manipulate a timing advantage between a vendor using a cash basis of accounting and a purchaser using a non-cash basis of accounting.

(m) Public Rulings

WETR 2014/1 Wine Equalisation Tax: provides the Commissioner's views on the arrangements set out in Taxpayer Alert TA 2013/2 Wine Equalisation Tax (WET) producer rebate schemes and whether Division 165 of the A New Tax System (Goods and Services Tax) Act 1999 applies.

GSTR 2010/1 Goods and services tax: application of Division 165 of A New Tax System (Goods and Services Tax) Act 1999 where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5.

GSTR 2005/5 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/8: use of the Going Concern provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax on the sale of new residential premises.

GSTR 2005/4 Goods and services tax: arrangements of the kind described in Taxpayer Alerts TA 2004/6 and TA 2004/7: use of the Grouping or Margin Scheme provisions of the GST Act to avoid or reduce the Goods and Services Tax on the sale of new residential premises.

GSTR 2005/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/9 - exploitation of the second-hand goods provisions to obtain input tax credits.

GSTR 2004/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/2: Avoidance of GST on the sale of new residential premises.

(n) Tax Determinations

GSTD 2011/3 Goods and services tax: do the acquisitions of the services provided under the arrangement described in Taxpayer Alert TA 2010/1 form part of a reduced credit acquisition made by the financial supply provider under item 9 of the table in subregulation 70-5.02(2) of the A New Tax System (Goods and Services Tax) Regulations 1999?

GSTD 2009/D2 Goods and services tax: are there GST consequences where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5?

GSTD 2007/2 Goods and services tax: what are the results for GST purposes of a charitable institution engaging with an associated endorsed charitable institution in an arrangement described in Taxpayer Alert TA 2007/1?

GSTD 2006/5 Goods and services tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4?

WETD 2011/1 Wine equalisation tax: what are the results for entities that engage in an arrangement described in Taxpayer Alert TA 2009/7.

WETD2010/1 Wine equalisation tax: what are the results for Wine Equalisation Tax purposes for entities engaging in an arrangement described in Taxpayer Alert TA 2009/6?

VI. CONCLUSION

The application of GST general anti-avoidance provisions is enhanced by a good understanding of different types of tax, especially income tax, stamp duty and GST, in line with a correct interpretation of the relevant law. It also needs competent experience in business structures and tax administration in order to balance the commercial objectives and particular means adopted by the taxpayer.

In the author's opinion, it is reasonable to conclude that it only needs to be found that there is a GST benefit, as the result of the scheme, when the scheme was artificial and had no or immaterial commercial benefit or outcome other than the obtaining of the GST benefit or perhaps other tax benefits.

A case which involves GST avoidance may involve other taxes too, but this cannot be caught by general anti-avoidance provisions of the GSTA. This is due to the sole, dominant purpose or principal effect test. It usually follows that, if the dominant purpose was to reduce income tax, then GST or even stamp duty shortfalls cannot be considered. In the author's opinion, it would be of benefit if the Commissioner were to take one such case, where income tax avoidance, GST avoidance and also stamp duty avoidance are in equipoise, to the court in order to obtain a definitive view.

The Commissioner, undoubtedly, has the power to make a declaration to negate the GST benefit when the circumstances for its exercise exist. However, whether the Commissioner has discretionary power to act or in fact is required to act when he has reached a reasonable conclusion about dominant purpose, or principal effect after considering the 12 factors, is not clear. Even though, there are suggestions, in some quarters, that the words in s 165-40 that the Commissioner 'may make a declaration' imply a discretionary power.[88] Such a discretion, if it exists, is not absolute. It must be exercised in compliance with the requirements of Division 165. It is not really clear what the implications of the power being limited discretionary are. It might be argued that if it is a discretionary power that it can only be effectively challenged before the AAT which is in the shoes of the Commissioner. The Court can only supervise the proper exercise of the power, not substitute its own opinion as to how the discretion should have been exercised by the Commissioner. The better view, it is suggested, is that the Commissioner's power is not a true administrative discretion.

88 *VCE v Federal Commissioner of Taxation* (2006) ATC 187, 63 ATR 1249 at [135] (SA Forgie); cf GT Pagone, Tax Avoidance in Australia (*Federation Press*, 2010), [158-9]; see PS LA 2005/24, above n 52, at [193]: 'It gives the Commissioner the discretion to negate a 'GST benefit' that an entity gets or got from a scheme to which Division 165 of the GST Act applies. This discretion is contained in section 165-40 of the GST Act.' and at [228]: 'If the foregoing elements are satisfied, the Commissioner may exercise the section 165-40 discretion to negate the GST benefit obtained.'