

THE EFFECTIVENESS OF PART IVA OF THE *INCOME TAX ASSESSMENT ACT 1936* (CTH): TIME FOR A 'NOT MERELY INCIDENTAL' PURPOSE TEST?

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ABSTRACT

This article examines whether Part IVA of the *Income Tax Assessment Act 1936* has been effective in preventing tax avoidance. It argues that the effective operation of the Part IVA anti-avoidance test turns on whether it can catch a scheme which has been entered into for the dominant purpose of a tax benefit. Drawing on case studies, it concludes that Part IVA has been effective, owing to the use of a counterfactual in determining whether there was a reasonable alternative postulate for the scheme in question and the section 177D(2) multifactorial test to determine the purpose of the scheme. However, this article argues that increasingly sophisticated ways of avoiding tax necessitate extension of the dominant purpose test to include any scheme where there is a collateral purpose of a tax benefit, even where the scheme was entered into primarily for commercial benefit.

I. INTRODUCTION

Tax avoidance is a fundamental problem that results in significant losses of government revenue and is a subtle form of defiance of the law. Yet the concept of tax avoidance is elusive.¹ The distinction between tax avoidance and legitimate tax planning or tax minimisation is often difficult to draw.² This makes tax avoidance difficult to tackle effectively.³

This article examines the general anti-avoidance rule (GAAR) under Part IVA of the *Income Tax Assessment Act 1936* (Cth) ('ITAA36') and considers its effectiveness. It revisits the fundamental concepts of tax avoidance and legitimate tax planning and sets out a clear distinction between tax avoidance and legitimate tax planning. It argues that legitimate tax

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¹ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 3.

² David Bloom, 'Tax Avoidance - A View from the Dark Side' (2016) 39 *Melbourne University Law Review* 950, 951-953; Lidia Xynas, 'Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance' (2010) 20(1) *Revenue Law Journal* 1, 18; GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 3.

³ Lidia Xynas, 'Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance' (2010) 20(1) *Revenue Law Journal* 1, 18.

planning seeks to minimise tax in circumstances where the law is framed specifically to permit such minimisation, whereas tax avoidance is an attempt to minimise tax beyond what the law contemplates as legitimate. It furtherers argue that the tax benefit test under Part IVA of the ITAA36 ('Part IVA') is necessary but insufficient for the task: although tax avoidance involves the receipt or expectation of a tax benefit, by itself, the receipt or expectation of a tax benefit does not amount to avoidance.

It is also argued that the dominant purpose test is inadequate to catch tax benefit-conferring schemes which have both a dominant commercial purpose and a collateral purpose of a tax benefit.⁴ It proposes a more effective test: entering into a scheme for a tax benefit which is more than merely incidental to the taxpayer's legitimate activities, schemes or transactions amounts to tax avoidance. This is here called the 'not merely incidental' test. Such a test is acknowledged to be radical, and it has not, thus far, been supported in practice. If adopted, it would be, in operation, more anticipatory than the current test. This would help to minimise the possibility of circumventing the current test.

The article also affirms the desirability of retaining the objective character of the Part IVA test in order to maintain the effectiveness of the definition of tax avoidance and prevent general erosion of anti-avoidance rules.

II. LEGITIMATE TAX PLANNING VERSUS TAX AVOIDANCE

The line between legitimate tax planning and tax avoidance is often unclear, as many features of legitimate tax planning and tax avoidance overlap — for example the decrease in assessable income or increase in allowable deductions.⁵ However, there is a real distinction. Legitimate tax planning respects the spirit of the law, that is, the intention or purpose of the law. It does not seek to circumvent the law but stays within the boundaries of the law as defined by its purpose, objective and intention.⁶ On the other hand, tax avoidance offends the spirit of the law. It seeks to circumvent the law where it can, often manifesting in strategies that push the boundaries of the law.⁷

However, it must be noted that it is not the minimisation of tax *per se* that is illegitimate, but rather, the intention of the taxpayer to avoid taxation obligations that the laws intends to impose on the taxpayer.⁸ Thus, it follows that an effective GAAR is one which effectively distinguishes between schemes that minimise tax in ways that depart from Parliament's

⁴ Although cases such as *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404 may be argued to show otherwise, it remains that on a strict application of Part IVA *Income Tax Assessment Act 1936* (Cth), there is no proper basis to find that such a scheme contravenes Part IVA.

⁵ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 3.

⁶ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 6-8.

⁷ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 3-6.

⁸ As indicated by the words 'dominant purpose' in section 177A of the *Income Tax Assessment Act 1936* (Cth) in relation to a scheme under section 177D(1) of *Income Tax Assessment Act 1936* (Cth) .

intention from those that are contemplated within the law as enacted.⁹ It is the purpose for which the taxpayer enters the scheme, rather than the mere receipt or entitlement to a tax benefit, that distinguishes tax avoidance from tax minimisation.¹⁰

Such an approach to tax avoidance necessarily requires rejection of a strictly textualist approach towards interpretation taxation statutes,¹¹ since that approach, in focusing on what the text means in its plain ordinary sense, gives excessive leeway to taxpayers and courts to use ambiguities as a ground (or excuse) to argue or hold that the taxpayer is entitled to the benefit of the doubt in cases where there may be some conflict with the intention of the legislature.¹²

This raises the issue of the appropriate approach to interpretation of tax statutes to ensure that tax avoidance is not facilitated by overly generous judicial construal of the legislation. The intentionist approach focuses on the intention of the legislature in drafting the statute. Legislative intent can be inferred from extrinsic material, such as second reading speeches and memoranda. The interpreter infers the objective meaning which is that which could be reasonably inferred from these extrinsic materials.¹³

This is in contrast to the purposive approach, which interprets the meaning of the statute in accordance with its purpose. The purpose may be inferred from the provisions in the statute concerned, or extrinsic materials.¹⁴ More controversially, it could be construed from the nature, text and structure of the statute itself. This means, in the context of the interpretation of tax statutes in relation to taxation avoidance, that it is open to courts to find that the purpose is to ensure that tax avoidance is not encouraged, facilitated, promoted or incentivised. This approach can be justified on the grounds that the fundamental purpose of any government is to collect tax by means of legislation. Enabling any tax avoidance would invariably defeat this purpose.

Thus, it is proposed that the best approach to interpreting statute to prevent tax avoidance is to assume that the underlying purpose of every taxation statute is to prevent tax avoidance, and that this purpose overrides other competing purposes, such as a purpose to ensure increased efficiency of businesses. Critics may characterise this as strict, or even extreme. However, it can arguably be justified on the basis that allowing a purpose which

⁹ Maurice Cashmere, 'Towards an appropriate interpretative approach to Australia's general tax avoidance rule - Part IVA' (2006) 35 *Australian Tax Review* 231, 240-243.

¹⁰ *Commissioner of Taxation v Hart* [2004] HCA 26, [5] affirming Hill J. See also *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [259].

¹¹ Justin Dabner, 'Are there too many witchdoctors in our tax courts: Is there a better way?' (2005) 15 *Revenue Law Journal* 36, 37; Jo Cleary, 'The Evolution of Tax Avoidance' (1995) 5(2) *Revenue Law Journal* 219, 240.

¹² Justin Dabner, 'In search of a purpose to our tax laws: Can we trust the judiciary?' (2003) 6 *Journal of Australian Taxation* 32, 65.

¹³ *Acts Interpretation Act 1901* (Cth) s15AB; Richard Ekins and Jeffrey Goldsworthy, 'The Reality and Indispensability of Legislative Intentions' (2014) 36 *Sydney Law Review* 39, 46-53.

¹⁴ Colleen Mortimer, 'The use of extrinsic materials by the courts in the interpretation of taxation legislation' (2015) 19(2) *Tax Specialist* 86.

conflicts with the broader purpose of preventing tax avoidance will erode that purpose of preventing tax avoidance.¹⁵

However, treating tax avoidance as the purpose which prevails over a conflicting purpose will be unlikely to erode away the other purpose, such as increasing tax efficiency, which is the ability to incur the minimum amount of tax for the maximum profit. This is because preventing taxation avoidance is a considerably difficult task, as taxpayers would naturally gravitate towards to minimise or avoid tax, rather than to not minimise or avoid tax.¹⁶ As such, taxpayers cannot simply be left to their own devices to ensure that they do not minimise tax to the point of avoidance. Purposes of tax statutes which conflict with this, however, such as the promotion of tax-efficient concessions are that which taxpayers would naturally gravitate towards, and therefore will not be eroded away.

Based on this assumption, it is proposed that the intention of the legislature for any statute or statutory provision on taxation or relating to taxation is that it is not intended to permit taxation avoidance. Any tax benefit that the legislature permits would be clear and unambiguously expressed by the provision. This could be described as a statutory presumption, which reverses the old statutory presumption that ambiguous taxation provisions would be interpreted in favour of the taxpayer, to the presumption that such provisions would be interpreted in favour of the government.¹⁷

To dispel any fear, what is meant by 'in favour of the government' simply refers the government's intention to that a taxpayer does not receive a tax benefit, where it is not otherwise made clear and unambiguous. This can be justified on the grounds that government, whether 'big government' or 'small government' would need to raise revenue by taxation to fund its core functions at the very least, namely the police services, the judiciary, and the military (and the taxation authorities!).¹⁸ Thus, 'in favour of the government' simply means that the ambiguity of the operation of a provision conferring a tax benefit is not taken advantage of. To allow such a tax benefit to be taken advantage of on the basis or, perhaps pretext, of ambiguity would set the precedent for tax avoidance, and erode anti-avoidance laws, by rendering them to be less effective than they are.¹⁹

What amounts to tax avoidance is determined by whether the act concerned goes against what the law intended or permitted. It is not determined by whether it is unfair by

¹⁵ Lidia Xynas, 'Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance' (2011) 20(1) *Revenue Law Journal* 1; Jo Cleary, 'The Evolution of Tax Avoidance' (1995) 5(2) *Revenue Law Journal* 219.

¹⁶ Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305, 374; See also Laffer curve.

¹⁷ DC Pearce and RS Geddes, 'Interpretation of Remedial, Penal and Fiscal Provisions' (eds.) in *Statutory Interpretation in Australia* (LexisNexis Butterworths, 2014) 357, 385-388.

¹⁸ Terry Dwyer, "'Purposive" interpretation of taxing statutes – a critical comment' (2010) 39 *Australian Tax Review* 61, 63.

¹⁹ Based on the natural gravitation of taxpayers to minimise tax, and therefore that path dependence favours this direction.

community standards or business standards, as there can be no clear uniform community or business standard on taxation. Inevitable conflicts between different sections of the community and different business render this impossible. Thus, the standard as to what amounts to tax avoidance should be determined by the legislators. This can be justified on the grounds that taxation is that which is imposed by government, for the government to carry out the functions as it sees fit. Whether it uses its taxation revenue appropriately is a different matter, which does not negate its right to determine what taxes, and what taxation rates to impose.

Should there be no objective standard imposed by the law predicated on the rationale the government does not intend to benefit a taxpayer that would apply generally, discretion is left to the judiciary to determine what amounts to tax avoidance and the legitimate tax minimisation in interpreting taxation statutes. This would be because what amounts to tax avoidance, legitimate tax minimisation, and the elusive demarcation between them would turn on one's method of statutory interpretation. Methods of statutory interpretation can be used to render desired outcome, rather than used in methodical way that is consistent applied across all taxation matters. For example, a provision which effectively allows a tax benefit to be conferred on a taxpayer by selling a house bought only for investment purposes or could be argued to be legitimate tax minimisation because the text itself permits it and there is no intention to prohibit selling a house. Yet, it could also equally be argued that it is not legitimate tax minimisation, but tax avoidance because although the text itself permits the selling of a house for investment purposes, it is done to gain a tax benefit, as that house is not sold as part of a decision to relocate.

As such, it follows that objective standards as to what amounts to tax avoidance and legitimate tax minimisation are necessary. It is crucial that the standard as to what amounts to tax avoidance and tax minimisation is objective, to ensure certainty in the law of taxation.²⁰

The High Court has more recently adopted a significantly stricter approach to tax avoidance than it formerly has. Formerly, the High Court, in particular the Barwick Court, would interpret any ambiguities in taxation legislation in favour of the taxpayer.²¹ However, since the introduction of Part IVA, the discretion of courts in doing so has been significantly reduced, in laying out general principles that are applicable to all taxation law.²²

Nevertheless, the existence of such principles cannot totally eliminate the discretion that a court may have in interpreting statute. Ambiguities may be deliberately constructed by courts who feel sympathetic towards a taxpayer, to justify finding in favour of the taxpayer,

²⁰ Maurice Cashmere, 'Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA' (2006) 35 *Australian Tax Review* 231.

²¹ Maurice Cashmere, 'Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA' (2006) 35 *Australian Tax Review* 231, 232-233.

²² Justin Dabner, 'In search of a purpose to our tax laws: Can we trust the judiciary?' (2003) 6 *Journal of Australian Taxation* 32, 43.

when proper construction of the legislation concerned would not so permit.²³ So, although there has been a significant shift away from the former approach where the court would ordinarily default on finding in favour of the taxpayer whenever ambiguity arises, it is warranted that further steps can be taken to tighten taxation avoidance.

While the GAAR has the right approach in setting out general principles, as opposed to specific rules, as to what amounts to taxation avoidance, this paper will argue that it has not extended far enough so as to be able to catch schemes that have a dual purpose of a commercial and tax benefit.²⁴ Such schemes, it will be argued, are able to use commercial benefits to disguise the real purpose of the scheme, which is to obtain a tax benefit.

It may be argued that such schemes already are caught by Part IVA in principle, but merely not enforced in practice owing to the difficulty of discerning the real purpose in such cases. However, it will be argued in this paper that the dominance purpose test does not extend far enough to catch schemes where obtaining a tax benefit is not the dominant purpose of entering a scheme, but merely a collateral, but nevertheless deliberate purpose.

Whether tax avoidance will remain facilitated even after broad-reaching principles depends on how courts approach the interpretation of tax avoidance statutes. Thus, it is crucial for legislature to be able strictly to control the way in which the judiciary interpret taxation statutes by giving the judiciary no discretion to determine what amounts to tax avoidance, legitimate tax minimisation, and the fine line between avoidance and minimisation.

III. EXAMINING AUSTRALIAN GENERAL ANTI-AVOIDANCE RULES UNDER PART IVA OF THE *INCOME TAX ASSESSMENT ACT 1936* (CTH)

A. *A Brief History of the General Anti-Avoidance Rules*

Part IVA contains the GAAR of Australian taxation law. It was enacted in 1981 to replace the old GAAR contained in section 260 of the ITAA36.²⁵ In 2013, amendments to Part IVA were inserted to clarify that a taxpayer who entered into a Part IVA scheme was 'reasonably to be expected' to receive a tax benefit.²⁶ This did not result in significant reform, if any at all in that respect, because a scheme from which a tax benefit was to be received already subsumed the reasonable expectation of a tax benefit.²⁷

²³ Justin Dabner, 'In search of a purpose to our tax laws: Can we trust the judiciary?' (2003) 6 *Journal of Australian Taxation* 32, 47.

²⁴ John Prebble, 'Should tax legislation be written from a principles and purpose point of view or a precise and detailed point of view?' [1998] 2 *British Tax Review* 112, 117.

²⁵ Gordon Cooper and Tim Russell, 'The new "improved Part IVA -with extra tax benefit!' (2013) 42 *Australian Tax Review* 234, 234.

²⁶ AH Slater, 'The 2013 Part IVA "reforms"' (2013) 42 *Australia Tax Review* 221, 222-223.

²⁷ AH Slater, 'The 2013 Part IVA "reforms"' (2013) 42 *Australia Tax Review* 221, 222-225.

B. *Elements of the Part IVA Anti-Avoidance Test*

Part IVA defines anti-avoidance as a taxpayer entering into a scheme for the dominant purpose of the tax benefit.²⁸ The three elements of the test are that there is (1) a scheme entered into by the taxpayer, (2) a tax benefit reasonably expected to be received, and (3) that the dominant purpose of the scheme was the tax benefit.²⁹ This section of the paper will examine each of these three elements separately as each constitutes a distinct element.

1 *Scheme*

A scheme needs to be entered into by the taxpayer for the Part IVA provisions to be attracted.³⁰ Since, a 'scheme' is defined so broadly so as to cover almost virtually any possible way to avoid tax, a person avoiding tax would inevitably have entered a scheme as defined by Part IVA.³¹ This includes even the mere promise that a taxpayer would receive a tax benefit.³² The purpose of the broad definition of 'scheme' is to catch all the possible ways in which a taxpayer may seek to avoid tax. Even a step can amount to a scheme.³³ Thus, the existence of a scheme would not be a contentious element as demonstrated by the case law.³⁴

2 *Tax benefit*

A tax benefit is that which enables a taxpayer to reduce his or her tax burden.³⁵ The inclusion of a reasonable expectation of a tax benefit as an element of the test is based on the assumption that all taxpayers will act in their best interests by maximising gain and minimising loss.³⁶ As such, the rationale is that a tax benefit is a gain to the taxpayer which he or she has an incentive to pursue, and can be expected to invariably pursue. Thus, the existence of the tax benefit is a useful, if not necessary test to determine whether the actions of the taxpayer amount to tax avoidance.

However, since a tax benefit is not itself against the intention of the law, the existence of a tax benefit alone is not sufficient to determine whether there has been tax avoidance. Thus, it follows that whether a tax benefit is obtained for the purpose of exploiting a gap in the law,

²⁸*Income Tax Assessment Act 1936* (Cth) s177D(1).

²⁹ *Income Tax Assessment Act 1936* (Cth) s177D(1).

³⁰ *Income Tax Assessment Act 1936* (Cth) s177D(1).

³¹ *Income Tax Assessment Act 1936* (Cth) s177A.

³² *Income Tax Assessment Act 1936* (Cth) s177A.

³³ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [30].

³⁴ Most cases do not involve a determination as to whether there is a scheme. However, where there is a determination as to whether there is a scheme, it is often, if not always, found that there is a scheme. See, for example, *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [24].

³⁵ As can be inferred by the plain and ordinary meaning of tax benefit and by the identified tax benefit bases of section 177C of the *Income Tax Assessment Act 1936* (Cth).

³⁶ Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305.

rather than whether the tax benefit was considered or sought by a particular taxpayer is determined.³⁷

It has been argued that since a tax benefit is a legitimate benefit given by the law itself, the receipt or expectation of receiving a tax benefit should not be an element of the anti-avoidance test. This is based on the rationale that a tax benefit received by a taxpayer is that which he or she is entitled to under the law, irrespective of how it was obtained.³⁸ However, the heart of tax avoidance is that which is permitted by the letter of the law, but offends the spirit of the law. As such, this argument ignores the spirit of the law, by assuming that the law is not concerned with manner in which a tax benefit is obtained.

3 *Dominant purpose*

The most contentious issue in determining whether there is tax avoidance is whether the tax benefit was the dominant purpose of the scheme. This is because it is often difficult to determine the purpose of the taxpayer in entering the scheme. The dominant purpose test is concerned with the intention of the taxpayer for entering into the scheme for which a tax benefit can be reasonably expected.³⁹ The ‘dominant purpose’ has been defined as the “ruling, prevailing, or most influential purpose” for which a scheme is entered into.⁴⁰ By requiring that a taxpayer entered into the scheme for the dominant purpose of the tax benefit, the test under Part IVA implies that receiving a tax benefit is not itself illegitimate, or against the spirit of the law.⁴¹ Rather, it is only where the taxpayer enters into the scheme which confers a tax benefit onto him or her, just because, or mainly because of the tax benefit, that it constitutes tax avoidance.⁴² This is in contrast to entering into a scheme where a tax benefit is merely incidental to the scheme which the taxpayer enters into, not for the dominant purpose of the tax benefit, but rather for the main purpose of commercial expansion or familial provision, for example.

As such, whether an act constitutes tax avoidance under Part IVA ultimately turns on whether it is entered into for the dominant purpose of the tax benefit. The purpose into which the tax benefit-conferring scheme is entered into is the essence of what makes it amount to tax avoidance. Even if there was a tax benefit conferred by a scheme, entering into the scheme would not amount to tax avoidance where obtaining the tax benefit is not the

³⁷ Leonard Hoffman, ‘Tax Avoidance’ [2005] *British Tax Review* 197, [206] quoted in David Bloom, ‘Tax Avoidance – A View from the Dark Side’ (2016) 39 *Melbourne University Law Review* 950, 953.

³⁸ Nabil Orow, ‘Part IVA – Seriously Flawed in Principle’ (1998) 1 *Journal of Australian Taxation* 57, 60-61.

³⁹ This is an objective test as per *Commissioner of Taxation v Hart* [2004] HCA 26, [96].

⁴⁰ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 416.

⁴¹ *Income Tax Assessment Act 1936* (Cth) s177A. See definition of “taxpayer”: *A reference in this Part (other than section 177DA) to a scheme or a part of a scheme being entered into or carried out by a person for a particular purpose shall be read as including a reference to the scheme or the part of the scheme being entered into or carried out by the person for 2 or more purposes of which that particular purpose is the dominant purpose.*

⁴² As indicated by the words ‘dominant purpose’ which could be said to be legalistic jargon for entering the scheme mainly because, or solely because of the tax benefit.

'dominant purpose'. Although entering into a scheme for commercial purposes does not preclude it from being deemed to be entered into for the dominant purpose of a tax benefit,⁴³ the question that still arises is whether entering into a scheme for a collateral purpose of a tax benefit can be caught by Part IVA. This is because it is possible for a tax benefit-conferring scheme to be entered into for the dominant purpose of a commercial benefit, but also for the collateral purpose of a tax benefit. Thus, the question as to how such a scheme can be caught under Part IVA arises.

C. Case studies

The cases studies will focus on the 'dominant purpose' test, as it is the contentious element of the Part IVA test. They will compare the reasoning between different cases, and trace how the dominant purpose test has been construed and applied by the courts over time.

1 *Spotless*

The taxpayers entered into a joint venture for the purpose of investing funds in the Cook Islands. The interest rate of the Cook Islands investment funds was significantly lower than that in Australia, but the interest income derived from the Cook Islands investment was exempt income.⁴⁴ The issue was whether this arrangement was entered into for the dominant purpose of receiving the tax benefit of not including as assessable income that which would reasonably be expected to be included as assessable income, if the scheme had not been entered into.⁴⁵

The reasonable alternative postulate test under section 177CB(3) of the ITAA36 was applied.⁴⁶ It was construed as whether a taxpayer had a reasonable justification to enter the scheme other than for the dominant purpose of the tax benefit.⁴⁷ It asks the question as to why would the taxpayer enter into the scheme, other than for the dominant purpose of the tax benefit. If the taxpayer can reasonably show why it would enter the scheme for a reason other than the tax benefit, its actions do not amount to tax avoidance under Part IVA.⁴⁸

Since it would only make commercial sense for a taxpayer to invest in a fund with a higher than a lower interest rate, the court concluded that the taxpayer invested in the Cook Islands

⁴³ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 415. The proposition that a rational commercial decision could also be tax avoidance scheme was affirmed in *Commissioner of Taxation v Hart* [2004] HCA 26, [51] and more recently in *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [216].

⁴⁴ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 411-413.

⁴⁵ *Income Tax Assessment Act 1936* (Cth) s177C(1)(a).

⁴⁶ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 424.

⁴⁷ *Income Tax Assessment Act 1936* (Cth) s177CB(3); *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 423.

⁴⁸ See Gordon Cooper and Tim Russell, 'The new "improved Part IVA -with extra tax benefit!" (2013) 42 *Australian Tax Review* 234, 246-250.

fund mainly for the tax benefit, being that the interest income would be exempt income.⁴⁹ The underlying rationale is that entering into an investment with a lower interest rate is contrary to commercial rationality which demands that profits are to be maximised.

Although there may have been other legitimate commercial reasons for entering into the lower-interest scheme such as lower costs of setting up the scheme, or less stringent rules, these were not considered. Had these factors been considered, the outcome may have been different, owing to a possibly different inference as to the purpose of the taxpayer in entering the Cook Island investment scheme, as opposed to the Australian investment scheme.

The court in *Spotless* took a narrow approach by focusing on the taxpayer choosing the lower-interest investment scheme and concluded on that basis alone that the taxpayer entered into the scheme for the obtaining exempt income which would not be received from the Australian investment scheme. It effectively treated this factor as sufficient to give rise to the inference of the taxpayer's purpose for entering a scheme.

The underlying assumption was that seeking to gain an exempt income amounted to a tax benefit under section 177C(1)(a) ITAA36 in this particular case because there was no other viable or commercially appropriate reason. No other reasons needed to be taken into account because it unequivocally showed that the taxpayer entered into the scheme for the dominant purpose of obtaining exempt income. That the investment entered into by the taxpayer in this case was the less commercially appropriate or viable option and received exempt income when a more commercially appropriate alternative was available led to the inference that it was entered into for the dominant purpose of a tax benefit.⁵⁰

The decision assumed a dichotomy between entering a scheme for a commercial purpose, and that for a tax benefit, such that a scheme entered into for a less commercially appropriate option was for a dominant purpose of a tax benefit, where a tax benefit under section 177C(1) of the ITAA36 would be obtained.⁵¹ Such reasoning fails to consider whether a tax benefit was simply a result of the scheme entered into for other legitimate reasons that are neither purely commercial nor for the tax benefit, such as for personal or family finances.⁵²

2 *Hart*

The taxpayers entered into a split loan arrangement for a mortgage, in which part of the repayments would contribute towards the mortgage on a private home, and the other part would contribute to repayments for an investment property.⁵³ Interest expenses incurred

⁴⁹ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 422.

⁵⁰ *Commissioner of Taxation (Cth) v Spotless Services Limited* (1996) 186 CLR 404, 416.

⁵¹ Although it was recognised that a taxpayer may enter into a scheme for both commercial purpose and tax benefits as a dominant purpose, the dichotomy was evident in the assumption that a scheme not entered into for a commercial purpose was for the dominant purpose of a tax benefit.

⁵² See generally John Azzi, 'Spotless: A Lesson in Form and Substance but Not in Substance Over Form' (1998) 8(1) *Revenue Law Journal* 175.

⁵³ *Commissioner of Taxation v Hart* [2004] HCA 26, [21]-[30].

by loans used for private purposes were not allowable deductions,⁵⁴ while interest expenses incurred by loans used for the production of assessable income were allowable deductions.⁵⁵ So, the issue was whether the taxpayers sought to contribute part of their debt toward the investment property for the dominant purpose of obtaining allowable deductions for interest incurred on repayments for the investment property, in contravention of Part IVA of the ITAA36.⁵⁶

The reasonable alternative postulate test was once again applied.⁵⁷ However, it was interpreted as whether the manner in which the scheme was entered into was explicable only by the taxation consequences.⁵⁸ This acknowledged that considering taxation consequences in deciding whether to enter the scheme does not itself amount to tax avoidance. The focus is on the manner in which the scheme was entered into.⁵⁹ It is not the scheme being entered with the expectation of receiving the tax benefit, which determines whether the actions of the taxpayer amount to tax avoidance. Rather, it is whether such a scheme being entered into mainly for the tax benefit that amounts to tax avoidance.⁶⁰ The approach is more sophisticated than the approach in *Spotless* where it was simply assumed that because a tax benefit would be obtained by entering into a less commercially appropriate scheme, the scheme was entered into for the dominant purpose of the tax benefit.

The eight matters enumerated by section 177D(2) of the ITAA36 are factors which must all be considered in determining whether obtaining a tax benefit in connection to the scheme was its dominant purpose.⁶¹ The article will call it a 'multifactorial test' which takes into account various factors in determining the purpose of the taxpayer in entering the scheme in question. It marks a shift from the somewhat simplistic approach in *Spotless* which simply assumed that a scheme was entered into for the dominant purpose of a tax benefit where a tax benefit could be obtained as a result of entering a scheme, and another scheme without that tax benefit was available to the taxpayer.

Since it was only the allowable deduction provided by the interest expense on the investment property repayments which improved the financial position of the taxpayers, the court found that the scheme was entered into for the dominant purpose of the tax benefit.⁶² The improvement in financial position being solely attributable to the tax benefit is

⁵⁴ *Income Tax Assessment Act 1997* (Cth) s8-1(2)(b).

⁵⁵ *Income Tax Assessment Act 1997* (Cth) s-25-25.

⁵⁶ *Commissioner of Taxation v Hart* [2004] HCA 26, [1]-[3].

⁵⁷ *Commissioner of Taxation v Hart* [2004] HCA 26, [66].

⁵⁸ *Commissioner of Taxation v Hart* [2004] HCA 26, [66].

⁵⁹ *Commissioner of Taxation v Hart* [2004] HCA 26, [58].

⁶⁰ *Commissioner of Taxation v Hart* [2004] HCA 26, [62].

⁶¹ *Commissioner of Taxation v Hart* [2004] HCA 26, [70].

⁶² *Commissioner of Taxation v Hart* [2004] HCA 26, [71].

indicative of the scheme being entered explicity for the tax consequences. This is not necessarily because a taxpayer entering into a scheme for a genuine commercial benefit could not possibly have a financial improvement solely attributable to the tax benefit. Improvements in financial position are not necessarily controllable by the taxpayer him or herself. Rather, it is the nexus between the scheme and the consequences which is indicative of entering the scheme for the dominant purpose of the tax benefit.

Hart therefore raises the question whether a scheme would still be found to be a Part IVA scheme if the improved financial position of the taxpayers was not solely or largely attributable to the tax advantage provided by the scheme in question.

3 *British American Tobacco Australia*

The taxpayer, British American Tobacco Australia (BATA) diverted certain brands, 9 Wills Brands, upon an order by the Australian Competition and Consumer Commission to Rothmans. Rothmans immediately resold the brands at the same price to companies within the Imperial Group. The taxpayer obtained a roll-over relief for capital gains made on the sale, while Rothmans gained a tax offset to be applied against tax losses from previous years.

BATA argued that the main purpose of the merger was for global expansion.⁶³ This argument was rejected upon application of the section 177D(2) multifactorial test.⁶⁴ Unlike *Hart* and *Spotless*, the scheme in question was compared to a counterfactual to determine whether the scheme was entered into for the dominant purpose of a tax benefit, which would serve as a comparative evaluative tool.

The court regarded the comparison between the scheme and counterfactual as that which was critical in this particular case because it showed the manner in which the scheme was formulated. This comparison showed that the scheme the taxpayer entered into could only have been explained by the taxation consequences.⁶⁵ It was found that the same merger and the commercial benefits would have been obtained under the counterfactual as under the scheme, indicating that the scheme was not chosen simply for the merger and commercial benefits.⁶⁶ Receiving a roll-over relief which enabled the taxpayer to disregard or defer their capital gain from capital gains tax was the dominant purpose for entering the scheme.

The timing of the disposition of the 9 Wills Brands to Rothman, and the length of time in which it was entered was critical to achieving the roll-over relief.⁶⁷ This was indicative of a deliberate, rather than coincidental move by the taxpayer to gain the advantage.

BATA also received capital from the disposition and avoided capital gains tax as a result of Rothman's acquisition and disposal of the brands for value. It was then able to deduct tax

⁶³ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [2].

⁶⁴ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [41]-[42].

⁶⁵ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [53].

⁶⁶ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [53].

⁶⁷ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [54].

losses of the Rothmans Group, to gain a tax benefit from the acquisition and re-selling of the brands.⁶⁸ The complexity of such actions made it less likely that it was a commercial action which simply incurred the tax benefit without it being purposely sought.

Furthermore, BATA and Rothmans were competitors prior to the disposition, who only became partners for mutual benefits at the time of the disposition, which further indicated that they entered into the scheme for a purpose other than for only a commercial one.⁶⁹ The timing of the partnership between BATA and Rothmans was critical. That they were competitors prior the disposition further indicates that the partnership was entered into to achieve a benefit which would not otherwise have been gained. Since both competitor companies received a tax benefit from their partnership, it is further evident that it was for the dominant purpose of a tax benefit.

All the factors considered indicated on balance that the scheme which BATA entered into amounted to tax avoidance under Part IVA when compared to the counterfactual. It may be inferred that the counterfactual was one where the disposition of 9 Wills Brand to Rothmans did not occur with the timing and duration for which it occurred. The taxpayer would not have entered into the merger at the specific timing that it did with a competitor company from which a mutual tax benefit would be gained as a result of that partnership. That the scheme in question did not provide more commercial benefits than the counterfactual provides stronger grounds for inferring that it was for the dominant purpose of a tax benefit.

The use of a counterfactual enabled a more forensic analysis of the facts to more closely probe for the purpose of entering the scheme. Owing to taking into account the relevant factors, it provides a more objective outcome in the sense that an assumption cannot be simply made about the purpose of entering the scheme, because a tax benefit would be obtained.

4 *Macquarie Bank*

The taxpayer and another company entered into an agreement for the sale of Minara shares owned by Mongoose. Macquarie Bank purchased all membership interests in Mongoose Acquisitions for consideration.⁷⁰ Mongoose sold its shares for a value equal to the consideration given by Macquarie Bank for the acquisition of shares. Macquarie derived a capital gain on the amount of the shares.⁷¹

The multifactorial test was applied, adopting the same approach in *British American Tobacco Australia*. In contrast to *British American Tobacco Australia*, the financial consequences of the two choices which could have been made by Mongoose, who was one of the scheme

⁶⁸ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [55].

⁶⁹ *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130, [56].

⁷⁰ *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [2].

⁷¹ *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [3].

participants, had different consequences.⁷² It was unnecessary for BATA to enter the scheme to receive the same commercial benefit as it would have under the tax-compliant counterfactual, whereas commercial benefits were gained under the scheme in *Macquarie Bank*.

The parties in *Macquarie Bank* were also in a commercial relationship with each other before the gains were derived, unlike in *British American Tobacco Australia*.⁷³ Thus, it could also be argued that because Mongoose and Macquarie were not competitors, this justifies the finding that they did not enter into the scheme for reasons other than commercial reasons.

There was also no evidence that the timing of entering the scheme was critical to obtaining the tax benefit, or other factors which show an intention to enter into a scheme for the dominant purpose of the tax benefit. As such, it was held that the acquisition of shares did not amount to a scheme under Part IVA.

Its underlying rationale appears to be that because the scheme reaped greater commercial benefits than the tax-compliant counterfactual, it could not be inferred that the dominant purpose of entering the scheme was for a tax benefit. Since there was a commercial benefit, it is more likely than not that the scheme was entered into for such purposes. Although the existence of a commercial benefit in a scheme does not preclude it from being entered into for the dominant purpose of a tax benefit, it makes it less likely.

There was no evidence which could positively demonstrate steps taken by the taxpayer to enter into the agreement for the dominant purpose of the capital gain. Companies, especially large companies, invariably enter agreements in the course of business to maximise profits. This made it difficult to infer from the agreements alone that they were for the dominant purpose of a tax benefit. That a tax benefit was merely anticipated or expected by the taxpayer entering the scheme is not sufficient to justify such an inference, as it is insufficient to constitute the driving purpose of entering the scheme. The question is whether the taxpayer entered into the scheme with the dominant purpose of obtaining the tax benefit.

This raises the question as to whether a taxpayer may conduct its business in such a way that is generally designed to both generate commercial benefits, as well as tax benefits, without contravening Part IVA. Although it has been recognised in previous cases such as *Hart* that a taxpayer may enter a scheme for the dual purposes of a commercial and tax benefit, it still remained difficult to infer that a taxpayer entered into a scheme for the dominant purpose of a tax benefit where there was a commercial benefit, and no obvious or manifest signs of the dominant purpose being the tax benefit.

5 *Orica*

The Orica Financial Limited (OFL) entered into three loan arrangements for which deductions for interest on the loans were claimed. The question was whether these loan

⁷² *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [21].

⁷³ *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [22].

arrangements were schemes entered into for the dominant purpose of claiming the allowable deduction, which would otherwise not be reasonably expected to be included as an allowable deduction had the scheme not been entered into.⁷⁴

The court considered the eight factors enumerated under 177D(2) in determining the purpose of entering the scheme by the use of a counterfactual.⁷⁵ The taxpayer, Orica Ltd, used a wholly intragroup funding arrangement to produce the operating profits of the group, from which it incurred deductible interest expense.⁷⁶ OFL provided internal funding of income for OUSI, a US subsidiary, from which it derived income.

The interest rates payable were determined by group policy, indicating that it was a non-arm's length transaction, and an uncommercial arrangement.⁷⁷ The interest expense did not arise out of the ordinary course of conducting business. Rather, the interest expense was deliberately created by the taxpayer for the purpose of creating an allowable deduction. This indicated that the dominant purpose for entering the scheme was to obtain an allowable deduction, evident by the manipulation of the financial arrangements.

Furthermore, the positive financial position of Orica Ltd was not brought about by ordinary business dealings with third parties. Rather, it was solely attributable to the OUSI's tax losses by the creation of loans, which gave rise to the corresponding tax deduction for Orica Ltd in Australia.⁷⁸ This indicated that the arrangement could only be intended to produce a loss, and hence, an allowable deduction.⁷⁹

It was held that the tax benefit obtained by the allowable deduction for the interest expense payable on the loan, was for the dominant purpose of obtaining a tax benefit.

It was apparent from these two factors alone that the dominant purpose for entering the scheme was for the tax benefit, that is, the allowable deduction. No other factors appeared to be particularly relevant in determining the purpose of entering the scheme. It was regarded as unequivocal that the intragroup loan and the financial position that resulted from the loan being solely attributable to the tax benefit gained that Part IVA was contravened.

Had the positive financial position not been solely owing to the allowable deductions resulting from the interest expense, it is possible that no finding that the scheme was entered into for the dominant purpose of the tax benefit would have been made. This is because an intragroup loan is not necessarily made for the purpose of obtaining interest expense for an allowable deduction. It may be made for commercial purposes, such as to fund another

⁷⁴ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [1].

⁷⁵ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [33].

⁷⁶ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [22].

⁷⁷ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [22].

⁷⁸ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [29].

⁷⁹ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [29].

company within the same corporate group, given that each company has its own finances. In such cases, it would be reasonable to expect a company in the same corporate group lending money to another at interest.

Where the positive financial position that results from an intragroup loan is attributable to reasons other than a tax benefit, it is more likely that the transaction was made for a genuine commercial purpose. This is distinguishable from a positive financial position resulting from solely a tax benefit. Such a result is highly indicative that the scheme, being the intragroup loan arrangement, was entered into for the purpose of obtaining a tax benefit, owing to the strong nexus between the result and the entering of the scheme.

It is not the entering into the scheme leading to such a consequence that is itself the basis for the inference. Rather, it is that the financial improvement being solely caused by the tax benefit which indicates a tax-driven motive for entering the scheme.

IV. EFFECTIVENESS OF PART IVA

A. *Overview of case studies*

The case studies show that under the approach adopted by the court in *Hart*, schemes for which there is both a tax and commercial benefit have failed to avoid Part IVA, on the basis that a purpose for a commercial benefit exists. In four of the cases examined (*Spotless*, *British American Tobacco Australia*, *Macquarie Bank* and *Orica*) where the taxpayer could have reasonably expected to, or did gain a commercial benefit, the court found that the scheme attracted Part IVA in three of those cases (*Spotless*, *British American Tobacco Australia*, and *Orica*). This indicates that Part IVA has been effective in catching schemes which for there was both a tax benefit and a commercial benefit.

Macquarie Bank was an exception to the four cases involving both a commercial and tax benefit, in which the scheme was not held to be a scheme to which Part IVA did not apply. The rationale of the finding was that the taxpayer had a genuine commercial benefit, notwithstanding the tax benefit it received. It can be distinguished from the other three cases involving both a commercial and tax benefit on the grounds that there is no indication that it deliberately and purposefully entered into the scheme for the sake of that tax benefit. Rather, the tax benefit was more incidental than purposive, to the commercial arrangement.

The key factor which led this finding was that there was greater commercial benefit conferred by the scheme than the counterfactual.⁸⁰ However, it is not that the commercial benefit of the scheme being greater than that of the counterfactual alone which led to the finding that the scheme was not a Part IVA scheme. Rather, it is that this factor served as a

⁸⁰ This is in contrast to the scheme in *British American Tobacco Australia Services Limited v Commissioner of Taxation* [2010] FCAFC 130 where one of the grounds on which the court found that the scheme was a Part IVA scheme was that the commercial benefits of both the scheme and counterfactual were the same.

very strong indicator that the purpose of the scheme was a commercial benefit. Should the commercial benefit of the scheme being greater than that of the counterfactual be a basis for the finding that the scheme was not a Part IVA scheme, it would be to imply that making a commercial benefit or a greater commercial benefit precludes a scheme from amounting to tax avoidance.

B. *Section 177D(2) multifactorial test*

In *Spotless*, *British American Tobacco Australia*, *Macquarie Bank* and *Orica*, the focus of the inquiry as to whether the tax benefit was the dominant purpose of the scheme was whether the scheme was “explicable only for taxation consequences”.⁸¹ Each of the section 177D(2) factors was to be considered in determining whether the scheme was explicable only for taxation consequences. Each factor was considered in each case examined in Part III C of this paper except for *Spotless*.

The multifactorial test under section 177D(2) is a holistic approach which sets out the general broad principles for determining whether the dominant purpose for entering the scheme was a tax benefit. This enables a proper examination by the court by which it makes an evaluative judgement based on the evidence, as to the purpose of the taxpayer. The factors, such as nature of the scheme, manner into which the scheme was entered into and timing of entering the scheme pertain to the intention of a taxpayer in entering a scheme for the dominant purpose of a tax benefit. This makes them effective principles in determining the purpose of entering the scheme. The contrast between *Macquarie Bank* and *British American Tobacco Australia* demonstrated this effectiveness by enabling a distinction between entering into a scheme for the dominant purpose of the tax benefit, and entering into a scheme with the mere consideration of tax benefits to be made.⁸²

C. *Objectivity of the dominant purpose test*

The test as to whether the dominant purpose of the taxpayer was to enter into the scheme for a tax benefit is an objective test as applied in *Hart* and subsequent cases examined in Part III c.⁸³ The actual intention of the taxpayer is irrelevant.⁸⁴ This renders the test effective as an objective definition of ‘tax avoidance’ is espoused by the law, and accordingly applied.

In *Macquarie Bank* and *Orica*, the subjective intention of the taxpayer to enhance the commerciality of the business was affirmed to be irrelevant and not even considered.⁸⁵ Had this subjective intention been considered at all as a factor in determining the dominant

⁸¹ *Commissioner of Taxation v Hart* [2004] HCA 26, [58].

⁸² See Part III c. iii-iv above.

⁸³ *Commissioner of Taxation v Hart* [2004] HCA 26, [96].

⁸⁴ *Commissioner of Taxation v Hart* [2004] HCA 26, [65].

⁸⁵ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, [19]; *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [129].

purpose, the case law precedent on tax avoidance would not have been as unambiguous as it currently is.⁸⁶ Such ambiguity would provide greater legal grounds for taxpayers to argue that they have not engaged in tax avoidance, despite having, upon an objective view of the evidence, a clear intention to receive the tax benefit. These case studies demonstrate how such a lack of allowance for taxpayers and judicial discretion for judges sympathetic towards taxpayers prevents taxpayers from using their own subjective intentions to achieve a commercial benefit, as a pretext for tax avoidance under Part IVA.

D. Counterfactuals

The more recent judgments of *British American Tobacco Australia* and *Macquarie Bank*, as well as *Orica* used counterfactuals to determine whether the scheme was entered into for the dominant purpose of a tax benefit. This marks a significant change from *Spotless* where no counterfactual scheme was used to determine the dominant purpose for which the scheme was entered into.

A counterfactual in the context of Australian taxation law is a tax-compliant scheme that the taxpayer would have entered into for the same commercial benefit as the scheme in question.⁸⁷ The scheme in question is compared with the counterfactual to determine whether the taxpayer has entered the scheme for the dominant purpose of a tax benefit.

The counterfactual scheme has been shown to be an effective tool in resolving ambiguity as to purpose that arises from schemes which can be used for both commercial and tax benefits.⁸⁸ This may explain why a counterfactual scheme was not used in *Hart*, but used in *British American Tobacco Australia*, *Macquarie Bank* and *Orica*. *Hart* did not involve a commercial benefit. In contrast, the scheme in *Spotless* which like *British American Tobacco Australia*, *Macquarie Bank* and *Orica*, had both commercial benefits and tax benefits, was found to amount to a tax avoidance scheme, without the use of a counterfactual. This can be explained by the scheme in *Spotless* being entered into for commercial benefits that were outside the ordinary purview of the business, such that it was clear that the scheme was not entered into for purely commercial reasons. This can be distinguished from the scheme in *Macquarie Bank* which was not outside the ordinary purview of the taxpayer's business activity, thereby, providing a stronger justification for the finding that the scheme was entered into mainly for a commercial benefit, rather than for a tax benefit.

V. PROPOSED NEW DIRECTIONS

⁸⁶ Maurice Cashmere, 'Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA' (2006) 35 *Australian Tax Review* 231, 232, 246.

⁸⁷ *Commissioner of Taxation v Macquarie Bank Limited* [2013] FCAFC 13, [152]; *Federal Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* [2011] FCAFC 49, [152]. The counterfactual is the same as the alternative postulate under section 177CB(3) of the *Income Tax Assessment Act 1936* (Cth).

⁸⁸ See case studies in Part III c. as above.

A. *'Not merely incidental' test*

One question that arises is whether the dominant purpose test should be modified to cover schemes entered into not for the dominant purpose of a tax benefit, but for the collateral purpose of a tax benefit. The case studies in Part III c. suggest that although a scheme is not precluded from attracting Part IVA provisions by being entered into for a commercial benefit, schemes where the tax benefit fell short of being a dominant purpose would not be caught by Part IVA. As such, a scheme which is actually intended to be for the ultimate purpose of a tax benefit will circumvent Part IVA where this can be hidden under the guise of the tax benefit being a collateral purpose, not amounting to a dominant purpose.

B. *Collateral purpose*

A collateral purpose can be defined as a secondary, additional, side or subordinate purpose. Although it is not the main or primary purpose, it is nevertheless not merely incidental to the taxpayer's ordinary course of business or production of assessable income. As such, entering into a scheme for the collateral purpose of a tax benefit is one designed to receive the tax benefit. It can be distinguished from a scheme entered into for the dominant purpose of a tax benefit, in that the tax benefit is not the ruling, prevailing or most influential purpose of the scheme.

C. *Distinguishing between Consideration of Tax Benefits and Entering into a Scheme for the Collateral Purpose of a Tax benefit*

Similarly, consideration of tax benefits in determining whether a taxpayer should enter into a scheme can be distinguished from entering into a scheme for the collateral purpose of a tax benefit. Taking tax benefits into account merely goes to considering what tax consequences may result from a particular course of action, and planning to minimise tax only in the manner the law itself intends to allow. This can be contrasted to entering into a scheme purposely or deliberately to obtain a tax benefit, albeit for a collateral, rather than for a dominant purpose.

For example (Example 1), a business may place its assets in an unregistered shell company, such that no capital gains or assessable income from income-producing assets is made.⁸⁹ Since the shell company has been formed, assets are transferred to the shell company on a regular basis, not only when a tax benefit, such as a roll-over relief, can be claimed. Its timing for transferring assets is not critical for gaining any particular tax benefit. The business may argue that it uses the shell company for the purpose of privacy and for protecting its assets, and not for the dominant purpose of a tax benefit. Receiving tax benefits is only a collateral purpose which happens as a result of using the shell company. Thus, the question is whether

⁸⁹ SEE FOR EXAMPLE, INTERNATIONAL CONSORTIUM OF INVESTIGATIVE JOURNALISTS, *FORMER EU OFFICIAL AMONG POLITICIANS NAMED IN NEW LEAK OF OFFSHORE FILES FROM THE BAHAMAS* (2014)
<<https://www.icij.org/offshore/former-eu-official-among-politicians-named-new-leak-offshore-files-bahamas>>.

it is possible for Part IVA as applied in *Hart* to find that the scheme in Example 1 is a Part IVA scheme.

It would appear that the scheme is not explicable only for tax consequences, owing to the multiple benefits that a shell company provides, such as protection from litigation and asset protection.⁹⁰ The scheme would be equally explicable as to protection from litigation, asset protection and tax considerations. Since the scheme was entered into in a manner which does not show it was entered into for the main purpose of a tax benefit, Part IVA provisions would not be attracted.

However, where the test for tax avoidance is broadened to catch schemes that are entered into not only for a commercial purpose, but also for a collateral purpose of a tax benefit, such schemes may be caught by anti-tax avoidance provisions. For example (Example 2), a business which seeks to determine what net capital gains can be offset against net capital loss from previous income years, and claims the offsets, is merely taking the tax consequences into account. The tax benefit conferred would be incidental, in that, in the ordinary course of its business, it receives that tax benefit. It does not take deliberate steps to bring it about either directly or indirectly.

In contrast, for example (Example 3), the same business, as per Example 2, which sells off assets to make a capital loss, purchases new assets and sells them after 12 months to receive a capital gains tax (CGT) concession,⁹¹ enters into a scheme for the dual purposes of commercial and tax benefits. It sells off the assets every 12 months as part of an upgrade which partially assists in but is not essential to boosting business performance as part of its ordinary course of business. The tax benefit could not be said to be the dominant purpose as it was not the prevailing purpose, given that the commercial purpose was the main purpose. However, in pursuing the commercial purpose, the tax benefit is conferred as a collateral benefit to the scheme, owing to its design. As such, the scheme is entered into for the collateral purpose of a tax benefit. Unlike in Example 2 where the taxpayer obtains the tax benefit in the ordinary course of its business, the taxpayer here does not obtain the tax benefit as part of its ordinary course of business. Instead, it takes deliberate steps outside its ordinary course of business to obtain the CGT concessions and CGT losses each year.

Owing to the increasingly sophisticated ways in which tax avoidance is carried out, the ability to catch schemes which disguise its true ultimate purpose for a tax benefit is critically important.⁹² The scenarios in Examples 2 and 3 demonstrate the need to modify the dominant purpose test to catch schemes where the purpose for receiving a tax benefit falls short of being a dominant purpose, but serves as a collateral purpose. Thus, the purpose test

⁹⁰ Maurice Cashmere, 'Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA' (2006) 35 *Australian Tax Review* 231, 240.

⁹¹ *Income Tax Assessment Act 1997* (Cth) s115-25(1)

⁹² Andrew Blair-Stanek, 'Intellectual Property Law Solutions to Tax Avoidance' (2015) 62(2) *UCLA Law Review* 4; Petr Jansky and Alex Prats, 'International Profit-Shifting out of Developing Countries and the Role of Tax Havens' (2015) 33(3) *Development Policy Review* 271.

should be modified to find that entering into a scheme for the collateral purpose of receiving a tax benefit that is not merely incidental to the ordinary course of business or production of assessable income, amounts to tax avoidance under Part IVA.

‘Ordinary course of business or production of assessable income’ refers to the normal or typical way a taxpayer of that kind, type or class would conduct his or her business or production of assessable income, to be determined on the whole of the facts. Engaging in new, irregular or unique business activities or activities to produce assessable income alone is not enough to show that the action is not in the ordinary course of business or production of assessable. Thus, the ‘not merely incidental’ purpose test does not mean that a tax benefit is conferred for a collateral purpose simply because a business is engaged in new business activities that are different from its ordinary course, for example. Rather, it refers to a scheme *designed* to ensure that relevant scheme participant receives a tax benefit as one of its purposes, although not being the ultimate, main, ruling, prevailing, or most influential purpose of the scheme.

D. *Subjective test?*

It has been suggested that a subjective test should be used to determine whether the taxpayer entered into a scheme for the dominant purpose of a tax benefit.⁹³ The objectivity of the Part IVA test indicates that tax avoidance is not determined by what the individual taxpayer believed to amount to tax avoidance, but by objective legal standards. This enables principles of tax avoidance to be maintained and safeguarded from being eroded away by ambiguous factors which may be used to sway in favour of the taxpayer who is seeking to avoid tax.⁹⁴

It also provides certainty in taxation law by providing objective criteria for what can be viewed as entering a scheme for the dominant purpose of a tax benefit. This enables the courts to determine with consistency across all decisions as to what amounts to tax avoidance. The case studies in Part III C show such a consistency in the application of section 177D(2) factors.

VI. ANTICIPATED OBJECTIONS TO THE PROPOSED TEST

This section will examine the objections that are anticipated to be raised in response to the test proposed in section V. The article has anticipated three such objections and will address each of them.

The first is that this test will unduly render legitimate tax-effective business measures to be tax avoidance. The second is that it is unfair to businesses in that it places disproportionate

⁹³ See Mark Burton, ‘The Rhetoric of Taxation Interpretation and The Definition of ‘Taxpayer’ for the Purposes of Part IVA’ (2005) 15(1) *Revenue Law Journal* 4, 13-16, 30.

⁹⁴ Chris Atkinson, ‘General Anti-Avoidance Rules: Exploring the Balance Between the Taxpayer’s Need for Certainty and the Government’s Need to Prevent Tax Avoidance’ (2012) 14(1) *Journal of Australian Taxation* 1, 53.

focus on business taxpayers, while neglecting tax avoidance by individual taxpayers. The third objection is that what is 'merely incidental' is indeterminate, such that it will not be effective, but only cause more uncertainty and therefore confusion in the GAAR and its application. This uncertainty will defeat the purpose of the GAAR, which is to ensure that ambiguity cannot be exploited to justified tax avoidance measures favourable to a taxpayer.

A. *Undue rendering otherwise legitimate tax-effective measures to be tax avoidance*

The purport of this objection is that businesses that engage in legitimate business activity will be unfairly caught by this test, because it characterises tax-effective business measures as taxation avoidance.⁹⁵

However, the purpose of the test is to ensure that taxpayers do not disguise the real purpose in obtaining a tax benefit. It only extends to catching taxpayers who, on the surface, take measures to obtain a business or commercial benefit, but whose intentions based on the evidence, could only be reasonably be conferred to be for the dominant purpose of a tax benefit.

The test is more a forensic tool than commercial rule in nature, in that it seeks to provide a legal framework to facilitate the investigation as to what is the real purpose of the benefit. It is not a commercial test which seeks to dictate what the appropriate business measure a business should take. Although it would necessarily need to take into account commercial matters, this would be for the purpose of determining what is the commercial reality to be expected in determining whether a business scheme is one that is truly for business, and not tax purposes.⁹⁶

Therefore, the test properly applied, will catch only taxpayers who are using a business benefit as a covering for a tax benefit. Its effect is to extend the current Part IVA tax avoidance test to cover the more insidious and deceptive schemes which could hypothetically exist, by implementing a more rigorous test.

B. *Bias against business taxpayers over individual taxpayers*

Another anticipated objection that owing to the focus on how business activity is used a disguise to entering into a scheme for a tax benefit, the test will unfairly target business taxpayers over individual taxpayers. Individual taxpayers are favoured by this test because they can use non-business means of finding ways to avoid tax, such as by placing income in a trust for family provision.

The rationale of this objection is that because individual taxpayers generally do not carry on a business, the principles underlying the proposed test with respect to tax avoidance

⁹⁵ For example, Rodney Fisher, 'Interpreting tax statutes: imposing purpose on a results-based test' (2013) 11(2) *eJournal of Tax Research* 138 which challenges the current purposive test used by courts in determining tax avoidance.

⁹⁶ The counterfactual tests in *British American Tobacco Australia*, *Macquarie Bank*, and *Orica* are an example of such a forensic test.

disproportionately applies to business taxpayers. Thus, it is unduly favours individual taxpayers by not proportionately applying to such taxpayers.

However, the merely incidental test need not necessarily apply to businesses. It is a broad general anti-avoidance rule which can equally apply to individual taxpayers using 'family provision' measures as a cover for a tax benefit, the most notorious example being the use of family trusts for tax avoidance. This is not to say that all family trusts are tax avoidance schemes, but rather that there is no reason why they should be judged more leniently or given special treatment in judging whether they contravene Part IVA. Such an application of this test to would then question whether a scheme in question is entered into for a purpose beyond the purpose of family provision. However, this is a question beyond the scope of this paper, which warrants a research paper for itself.

C. *Indeterminacy of 'Merely incidental' test*

Another objection that can be anticipated is that it is what amounts to 'beyond merely incidental' is indeterminate because it is in itself a vague term.⁹⁷ It will not prevent taxation avoidance, or even if it does, will cause the GAAR to be more confusing, and therefore, erode away its effectiveness.⁹⁸

However, this objection is based on the flawed assumption that the beyond merely incidental test is one for which there cannot be a clear line between a tax benefit which is simply incidental to a business measure which is commercially beneficial, and a entering a scheme with a commercial benefit, for the collateral tax benefit.

The line between a collateral benefit and a merely incidental benefit can be distinguished on the grounds that a collateral benefit is one for which there is a deliberate intention by the taxpayer to obtain the benefit, by which he or she uses deliberate means to obtain. A merely incidental benefit is one for which there is no deliberate intention by the taxpayer to obtain the benefit, for which he or she by deliberate means seeks to obtain. A collateral tax benefit will be caught by the proposed test, to catch schemes which are entered into for the tax benefit, but which fall short of being the dominant purpose of entering the scheme.⁹⁹

VII. CONCLUSION

The GAAR under Part IVA has so far been largely effective in catching tax avoidance schemes. It provides the legal grounds to unmask schemes which are predominantly commercial but entered into for the main or prevailing purpose of a tax benefit. This has been facilitated by

⁹⁷ Justin Dabner, 'Are there too many witchdoctors in our tax courts: Is there a better way?' (2005) 15 *Revenue Law Journal* 36, 44.

⁹⁸ Justin Dabner, 'In search of a purpose to our tax laws: Can we trust the judiciary?' (2003) 6 *Journal of Australian Taxation* 32, 63-64.

⁹⁹ See Section V. C above.

the use of counterfactuals and the multifactorial test derived from section 177D(2) of the ITAA36, which enable evaluative judgements as to the purpose of a scheme to be made.

However, Part IVA provisions will not be adequate in catching schemes which are entered into for the collateral purpose of a tax benefit, or where the tax benefit is not merely incidental to its ordinary course of business or production of assessable income, but yet fall short of being the dominant purpose of the scheme. The need for a broadened purpose test to include such schemes is highlighted by the increasingly sophisticated and subtle ways in which tax avoidance can be carried out.