SOME NOTES ON RECENT DEVELOPMENTS IN PART IVA (and in passing, on s100A)

These notes assume the reader has some familiarity with the decision at first instance [2021] FCA 1619, and on appeal in the *Guardian* case [2023] FCAFC 3, and with the decision in *Minerva* [2022] FCA 1092[1].

Guardian on appeal was the first Part IVA case that acted on the 2013 amendments to Part IVA.

Tony Slater QC has said[2] in concluding that the 2013 amendments were unnecessary from a policy perspective:

> "While the 2013 amendments have been justified on the grounds that these decisions [*FC of T v AXA Asia Pacific Holdings Ltd*, *FC of T v Futuris Corporation Ltd,* and *RCI Pty Ltd v FC of T]*, revealed a "structural deficiency" in Part IVA, on closer examination it seems more accurate to say that the Commissioner failed in each because his perception of what was "reasonably to be expected" could not be supported on the evidence."

The decision in *BBlood Enterprises* [2022] FCA 1112 only dealt with s100A and is not discussed in any detail as it appears to have been an egregious scheme marketed to several clients of an accounting firm, and the result was probably fairly predictable[3]. It presumably did not involve Part IVA because the Commissioner was out of time to amend, whereas s100A has no limitation period[4].

Guardian Case Not a True "Washing Machine"

A true "washing machine" involves an entirely circular flow between a discretionary trust (DT) which earns the income, and a corporate beneficiary (CB), with the funds (less corporate tax) being returned to the DT. That is, the CB is also owned by the DT, and the flow of franked dividends is continual (to overcome Div 7A)[5], subject to the contingency of the DT releasing the franked dividends potentially to an individual(s), which may include the principal, or a non "at risk" family member, one day in the long term. While the "washing machine" is "washing", it provides the principal with "asset protection", as does an ultimate distribution to a non "at risk" family member. It is likely that true "washing machines" have been marketed (to resident principals), rather than being the result of one-off advice (as was the case for the non-resident principal in *Guardian*).

This situation of distributions not being paid, is really only necessary, if the funds are required for working capital of a business by the DT, or a DT is used for investment (rather than a company), in order to attract the 50% CGT discount on disposal of trust assets.

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[1] *Minerva* is on appeal. Further reading on the topic might include F. O'Loughlin KC & J McGrath, "Discretionary Trusts –Are they alive and well, sick, terminally ill or dead?" TTI Local Tax Club 23.02.23; Can Part IVA apply to trustee discretions- Yes, according to the Federal Court - Sladen Legal website 27.09.22; Bill Orow, "Taxation of Trust Distributions, Greens List Feb 2023; Paper dated 02.03.23 delivered by M. Flynn KC at session with J. Strong, "Section 100A, Part IVA and Guardian: insights from the Full Court", Vic Bar 07.03.23. I understand no special leave has been sought to appeal to the High Court in *Guardian*.

[2] "Part IVA Reform", Taxation Institute, National Division 13-15 March 2013, Perth

[3] Involving a share buy-back, a deliberate mismatch of tax & trust income, & the introduction of a new beneficiary, all in circumstances where the taxpayer said his purpose was simplification!

[4] It is observed that the appeal in *Guardian* did not refer to the decisions in *BBlood Enterprises* or *Minerva*, whereas the decision in *BBlood Enterprises* did refer to the decision in *Guardian* at first instance.

[5] This arrangement is Ex 12 in TR 2022/4 (dealing with s100A), & PCG 2022/2 (also dealing with s100A - Red zone: scenario 2). Whilst neither the TR nor the PCG refers to the arrangement as a "washing machine", it has assumed that description amongst professional advisors.

Otherwise, it might have arisen historically because a DT was used, and then, often years later, a CB is added as a beneficiary to attract the corporate tax rate. The DT owning the CB often arises as the principal does not want to pay for another trust to be formed to own the CB. If in the *Guardian* example, the CB was owned by the non-resident principal, and the fully franked dividend was paid, an alleged Part IVA scheme would not have involved a choice to direct the fully franked dividend via the DT back to the CB, or to the non-resident principal. In *Guardian,* that the principal became a non-resident was not alleged to be part of the scheme. So, if the principal had owned the CB, the only "choice" was to not pay a dividend and enter into a Div 7A loan agreement with the DT, to call for the funds, or to pay a dividend to the non-resident principal.

Further in the alternative, due to on-going Div 7A issues, the business otherwise conducted by the DT might be "rolled" to a wholly owned company, which will simply retain its profits (subject to liability claims on the company). That liability issue, is often dealt with by a second rollover, by having the operating company owned by a holding company[6] (owned by a DT), to which regular dividends are paid, and the funds loaned back[7], preferably on a secured basis.

In the *Guardian* case, the fully franked dividend was released to the non-resident principal within two years of the structure being set up[8]. The Full Court held Part IVA applied in the 2013 tax year, but not the 2012 tax year. Section 100A did not apply in the 2012 or 2013 tax years, as there was no agreement reached before the beneficiary became presently entitled to the trust income[9].

The explanation of the Full Court of the different result in the 2012 tax year from the 2013 tax year was as follows:

> "188 As is apparent from the description accorded to the transactions (at PJ [192]), it was the creation of the present entitlement to income in AITCS that resulted in the need for the declaration of a dividend by AITCS. In this sense the first step was a precondition to and causative of the second step. However there is a danger in using hindsight to reach a conclusion about purpose that is not objectively apparent when the circumstances are considered as an **evolving** chronology.
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> 189 The manner in which the steps came to be carried out was different in relation to the 2013 related scheme from the **manner** in which they came to be carried out in relation to the 2012 related scheme. As the primary judge found, at the time the 2012 AIT trust income was appointed to AITCS, there was nothing in the objectively ascertainable circumstances that would have given rise to an expectation that a dividend would be declared by AITCS. At that time, being 28 June 2012, Mr Springer had expressed no discomfort with AITCS holding a significant cash balance in its account. As at that date, Mr Springer was in his transition to retirement and had been advised that it would be appropriate to incorporate a "clean skin" company in which to accumulate wealth. Being a newly incorporated company, AITCS had **no history** of dividend declarations and the explicit wishes of Mr Springer at that time were that AITCS be used to accumulate wealth (PJ [165]).

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[6] The only liabilities which cannot be avoided by the dividend, are the dividend being a preference within 6 months of insolvency, or where the operating company has traded while insolvent.

[7] Inter-company interest free loans don't attract Div 7A.

[8] FN 132 to TR 2022/4 observes that the payment of the dividend by the DT to the principal, in year 2, rather than back to the CB, differentiates Ex 12 from the facts in *Guardian*.

[9] In the Full Court, the Commissioner did not appeal in relation to the 2014 tax year as to s100A or Part IVA, as in that year, the CB's entitlement was loaned back to the DT under a complying Div 7A loan agreement. That approach has also been taken in PCG 2022/2.

190 The dividend that came to be declared and paid by AITCS out of its 2012 AIT trust distribution was entirely referable to objective circumstances which came to exist after the creation of its present entitlement. It was only after the creation of that present entitlement that Mr Springer, having expressed his concern about accumulating a cash balance in AITCS's bank account, proposed the payment of a dividend by AITCS to himself. Ms Burke, recognising that **Mr Springer had erroneously assumed he was the shareholder of AITCS**, in turn proposed the payment of a dividend to AIT and a distribution of that franked income by the trustee of the AIT to Mr Springer. There was nothing in the way in which the chronology of events unfolded in relation to the 2012 AITCS unpaid present entitlement that would support a conclusion that the dominant purpose of any party to those steps carried out the scheme for the dominant purpose of enabling Mr Springer to obtain a tax benefit in the year ended 30 June 2012.

191 At the time that the 2013 AIT trust income was appointed to AITCS, the **objective circumstances were quite different**. By that time, Mr Springer was in receipt of advice that any unpaid present entitlement created in AITCS would need to be cleared out before the lodgement of the AIT's tax return for that year of income, had expressed his concern about AITCS holding a significant cash balance, and had procured the payment of a dividend by AITCS to the AIT and the distribution of that franked income to himself (see [114]–[115], above).

192 The declaration of the dividend by AITCS in March 2013 necessarily meant that, in the year ended 30 June 2013, **AITCS was not being used as a vehicle for the accumulation of wealth**. By paying out the distribution it had received as a dividend, the balance of retained earnings recorded in AITCS's financial statements as at 30 June 2012 were dissipated. Any wealth acquired by AITCS as a result of it being appointed income in the year ended 30 June 2012 was held by AITCS for no more than eight months. By no reasonable commercial measure could the holding of a balance of value for a period of eight months be described as an accumulation of wealth in AITCS. His Honour's findings on this matter at PJ [195] and [196] are erroneous. The balance of retained earnings of AITCS as at 30 June 2014, referred to at PJ [153], were not and could not be the result of distributions of the AIT's net income for the years ended 30 June 2012 or 30 June 2013.

193 The fact that Mr Springer may not have subjectively turned his mind to the payment of a dividend by AITCS at the time that the present entitlement in AITCS was created in June 2013, or the fact that Mr Fischer may not have discussed such a recommendation with Ms Burke in June 2013, is not to the point. The **inquiry mandated by s 177D does not relate to the subjective state of mind** or fiscal awareness of any person: *CPH Property Pty Ltd v Commissioner of Taxation* [1998] FCA 1276; (1998) 88 FCR 21 at 41 (Hill J).

194 Upon the creation of AITCS's unpaid present entitlement to the income on 23 June 2013, the objective circumstances would give rise to an expectation in an objective, reasonable observer that AITCS's unpaid present entitlement would be cleared out in the same way as it was in respect of the entitlement created for the year ended 30 June 2012, enabling Mr Springer to enjoy the benefit of that distribution in the form of a franked distribution paid to him in the following year. This is precisely what happened.

195 The essential difference between the 2012 related scheme and the 2013 related scheme was that objective circumstances would support a conclusion that, at the time AITCS's present entitlement to the AIT income was created for the year ended 30 June 2013, Mr Springer (or those advising him) would procure the payment of a dividend by AITCS to clear out the present entitlement and, following the payment of tax by AITCS, flow the franked dividend income

> back to Mr Springer, giving him direct ownership and control of the value of that present entitlement. Far from the payment of a dividend by AITCS to clear out that present entitlement being wholly conjectural, it would be the most likely course of action.
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> 196 Unlike the 2012 related scheme, it is considered that the **manner** in which the 2013 related scheme was entered into and carried out supports a conclusion that Mr Springer, Guardian or AITCS (**or those advising them**) entered into or carried out that scheme for the dominant purpose of enabling Mr Springer to obtain a tax benefit in the year ended 30 June 2013. The scheme was entered into and carried out in a **manner** that enabled Mr Springer to obtain the benefit of the unfranked income of the AIT derived by it in the year ended 30 June 2013 at a tax cost limited to the corporate tax rate." (bolding added)

True it is that Hill J said at first instance in *Consolidated Press Holdings*, referred to with approval before the High Court, that the intention of advisers could be relevant when their clients didn't have an intention or understanding of that they were implementing, but I am troubled by that subjective intention of advisers being substituted for what the scheme effects from the objective perspective (even though Part IVA is expressed as a dominant purpose of a party to a scheme, rather than the scheme itself). The subjective purpose of advisers seemed to be of great weight according to Gordon J in *Noza Holdings*, that purpose being to achieve reductions in Illinois' state tax and results under US accounting standards[10].

Had the income in *Guardian* not been earned by the DT, but rather by a company in its own right, the shares in which were owned by a DT, would a distribution of the fully franked dividend to the non-resident principal have attracted Part IVA? One is left with an uncomfortable feeling that the complexity of the structure in *Guardian* attracted Part IVA in the Full Court, against express statements in the case this was not so, viz:

> "185 The Commissioner's written submissions did not draw a distinction between the 2012 related scheme and 2013 related scheme, but emphasised the **circularity** involved in the form of a trust distribution by the AIT to AITCS followed by a dividend back from AITCS to the AIT (except for the income tax paid by AITCS). That circularity was said to reveal an element of **artificiality**, the existence of which was to be readily explained by a tax purpose.
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> 186 It is important to bear in mind the object of the s 177D inquiry. It is to ascertain whether it would be concluded by a reasonable person that a person who entered into or carried out the scheme (or part thereof) did so for the sole or dominant purpose of enabling Mr Springer to obtain a tax benefit in the form of the non-inclusion of an amount in his assessable income in the year ended 30 June 2012 (in connection with the 2012 related scheme) and the year ended 30 June 2013 (in connection with the 2013 related scheme).
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> 187 To this end, in considering the **manner** in which the scheme was entered into or carried out, it is necessary to consider how the scheme came to take the **form** it did. To describe the schemes as involving a **circularity** is a description of the form or consequence of the scheme. **It does not address the manner in which the scheme came to be entered into or carried out**." (bolding added)

[10] One of the cases where Vanda Gould was an adviser also sheeted home his subjective intention to his clients (*Millar v FCT* [2016] FCAFC 94 per Pagone & Davies JJ in the majority), whereas in another the client was well aware of what they were doing and Mr Gould's intention was held not to be relevant (*Normandy Finance Pty Ltd v FCT* [2016] FCAFC 180 per Jagot & Davies JJ in the majority)

In the end, the corporate rate of tax was paid in Australia, and an alternative postulate would generally be the income might have been earnt directly by a company, with the same overall tax rate as was achieved, but for Part IVA, in the *Guardian* case[11].

In practice, it is often the case that "asset protection" is thrown out the window by the principal owning the shares in the CB. Further, the more distributions the CB receives, the more the shares in CB are worth, with the principal accruing an ultimate capital gains tax liability on disposal of the shares or a "top-up" tax liability on liquidation of the company (on the difference between the accumulated profits and the franking account).

Guardian first Part IVA case to apply 2013 amendments

The Full Court held that s177CB(4)(b) prevented the taxpayer from arguing that he would not have received an unfranked distribution because the Australian tax cost of doing so, was too high. The Full Court said in the case at first instance, the 2013 amendments to Part IVA were "raised but not addressed"[12]. The s177CB(4)(b) amendment was designed to counter the "do nothing" argument which was successful in the cases of *RCI* and *Futuris*.

"Tax Benefit" and "Tax Effect"

Section 177C says you have a "tax benefit" if e.g. (a) an amount is not included in your assessable income as a result of the scheme. That is, the "tax benefit" happens to "the taxpayer". The "new" s177CB says for the purpose of whether any of the following would have occurred, or might reasonably be expected to have occurred, you have a "tax effect" if, e.g. (a) an amount would be included in the assessable income. That is, the "tax effect" can happen to the taxpayer or another person.

Section 177CB(2)

The relevant amendments in s177CB were, firstly:

> "(2) A decision that a **tax effect** **would have occurred** if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that **actually happened or existed** (other than those that form part of the scheme)." (bolding & underlining added)

This is said to usually apply to a deduction case and the EM described its effect as an "annihilation" of the deduction. If it was applied to an assessable income case, in the words of then junior counsel, Tom Thawley (as his Honour then was) in describing how the amendments to Part IVA might be legislated[13]:

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[11] Curiously, at [175] of TR 2022/4, the Commissioner seems to postulate that the alternative in the "washing machine", would be that the trustee would retain the trust income, even though in the *Guardian* case in the Full Court, he successfully argued that that the principal would have received an unfranked trust distribution in year 1, and indeed, did receive, the fully franked trust distribution in year 2. Where the principal is already on the top marginal tax rate, for the trustee to pay tax at the top marginal tax rate (under s99A), might be a reasonable alternative postulate as it would achieve asset protection, whereas a distribution to the principal would not.

[12] Hespe J at [172]. This is a bit cryptic: see [177] of Logan J, in the sense that if the parties at first instance, didn't submit s177CB(4) created a different result, why should Logan J have to deal with it? On the other hand, neither Logan J nor Hespe J mentioned a postulate that Mr S would have received the cash from the CB and personally entered into a Div 7A loan agreement. Presumably the taxpayer did not put forward that OBVIOUS postulate which would have countered Hespe J's saying the alterative had to put the cash in the hands of Mr S.

[13] Part IVA; Where to from here?", Taxation Institute, WA Division, 23-24 Aug 2013.

"One method which would achieve the result would be an amendment to s 177C(1)(a), such that it read:

(a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if:

(i) the taxpayer had engaged in the events which in fact occurred apart from the scheme; and

(ii) the scheme had not been entered into or carried out.

Such an amendment would effectively implement what the Commissioner contended in *RCI* and *Futuris* was the present operation of s 177C. An amendment to such effect would create a **draconian** provision. It would mean that the Commissioner could dictate the result by his process of selection of which steps constitute the "scheme". He could merely eliminate those steps that gave rise to the tax benefit, even though the remaining steps might mean that the transaction was one which no rational taxpayer would have embarked on. The provision would no longer require any prediction of what would have occurred; what would have occurred would be dictated: it would be what in fact happened after excluding the steps selected by the Commissioner to constitute the scheme."(bolding added)(underlining in the original)

Slater[14] has given examples of when s177CB(2) might apply:

"There will be some few cases where it can be said that if a scheme (event) did not transpire, an amount of income would have been derived: if for example a trust instrument provides that the income of a fund accrues to A unless the trustee appoints it to B, and the appointment to B is the "scheme" in question, it can be said that derivation of the income by A (the "tax effect") would have occurred if the appointment had been made without reference to anything other than "the events or circumstances that actually happened or existed." Other instances include a disposal of a share between declaration and payment of a dividend (but for the disposal the dividend would have been derived by the disponor), and an assignment of a share of a partnership during a year of income (but for which the share of partnership income would have been derived by the assignor). But these cases are rare indeed in practice: usually the prediction as to the derivation of income is based on events which are likely, perhaps overwhelmingly likely, to have occurred, but which there is a residual possibility might not have occurred, in the absence of the scheme. It is these cases which are picked up by the "might reasonably be expected to have" alternative in s 177C."

Indeed, the EM also provides examples of the operation of s177CB(2), both in a deduction case and in an assessable income case:

"1.80 Under this approach, a taxpayer will have obtained a tax benefit in connection with a scheme if it can be demonstrated that a relevant tax effect would have flowed, as a matter of law, from the application of the taxation law to the facts remaining once the scheme is assumed away, that is, a tax effect less advantageous to the taxpayer than the tax effect secured by the taxpayer in connection with the scheme.

Example 1.1: Postulating the absence of the scheme

[14] Op Cit

> Sandy enters into a scheme from which he secures a large, up-front, tax deduction. The scheme is structured so as to provide him with a highly contingent right to income payable some years in the future. The potential investment returns are speculative and clearly subordinate to the tax deduction.
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> When postulating what the tax effects would have been absent the scheme, the events and circumstances comprising the scheme must be assumed not to have happened, and it is impermissible to speculate about events or circumstances that did not exist (for example, that Sandy would have done something else that would have also secured a tax deduction).
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> If the scheme is assumed not to have happened, Sandy would not have obtained a tax deduction. Sandy has therefore obtained a tax benefit in connection with the scheme that is equal to the amount of the tax deduction that he secured by entering into the scheme.

1.81 An annihilation approach is a simple and effective way to identify a tax benefit in a case where the mere deletion of a scheme exposes a coherent taxable situation — without the need to engage in any kind of reconstruction or speculation.

1.82 Typically, this will be the case where the scheme in question does not produce any material non-tax results or consequences for the taxpayer.

1.83 For example, a straightforward application of this approach would be expected to expose the same deduction benefits as the Full Federal Court found had been obtained in connection with the agricultural schemes at issue in *Puzey* [2003] FCAFC 197 and *Sleight* [2004] FCAFC 94.

1.84 Similarly, it can be expected that this approach would be effective to expose tax benefits obtained in connection with schemes that shelter economic gains already in existence.

> **Example 1.2: Changing the source of income**
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> Deborah, a foreign resident, enters into an arrangement under which assessable income that would otherwise be derived by her from Australian sources is instead derived by her from foreign sources with the result that it is not assessable in Australia.
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> If the scheme had not been entered into, the income *would have* been included in Deborah's assessable income because the only operation of the scheme was to change the source of the income for taxation purposes. The tax benefit is the reduction in Deborah's assessable income.
>
> No speculation is necessary or permitted in deciding what else might have happened if Deborah had not entered into the scheme."

In Example 1.2, one wonders what sort of scheme this may be or the type of income involved. If it was from the provision of services, the source would be where the work was done, unless like in Mitcham's case, the contract wasn't confined to doing the work in Australia. If the income was from the sale of goods, the place where the contract was entered into would determine the source of income.

Section 177CB(3)

The relevant amendments in s177CB were, secondly:

> "(3) A decision that a **<u>tax effect</u> might reasonably be expected to have occurred** if the scheme had not been entered into or carried out must be based on a postulate that is a **reasonable alternative** to entering into or carrying out the scheme." (bolding & underlining added)

This would usually apply to an assessable income case and the EM described its effect as a "reconstruction" of where the income would have flowed.

Section 177CB(4)

The relevant amendments in s177CB were, thirdly:

> "(4) In determining for the purposes of subsection (3) whether a postulate is such a **reasonable alternative**:
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> (a) have particular regard to:
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> (i) the substance of the scheme; and
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> (ii) **any result or consequence** for the taxpayer that is or **would be achieved** by the scheme (**other than** a result in relation to the **operation of this Act**); but
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> (b) **disregard any result** in relation to the **operation of this Act** that **would be achieved by the postulate** for any person (whether or not a party to the scheme)." (bolding added)

That s177CB(3) & (4) refer to "a reasonable alternative" raising the question of multiple alternatives, Magid & Pettigrew said[15]:

> "Interestingly, the more substantive conceptual aspect of the tax benefit requirement from *RCI* (that it requires a court to determine **the most reliable** alternative counterfactual to the scheme) that was argued against by the ATO in the special leave applications in both *AXA* and *RCI* has not been the subject of any announced change or comment in the 1 March 2012 announcement, the 16 November 2012 announcement, the ED or the EM.
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> Although some commentators anticipated that this point would be the basis of the legislative amendments, it has not featured in any of the amending material. This is curious to say the least.
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> To some extent, it may reflect a view on the part of the ATO and/or Treasury that the Full Federal Court's comment in *RCI* that a court, in identifying a tax benefit must undertake:
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> > "an objective enquiry and determination amongst alternative possibilities as to which is the most reliable prediction.."(our emphasis added)
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> is to be interpreted in light of, and is qualified by the court's ultimate finding that:
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> > "the relevant parties would have either abandoned the proposal, indefinitely deferred it, altered it so that it did not involve the transfer by RCI of its shares in [JHI] to RCI Malta at a tax cost of $172 million or pursued one or more of the other alternatives

[15] "The shifting Part IVA landscape", Taxation Institute, National Division 13 Feb 2013., Queensland.

referred to in the Information Memorandum [for the float].” (our abbreviation and words in square brackets added),

as this finding involves the identification of a range of alternate postulates, not a prediction of just one, and a literal interpretation of the first comment would make it difficult to reconcile with the second.

Alternatively, Treasury and/or the ATO may consider this particular point to have been resolved in favour of the revenue by the approach advocated in the 16 November 2012 EM discussed further below of approaching Part IVA as involving a single holistic enquiry into whether the purpose requirement in s.177D is satisfied, it being relevant in **that** inquiry to consider the various “alternative possibilities”. This may be interpreted as contemplating the assessment of a range of counterfactuals in the context of the inquiry into purpose only, with a view to identifying an alternative possibility capable of giving rise to an application of Part IVA.

This is something of a mystery nonetheless, and a factor which will be relevant in the interpretation and application of the ED amendments, as discussed below. The proper application of this aspect of the decision in *RCI* will be critical to the future application of Part IVA in many cases.”

I note that the EM to the 2013 amendments does provide a table on p17 which does under the heading “new law”, refer to “reasonable alternatives” i.e. in the plural.

As to what “might reasonably be expected to have occurred” that might be legislated, Thawley[16] said:

“An alternative would be to create a statutory non-rebuttable presumption that the taxpayer would have engaged in the underlying commercial transaction, but in a way which did not involve the identified scheme. If this could effectively be done, this might address the result in *RCI*. Presumably, this course would leave open to the taxpayer flexibility in putting forward alternative structures which might have been adopted in order to undertake the underlying transaction or arrangement. However, such an approach has difficulties:

- it assumes that it will always be possible to identify a basic underlying transaction which would always have been entered into. In the case of the sale of a particular asset that might be so, but in other situations, such as a series of transactions under a global restructure that might not be so – which aspects of such a restructure would be ones which it must be presumed would have occurred? How does one identify what is the substance of an underlying commercial arrangement in circumstances where there is a complicated and highly nuanced set of arrangements designed to achieve a whole series of outcomes, often in many jurisdictions?

- it has the potential to create a **very artificial inquiry**, divorced from what really would have occurred in the absence of the scheme. Assume, for example, that a taxpayer makes an investment in the bond market under a structure which sees significant tax benefits but, in the absence of the availability of those tax benefits, the taxpayer would have made a radically different investment. It is difficult to see why the taxpayer should be bound to a hypothetical

[16] Op Cit

investment in the bond market if that is identified as the commercial substance of the underlying arrangement.

It is difficult to predict what the legislative changes might be. However, it is clear that they will be directed to preventing the argument that the taxpayer would have done nothing. The real question is what flexibility will remain in the question of determining what would have occurred had the scheme not been entered into or carried out, apart from what is likely to become an impermissible argument that the taxpayer would simply have done nothing. The task of drafting a change which is capable of eliminating the "do nothing" counterfactual, whilst maintaining sufficient flexibility in the operation of the provisions cannot be easy. This is perhaps evidenced by the length of time it has taken to produce an exposure draft of what is apparently perceived to be a high priority legislative change.

It is critical to retain flexibility in the operation of s 177C(1)(a). The Commissioner's argument advanced in *RCI* and *Futuris* to the effect that the provision required the elimination of the scheme steps but left the transaction otherwise intact would give to the section an obviously **draconian** operation. Those arguments were clearly wrong on the statutory language, but it is to be hoped that they are not legislated into effect. The argument advanced in *Futuris* and *RCI* that the Commissioner only need establish ***a*** **reasonable prediction** as to what might have occurred (notwithstanding that there might be any number of more likely scenarios) would also give rise to an unfair operation of the provision." (italics & bolding added)

As to s177CB(4)(b) Slater has said[17]:

"It is not apparent why the anti-avoidance policy of Part IVA – to cancel the tax benefit obtained by the taxpayer assessed – is served by expressly excluding from consideration the **tax consequences to other taxpayers** in deciding whether it is reasonable to expect that an alternative postulate would have been adopted. Why, for example, it is an appropriate part of the legislative scheme to direct that, in deciding whether it is reasonable to expect that but for a scheme a beneficiary would have been presently entitled to a share of trust income, one should disregard that in the absence of the scheme **another beneficiary, or the trustee**, would have been subjected to tax, at a different rate?" (bolding added)

The EM to amending law in ss177CB(3) & (4) says:

1.87 Such a postulate will necessarily require speculation about the state of affairs that would have existed if the scheme had not been entered into or carried out. This may include speculation about the way in which connected transactions would have been modified if they had had to accommodate the absence of the scheme.

1.88 Under this approach, a taxpayer will obtain a tax benefit in connection with a scheme if it can be demonstrated that a relevant tax effect would have flowed, as a matter of law, from the application of the taxation law to the alternative postulate; again, a tax effect that is less advantageous to the relevant taxpayer than the tax effect secured by the taxpayer in connection with the scheme.

Example 1.3: Reconstructing events

Mr and Mrs Heginbothom want to borrow money to acquire both a family home and a holiday house that they plan to rent to holidaymakers. They borrow the money

[17] Op Cit

> under an arrangement in which the repayments are applied exclusively to the borrowing in relation to the family home. The result is that the deductible interest payments are increased for the holiday home borrowing and the non-deductible interest payments for the family home borrowing are minimised.
>
> Merely annihilating the scheme would not leave a sensible result because there would be no borrowing at all, so some reconstruction is necessary. It is therefore necessary to consider what might reasonably be expected to have happened if the scheme had not been entered into. A reasonable alternative in this case might be that the Heginbothoms took out two loans, one for each of the homes they wished to acquire, each of which was entered into on normal commercial terms.

[This looks a lot like *Hart*'s case discussed in the EM at 1.96 below]

1.89 A reconstruction approach is an effective way to identify a tax benefit in relation to a scheme that achieves substantive non-tax results and consequences. In these cases, simply annihilating the scheme would be inconsistent with the non-tax results and consequences sought for the taxpayer by the participants in the scheme.

1.90 Typically this will be the case in an income scheme (or a withholding tax scheme) that both produces and shelters economic gains. In such cases an annihilation approach would be an ineffective way to expose the tax avoidance achieved by the tax shelter, since deleting the scheme would destroy both the gain and the shelter. In such cases, a prediction will necessarily be required about other ways in which a comparable gain could have been produced without the tax shelter.

1.91 The role of the reconstruction approach in relation to income schemes is usefully illustrated by the High Court decision in *Spotless* (1996) 141 ALR 92. There (at pp 103-104) the Court rejected a submission on behalf of the taxpayers, in relation to paragraph 177C(1)(a), that, had they not entered into the investment scheme, there would have been no interest, and no amount included in their assessable income that would satisfy the definition of 'tax benefit'.

> 'In our view, the amount to which para (a) refers as not being included in the assessable income of the taxpayer is identified more generally than the taxpayers would have it. The paragraph speaks of the amount produced from a particular source or activity. In the present case, this was the investment of $40 million and its employment to generate a return to the taxpayers. It is sufficient that at least the amount in question might reasonably have been included in the assessable income had the scheme not been entered into or carried out.'

….

1.93 If a postulate that the scheme merely would not have happened would be inconsistent with the non-tax results and consequences sought for the taxpayer by the participants in the scheme then a reconstruction of either the scheme, or of the scheme and things that happened in connection with the scheme, may expose other ways in which the non-tax results and consequences of the scheme could reasonably have been achieved without the impugned tax advantages.

1.94 This is usefully illustrated by the decisions in *Consolidated Press* [1999] FCA 1199 and in *Hart* (2004) 206 ALR 207.

1.95 In *Consolidated Press* the Full Federal Court concluded (at [89]) that, absent the scheme, an amount of interest on a borrowing 'might reasonably be expected … not to have been allowable'. In so doing, it upheld the trial judge's hypothesis that, had the particular scheme not been entered into, it was reasonable to expect that the borrowed money would have been directly invested in a foreign subsidiary and therefore been non-deductible because of former section 79D of the ITAA 1936. The trial judge based his hypothesis on the way in which the actual investment had been structured ((1998) 98 ATC 4983 at 4998 per Hill J).

1.96 Similarly in *Hart*, where a husband and wife had borrowed money on unusual terms with advantageous taxation consequences, the High Court concluded that absent the scheme it was reasonable to expect the taxpayers would have still borrowed the money (for two purposes, one private and the other income producing) but that they would have done so on standard financing terms rather than the special terms which had produced the relevant tax advantages.

1.97 In each of *Consolidated Press* and *Hart*, the reasonable expectation as to what would have happened absent the respective schemes was informed by the commercial results to which the schemes were directed.

….

1.102 A tax advantage cannot meaningfully be linked to a scheme by comparing the tax consequences of the scheme to the tax consequences that would have flowed if the parties had **chosen to pursue some other objective**. To provide a meaningful comparison, the tax consequences of the scheme should be compared with the tax consequences of an alternative that is reasonably capable of achieving for the taxpayer substantially the same non-tax results and consequences as those achieved by the scheme.

….

> **Example 1.5**:
>
> The results achieved for the taxpayer Gadget Co negotiates, with the assistance of its selling agent, Banker Co, to sell its Sydney factory to Widget Co for $500,000. However, rather than transferring the factory directly to Widget Co, Gadget Co enters into a complex transaction that involves the factory passing through the hands of Banker Co before it is finally transferred to Widget Co. Gadget Co realizes $475,000 from the transaction and Banker Co takes the $25,000 balance. The transaction is constructed in such a way that Gadget Co is not liable for capital gains tax on the disposal of the property. From Gadget Co's perspective, the end result achieved by the transaction was the disposal of its factory to Widget Co for $500,000. A reasonable alternative to the transaction, that would have achieved the same non-tax effect for Gadget Co, would have been for Gadget Co to dispose of the factory directly to Widget Co for $500,000 and for Gadget Co to have paid Banker Co a fee reflecting the value of its services in finding a buyer.

[This looks a lot like the *Axa Asia* case in the next paragraph]

1.111 The amendments are intended to make it clear that the focus is on the results and consequences achieved by the scheme for the taxpayer, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 26 as distinct from the results and consequences achieved by the scheme for one or more of the other participants in the scheme (compare the emphasis that was placed on the fact that a direct sale of Axa Health to MB

Health would have denied Macquarie Bank Limited its underwriting and sell-down fee in Axa Asia [2010] FCAFC 134 (at [143])).

1.112 More particularly, there is no need for the alternative postulate to involve all the same participants as the scheme itself comprised (see, for example, the alternative postulate relied upon by the High Court in Spotless (1996) 141 ALR 92).

Schemes within broader transactions

1.113 Where a scheme forms part of a broader commercial transaction, a postulate would be a reasonable alternative to the scheme if it performs the same role in relation to the broader transaction as the scheme itself performs, disregarding its tax effects.

1.114 Consequently, if the scheme itself has no non-tax results and consequences and the broader transaction remains effective without the scheme, there would be no warrant for an alternative postulate involving a reconstruction of the broader transaction (compare Futuris [2012] FCAFC 32).

1.115 Where, however, a scheme is integral to a broader transaction in the sense that it is intertwined with the broader transaction and facilitates it in some way, then it would be reasonable for an alternative postulate to involve a reconstruction of the broader transaction, so long as the reconstruction produces the same non-tax results and consequences as were in fact achieved by the broader transaction.

1.116 The extent to which the broader transaction should be reconstructed should be limited by the role the scheme plays in that transaction.

> **Example 1.6**:
>
> A scheme that facilitates a broader transaction Assume that in order for Kerry-Anne to secure a tax deduction for borrowing money to invest in an offshore company (Offshore Co) it is necessary for her to interpose a resident Australian company. She does this by using the borrowed funds to buy shares in an Australian shelf company (Oz Co). In turn, Oz Co buys ordinary shares in Offshore Co. Oz Co performs no other role. The Commissioner makes a Part IVA determination on the basis that the interposition of Oz Co is a scheme to which Part IVA applies. Objectively viewed, the interposition of Oz Co achieves two effects. One is securing a deduction for interest on the borrowing, and the other is the acquisition of shares in Offshore Co. A correct alternative postulate should be another way in which Kerry-Anne could reasonably be expected to have acquired ordinary shares in Offshore Co. An alternative postulate that involved Kerry-Anne lending the borrowed monies to Offshore Co would achieve a different effect. So too would be a postulate that involved Kerry-Anne investing the borrowed monies in a completely different company."

[This looks a bit like the *Consolidated Press Holdings* case] (comments in brackets inserted)

I must say I find Example 1.6 somewhat confusing. If the alternative postulate to what Kerry-Anne actually does is that Kerry-Anne borrows the money and buys the shares in Offshore Co it seems the Commissioner is saying Part IVA would apply, but that was her subjective reason. Objectively, informed by evidence, there may be non-tax reasons why she interposed Oz Co, but the example doesn't state that as a starting point.

The other tax result from Oz Co buying the shares (if they represented at least 10% of Offshore Co's capital), is Oz Co would get the benefit of Div 768-A and potentially, Div 768-G, and if Oz Co borrowed the money from her or a 3rd party, it would have been entitled to a deduction for interest under s25-90. If the example was meaning to say that she had no existing Australian company and that the shareholding she was buying was only portfolio, then it would have been helpful for the example to say so.

As discussed below, every day Australian resident individuals interpose an Australian company owned by a DT, to earn income that they otherwise might have derived personally, and their subjective intention may well be to minimise tax immediately payable, but viewed objectively there are obvious reasons for the interposition e.g. asset protection.

More on the Part IVA schemes alleged in the *Guardian* appeal

At first instance, the Commissioner relied on a Primary Scheme, which started with the incorporation of the CB, and covered the 2013, 2013 & 2014 tax years. Alternatively, he relied on narrower schemes dealing with what happened in each year, and the 2013 scheme did not involve the incorporation of the CB. On appeal, he did not rely on the Primary Scheme nor on the 2014 scheme.

Presumably he abandoned reliance on the Primary Scheme as the circumstances were different in each year so he risked running an "all or nothing" case? The mere creation of the CB was not argued to be part of the 2013 scheme. Making the CB presently entitled was part of the scheme in both the 2012 and 2013 years. However, the Commissioner did not argue that any tax benefit from the use of the CB was egregious i.e. an actual payment and retention of trust income by the CB to attract the 30% corporate tax rate[18] was not argued by him to a subset of a wider Part IVA scheme, which could have stood alone? As stated above, presumably he abandoned reliance on the 2014 scheme, as in that year, the CB entered into a complying Div 7A loan, which itself was not objectionable?

The relevance of identifying the scheme is that the question of whether there is a "tax benefit", is answered by postulating what would have happened but for the scheme.

It has been said that the narrower the scheme, the more likely it is that Part IVA would apply, as a narrower scheme (if "not robbed of all practical meaning") will disregard the ultimate step which gives rise to the different tax result in determining the reasonable alternative postulate. The wider the scheme, the more chance is that there are more reasonable postulates as to what would happen but for the scheme. This is the point Thawley was making.

Further, the wider the scheme, the less likely that viewed objectively, a party to the scheme would have had the dominant purpose of obtaining the tax benefit. For instance, if the decision to carry on business in a company is the starting point of the scheme, the fact that there will be a deferral of "top-up" tax in the hands of the shareholder is explicable by commercial reasons e.g. the limitation of liability from the carrying on of the business, and the decision not to pay dividends or even draw a salary - to allow the company working capital to expand. If the scheme is narrowed to the decision to

[18] It was certainly acceptable to the Commissioner in his original PCG on income splitting and professional practices. Cryptically, at [207] Hespe J says that the fact that a tax benefit exists doesn't mean the dominant purpose must have been to achieve that tax benefit, referring to *Hart* and *Ashwick*. If the CB in *Guardian* had provided asset protection, then this comment might have been of more use, but as she rejected the CB had that purpose, what was its purpose other than to achieve a tax benefit?

not declare a dividend, or not to pay a salary, clearly the shareholder will have the benefit of tax deferral as a result of that choice[19].

The decision on appeal in *Guardian* might be seen to be a function of multiple factual findings which did not support the professed interest in asset protection, viz:

> "220 The s 177D factors are not in the nature of a mathematical equation adding up two different sides of a notional ledger. The evaluative task required by s 177D is more nuanced. Here, it seems to us critical to consider what was driving the **form** of the transactions.
>
> 221 The learned **primary judge concluded** (at PJ [184]) **that the dominant purpose of Mr Springer, Guardian and AITCS was, on and from 27 June 2012, the minimisation of risk to Mr Springer in his transition to retirement and having a new corporate beneficiary in the AIT's eligibility class to serve as a vehicle for wealth accumulation and passive investment. However, as explained above, the particular form of the identified schemes included the declaration and payment of the franked dividend by AITCS to the AIT following the creation of AITCS's unpaid present entitlement and the distribution by AIT of that franked income to Mr Springer. The declaration and payment of those dividends ultimately to Mr Springer was not consistent with either of the commercial benefits identified by the primary judge**.
>
> 222 As the chronology of events demonstrates, the **manner** in which the 2012 related scheme came to be entered into and carried out, and the **form** which it came to take, were the products of an **evolving set of circumstances**. It was not a scheme that objectively any party could be seen to have entered into for the dominant purpose of enabling Mr Springer to obtain a tax benefit in the year ended 30 June 2012. Furthermore, given that there was no objective basis for expecting, prior to 30 June 2012, that AITCS would declare a dividend to AIT, it would not be concluded that any of the persons who carried out the scheme after that time did so for the dominant purpose of enabling Mr Springer to obtain a tax benefit in the year ended 30 June 2012. The steps carried out in 2013 do not, with hindsight, take on a character that they did not objectively have at the time they were in fact carried out.
>
> 223 By contrast, the form of the 2013 related scheme was not the product of an evolving set of circumstances, but was the implementation of a strategy that had been developed with the evolution and implementation of the 2012 related scheme. The 2013 related scheme commenced with the creation in AITCS of a present entitlement, the benefit of which (at the time of its creation in June 2013) would not objectively be expected to be retained by AITCS but was to pass to Mr Springer. In our view, it would be concluded that a party entering into or carrying out the 2013 related scheme did so for the dominant purpose of enabling Mr Springer to obtain a tax benefit in the **form** of the non-inclusion of an amount in his assessable income in the year ended 30 June 2013." (bolding & underlining added)

In note the expression "in our view" in [223] above, which would seem to suggest that whilst this was Hespe J's judgment, it had input from the other appeal judges[20].

[19] That deferral of tax can be tax avoidance is apparent from the words "of that year of income" in s177C(1).

[20] There is at least one other use of the expression in her Honour's judgment. As her Honour was new to the Court, her judgment agreed with by the other judges appears to be a quaint custom, which was also followed in the High Court in *Mills* case, where Gaegler J was the new member, and his judgment was agreed to by all other judges.

Is the Antecedent Transaction Test Really "Dead"?

It has always been the case that if one starts off with the best structure, the risk of the application of Part IVA is lesser than if a sub-optimal structure is the starting point and a restructure is effected to get the situation where it should always should have been[21]. That is, there is no prior (antecedent) situation that is changed[22]. I hear you say but this is a "muffled echo of an old argument"?

For the first 25 years of the life of Part IVA, the various Commissioners were heard to say that the predication test in *Newton's* case would guide the practical approach to whether Part IVA applied[23]. However, the closest the Courts got to saying that was Gleeson CJ & McHugh in *Hart* where they said a lower tax result did not automatically trigger Part IVA, e.g. a decision (choice?) to rent a building and get deductions for rent as again buying the building, was not assailable under Part IVA. Another "muffled echo" perhaps as well (the "choice" test under s260[24]). Only in the dividend stripping part of *Consolidated Press Holdings* at [108] did the High Court actually refer to the EM to the introduction of Part IVA to inform the purpose of s177E. Had the High Court in *Peabody* or *Spotless* (the first two cases to get to the High Court), actually referred to the second reading speech of John Howard and to the EM, that Part IVA was only directed as "blatant, artificial and contrived" schemes might we have landed in a different place to where we are now? The scars of the Barwick High Court (which created a tax avoidance industry e.g. *Slutkzin*, *Curran*), were too much to bear by the successor High Courts.

Explanatory Memorandum to 2013 Amendments

Interestingly, what Part IVA is directed at was also repeated in the EM to Taxation Law Amendment (Countering Tax Avoidance and Multinational Profits Shifting) Bill 2013, which effected the 2013 Part IVA amendments, viz:

> "1.10 The explanatory memorandum accompanying Part IVA explained that Part IVA was 'designed to overcome' the difficulties with section 260 and 'provide — with paramount force in the income tax law — an effective general measure against those tax avoidance arrangements that — inexact though the words may be in legal terms — are **blatant, artificial or contrived**' (see explanatory memorandum, Income Tax Laws Amendment Bill (No 2) 1981).
>
> 1.11 Further, the explanatory memorandum made it clear that the 'test for application' of Part IVA was 'intended to have the effect that arrangements of a **normal business or family kind**, **including those of a tax planning nature**' would be beyond the scope of Part IVA.
>
> 1.12 The distinction between tax avoidance and legitimate commercial and family arrangements was emphasised by the then Treasurer in his second reading speech on the Bill. There he stated that Part IVA **was not intended to 'cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs**'.
>
> 1.13 Part IVA gives effect to this distinction by requiring an examination of whether, having regard to eight objective matters (including the manner in which an arrangement was entered into, its form and substance, and the taxation results it produces), it would be concluded that

[21] The professed reason for the introduction of the Div 328-G rollover for Small Business Entities.
[22] FCT v *Gulland* (1985) 160 CLR 73; *Mullens v FCT* (1976) 135 CLR 302.
[23] This was even though Murray Gleeson QC and the late Graham Hill (as they then were), settled the drafting of Part IVA and clearly did not directly refer to the predication test. See further, GT Pagone, "Part IVA: The General Anti-Avoidance Provisions in Australian Tax Law", 27 Melb Uni Law Review 770 at 775-6.
[24] *WP Keighery Pty Ltd v Commissioner of Taxation* (1957) 100 CLR 66; *Cridland v FCT* (1977) 140 CLR 330 at 338-340.

the arrangement **was entered into in the particular way** it was for the sole or dominant purpose of obtaining a tax advantage.

1.14 Part IVA does not inquire into the subjective motives of taxpayers and it **does not therefore strike at every arrangement that is entered into with an eye to tax minimisation**. This has been established by decisions of the High Court of Australia. Their Honours Gleeson CJ and McHugh J said in *Commissioner of Taxation v Hart* (2004) 206 ALR 207 (*Hart*) at [15]:

> '… the fact that a particular commercial transaction is chosen from a number of possible alternative courses of action because of tax benefits associated with its adoption does not of itself mean that there must be an affirmative answer to the question posed by s 177D. Taxation is part of the cost of doing business, and business transactions are normally influenced by cost considerations. Furthermore, even if a particular form of transaction carried a tax benefit, it does not follow that obtaining the tax benefit is the dominant purpose of the taxpayer in entering into the transaction. A taxpayer wishing to obtain the right to occupy premises for the purpose of carrying on a business enterprise might decide to lease real estate rather than to buy it. Depending upon a variety of circumstances, the potential deductibility of the rent may be an important factor in the decision. Yet, **if there were nothing more to it than that, it would ordinarily be impossible to conclude, having regard to the factors listed in s 177D, that the dominant purpose of the lessee in leasing the land was to obtain a tax benefit. The dominant purpose would be to gain the right to occupy the premises**, not to obtain a tax deduction for the rent, even if the availability of the tax deduction meant that leasing the premises was more cost-effective than buying them.'

1.15 It does not follow, however, that Part IVA is incapable of applying to arrangements that also advance wider commercial objectives. **There is no 'dichotomy' between a 'rational commercial decision' and 'the obtaining of a tax benefit**' (see Gummow and Hayne JJ in *Hart* (2004) 206 ALR 207 at [64]).

1.16 The High Court has confirmed on a number of occasions that Part IVA will apply to an arrangement if the **particular form** in which the arrangement is implemented evinces the requisite tax avoidance purpose (see *Federal Commissioner of Taxation v Spotless* (1996) 141 ALR 92 (*Spotless*) at pp 97-98 and 105, and *Hart (2004) 206 ALR 207* at [16][52] and [94]).

1.17 More particularly, as Callinan J observed in *Hart* (2004) 206 ALR 207 at [94], 'an aspect of' the direction in Part IVA to consider the 'form and substance' of a scheme 'is whether the **substance** of the transaction (tax implications apart) **could more conveniently, or commercially, or frugally have been achieved by a different transaction or form of transaction**.' (bolding added)

The Full Court in *Guardian* saw no need to look at the EM to see what s177CB(4)(b) intended. On the other hand, the decision in *Minerva* (at [260]-[261] did recite the EM as to what the 2013 amendments were intended to achieve, but not the preamble to the EM as to the history of the introduction of Part IVA. In the end, as the taxpayer conceded the existence of a tax benefit in all three schemes in *Minerva*, the judge did not have to apply the amendments, which he said could have been relevant to the third scheme.

Use of EMs

Clearly the EM cannot dictate the meaning of the statutory text. In *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 it was said at [39]:

> "This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself." (references omitted)

This was applied in both *Guardian* and *BBlood cases, viz:*

Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT [2021] FCA 1619:

> "The occasion, as expressed in the relevant explanatory memorandum (Explanatory Memorandum to the Income Tax Assessment Bill (No.5) 1978 (Cth)), for the insertion of s 100A into the ITAA 1936 and its place in the general scheme for the taxation of trust income is described in the joint judgment of Hill and Sackville JJ (Beaumont J agreeing) in *Federal Commissioner of Taxation v Prestige Motors Pty Ltd* (1998) 82 FCR 195 (Prestige Motors). However, as is later made plain in *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503, to begin with such subjects would apt to distract from a necessary starting point, which is the text of the relevant provision. …" at [127]

BBlood Enterprises Pty Ltd v FCT [2022] FCA 1112:

> "Contrary to the applicants' submissions, the terms of s 100A(7) should not be read down so as to be limited to the specific types of mischief which were identified in the 1978 EM as then being of concern. Legislative history and extrinsic materials cannot displace the meaning of the statutory text: *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55; 250 CLR 503 at [39]. What the legislature is presumed to have intended is to be resolved by reference to the text and structure of the statute and appropriate reference to extrinsic material; the presumed intention is not derived primarily from the extrinsic material. If the provision was intended to capture only the kinds of arrangements identified in the 1978 EM, one might have expected a more focussed provision. The broad language of s 100A(7) indicates it was intended to capture all arrangements which fell within its terms, whether or not they were of a type which existed as at the time of the 1978 EM, with exclusionary work to be done by ss 100A(8) and (13). That is precisely what one would expect in this kind of anti-avoidance context" at [122]

However, whilst from the judiciary's perspective, the meaning of the statutory text[25] cannot be dictated by the EM, everyone else, including the parliamentarians themselves, assume the EM properly describes what the Bill before the Parliament is designed to do, and will go about their affairs

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[25] The High Court also now regards the text of contracts and trust deed to have the same mode of interpretation: see recently in relation to contracts – *CFMMEU v Personal Contractors Pty Ltd* [2022] HCA 1 at [59]-[61], and in relation to trusts *Byrnes v Kendle (*2011) 254 CLR 253 at [53].

accordingly. As it is understood the Parliamentary Draftsman did not settle the terms of the EM drafted by the ATO/Treasury back in 2013, the repeating of what was said in the 1981 EM in the 2013 EM is somewhat disingenuous by ATO/Treasury, when, by 2013 it was clear that the guidance provided in 1981 has been completely overtaken by court decisions that have had no regard to the 1981 EM.

Assumptions as to Statutory Intention

Peter Greensill Family Co Pty Ltd (trustee) v FCT [2020] FCA 559

> ".... The role which legislative history and extrinsic material can take in the task of statutory construction was explained by the High Court in *Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at [39]…
>
> "Much of the applicant's argument proceeded upon an assumption that there existed a policy objective of not taxing foreign beneficiaries of resident trusts in respect of CGT events in relation to CGT assets which were not taxable Australian property. The applicant's process of construction then analysed the statutory provisions through this lens. This approach falls foul of the caution expressed in *Certain Lloyd's Underwriters v Cross* (2012) 248 CLR 378 at [26] that a danger to be avoided in construing a statute is making an a priori assumption about a statute's purpose and construing the statute to coincide with the assumption. The correct process is the inverse: the purpose is to be derived from what the legislation says, not from an assumption about the desired or desirable operation of the provisions. The policy objective asserted by the applicant is not to be found in the legislative history identified above and nor is it supported by the terms of former s 160L of the ITAA 1936 or the capital gains tax regime when it was introduced." at [70]

And on appeal, *Peter Greensill Family Co Pty Ltd (Trustee) v FCT* [2021] FCAFC 99

> "…, underpinning the appellants' arguments about the proper construction of div 855 is the a priori assumption that Parliament did not intend that foreign residents be taxable on gains from non-taxable Australian property. As the High Court cautioned in *Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Cross*], in construing legislation the purpose of legislation must be derived from what the legislation says, not from any assumption about the desired or desirable reach or operation of the provisions: see also *Carr v Western Australia.*. Nothing in the express statement of objects of div 855 in s 855-5 or in the extrinsic material warrants a construction by reference to that a priori assumption, to the disregard of the text of ss 855-10 and 855-40. To the contrary, the contrast between ss 855-10 and 855-40 demonstrates that Parliament specifically directed its attention to when, and in what circumstances, a foreign beneficiary is entitled to an exemption under div 855. Section 855-40(1) makes this clear in the identification of the legislative purpose or the exemption in relation to interests through fixed trusts" at [70] (citations omitted)

Under s260, the antecedent transaction test was to the effect that if you haven't changed anything, s260 couldn't apply. It is not suggested that if you start with an egregious structure, there can be no Part IVA problem, but starting with a company owning the income producing assets and generating franking credits that could only ever go to one shareholder who happens to be a non-resident at the time, could only be a problem if the aspect of going non-resident was part of the scheme. Often this will only be the case where the foreign residence was necessarily temporary and there was objective

evidence that it was effected for the purpose of receiving tax-free fully franked dividends. If the new country of residence is not a tax haven, then such a conclusion would be less likely.

If the investee companies in the *Guardian* case had been owned by a company what was owned by a DT, the income of the company would always have been franked and there would have been no Div 7A problem if the income had stayed in the company or dividend-ed out. As the ATO did not argue the principal becoming a non-resident was part of a scheme, the alternative postulate to paying the principal a fully franked dividend, would have been for the company to retain the funds indefinitely (rejected by Hespe J), but for him to become the sole signatory on the company's bank account (not mentioned by Hespe J).

If the trust "silo" in the *Minerva* case was in existence from the beginning, and the owner of the units was a non-resident (without special units held by Australian resident entities), it is hard to see that Part IVA could have applied.

<u>Other issues with Guardian</u>

Hespe J says Mr S was subsequently a resident of NZ. Logan J said after Vanuatu he was a resident of Australia (at [57]) but doesn't mention NZ). I observe that if Mr S got a franked dividend whilst resident in NZ or Australia he would have had top-up tax.

There was no express finding of fact as to who were the signatories to the bank accounts for DT nor CB, at all times, only that Mr S did not "control" the bank account of CB, at least in the 2012 and 2013 tax years (query 2014 tax year). Logan J accepted that Mr S was the only signatory to the DT bank account in 2012 (at [102]). However, Logan J found that all UPEs from 2014 and 2015 were paid in full to CB in March 2016, without any reference to who was the signatory to CB's bank account at that time (at [116]).

There were no findings of fact as to why Mr S did not "control" CB's bank account[26]. Alternative postulates may have including him taking control of the account. It is curious that there was no finding of fact as to who "controlled" DT's bank account after 2012 (when there was the finding by Logan J that Mr S was the only signatory), because presumably it was the main bank account. It is inferred by me that CB's tax liability was discharged by a payment to the ATO by DT, rather than DT paying funds into CB's bank account from where it was paid to the ATO.

Hespe J says 2013 entitlement would not have been put on Div 7A loan agreement with the DT (at [164][27]) or 7 or 10 year sub-trust (at [162][28]), yet a Div 7A loan agreement was entered into in 2014 with the DT, and Mr S at one stage preferred a 7 year sub-trust, and indeed entered into 10 year sub-trust in 2013 as a "back-up".

Hespe J says alterative postulate had to result in Mr S getting the cash, whereas he was the principal of the whole structure. Nor was the prospect of the CB entering into a Div 7A loan agreement direct with Mr S canvassed. Saying he had to get the cash (at [162]), is like effectively applying s177CB(2),

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[26] The evidence that he would find it difficult to write cheques from Vanuatu seems strange as by 2013 internet banking would have been more common.

[27] Her Honour said Mr S "evidenced no desire for a loan agreement" – I suggest this is a different thing as to whether the was a reasonable postulate that there could be one, as there was in 2014.

[28] Also referred to in that para as a Div 7A loan agreement as though it is the same thing as the 7 or 10 year sub-trust ("investment agreement").

that is, there were no alternative postulates to him getting the cash, rather than s177CB(3) applying to allow alterative postulates. He would have “got the cash” if he had entered into a Div 7A loan agreement with the CB but that OBVIOUS alternative postulate was not referred to, presumably because it was not raised by the taxpayer?

That alternative postulates were not accepted by the taxpayer doesn’t mean they weren’t reasonable alternative postulates. When a taxpayer decides to go one way rather than another, he necessarily rejects the alternatives. The real question is whether there were reasonable alternatives, not whether the taxpayer rejected them. That Hespe J says there was only one “recommendation” out of the three alternatives set out by Pitcher Partners (at [98]), what does it matter that one may have been ”recommended” if the others were actually viable?

It must be remembered that in *Minerva*, it was conceded that there was a tax benefit, so the battleground moved to dominant purpose. In *Guardian*, it was not conceded that there was a tax benefit, so what happened needed to be compared to a reasonable alternative postulate, and the finding of Hespe J (somewhat unconvincing in my respectful view), was that there wasn’t one.

It is not clear from the judgments whether the taxpayer’s filed the evidence of the emails and letters they sent their client, or that the material was obtained under compulsion using the Commissioner’s statutory powers. As the advisers were accountants, the advice they provided was not privileged, but query the “accountants concession”. Had the correspondence been between taxpayer and their lawyer, the privilege could have been claimed and then it would have been more likely that whether there was a dominant purpose would have been viewed by looking at the alleged schemes themselves, rather than “out of the mouths” of the taxpayer and their lawyers. However, this needs to bear in mind the onus of proof is on the taxpayer.

<u>More on the Part IVA schemes alleged in the *Minerva* case</u>

The summary prepared by the Court said:

Broadly speaking, the three schemes alleged were as follows:

> “(1) The first scheme comprised the establishment of corporate and trust “silos”, and the nomination of Minerva Holding Trust (**MHT**) as the residual income unitholder of the securitisation trusts established from 2009, and directing income from the securitisation trusts through MHT.
>
> “(2) The second scheme comprised the transfer of ownership of Minerva Financial Group Trust (**MFGT**) from the applicant to the ultimate parent company, Jupiter Holdings BV, in December 2007, and the failure of the applicant, as trustee of MHT, to distribute more than only nominal amounts of MHT’s distributable income to the corporate silo, instead distributing the majority of income to the trust silo.
>
> “(3) The third scheme was similar to the second scheme, except that it did not involve the transfer of ownership of MFGT from the applicant to Jupiter.”

I note that the various schemes commenced to take place before the 2013 amendments to Part IVA, but at [262] the judge said that the third scheme could have been subject to the amendments[29] had the taxpayer not conceded that it has received a tax benefit under all three schemes.

As the first scheme didn't involve the transfer of ownership of MFGT to the non-resident ultimate owners, but only steps taking place before the change in ownership, it might be regarded as a narrow scheme. The Commissioner's reliance on it failed as the steps in the first scheme were commercially motivated to allow the structure to go to an IPO. It put the interest income to be earned from securitisation into a trust structure so that it would be taxed at the marginal rate of residents or subject only to 10% withholding tax in the hands of non-residents, whereas before, the interest income would first be subject to 30% company tax in the hands of *Minerva*.

The second scheme was held to be subject to Part IVA. It was also a narrow scheme in the sense that it did not include the creation of the corporate and trust "silos". If the ownership of MFGT had not been transferred from the taxpayer to the non-resident entities, the income could have been subject to 30% corporate tax in the hands of *Minerva*.

The third scheme omitted the transfer of ownership and only focused on the appointment of income to the non-resident beneficiaries (the ultimate owners of the group). The Court held that was also a Part IVA scheme. Again, it is a narrow scheme.

Unlike in *Guardian*, whilst the Commissioner did start with a broad scheme commencing with the creation of the trust and corporate "silo" and ending with the appointment of income to the non-resident owners, his first scheme ended earlier, with the appointment of income to MHT.

In relation to the second and third schemes in Minerva, the judge said:

> "[494] While the various contentions set out above were said to be relevant to the second and third schemes, it seems to me that the submissions regarding the applicant's **failure to exercise its discretion** to distribute, or to distribute more, to MHT's special unitholders is the **true gist of both the second and third schemes**.
>
> [515] ….As Mr Looney said in his closing address, and I agree:
>
> Firstly, what's clear is that before the schemes versus after the schemes, income was flowing through to the foreign owner. Previously, it – the income stopped at the domestic level and didn't flow through to the ultimate owner. Now income did flow through.
>
> What's important to recognise is that the amount that flowed through after the restructure, after the schemes, was an amount that was greater than it would have been if income was paid previously under the old structure because of the reduced incident of tax – 20 per cent of the amount of income paid. So while there's an economic benefit that we do accept was received by the foreign owner, it's an enhanced economic benefit attributable in – to that extent to the tax benefit. And the fact of it being paid through to the owner, we say, is because of the tax benefit of the scheme**. It may be inferred that but for the tax benefit it wouldn't have been paid through to the owner**, the inference being drawn based on it wasn't when there was a tax impost that would have occurred by a declaration from LF." (bolding added)

[29] At [303] he explains that as the third scheme took place in each year, for the tax years 2013-2015 the amendments were relevant.

It was noteworthy, but not determinative in the judge's view, that the income was not paid to the non-resident owners, but set off against debt.

In some ways, the third scheme in *Minerva* is like the 2012 & 2013 schemes in *Guardian*, in that it is the final decision as to where the income would go which creates the tax benefit, not the whole of the background to how that position is reached.

More Garden Variety Trust Distributions

Where there are at least two beneficiaries of a DT, s177CB(2) is unlikely to be applicable as the choice is not that one beneficiary gets all the income, or the other, but each may get some distribution, and perhaps the trustee might accumulate some or all the income. Thus, s177CB(3) requires an examination of a reasonable alternative postulate to the taxpayer getting all the trust income.

The strictures of s177CB(4)(b) post 2013, do not allow an examination of the tax position of i.e. "tax effect" on, an alternative beneficiary to the one who got the distribution. This is a point Slater made. What that means is that there may have been a beneficiary on a lower marginal tax rate than the beneficiary who received a distribution, but in determining "tax benefit", that can't be taken into account. Where it is presumably taken into account is whether in distributing to a higher rate taxpayer, there would have been a dominant purpose of a party to the scheme, of achieving a tax benefit.

So, let's take the example of adult children who are on a higher marginal rate but have a need for money due to a house mortgage and school fees, and their parents who are on a lower marginal rate and have no need for funds as they are self-funded retirees drawing a tax-free pension from their super fund. The DT was set up by the parents. There is no regular history of the DT making distributions to the adult children. Is distributing to the parents a tax benefit in the defined sense? Certainly, that a lower marginal rate of tax is payable *prima facie* is a "tax benefit" in the ordinary sense of the word. Is it a reasonable postulate that absent the scheme, the distribution would have been to the adult children? In testing that, as a result of s177CB(4)(b) you can't look at the tax rate of the adult children. All that you see is that the beneficiaries that received the distribution pay less than the top marginal rate of tax on it. However, as there is no regular history of making distributions to adult children, that postulate is probably not a reasonable alternative. If there is no history of the DT accumulating the income, that is probably not a reasonable alternative postulate. So, even though the DT was set up by the parents, making a distribution to themselves upon which they pay a low marginal rate, would be a "tax benefit" in the defined sense. However, the dominant purpose of them distributing to themselves would not be to achieve that "tax benefit", as that would be the "natural" history of the DT.

Would it be different if the DT was set up by the adult children with no regular history of the DT making distributions to the parents, but the decision was now made to make the parents presently entitled but leave the entitlement as a UPE? Section 100A would probably be a problem if there was an agreement to leave the entitlement as a UPE, but not if it was happenstance that the parents did not call on their entitlement (relying on the Full Court in *Guardian*). There is a "tax benefit" in the ordinary sense, but in the defined sense, you can't look at the tax effect for the adult children. Accordingly, there is a tax benefit in the defined sense. However, it is a reasonable postulate that the adult children would have received trust distributions but for the scheme, as that is what has happened historically and consistent with the DT having been set up by the adult children

Commissioner's selection of cases in which to apply Part IVA

Due to the wide potential application of Part IVA, unfortunately the reality is that taxpayers need to hope that the Commissioner uses good judgement as to what cases he should peruse using Part IVA. An unfortunate example of him going "too far" was his test case program to test the application of Part IVA to "mum & dad" partnerships. However, after his loss in the case of *Ryan* [2004] AATA 753 (a decision of Downes J sitting as AAT President), on the basis that each partner in a partnership has real economic consequences and liabilities, he abandoned his quest.

Conclusion

One cannot help feel that after the *Guardian* appeal, Part IVA is a real threat to making trust distribution decisions (even where there is actual payment, not just creation of a UPE), based on the tax profile of the beneficiaries, unless there is a strong commercial purpose or personal need for the income by that beneficiary[30], although there is nothing "blatant, artificial or contrived" nor complexity, in a trust making actual distributions within a family group (as defined in the legislation).

After *Minerva*, a restructure to allow non-resident owners to obtain 10% interest withholding tax rather than 30% corporate tax rate is a real risk, even though if that structure was in place from day one (i.e. no antecedent transaction), the choice to set up a trust structure rather than a company structure would probably be unassailable.

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22.03.23

[30] Especially since the Victorian Court of Appeal decision in the *Owies* case [2022] VSCA 142: see "Owies – is this the end of trustees' unfettered discretion", Sladen Legal website 10.08.22.
[31] Comments on the draft of this paper were kindly provided by Neil Brydges of Sladen Legal but any errors herein are mine alone.