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Tax Planning v Tax Avoidance: Simply an Objective Test?

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Tax Planning v Tax Avoidance: Simply an Objective Test?

Abstract
Tax planning is the arrangement of one’s financial and business affairs so as to comply with taxation laws at the lowest possible tax cost. Tax avoidance on the other hand endeavours to convey the illusion that a transaction complies with the literal meaning of the law while seeking to obtain a tax advantage not intended by the law. One of the roles of anti-avoidance rules\(^1\) is to assist taxpayers, tax professionals and tax administrators to distinguish the two concepts.

Tax avoidance is more likely to be present where aggressive tax planning strategies have been employed. The hallmarks of aggressive tax planning strategies include the presence of contrived or artificial arrangements, little or no real underlying business activity or purpose and complete or substantial removal of any risk to the taxpayer.

This paper reviews the current state of play in relation to distinguishing tax planning and tax avoidance. Recent court decisions where anti-avoidance rules have been applied (eg. Cumins v FC of T [2006] FCA 43; VCE v Commissioner of Taxation [2006] AATA 821) are evaluated to determine what additional insights these decisions can deliver. In addition recent administrative guidelines issued by the Australian Tax Office (eg Practice Statement PS LA 2005/24) are reviewed.

The paper concludes that distinguishing between tax planning and tax avoidance requires the application of a relatively simple objective test but taxpayers, tax professionals and tax administrators face practical difficulties in applying that test to a range of commercial and financial transactions.

\(^1\) Part IVA Income Tax Assessment Act 1936 contains the general anti avoidance rules while Division 165 A New Tax System (Goods and Services Tax) Act 1999 provides the GST anti-avoidance rules.
**Tax Planning v Tax Avoidance: Simply an Objective Test?**

**Introduction**

Tax planning\(^2\) is concerned with the organisation of a taxpayer’s affairs within the letter and the spirit of the law so that they give rise to the minimum tax liability. By contrast tax avoidance while also seeking to reduce the overall tax liability does it by complying with the letter of the law but not necessarily with the spirit of the law. A characteristic of tax avoidance schemes generally involves the entry into contrived or artificial transactions. Because of the proximity of meaning between the two terms\(^3\) tax avoidance is sometimes described as aggressive tax planning.

**Aggressive Tax Planning**

Aggressive tax planning refers to schemes or arrangements (in the broad sense of those words) that are designed to obtain benefits under revenue laws that were not intended to be available.\(^4\)

> Aggressive tax planning undermines the integrity of the tax system. Left untreated, aggressive tax planning will erode community confidence in the fairness and equity of the tax system.\(^5\)

Aggressive tax planning can be identified by reviewing the characteristics of the transaction which may include some or all of the following features:\(^6\)

- contrivance and artificiality in the method of execution;
- little or no real underlying business activity or purpose;
- the claimed tax benefit may be significant in realising an economic return;
- complete or substantial removal of any risk to the taxpayer;
- the contrived transfer of a tax benefit;
- limited or non recourse financing associated with a round robin arrangement;
- little cash outlay associated with borrowing of funds under a capitalising debt facility;
- a mechanism for winding up or exiting an arrangement before net income is generated for an investor;
- assumptions, including 'blue sky' projections, that can lead to seemingly excessive valuations of assets resulting in inflated deduction claims;
- use of tax exempt entities to wash income;
- transactions involving tax havens;
- use of superannuation funds for purposes other than retirement income;
- interposed entities which have no substantial commercial rationale except to create a tax benefit; and
- transactions which do not appear to be legitimate business dealings.

**Tax Planning v Tax Avoidance**\(^7\)

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\(^2\) Tax planning is sometimes described as tax mitigation.

\(^3\) Tax planning and tax avoidance.


\(^5\) Paragraph 1 ATO Practice Statement Law Administration PS LA 2005/25: Aggressive tax planning end-to-end process.

\(^6\) Paragraph 7 ATO Practice Statement Law Administration PS LA 2005/25: Aggressive tax planning end-to-end process.
While the theoretical difference between tax planning (operating within both the spirit and letter of the law) and tax avoidance (operating within the letter of the law but not the spirit of the law) is quite clear the courts have found difficulty over time in distinguishing the two concepts based on a range of factual scenarios. Lord Nolan in IR Commrs v Willoughby [1997] 3 All ER 65 at p 73 stated that:

“The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation (tax planning), on the other hand, is that the taxpayer takes advantage of fiscally attractive options afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option. Where the taxpayer’s chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer’s purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax.”

Anti-Avoidance Rules

This paper will review the operation of the general anti-avoidance rules contained in Part IVA Income Tax Assessment Act 1936 and the GST anti-avoidance rules in Division 165 A New Tax System (Goods and Services Tax) Act 1999. It is noted that the general operation of the two sets of rules is quite similar but this paper will confine itself to analysing the purpose test in each set of rules.

General Operation of Part IVA

The comments of the Australian Treasurer when introducing the Part IVA legislation stated the objective of the law or the policy underlying the law as follows:

“.. Pt IVA is designed to operate against "blatant, artificial, or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs"."9

It is evident that that policy of the Australian general anti-avoidance provisions is to counter blatant, artificial or contrived arrangements. There is evidence that Australian courts have attributed these hallmarks to cases where the general anti-avoidance rules have applied.10

Part IVA is not a self-operating provision and requires the Commissioner to exercise his discretion to cancel a 'tax benefit' that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.12

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7 Tax evasion (which is a term related to tax avoidance and tax planning) is the non-payment of the tax which would properly be chargeable to a taxpayer if the taxpayer made a full and true disclosure of assessable income and allowable deductions. It usually involves the failure to declare income and/or the claiming of deductions or tax offsets to which the taxpayer knows that he or she has no legitimate entitlement.
8 Part IVA ITAA 36 is a provision of last resort as provided for in s 177B(3) and s 177B(4).
9 Comments of the then Treasurer when introducing the general anti-avoidance legislation.
11 It replaced the former s 260 Income Tax Assessment Act 1936 because of perceived problems with the operation of s 260.
12 See s 177F(1) ITAA 36 in relation to the Commissioner’s powers to cancel a tax benefit.
While there are individual elements to the Part IVA rules the provision must be interpreted as a whole. In other words while a tax benefit may exist this will not be sufficient for Part IVA to apply if the dominant purpose of the scheme was not to derive the tax benefit. Part IVA cannot apply unless a taxpayer has obtained, or would, but for section 177F obtain, a tax benefit in connection with a scheme. There are four kinds of tax benefit, as follows:

(i) an amount not being included in the assessable income of the taxpayer of a year of income;
(ii) a deduction being allowable to the taxpayer in relation to a year of income;
(iii) a capital loss being incurred by the taxpayer during a year of income;
(iv) a foreign tax credit being allowable to the taxpayer.

The reference in paragraph (i) to ‘an amount not being included in the assessable income of the taxpayer’ is a reference to an amount not being included that would be or might reasonably be expected to be included in the taxpayer's assessable income under the counterfactual scenario(s). Case 14/2006 provides substantial discussion on the operation of the reasonable expectation test and the counterfactuals raised by the taxpayer in that case. This case is discussed at length later in this paper.

It is noted that tax benefits that arise from the making of a declaration, agreement, election, selection or choice, and the relevant scheme was not entered into or carried out by any person for the purpose of creating any circumstance or state of affairs the existence of which is necessary to enable the election or choice to be made will not be subject to Part IVA etc. to be made. Conversely the relevant tax benefit will not be excluded if it was obtained in connection with a scheme that was entered into or carried out by any person for the sole or dominant purpose of enabling that person or any other person to make the election or choice etc.

**Counterfactuals and the purpose test**

A counterfactual scenario could be described as an alternative hypothesis or what would have happened or might reasonably be expected to have happened if the particular scheme had not been entered into or carried out. The identification of a tax benefit must be done in recognition of the alternative hypothesis and the counterfactuals form a backdrop for the operation of the objective purpose test which is used to determine whether the relevant taxpayer had a dominant purpose of gaining the tax benefit. It is recognised that the reasonable expectation test requires more than a possibility and involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.

**Subjective and Objective Tests**

A subjective evaluation is based on somebody’s opinions or feelings rather than strictly on facts or evidence. In relation to a subjective purpose we need to determine an individual’s purpose to determine whether a particular provision applies. By comparison an objective evaluation should be free of any bias or prejudice caused by personal feelings where a determination is based on facts rather than individual thoughts or

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13 Federal Commissioner of Taxation v Peabody 94 ATC 4663; 28 ATR 344.
15 Subsection 177C(1) ITAA 36.
16 Subsection 177C(1)(a) ITAA 36.
18 Subsection 177C(2) ITAA 36.
19 Subsection 177C(2) ITAA 36.
20 Subsection 177D ITAA 36.
21 Federal Commissioner of Taxation v Peabody 94 ATC 4663 at 4671; 28 ATR 344 at 353.
opinions. An objective purpose can be determined independently of an individual mind or perception. In a theoretical sense an objective evaluation should produce a better result when compared with a subjective evaluation and this is no doubt why Part IVA was designed with an objective purpose test.

**The Purpose Test in Section 8-1 Income Tax Assessment Act 1997**

The second positive limb of s 8-1\textsuperscript{22} uses a purpose test and given the significant amount of litigation that section has received over the years it is appropriate to review the manner in which this test is interpreted particularly in relation to whether a subjective or objective test is used. Section 8-1\textsuperscript{23} provides as follows:

\begin{enumerate}
\item You can deduct from your assessable income any loss or outgoing to the extent that:
\item it is incurred in gaining or producing your assessable income; or
\item it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.
\end{enumerate}

Wilcox J in [Federal Commissioner of Taxation v Creer\textsuperscript{24}] confirmed that there were at least two type of purpose when interpreting the application of s 51(1)\textsuperscript{25} (which has been replaced by s 8-1) as follows:

``Purpose'' may refer to the taxpayer's subjective purpose: the end which he or she seeks to achieve by incurring the expenditure. It may mean objective purpose, the object which the incurring of the expenditure is apt to achieve.

It is evident from this quote that a subjective purpose is in the mind of the taxpayer while an objective purpose will be evident from the facts. The question then is whether the courts in interpreting s 8-1\textsuperscript{26} (or s 51(1))\textsuperscript{27} have given equal weight in their interpretation to subjective purposes or objective purposes. Wilcox J\textsuperscript{28} went on to discuss the concept of purpose as follows:

``An objective purpose is attributed to a transaction by reference to all the known circumstances; whereas subjective purpose and motive, being states of mind, are susceptible of proof not by inference alone but also by direct evidence, for a state of mind may be proved by the testimony of him whose state of mind is relevant to a fact in issue.''

The evidence in the present case\textsuperscript{29} shows that the incurring of expenditure for `rent' was in every sense a voluntary act of the taxpayer. Not only did the taxpayer choose to enter into the transaction; he was the author of its form. Consequently, it is relevant to have regard to his purpose in

\begin{footnotes}
\item[22] Income Tax Assessment Act 1997.
\item[23] Income Tax Assessment Act 1997.
\item[24] 86 ATC 4318.
\item[25] Income Tax Assessment Act 1936.
\item[26] Income Tax Assessment Act 1997.
\item[27] Income Tax Assessment Act 1936.
\item[28] In FCT v Greer 86 ATC 4318.
\item[29] The facts in Greer were that the taxpayer made a pre-payment of rent for five years for a commercial property and then a company related to the taxpayer purchased the underlying property for substantially less than it would have paid because the value of the underlying property was reduced because of the fact that the vendor of the property would retain the pre-paid rent and that the new owner would not receive rental income for five years. In other words the prepayment of rent made by the taxpayer achieved a reduction in the capital cost of the building. The court concluded that the rental expense was of a capital nature.
\end{footnotes}
determining whether that expenditure should be characterised as being upon capital or revenue account.

Wilcox J went on to discuss the concept of purpose as follows:

Here, objective purpose and subjective purpose coincide. Subjectively, as he stated in his evidence and following a reference to the derivation of rental income, the ``prime purpose'' of the taxpayer was to seek an investment for myself through Edisea rb Pty. Limited to purchase properties where there was a reasonable chance of good capital gain and, in regard to those two purposes, to secure for myself a tax benefit. The ``two purposes'' — rental income and capital gains — being achievable without resort to prepaid leases, the answer makes plain that the only reason for their creation — and the consequent incurring of expenditure for prepaid rent — was the desire to secure a taxation advantage.

Brennan J in Magna Alloys & Research Pty Ltd v Federal Commissioner of Taxation\(^{30}\) considered the matter of subjective and objective tests of purpose and concluded as follows in relation to an objective purpose:

Similarly, when the question is whether expenditure is incurred in gaining or producing assessable income, the connection between the advantage for the taxpayer which the incurring of the relevant expenditure is calculated to effect and the taxpayer's income-earning undertaking or business must be considered. If the advantage can be sufficiently identified by reference to a contract, and the taxpayer's undertaking is known, the connection between the incurring of the expenditure and the undertaking is manifest, and it would be otiose to refer to the purpose of incurring the relevant expenditure.

**Legal Rights Approach**

This extract appears to be indicating that where the facts of the matter are clear and relationships have been determined through contract then on an objective basis there is no need to determine the subjective purpose of the taxpayer. Brennan J’s approach here would appear to align with a more traditional legal rights approach to the interpretation of purpose. This legal rights approach was applied in cases such as Cecil Bros Pty Ltd v FCT\(^{31}\) (see also FCT v South Australian Battery Makers Pty Ltd (1978) 140 CLR 645; 78 ATC 4412 for a similar approach) wherein the contractual basis or the form of the transaction was deemed to be more persuasive when compared with the substance of the transaction. Owen J rationalised the conclusion that the expense for trading stock was deductible on the basis that:\(^{32}\)

> The fact that the taxpayer paid more for its purchases than it would have paid had it dealt direct with the manufacturers or wholesalers in order that Breckler Pty. Ltd. might make a profit out of the transactions does not, in my opinion, prevent the amount which it in fact paid from being regarded, for the purposes of s. 51(1), as an outgoing incurred in gaining its assessable income. It seems to me that the contention really is that the taxpayer paid more for its goods than it should have. But `it is not for the Court or the commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent' (Ronpibon Tin N.L. and Tongkah Compound N.L. v. Federal Commissioner of Taxation (1949) 78 C.L.R. 47, at p. 60 and the cases therein cited).”

Brennan J\(^{33}\) by contrast went on to clarify that a legal rights approach could not be taken as conclusive and that the subjective purpose of the taxpayer needed to be determined:\(^{34}\)

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\(^{30}\) 80 ATC 4542 at paragraph 4544.

\(^{31}\) (1964) 111 CLR 430.

\(^{32}\) At paragraph 434.

\(^{33}\) Magna Alloys & Research Pty Ltd v Federal Commissioner of Taxation.
But purpose is relevant to describe an element of connection between expenditure and a taxpayer’s undertaking or business in cases where a taxpayer incurs expenditure or agrees to incur expenditure without any antecedent obligation to do so or where the occasion of the expenditure (unlike the purchase of trading stock) is not manifestly to be found in whatever is productive of assessable income or in whatever would be expected to produce assessable income, or in the carrying on of a business.

It would appear in this extract that Brennan J is clearly recognising that where voluntary expenditure is incurred then the purpose of the taxpayer may need to be considered. The need to determine the purpose of the taxpayer was clearly stated by Brennan J as follows: 35

Though purpose is not the test of deductibility nor even a conception relevant to a loss involuntarily incurred, in cases where a connection between an outgoing and the taxpayer’s undertaking or business is affected by the voluntary act of the taxpayer, the purpose of incurring that expenditure may constitute an element of its essential character, stamping it as expenditure of a business or income-earning kind.

In other words Brennan J is recognising that if the subjective purpose of the taxpayer is known this may assist in determining the essential character of the expenditure and accordingly assist in determining whether the expense relates to the earning of assessable income.

The discussion in this paper to date particularly the comments of Brennan J may in some small way be appearing to suggest that where the subjective purpose of the taxpayer shows a relationship with earning of assessable income then the relevant expenditure may be deductible. This may appear to be going too far by placing too much emphasis on the taxpayer’s stated intention or purpose. Clearly there is a concern that given that the taxpayer will have an economic interest in the outcome it is highly likely that the taxpayer’s stated intention would be that the relevant expenditure was to earn assessable income. The question then is how do we reconcile Brennan J’s approach which indicates a need to determine subjective purpose (in association with an objective purpose) with the concern that the taxpayer may modify their stated subjective purpose to achieve a desired tax outcome or favourable decision?

The answer to this question appears to be that the subjective purpose should be determined objectively. In other words while recognising the need to consider the subjective purpose 36 any perceived taxpayer bias in determining the subjective purpose would be reduced by determining the subjective purpose objectively.

**Objectively Determined Subjective Purpose and Section 8-1** 37

Brennan J’s discussion in Magna Alloys clearly set a platform for change in the way in which the subjective intention of the taxpayer could be taken into account in determining whether expenditure was incurred for the purpose of earning assessable income. While the decision in Magna Alloys was favourable to the taxpayer subsequent decisions which considered the subjective purpose of the taxpayer were not treated so favourably. A good example can be seen in the case of Ure v FCT 38 where a significant proportion of interest deductions were denied to the taxpayer because the court concluded that the taxpayer’s subjective purpose was to gain a personal or non-income earning benefit from the use of monies borrowed. Deane and Sheppard JJ’s comments outline their concerns in relation to the purpose of the taxpayer: 39

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34 At paragraphs 4588-4589.
35 Paragraph 4547.
36 Brennan J’s approach in Magna Alloys.
38 81 ATC 4100.
39 Paragraph 4100.
One of the most difficult aspects of the problem of characterizing an outgoing is the assessment of what, if any, weight is to be given to indirect objects which a taxpayer had in mind in incurring the outgoing. Such objects form part of the relevant circumstances by reference to which the problem of characterization must be resolved. There is however no rigid principle which can be applied in determining what, if any, weight should be given to them. In the ordinary case, such as, for example, where the immediate object achieved by the outgoing is the production of assessable income which is commensurate with the amount of the outgoing or where it is clear that the outgoing was for the purchase of stock-in-trade or the acquisition of services or hire of equipment used in earning assessable income, indirect objects or motives of a personal or domestic character will plainly not prevent the characterization of the outgoing as having been incurred in earning assessable income (see, for example, Cecil Bros. Pty. Ltd. v. F.C. of T. (1964) 111 C.L.R. 430; Phillips v. F.C. of T. 77 ATC 4169). In other cases, the immediate object or effect of an outgoing will not suffice either to explain or to characterize it. In such cases, indirect objects or motives can assume a sometimes decisive importance.

Deane and Sheppard JJ appear to be suggesting that the transaction (incurring interest at a rate of around 12% and receiving around 1% in interest from the on-lending of this money to his wife and family company) cannot be explained by reference to the earning of assessable and that the taxpayer must have had other objects or motives (subjective motives) in entering into this transaction. Their honours went on to state how they determined these subjective motives as follows:

In the present case, it would be a misleading half-truth to say that the object which the taxpayer had in mind or the advantage which he sought in incurring the liability to pay interest at rates of 12.5% or more was the derivation by him of interest at the rate of 1% per annum by re-lending the money which he borrowed. That was, no doubt, an object which the taxpayer had in mind: it was an advantage which he sought. In the circumstances however, characterization of the outgoing cannot properly be effected by reference to that object or advantage alone. The incurring of the outgoing can only be explained by reference also to less direct objects and advantages which the taxpayer sought to achieve and which plainly were of paramount importance. These indirect objects or advantages were, in so far as the taxpayer was concerned, not of an income-earning character in that they involved the provision of accommodation for the taxpayer and his family, the financial benefit of the taxpayer’s wife and a family trust and a reduction in the taxpayer’s personal liability to pay income tax...

The strength of conviction that their honours had in identifying the subjective purpose is clear from the language that they used (..That was, no doubt, an object which the taxpayer had in mind…) or in other words the court had confidently determined the subjective purpose of the taxpayer objectively. The court went on to conclude as follows that the taxpayer had two purposes and that the deductibility of the interest expense should be apportioned between the competing objectives:

In the result, the outlays of interest can be seen as servicing a number of objects indifferently. The predominant, though indirect, objects were not concerned with earning assessable income for the taxpayer but were, for the purposes of sec. 51(1), of a private and domestic nature. The object of earning assessable income in the form of interest was present in a subordinate role. If, in these circumstances, apportionment were not possible and it were necessary to give a single characterization to the whole of the interest which was paid, we would conclude that the interest could not be characterized as having been incurred in earning assessable income and that its primary characterization was as being of a private or domestic character. It is however established that apportionment is, in these circumstances not only permissible but required.

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40 At paragraph 4110.
41 At paragraph 4110.
In this extract their honours clearly come to the conclusion that the dominant purpose of incurring the interest expense was a non-income earning purpose and on this basis they would have been happy to deny the deduction fully but for the fact that the general deduction provision\textsuperscript{42} enables the expense to be apportioned. It is recognised that the mathematical quantification of purpose is a difficult task but their honours had no difficulty in apportioning the expense between the income earning and non-income earning purpose on the basis of the income earned. They concluded that the interest expense should be deductible to the extent of the income earned.\textsuperscript{43}

The discussion so far in this paper appears to be suggesting that where voluntary expenditure is incurred that the subjective purpose of the taxpayer is more relevant to determine if the expenditure was incurred for an income earning purpose. Wilcox J in Anderson v FCT\textsuperscript{44} concluded similarly:\textsuperscript{45}

\ldots in doubtful cases of voluntary expenditure purpose may be relevant, even decisive, in determining whether there is the necessary nexus between a particular outgoing and the gaining or producing of assessable income. In other cases the position will be so clear that purpose is of no consequence. Thus, if particular expenditure was clearly incurred in the gaining or producing of assessable income, it is deductible notwithstanding that the money may have been spent with some other purpose in mind. Conversely, if there was no actual nexus between the expenditure and the gaining or producing of assessable income, a purpose of gaining or producing assessable income will not suffice. In the vast majority of cases, no doubt, purpose and actuality will coincide.

The concern of the courts in relation to incurring voluntary expenditure was also explored in Fletcher and Ors v FCT.\textsuperscript{46} In this case the taxpayers had entered into a complex annuity investment scheme in 1982 which involved the purchase of an annuity by the partnership for $2.02m, of which $2m and the interest payable on the $2m were financed by a `round robin" of bills of exchange. Under the scheme, substantial tax deductions would be available to the partnership in the first five years, small deductions in the following five years and very large taxable receipts over the last five years. However, the scheme provided a mechanism whereby the adverse tax consequences of the last five years could be avoided. The taxpayers claimed in their 1981/82 to 1984/85 personal tax returns their share of the partnership loss while the Commissioner disallowed the claims and the taxpayers objected. Initially the Commissioner sought to apply Part IVA\textsuperscript{47} but the case was finally heard by the Full High Court in relation to the purpose test in s 51(1).\textsuperscript{48}

The High Court concluded that the deductibility of interest depended on whether the investment scheme would run its full term which was a question of fact to be determined by remitting the case to the AAT. The AAT\textsuperscript{49} concluded that the annuity scheme was constructed on the premise that the various agreements would be terminated at some time before the first 10 years had elapsed to avoid earning substantial assessable income that would be derived in the final five years. The AAT concluded that the dominant purpose of the taxpayers in entering into the scheme was directed to minimising a possible increase in tax liability.

Mason CJ, Brennan, Deane, Dawson, Toohey, Guadron and McHugh JJ indicated that they would not have been concerned with the subjective purpose of the taxpayer where the income derived was greater than the deductions claimed:\textsuperscript{51}

\begin{itemize}
    \item Section 51(1) ITAA 36 or section 8-1 ITAA 97.
    \item The deduction was approximately equivalent to a deduction for 1% of the interest incurred.
    \item 89 ATC 4982.
    \item At paragraph 4991.
    \item 91 ATC 4950.
    \item General anti-avoidance provisions Income Tax Assessment Act 1936.
    \item 88 ATC 113.
    \item Income Tax Assessment Act 1936 – now s 8-1 ITAA 97.
    \item 92 ATC 2045.
    \item Paragraph 4957 and 4958.
\end{itemize}
Nonetheless, it is commonly possible to characterise an outgoing as being wholly of the kind referred to in the first limb of s. 51(1) without any need to refer to the taxpayer's subjective thought processes. That is ordinarily so in a case where the outgoing gives rise to the receipt of a larger amount of assessable income. In such a case, the characterisation of the particular outgoing as wholly of a kind referred to in s. 51(1) will ordinarily not be affected by considerations of the taxpayer's subjective motivation. If, for example, a particular item of assessable income can be earned by making a lesser outgoing in one of two possible ways, one of which is a loss or outgoing of the kind described in s. 51(1) and the other of which is not, it will ordinarily be irrelevant that the taxpayer's choice of the method which was tax deductible was motivated by taxation considerations or that the non-deductible outgoing would have been less than the deductible one. In such a case, the objective relationship between the outgoing actually made and the greater amount of assessable income actually earned suffices, without more, to characterise the whole outgoing as one which was incurred in gaining or producing assessable income. If the outgoing can properly be wholly so characterised, it "is not for the Court or the commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent".

The High Court\textsuperscript{52} however was clearly concerned with the subjective purpose of the taxpayers in incurring the interest expenditure on the particular annuity scheme given that the assessable income earned was less than the amount of deductions claimed:

\begin{quote}
The position may, however, well be different in a case where no relevant assessable income can be identified or where the relevant assessable income is less than the amount of the outgoing. Even in a case where some assessable income is derived as a result of the outgoing, the disproportion between the detriment of the outgoing and the benefit of the income may give rise to a need to resolve the problem of characterisation of the outgoing for the purposes of the sub-section by a weighing of the various aspects of the whole set of circumstances, including direct and indirect objects and advantages which the taxpayer sought in making the outgoing. Where that is so, it is a "commonsense" or "practical" weighing of all the factors which must provide the ultimate answer. ...If, upon consideration of all those factors, it appears that, notwithstanding the disproportion between outgoing and income, the whole outgoing is properly to be characterised as genuinely and not colourably incurred in gaining or producing assessable income, the entire outgoing will fall within the first limb of s. 51(1) ... If, however, that consideration reveals that the disproportion between outgoing and relevant assessable income is essentially to be explained by reference to the independent pursuit of some other objective and that part only of the outgoing can be characterised by reference to the actual or expected production of assessable income, apportionment of the outgoing between the pursuit of assessable income and the pursuit of that other objective will be necessary.
\end{quote}

The High Court accordingly concluded that because the subjective purpose of the taxpayers was not solely to earn assessable income that the interest deductions should be limited to the assessable income earned.

The foregoing discussion in relation to the application of a purpose test to the general deduction provision would appear to conclude as follows:

\begin{itemize}
  \item where the outgoing is involuntary or incurred for commercial expedience and the legal rights secured are in accordance with the expenditure incurred that the courts will not need to question the subjective purpose of the taxpayer;
\end{itemize}

\textsuperscript{52} Mason CJ, Brennan, Deane, Dawson, Toohey, Guadron and McHugh JJ in Fletcher.
where the outgoing is voluntary and/or no clear relationship exist with the earning of assessable income then the courts will need to review the subjective purpose of the taxpayer. The subjective purpose of the taxpayer will need to be determined objectively.

**Purpose Test and Part IVA**

Section 177D provides that Part IVA applies to a scheme in connection with which the taxpayer has obtained a tax benefit if, after having regard to eight specified factors, it would be concluded that a person who entered into or carried out the scheme, or any part of it, did so for the purpose of enabling the taxpayer to obtain the tax benefit. The test in s 177D(b) is an objective test and is central to the operation of Part IVA. Section 177D provides as follows:

This Part applies to any scheme that has been or is entered into after 27 May 1981, and to any scheme that has been or is carried out or commenced to be carried out after that date (other than a scheme that was entered into on or before that date), whether the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia, where-

(a) a taxpayer (in this section referred to as the "relevant taxpayer") has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme; and

(b) having regard to-

(i) the manner in which the scheme was entered into or carried out;
(ii) the form and substance of the scheme;
(iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
(iv) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
(v) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
(vi) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
(vii) any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi), of the scheme having been entered into or carried out; and
(viii) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in subparagraph (vi), it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme or of enabling the relevant taxpayer and another taxpayer or other taxpayers each to obtain a tax benefit in connection with the scheme (whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers).

Section 177D refers to 'the purpose' of the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme. The person need not be the taxpayer. Subsection 177A(5) clarifies that the 'purpose' includes the dominant purpose where there are two or more purposes. The dominant of two or more purposes is the ruling, prevailing or most influential purpose. In FC of T v Spotless Services Ltd & Anor (supra), Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ said at ATC 5206; CLR 416:

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53 Income Tax Assessment Act 1936.
“Much turns upon the identification, among various purposes, of that which is ‘dominant’. In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose.”

It is possible for Part IVA to apply notwithstanding that the dominant purpose of obtaining the tax benefit was consistent with the pursuit of commercial gain. The key issue under Part IVA is whether the particular scheme, or any part of it, was entered into or carried out by any person for the relevant purpose having regard to the objective factors in paragraph 177D(b).

**Objective Purpose Test and Part IVA**

It is recognised that an objective purpose rather than a subjective purpose must be determined and the relevant objective purpose must have been determined without reference to the taxpayer’s subjective purpose. While it is recognised that a taxpayer involved in a particular scheme may have a subjective purpose s 177D requires an objective conclusion as to purpose to be reached having regard to objective facts. The earlier discussion in this paper on the purpose test in s 8-1 concluded that when interpreting the concept of “purpose” for s 8-1 that an objective test should be used for the most part but in cases where the expenditure was voluntary or the transaction exhibited non-commercial attributes that the subjective purpose of the taxpayer should be considered. While s 8-1 takes into account the subjective purpose of the taxpayer it is noted that the subjective purpose of the taxpayer will for the most part be determined objectively.

The eight matters in s 177D(b) are to be each individually taken into account for the scheme having regard to all the relevant evidence, and then weighed together, in arriving at the conclusion as to dominant purpose. The design of the eight factors in s 177D(b) indicates that they consist of three overlapping sets:

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...... The first set is about how the scheme was implemented: how its results were obtained. It comprises the first three factors in subparagraphs (i), (ii) and (iii) of paragraph 177D(b) and deals with manner, form and substance, and timing. The second set comprises the next four factors in subparagraphs (iv), (v), (vi) and (vii) of paragraph 177D(b) and deals with the effects of the scheme: the tax results, financial changes, and other consequences of the scheme. The third set is the eighth factor in subparagraph (viii) of paragraph 177D(b) which deals with the nature of any connection between the taxpayer and other parties.... The eight factors are considered against the background of the counterfactual ....
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In essence the first set review how the scheme was implemented, the next set review the effect of the scheme while the final factor looks at the nature of the relationship between the taxpayer and any other person who was part of or related to the scheme.

The second set of factors clearly require a comparison to be made between what actually happened and what might reasonably be expected to have happened if the scheme had not been entered into or carried out. In other words the terminology used in the second set of factors and the terminology used in s 177C(1) (in relation to the definition of tax benefit) indicate that there must be a comparison between the relevant scheme and what might reasonably have been expected to happen in the absence of the scheme (the alternative postulate).

**Applying Part IVA in Cumins v FC of T**

56 2006 ATC 4084.
The brief facts of this case were that the taxpayer was the trustee of a discretionary trust (Trust A) and in the relevant year of income that trust derived a capital gain of approximately $787,375 from the sale of a parcel of shares. The trust also owned other shares which it had borrowed money from the National Australia Bank to purchase. The bank was entitled as attorney to deal with the shares and received dividends from the shares. On 12 June 1998 a second trust ("Trust B") was created. The taxpayer acted as trustee for Trust B, which was also formed for the benefit of the taxpayer and his family. On the same day, the taxpayer as trustee of Trust A sold 8 million of the shares to himself as trustee of Trust B for $1.6m. The sale was affected by an unsigned agreement, Trust B did not pay for the shares and the NAB was not informed of the sale. The sale resulted in Trust A incurring a capital loss of $800,000, which reduced its assessable income (capital gain) for the year by $800,000.

The Commissioner issued an amended assessment in accordance with Part IVA increasing the taxpayer's assessable income for the year ended 30 June 1998 by $800,000 together with interest and penalties. The Commissioner contended that the taxpayer had obtained a tax benefit in connection with a scheme to which the anti-avoidance rules in Pt IVA applied. The relevant scheme identified involved the establishment of Trust B, the sale of the shares to it and the consequent reduction in the capital gain derived by Trust A in the 1998 year.

The issues before the court included whether, in the year of income, the applicant in his capacity as trustee of his family trust (Trust A) had incurred a capital loss in the sum of $800 000 under Pt 3-1 of the Income Tax Assessment Act 1997 and, if so, whether Pt IVA of the Income Tax Assessment Act 1936 operated to deem that no part of the capital loss had been incurred.

At first instance the Tribunal having considered the relevant factors in s 177D(b) found that a reasonable person would conclude that the applicant, as trustee of Trust A, carried out the scheme with the sole purpose of obtaining the identified tax benefit. The taxpayer in his appeal against the Tribunal’s decision contended that the Tribunal had mis-applied Part IVA. Nicholson J was not persuaded by the taxpayer’s argument that the Tribunal had mis-applied Part IVA and he said:

..... Part IVA requires the decision-maker to have regard to the eight objective factors posited in s 177D(b) of the 36 Act. If a reasonable person would conclude from those factors that the sole or dominant purpose of one or more of the participants in the scheme was to enable the taxpayer to obtain a tax benefit, the decision-maker is empowered to make a determination under s 177F cancelling the tax benefit. The fact that the scheme may have been "genuine or directed at crystallising a loss" does not preclude the application of Pt IVA. In the present case, the Tribunal considered the matters it was required to have regard to by s 177D(b) and found that it would be concluded that the applicant entered into the scheme for the purpose of obtaining the tax benefit.

Some discussion took place on whether the transaction being the transfer of the shares from Trust A to Trust B was in fact a transfer that gave rise to a disposal of the shares and an application of CGT event A1. In relation to this Nicholson J said:

I also agree that the scheme in the present case could hardly be described as "a genuine transaction which crystallises losses actually incurred on the value of listed shares". No economic loss was suffered as a result of the scheme. The beneficial ownership of the shares remained under the sole and complete control of the applicant who retained the power to distribute the benefit of the shares.

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57 Cash Converters International Limited.
59 2006 ATC at paragraph 4091.
60 Section 104-10 ITAA 97.
61 2006 ATC at paragraph 4091.
to himself and/or to such other members of his family as he thought fit and in his unfettered discretion. The legal ownership of the shares remained with the Bank as security for the debt owed by the Trust. The scheme was such that it was open for it to be found that it was in the character of a contrivance to create a capital loss for the purpose of the income tax legislation in order to reduce the amount of the net capital gain that the Trust would otherwise be required to return by reason of other sales that had given rise to capital gains.

It is evident from this extract that Nicholson J does not go as far as stating that the transaction is not genuine but he is certainly suggesting that given that no economic loss has been suffered the transaction can hardly be considered to be a normal commercial transaction. The taxpayer in his argument suggested that the transaction was a normal transaction similar to a wash sale where a capital loss is triggered by the sale and re-purchase of shares in a company in liquidation. A wash sale allows a taxpayer to lock-in capital losses for tax purposes even though the fall in share or asset price may be temporary.

Taxation Ruling IT 2643 is titled "Income Tax: Sale of Shares in Companies in Liquidation, Receivership ('Wash Sales')" and provides discussion on the potential application of Part IVA to wash sales. The Commissioner in that ruling state:

4. Before any consideration of the application of Part IVA to such arrangements in relation to shares in companies in liquidation, it is necessary to determine whether there can legally be an effective transfer of shares (i.e. in accordance with the Corporations Act 1990 and the subject company's Articles).

5. Assuming that shares in a particular case are effectively transferred, the question of whether Part IVA might apply would depend on the facts of the particular case, applying the tests set out in section 177D. In this connection, we do not accept a proposition that share arrangements between related parties such as family members are precluded from the possible application of Part IVA.

6. However, subject to these reservations and to the terms of Taxation Ruling IT 2500, a transfer of shares in a company in liquidation would not, as a general rule, attract the application of Part IVA where:
(a) absolute control and ownership of the shares are validly and effectively transferred;
(b) the shares are transferred at a true market value; and
(c) there is no intention, arrangement or understanding at the time of transfer that the shares are to be re-acquired."

The Commissioner’s argument contended that the factors in paragraph 6 were not present. While Nicholson J did not clarify why he agreed with the Commissioner on this point it is suggested that paragraph 6(a) could not be satisfied on the grounds that absolute control and ownership was not validly and effectively transferred. This observation is based on the fact that the taxpayer still retained control over the shares that were transferred to Trust B and he still retained some beneficial ownership of the shares.

The taxpayer also suggested that Taxation Determination TD 95/4 could also apply to support an argument that Part IVA did not apply. The determination provides that of itself a simple disposition of an income producing asset by a natural person to a wholly owned private company is not an arrangement to which the Commissioner will seek to apply Part IVA of the Income Tax Assessment Act 1936 (the Act). The determination however tempers its guidance as follows.

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62 Income tax: does the simple disposition of an income producing asset by a natural person to a wholly owned private company constitute the carrying out of a scheme to which Part IVA of the Income Tax Assessment Act 1936 will be applied?
63 Paragraph 2 of the determination.
2. It should be noted however that where there are other associated transactions, transfers or arrangements, whether antecedent or subsequent, the disposition will be examined within that broader context, and it may be concluded that Part IVA of the Act should be applied.

The Determination goes on to provide the following example: 64

Example 1:
Geoff holds a significant portfolio of shares in a number of public companies. Most of these pay out fully franked dividends. Geoff disposes of his shares to a wholly owned private company which has been newly incorporated for that purpose. The intention is that the earnings from the shares will be retained in the company until such time as it is considered appropriate to declare and pay a dividend to Geoff.

The underlying intention in this case appears to be the transfer of the shares to a company to enable the company to derive the dividend income and the individual taxpayer to defer deriving that income until such a time that their tax rate equated to the company rate of tax. It could be argued that there is a tax benefit present here being the non inclusion of the dividend income in the taxpayer’s income in the years after the shares were transferred. Notwithstanding if the transfer took place in accordance with paragraph 6 of Taxation Ruling IT 2643 and the legal and beneficial ownership of the shares has been transferred at market value with no intention to re-acquire the shares Part IVA should not apply.

Another example in TD 95/4 relates to the transfer of real property: 65

Example 2:
Anna holds a rental property. The initial intention was that the property would be negatively geared. However, because of an unexpected reduction in interest rates a net profit is now being returned. Anna disposes of the property to a wholly owned private company which has been newly incorporated for that purpose. The intention is that the rental earnings from the property will be retained in the company until such time as it is considered appropriate to declare and pay a dividend to Anna.

Here again the underlying objective of the transfer is to defer the derivation of income until a time that the taxpayer’s marginal rate of tax has been reduced and again a reduction in assessable income has occurred and a tax benefit derived. It could be suggested that the dominant purpose of the scheme was to gain the tax benefit. However as suggested earlier in relation to example 1 if the transaction took place in accordance with paragraph 6 of Taxation Ruling IT 2643 then it may be argued that Part IVA applied.

A further example is provided in Taxation Determination TD 95/4 in relation to the transfer of shares which have the potential to derive capital gains: 66

Example 3:
Karl holds a parcel of shares in XYZ Pty Ltd which currently have an indexed cost base of $10,000, and a market value $15,000. The shares were acquired by Karl after 19 September 1985. Karl wishes to sell the shares to finance another investment, and prior to arranging the sale, he disposes of the shares to his wholly owned family company (or alternatively disposes of them to a wholly owned private company which has been newly incorporated for that purpose). The company sells the shares, retains the gain, and makes the new investment. The Commissioner will not seek to apply Part IVA to these facts alone. However, if for example there were objective evidence of an antecedent arrangement to sell the shares, suggesting that the use a private company was no more

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64 Paragraph 2 of the determination.
65 Paragraph 2 of the determination.
66 Paragraph 2 of the determination.
than a late contrivance the dominant purpose of which was simply to reduce the level of tax on that sale, it is likely that Part IVA would be applied.\textsuperscript{67}

Here again we can see there is a tax benefit derived from the transaction and it is only in the last sentence does the example suggest that Part IVA may be applied. On balance it can be seen that the taxpayer could have felt that he had an argument that his transfer of the shares from Trust A to Trust B would have been effective and not caught by Part IVA. Nicholson J however rejected the taxpayer’s arguments as follows:\textsuperscript{68}

\begin{quote}
The applicant argues that in not dealing with "wash sales" the decision of the Tribunal fell into error, undermining its decision in several respects. The first was that it did not have regard to the availability of alternative transactions which could have been implemented to produce a wash sale effect. The second was the context of the non-applicability of Pt IVA to CGT, an issue addressed in the previous ground. The third was that a number of public tax rulings reflect the practice of the respondent to not apply Pt IVA to wash sales of shares even when they occur (as may be usual) near the end of the financial year and involve re-acquisition of the same number of shares. These considerations are said by the applicant also to have importance to whether the position taken by the applicant was reasonably arguable in relation to the imposition of penalties by way of additional tax (ss 222C and 226(2)(a) of the 36 Act) or whether it was defensible for the purposes of the exercise of the discretion to remit any additional tax pursuant to s 227(3) of the 36 Act.
\end{quote}

Nicholson J went on to discuss whether it was appropriate for the taxpayer to rely on Taxation Ruling IT2643 and Taxation Determination TD 95/4 and concluded on balance that the taxpayer could have placed some reliance on these authorities in establishing a reasonably arguable position. Having agreed that some reliance could be placed on the authorities his honour then went on to reject the taxpayer’s arguments that relied on these authorities as follows:\textsuperscript{69}

\begin{quote}
There is nothing in the rulings, however, to support the applicant's ground of appeal or his submissions. Taxation Determination 95/4 concerns the "simple disposition of an income-producing asset by a natural person to a wholly-owned private company"…. None of the rulings are relevant to the transaction carried out by the applicant in the present case. Moreover all rulings state that Pt IVA may apply to the arrangements with which they are concerned depending upon the particular facts and circumstances. In my view it follows that this ground cannot be made out.
\end{quote}

In rejecting the taxpayer’s arguments his honour appeared to have the following reasons:

- the examples used in the relevant rulings were exhaustive;
- the principles established should be confined to the facts in the particular rulings;
- even if the rulings applied they could not be relied upon where there was objective evidence that the taxpayer’s objective was to derive a tax benefit.

\textbf{Reasonable Expectation Test}

The taxpayer in Cumins\textsuperscript{70} argued that the Tribunal did not take full account of the alternative actions or counterfactuals in concluding that Part IVA applied. Particularly the taxpayer argued that if the sale of the shares to Trust B did not occur that a sale to another party would have occurred. In addition the taxpayer argued that there were commercial advantages associated with Trust A disposing of the shares. The

\textsuperscript{67} Note: In the above examples, it is assumed for the purposes of this Determination, that the capital gains tax rollover relief provisions (section 160ZZN of the Act) (now Subdivision 122-A Income Tax Assessment Act 1997) would apply to the disposal of the assets to the wholly owned company.

\textsuperscript{68} 2006 ATC at paragraph 4092.

\textsuperscript{69} 2006 ATC at paragraph 4092.

\textsuperscript{70} Cumins v FC of T 2006 ATC 4084.
commercial advantages the taxpayer argued were the removal of those shares from the scope of the creditors of Trust A because Trust B did not have any commercial exposure.

For an alternative action to be considered to be reasonable it must be possible for it to occur. The tribunal observed that it would have been necessary for the bank to give approval for a sale to another party to have occurred. The question then was whether it was reasonable to expect that the bank would have given such approval. The Tribunal states its concerns as follows:  

...It is unlikely that the bank would have consented to a sale of 8 million of the shares to realise a loss, without repayment of the loan, for the same reasons the applicant decided not to seek its consent to such a sale. So the Tribunal finds for the purposes of s 177D(a) of the Act that the applicant, as trustee of the trust, obtained a tax benefit connected with the scheme identified by the respondent because, in the circumstances of this matter, it is unreasonable to expect that the applicant would have incurred the capital loss had the scheme not been carried out. The scheme identified by the respondent includes the sale of 8 million of the shares at the capital loss.

It is clear that the Tribunal was arguing that there was no alternative hypothesis and that the only avenue available to the taxpayer was to undertake the transaction in the manner that the transaction was carried out. The taxpayer had suggested that the alternative action was possible but it brought with it certain commercial disadvantages including the risk of driving share prices down, paying brokerage and making the Bank nervous. Both the Tribunal and Nicholson J concluded that given that the commercial disadvantages of the alternative actions existed then the alternative action was not reasonable. Nicholson J stated it thus:  

Given the identification of those disadvantages, the evidence that the applicant had not approached the Bank and the absence of any evidence from the Bank, it was open to the Tribunal to infer that it was unlikely the Bank would consent to the sale for the same reasons the applicant decided not to seek its consent to such a sale.

In other words the Tribunal and Nicholson J were concluding that on the basis that the taxpayer undertook the transaction in the manner that he did provided further support of the contention that the alternative hypothesis was not reasonable. Nicholson J said:  

The Tribunal correctly held that a reasonable expectation requires more than a possibility citing Peabody that it "involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable".

In relation to the commercial advantages being the protection of the shares from attach by the creditors of Trust A Nicholson J considered that nothing was achieved in this regard by the transfer of the shares to Trust B:  

The commercial advantage identified by the applicant of protecting the shares from the creditors of the Trust was not one achieved by the scheme. This was because the Bank both before and after the scheme retained legal title to the shares as security for the debt. The debt created by the scheme between the two trusts was one which it was open to the creditors of the Trust to access at some future time.

The Manner … Scheme was Entered Into or Carried Out ... Form and Substance of the Scheme

72 2006 ATC at paragraph 4093 and 4094.
73 2006 ATC at paragraph 4094.
74 2006 ATC at paragraph 4094.
The first factor to consider in s 177D is the manner in which the scheme was entered into or carried out. This test looks at whether the scheme was contrived or artificial and it would appear that the transaction demonstrated a certain amount of contrivance given that it could be argued that there was no reasonable alternative hypothesis. In determining an objective purpose for s 177D, the form and substance of the transaction needs to be considered. Nicholson J agreed with the Tribunal that the sale was not carried on in an ordinary manner or in the correct form because the shares were mortgaged to the bank and for the correct procedure to have been followed it would have been necessary for approval from the bank to be achieved for the sale to have taken place.

Nicholson J went on to state that there was a disconnection between the form and substance of the sale agreement and clarified his position as follows:

The form of the transaction was the sale and transfer of shares free from encumbrances. In substance, legal title to the shares remained with the Bank unaffected and untouched by the transaction, and the beneficial title remained with and under the sole control of the applicant. The explanation for the difference between the form and substance of the scheme lies on the evidence only in the generation of a capital loss for the purposes of the income tax legislation. Section 177D(b)(ii) of the 36 Act required the Tribunal to take the form and substance of the scheme into account.

The Time at Which the Scheme Was Entered Into….

The timing of the transaction is a further important consideration. This will include consideration of the time the scheme, or any part of it, was entered into or carried out, and the length of the period during which it was carried out. This factor will enable consideration of the extent to which the timing and duration of the scheme go towards delivering the relevant tax benefit or are related to commercial opportunities or requirements. The taxpayer in Cumins argued that in relation to the time that the scheme was entered into was similar to the normal actions of investors managing their share portfolio at the year end. Nicholson J recognised this as follows:

Ground 4.7 contends that when considering the timing of the transaction as being close to the end of the year, the Tribunal failed to take into account the relevant consideration that holders of share portfolios regularly enter into such transactions near the end of the financial year pursuant to Pt III of the 36 Act.

The court in concluding that the timing of the transaction exhibited a tax avoidance purpose provided the following reasons:

- The sale of the shares on 11 June 1998 which generated a capital gain prompted the sale of the shares on 12 June 1998 to generate the capital loss. In other words the proximity of the transaction to generate the capital loss to the transaction that generated the capital gain indicated that the transaction to generate the capital loss was motivated by the desire to generate a tax benefit.

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75 Section 177D(b)(i)(ii) ITAA 36.
76 ITAA 36.
77 2006 ATC at paragraph 4094.
78 2006 ATC at paragraph 4095.
79 Section 177D(b)(iii) ITAA 36.
80 Section 177D(b)(iii) ITAA 36.
81 2006 ATC at paragraph 4095.
82 The Tribunal and Federal Court.
If there was no transaction on 11 June 1998 it was expected that no transaction would have taken place on 12 June 1998 leading to a conclusion that the transaction on 12 June 1998 was motivated only by a tax avoidance object.

The sale of the shares on 12 June 1998 was not a transaction that was carried out in an ordinary manner (as already discussed in this paper) and accordingly it was not open to the taxpayer to argue that he had undertaken a transaction in a manner similar to other taxpayers. Nicholson J stated in relation to this matter: 83

In the light of those findings, the asserted regular practice of other holders of shares is immaterial. Moreover there was no evidence before the Tribunal supporting the assertion that "wash sale" transactions are common at the end of financial years.

The Effect of the Scheme 84

The second set of factors in s 177D focus on the tax, financial and any other consequences or effect of carrying out the scheme. These factors require consideration of the tax result, financial change and any other consequences of the scheme for the taxpayer and for related parties. The taxpayer in Cumins suggested that the Tribunal did not address these factors individually in its judgement that Part IVA applied. Nicholson J recognised this factor as follows: 85

The applicant contends that the Tribunal was not entitled to consider all the above matters in s 177D globally and was obliged to consider them individually and give reasons in respect of each.

It is noted that a court does not need to consider each and every factor if a particular factor is not relevant. Nicholson J went on to conclude that it was open to the Tribunal to conclude globally in relation to the factors: 86

Reading the reasons as a whole, the Tribunal has sufficiently set out both the substance of its material findings and the reasons for reaching them. It cannot be said in the circumstances that the Tribunal has failed to meet the requirements …. or has otherwise erred in law. In my view it cannot be said that the global expression of the Tribunal with respect to items raised by this ground has the consequence that there was no consideration of the factors.

The Nature of the Connection...

The eighth factor 87 inquires into the nature of the connection between the taxpayer and any other person whose financial position is reasonably expected to change as a result of the scheme or for whom there are any other consequences from the scheme. This factor was considered globally in Cumins and no individual discussion on the factor is present.

Reasonable Arguable Position

Where a taxpayer has a reasonably arguable position 88 the level of additional tax payable by the taxpayer is limited. A reasonably arguable position arises where that what the applicant argued for is about as likely as

83 2006 ATC at paragraph 4096.
84 Section 177D(b)(iv),(v), (vi), (vii) ITAA 36.
85 2006 ATC at paragraph 4096.
86 2006 ATC at paragraph 4097.
87 Section 177D(b)(viii) ITAA 36.
88 Section 222C ITAA 36.
not correct. Nicholson J concluded that the Tribunal’s findings were correct that the taxpayer did not have a reasonably arguable position as follows:\textsuperscript{89}

\textit{The Tribunal held against the applicant on the question of penalty because it held the facts of the scheme, as found by it, and the relevant provisions of Pt IVA, "do not, in any material sense, support the position taken by the applicant in relation to Part IVA". Those fact findings are inconsistent with the applicant's position that the scheme was a normal sale of the beneficial interest in shares conferring no relevant benefit on the applicant.}

\textbf{Conclusions in Cumins}\textsuperscript{90}

The Federal Court in coming to its decision that Part IVA applied arrived at the following conclusions:

- The transaction was not a genuine transaction as it was contrived to generate a capital loss for the sole purpose of reducing capital gains on the sale of other shares.
- The authorities referred to by the taxpayer in support of his contention that the transaction was acceptable could not be relied upon because they related to factually different transactions and in any event those authorities still suggested that Part IVA would apply.
- There was no reliable reasonable alternative hypothesis as to how the transaction was entered into or carried out because all alternative actions would have required the taxpayer to get the approval of the bank which was likely to deliver negative commercial outcomes.
- The substance of the transaction was that there was no change in the material factors including the ownership, legal rights and economic position of the taxpayer associated with the shares and accordingly while an effective disposal for Capital Gains Tax\textsuperscript{91} purposes had occurred (in the opinion of the court) because of the form of the transaction no change in substance had occurred. In other words there was no change in the legal ownership and no real recognition of an economic loss. It was a paper transaction designed to trigger a capital loss.

\textbf{ATO Position in ATO Practice Statement Law Administration PS LA 2005/24}

The ATO in PS LA 2005/24 provided certain guidelines (features of transaction) to assist in identifying situations where Part IVA may apply.\textsuperscript{92} The features outlined may provide direction to assist in determining whether a particular arrangement is tax driven.\textsuperscript{93}

\begin{itemize}
  \item the arrangement (or any part of the arrangement) is out of step with ordinary family dealings or the sort of arrangements ordinarily used to achieve the relevant commercial objective;
  \item the arrangement seems more complex than is necessary to achieve the relevant family or commercial objective, or includes a step or a series of steps that appear to serve no real purpose other than to gain a tax advantage, for example:
    \begin{itemize}
      \item transactions which interpose an entity to access a tax benefit;
    \end{itemize}
  \item intra-group or related party dealings that merely produce a tax result;
  \item arrangements involving a circularity of funds or no real money;
  \item the tax result of the arrangement appears at odds with its commercial or economic result, for example:
    \begin{itemize}
      \item a tax loss is claimed for what was a profitable commercial venture or transaction;
    \end{itemize}
  \item the arrangement results in little or no risk in circumstances where significant risks would normally be expected, for example:
    \begin{itemize}
      \item use of non-recourse or limited recourse loans which limit the parties' risk or actual detriment in relation to debts/investments;
    \end{itemize}
\end{itemize}

\textsuperscript{89} 2006 ATC at paragraph 4097.
\textsuperscript{90} Cumins v FC of T 2006 ATC 4084.
\textsuperscript{91} Part 3.1 Income Tax Assessment Act 1997.
\textsuperscript{92} Paragraph 113 of PS LA 2005/24.
\textsuperscript{93} Part IVA Warning Signs:
The final factor identified in PS LA 2005/24 being that there is a gap between the substance of what is being achieved under the arrangement (or any part of it) and the legal form it takes would appear to have been applied as one of the primary reasons for concluding that Part IVA applied in Cumins. In other words Part IVA could apply where a transaction or series of transactions taken together produce no economic gain or loss.

**Goods and Services Tax – Anti-Avoidance Rules**

Division 165 provides certain anti-avoidance rules for the operation of the Goods and Services Tax (GST) system in Australia. The rules include similar requirements to those contained in Part IVA that have already been discussed in this paper being that:

- A GST benefit is derived from the scheme;
- The GST benefit is not attributable to the making of a choice or election provided for under the GST law; and
- Taking into account certain objective matters outlined in s 165-15 it could be concluded that:
  - The entity that entered into or carried out the scheme did so for the sole or dominant purpose of getting a GST benefit; or
  - The principal effect of the scheme is that the avoider gets the GST benefit.

The first case on the application of the GST rules has just been decided and this paper now reviews certain aspects of that decision.

**Case 14/2006 2006 ATC 187**

The concise facts: The taxpayer (VCE) was a company that was incorporated on 11 April 2003. It entered into an agreement on 25 April 2003 to purchase real property from an individual (SH1) for $770,000 (including GST). SH1 and his wife were the two shareholders in VCE and SH1 was its sole director. Under the agreement, VCE agreed to pay the purchase price to SH1 in instalments as follows:

- a deposit of $550 on the signing of the agreement
- $11,000 on 30 June 2008
- $11,000 on 30 June 2013, and
- the balance of the purchase price ($747,450) on 30 June 2018

arrangements where the taxpayer's risk is significantly limited because of the existence, for example, of a 'put' option;
- the parties to the arrangement are operating on non-commercial terms or in a non-arm's length manner, for example:
  - financial arrangements made on unusual terms, such as interest rates above or below market rates, insufficient security, or deferment of repayment of the loan until the end of a lengthy repayment period;
- transactions which do not occur at market rates/value;
- there is a gap between the substance of what is being achieved under the arrangement (or any part of it) and the legal form it takes, for example:
  - arrangements where a series of transactions taken together produce no economic gain or loss, such as where the whole scheme is self-cancelling.

94 Cumins v FC of T 2006 ATC 4084
96 Section 165-5 GSTA 1999.
97 Section 165-15 GSTA 1999.
98 These concise facts have been extracted from CCH Australian Tax Cases Summary.
At the time of the agreement, the property was leased by SH1 to a medical practitioner and its market value was between $220,000 and $250,000. Both SH1 and VCE were registered for GST. However, SH1 accounted for GST on a cash basis and VCE on an accruals basis. This meant that, subject to the application of the GST anti-avoidance provisions\(^99\) VCE was entitled in the April 2003 tax period to an input tax credit of $70,000 in respect of the acquisition of the property, while SH1 was not liable to pay most of the GST in respect of the sale until 2018.

The Commissioner having considered the GST anti-avoidance provisions concluded that the anti-avoidance rules applied and determined that VCE's net amount for the April 2003 tax period was nil, instead of the $70,000 previously claimed by VCE. The Commissioner also imposed a shortfall penalty amount of $35,000. The taxpayer sought review of the Commissioner's assessment and penalty.

The issues as identified by SA Forgie (Deputy President) were as follows:\(^{100}\)

> In deciding this matter, I must consider:
> * whether the anti-avoidance provisions in Division 165 of the GST Act disallow the input tax credit of $70,000 claimed by VCE; and
> * if so, whether the penalty on the shortfall amount of $70,000 was properly imposed at the rate of 50%.

The AAT then discussed some basic issues in relation to the operation of GST including the concept of a taxable supply\(^{101}\) and the concept of a creditable acquisition.\(^{102}\) The Tribunal discussed the requirements for registering for GST and the calculation of the GST liability on a particular transaction. In relation to accounting for GST the Tribunal discussed division 29\(^{103}\) which is concerned with attribution of GST liability and entitlement to particular tax periods. In essence the relevant rules can be stated as follows:

**GST Liability:**\(^{104}\)
The GST payable by you on a taxable supply is attributable to:
(a) the tax period in which any of the consideration is received for the supply; or
(b) if, before any of the consideration is received, an invoice is issued relating to the supply - the tax period in which the invoice is issued.

However, if you account on a cash basis, then:
(a) if, in a tax period, all of the consideration is received for a taxable supply - GST on the supply is attributable to that tax period; or
(b) if, in a tax period, part of the consideration is received - GST on the supply is attributable to that tax period, but only to the extent that the consideration is received in that tax period; or
(c) if, in a tax period, none of the consideration is received - none of the GST on the supply is attributable to that tax period.

**Entitlement to input tax credits:**\(^{105}\)
The input tax credit to which you are entitled for a creditable acquisition is attributable to:
(a) the tax period in which you provide any of the consideration for the acquisition; or
(b) if, before you provide any of the consideration, an invoice is issued relating to the acquisition - the tax period in which the invoice is issued.

However, if you account on a cash basis, then:

\(^{99}\) Division 165 of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act), 2006 ATC at paragraph 188.
\(^{100}\) Section 9-5 GSTA 1999.
\(^{101}\) Section 11-5 GSTA 1999.
\(^{102}\) GSTA 1999.
\(^{103}\) Section 29-5 GSTA 1999.
\(^{104}\) Section 29-10 GSTA 1999.
(a) if, in a tax period, you provide all of the consideration for a creditable acquisition - the input tax credit for the acquisition is attributable to that tax period; or
(b) if, in a tax period, you provide part of the consideration - the input tax credit for the acquisition is attributable to that tax period, but only to the extent that you provided the consideration in that tax period; or
(c) if, in a tax period, none of the consideration is provided - none of the input tax credit for the acquisition is attributable to that tax period.

If you do not hold a tax invoice for a creditable acquisition when you give to the Commissioner a GST return for the tax period to which the input tax credit (or any part of the input tax credit) on the acquisition would otherwise be attributable:
(a) the input tax credit (including any part of the input tax credit) is not attributable to that tax period; and
(b) the input tax credit (or part) is attributable to the first tax period for which you give to the Commissioner a GST return at a time when you hold that tax invoice.

Choice of Accounting on a Cash Basis:
It is evident from the discussion above that the timing of the liability to GST and the entitlement to input tax credits depends on the method by which an entity is accounting for GST, either on the other than cash or the cash basis. The construction of Division 29 would appear to suggest that when a person registers for GST they are considered automatically to be accounting on the other than cash basis and to account on a cash basis a taxpayer needs to elect under s 29-40 to account on the cash basis. A person can elect to account on a cash basis if:

(a) your annual turnover does not exceed the cash accounting turnover threshold; or
(b) for income tax purposes, you account for your income using the receipts method; or
(c) each of the enterprises that you carry on is an enterprise of a kind that the Commissioner determines, in writing, to be a kind of enterprise in respect of which a choice to account on a cash basis may be made under this section;
you may choose to account on a cash basis, with effect from the first day of the tax period that you choose.

The cash accounting turnover threshold is $1,000,000 or such higher amount as the regulations specify. It is evident from the foregoing that you can elect to account on a cash basis if you satisfy the requirements but you automatically account on an other than cash basis if no election or choice is made.

GST Anti-Avoidance Rules
Section 165-5 provides that if:
(a) an entity (the avoider) gets or got a GST benefit from a scheme; and
(b) the GST benefit is not attributable to the making, by any entity, of a choice, election, application or agreement that is expressly provided for by the GST law, the wine tax law or the luxury car tax law; and
(c) taking account of the matters described in section 165-15, it is reasonable to conclude that either:
(i) an entity that (whether alone or with others) entered into or carried out the scheme, or part of the scheme, did so with the sole or dominant purpose of that entity or another entity getting a GST benefit from the scheme; or
(ii) the principal effect of the scheme, or of part of the scheme, is that the avoider gets the GST benefit from the scheme directly or indirectly; and
(d) the scheme:

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106 GSTA 1999.
107 Section 29-40(1) GSTA 1999.
108 Section 29-40(3) GSTA 1999.
109 GSTA 1999.
(i) is a scheme that has been or is entered into on or after 2 December 1998; or
(ii) is a scheme that has been or is carried out or commenced on or after that day (other than a scheme that was entered into before 18.

**GST Benefit**

An entity gets a GST benefit from a scheme if: \(^{110}\)

(a) an amount that is payable by the entity under this Act apart from this Division is, or could reasonably be expected to be, smaller than it would be apart from the scheme or a part of the scheme; or
(b) an amount that is payable to the entity under this Act apart from this Division is, or could reasonably be expected to be, larger than it would be apart from the scheme or a part of the scheme; or ....

**What is a scheme?**

A scheme is: \(^{111}\)

(a) any arrangement, agreement, understanding, promise or undertaking:
   (i) whether it is express or implied; and
   (ii) whether or not it is, or is intended to be, enforceable by legal proceedings; or
(b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

**Determining the purpose or effect**

The following matters are to be taken into account under section 165-5 in considering an entity's purpose in entering into or carrying out the scheme from which the avoider got a GST benefit, and the effect of the scheme: \(^{112}\)

(a) the manner in which the scheme was entered into or carried out;
(b) the form and substance of the scheme, including:
   (i) the legal rights and obligations involved in the scheme; and
   (ii) the economic and commercial substance of the scheme;
(c) the purpose or object of this Act, the Customs Act 1901 (so far as it is relevant to this Act) and any relevant provision of this Act or that Act (whether the purpose or object is stated expressly or not);
(d) the timing of the scheme;
(e) the period over which the scheme was entered into and carried out;
(f) the effect that this Act would have in relation to the scheme apart from this Division;
(g) any change in the avoider's financial position that has resulted, or may reasonably be expected to result, from the scheme;
(h) any change that has resulted, or may reasonably be expected to result, from the scheme in the financial position of an entity (a connected entity) that has or had a connection or dealing with the avoider, whether the connection or dealing is or was of a family, business or other nature;
(i) any other consequence for the avoider or a connected entity of the scheme having been entered into or carried out;
(j) the nature of the connection between the avoider and a connected entity, including the question whether the dealing is or was at arm's length;
(k) the circumstances surrounding the scheme;
(l) any other relevant circumstances.

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\(^{110}\) Section 165-10(1) GSTA 1999.
\(^{111}\) Section 165-10(2) GSTA 1999.
\(^{112}\) Section 165-10 GSTA 1999.
The first criterion: Did VCE get a GST benefit from a scheme?

The AAT discussed at length the concept of a scheme drawing on a substantial amount of authority primarily related to the interpretation of Part IVA schemes. After extensive discussion the AAT concluded that:  

Parliament has chosen to define the words in terms that have been the subject of previous judicial consideration. It has done so in legislation that, like Division 165, is also directed towards ensuring that the tax burden is borne by those who should properly carry it by not permitting them to take advantage of schemes contrived to their avoiding it.

It seems to me that I should adopt the same approach and simply consider whether there was a scheme without reference to purpose until I consider s 165-5(1)(c).

In view of the events that I have found and that are set out above, I am satisfied that there was a scheme.

The Tribunal having concluded that a scheme existed considered that the scheme commenced with the incorporation of VCE on 11 April 2003 continuing through to management of the property throughout the period of the lease.

The next issue addressed by the Tribunal was whether VCE gets or got a GST benefit from a scheme recognising that an entity gets a GST benefit from a scheme if that amount is larger than it would be apart from the scheme or part of the scheme. In the case of VCE it received an input tax credit of $70,000 and the question was whether a similar amount would have been received in the absence of the scheme. The Tribunal noted the arguments for the taxpayer as follows:

On behalf of VCE, Dr Orow of counsel submitted that the test prescribed to determine whether there is a GST benefit is made to depend on, and requires, the making of an alternative hypothesis or to postulate what would or might reasonably be expected to have happened if the particular scheme had not been entered or carried out. He described this approach as "the counterfactual" and noted that none had been put forward on behalf of the Commissioner. Dr Orow put forward several "counterfactuals"

The counterfactuals put forward by Dr Orow are as follows:
(a) VCE did not acquire the Property;
(b) VCE acquired the Property at market value in 2003 and paid for it in full using borrowed money;
(c) VCE acquired the Property as above but elected to account on a cash basis;
(d) VCE acquired the Property as above but did not register for GST purposes; and
(e) VCE insists upon the application of the going concern exemption under s 38-325.

Dr Orow went on to discuss the counterfactuals in his submission and concluded that none of them were sufficiently reliable for it to be regarded as reasonable. In other words he was suggesting that if no counterfactual could be established then a tax benefit could not be determined because there was nothing with which to compare what actually happened. The Tribunal stated its concerns as follows:

I have difficulty with Dr Orow's submission. It puts forward reasons for rejecting each of his "counterfactuals" and yet I am required by s 165-10(1)(b) to look at what would be, or what could reasonably be expected to be, the position apart from the scheme. If I were to accept his submission, I would be left with the conclusion that none of the "counterfactuals" was relevant. That would then

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113 Case 14 ATC at paragraph 197.
114 Case 14 ATC at paragraph 198.
115 Case 14 ATC at paragraph 199.
lead to the further conclusion that the scheme itself was the only course that could be regarded as reasonable.

The Tribunal went on to explain its concerns and finally concluded that:¹¹⁶

Given those facts, it is reasonable to expect that SHI might not have sold the Property to VCE or at all. That is a course of action that it is reasonable to expect could have been followed.

The Tribunal accepted that a second course of action being the sale of the Property to VCE at a price that equated with market value in 2003 and that was payable at, or shortly after, the time of the Agreement was a reasonable expectation as well.

Was the GST benefit attributable to VCE’s making an election that is expressly provided for …?

It is noted that a tax benefit that arises from the taxpayer making a choice that is provided for in the legislation will not give rise to the application of division 165. Dr Orow submitted that the taxpayer had made two choices:

- Voluntarily electing to registering for GST even though its turnover was below the turnover threshold of $50,000.
- Electing to account for GST on an other than cash basis.

The Tribunal agreed with Dr Orow in relation to electing to register for GST:¹¹⁷

It follows that, in electing to apply for registration, VCE has made an election that is expressly provided for by GST law.

However the Tribunal then considered whether the choice of registration was a choice that could be considered for s 165-5(1)(b). The Tribunal in rejecting the choice of registration as a choice for the purposes of s 165-5(1)(b) stated its position as follows:¹¹⁸

It is inherent in the statement that Parliament intends that the obligation to pay GST and the privilege of obtaining input tax credits fall according to the general scheme under the GST Act. It would be inconsistent with that object if it were to provide that a person could sidestep the obligation or take advantage of the privilege simply by being a participant in the scheme. That is to say, if the fact of registration were of itself to be regarded as a causal link of a type that excludes the operation of the anti-avoidance provisions, those provisions would always be excluded.

Having rejected the voluntary election to register for GST as a relevant choice the Tribunal then went on to discuss whether electing to account for GST on an other than cash basis (accrual) was a relevant choice. The Tribunal concluded that this was not a choice provided for under the GST Act because a person who registers for GST is automatically registered on an accruals basis and the only choice is the election to account for GST on a cash basis. In other words if the taxpayer did not choose to account on an accruals basis then no choice had been made. In the alternative if it could be argued that the taxpayer chose to account on an accruals basis they would have derived a tax benefit from that choice. However the Tribunal indicated that it did not consider that the tax benefit came from the choice to account on the accruals basis:¹¹⁹

³¹⁶ Case 14 ATC at paragraph 199 and 200.
³¹⁷ Case 14 ATC at paragraph 201.
³¹⁸ Case 14 ATC at paragraph 202.
³¹⁹ Case 14 ATC at paragraph 203.
That is not the consequence of the accounting method but of the terms of the Agreement and the decision to issue a Tax Invoice for the full amount. The Agreement effectively provided for deferred payment of the consideration. Had the full amount of the consideration been paid at the time of the Agreement, the GST benefit would have been the same whether VCE was accounting on an accruals basis or on a cash basis.

This is an interesting approach because what the Tribunal is really saying is that the mere fact of making the choice did not deliver the benefit but instead it was the manner in which the contract was designed (with deferred consideration) to suit the election or choice that delivered the tax benefit.

**Did the Taxpayer Carry out the Scheme with the Sole or Dominant Purpose of Getting a Tax Benefit?**

By comparison with the design of the purpose test in Part IVA which has only one course of action to evaluate the GST Act has two courses of action to consider. The Tribunal\(^{120}\) only looked at the first course of action being that the entity entered the scheme for the sole or dominant purpose of getting a tax benefit. The Tribunal concluded that the parties whose purpose was under consideration were SH1 and VCE. Both entered or carried out the scheme as identified. In relation to determining the sole or dominant purpose the Tribunal stated:\(^ {121}\)

> What is meant by a "sole purpose" is clear. As to the meaning of a "dominant purpose", I have turned to the authorities that considered the meaning of that term in s 177D(b) of the ITA Act. I have done that even though I recognise that there are differences as well as similarities between the sole or dominant purpose tests set out in Part IVA and Division 165. Both are similar in that neither s 165-5(1)(c)(i) nor s 177D(b) sets out the entire test. Section 177D(b) must be read with s 177A(5) in order to understand the meaning of "purpose" and s 165-5(1)(c)(i) must be read with s 165-15(1) to understand the matters that must be taken into account.

The Tribunal made reference to authorities related to Part IVA in relation to the meaning of dominant purpose:\(^ {122}\)

> In considering s 177D(b), the majority of the High Court in Commissioner of Taxation v Spotless Services Limited (Spotless)\(^ {123}\) said of a "dominant purpose":

> "... a reasonable person would conclude that the taxpayers in entering into and carrying out the particular scheme had, as their most influential and prevailing or ruling purpose, and thus their dominant purpose, the obtaining thereby of a tax benefit, in the statutory sense."

Having discussed the determination of the objective purpose of the taxpayer based on decided cases that relate to Part IVA the Tribunal concluded as follows:

> In view of the similarity in construction between s 165-15(1) and s 177D(b), it seems to me that I should adopt the same approach in considering deciding the question posed by s 165-5(1)(c) in this case i.e. is it reasonable to conclude that SH1 or VCE entered into or carried out the scheme with the sole or dominant purpose of either of them getting a GST benefit from the scheme.

**Section 165-15(1)(a): "The manner in which the scheme was entered into or carried out"**

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\(^{120}\) In Case 14.

\(^{121}\) Case 14 ATC at paragraph 203 and 204.

\(^{122}\) Case 14 ATC at paragraph 204.

\(^{123}\) 96 ATC 5201.
The Tribunal considered that s 165-15(1)(a) is drafted in the same terms as s 177D(b) of the ITA Act. The method by which the scheme was entered into indicated in the opinion of the Tribunal that the transaction was not commercial because it was not likely that un-related parties would contract on the basis that SH1 and VCE had contracted.

Section 165-15(1)(b): "the form and substance of the scheme"

The Tribunal concluded that the form of the scheme was the sale and purchase of the property but in substance the contract did not transfer the present rights and responsibilities in relation to the property. In essence there was substantial disconformities between the form and the substance of the scheme and the Tribunal concluded:124

Overall the contract of sale is not commercially defensible and is considered totally out of whack with normal commercial practice. We understand the Vendor and the Purchaser are connected and if so this would account for the unrealistic terms (to the vendor) of the contract of sale.

Section 165-15(1)(c): "the purpose or object of this Act ..."

The Tribunal looked to the purpose of the GST Act and in particular Division 29 which provides for the timing of the attribution of GST liability and the entitlement to input tax credits and concluded that based on the construction of Division 29 it was clear that differences in the timing of the liability and entitlement may occur from the operation of the Act. However the Tribunal considered that the purpose of Division 165 was to deter schemes that sought to take advantage of the timing rules and went on to state:125

Alteration of the timing of the payment of GST and payment of a refund is precisely what has happened here. It has altered it to the extent that payment of the bulk of the GST is deferred for some fifteen years but it is immediately refundable. This results not from the attribution provisions of Division 29 themselves but from the application of those provisions to the scheme.

In other words the Tribunal was stating that the scheme was designed for the purpose of taking advantage of the timing rules in the GST Act.

Section 165-15(1)(d): "the timing of the scheme"....

The Tribunal was somewhat uncertain as to what the "timing of the scheme" meant but suggested that:126

It could mean the time at which it was put in place or it could mean the time at which its elements were put in place.

The time that the scheme was put in place in the current case was April 2003 while the major elements of the scheme were put in place in a period of less than three weeks. The major elements included the incorporation of VCE with SH1 as its sole director and half owner of its shares, its registering for the purposes of GST, its entering an Agreement to purchase the Property from SH1, its paying the deposit and SH1's giving it an invoice for the whole of the consideration. It would appear from the language used by the Tribunal that the

124 Case 14 ATC at paragraph 208 and 209.
125 Case 14 ATC at paragraph 209.
126 Case 14 ATC at paragraph 209.
speed with which the major elements of the scheme were effected was of concern to it and pointed to a tax avoidance purpose.

**Section 165-15(1)(e): "the period over which the scheme was entered into and carried out"**

The Tribunal went on to discuss the fact that the scheme could last up to 15 years and that there was significant uncertainty as to whether the contract of sale would ever settle and SH1 receive consideration for the sale on which he would pay GST. The Tribunal reviewed the contractual arrangement between the parties and concluded that SH1 may never enforce its rights under the contract as vendor to demand that VCE complete the contract and accordingly never incur a GST liability. The Tribunal considered that the nature of the contract being for a deferred settlement in 15 years time suggested that SH1 would never be liable to GST. If SH1 is never liable to GST then the purpose of the scheme appears to be for the purpose of just getting $70,000 input tax credits for VCE.

**Section 165-15(1)(f): "the effect that the GST Act would have in relation to the scheme apart from this Division"**

The Tribunal was in no doubt as to the effect of the scheme and stated is as follows:

> Putting Division 165 to one side, the effect of the scheme is that VCE would be entitled to an immediate payment of input tax credit of $70,000 from the Commissioner whereas SH1 could defer all but $50 of the $70,000 of GST that would otherwise be payable. That is because $50 is the amount of GST payable on the deposit i.e. 10% of 10/11ths of $550.

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

Similarly the Tribunal was clear on the positive change that the scheme had on the financial position of VCE:

> I am satisfied that VCE's financial position would be substantially improved as a result of the scheme. As an immediate result of the scheme, it has gained $70,000 less, perhaps, $550, which it might have paid as a deposit. I say "might have paid" because I am not clear whether it paid it, SH1 paid it or, if he did, whether it is shown in its accounts as debt to SH1.

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

The Tribunal identified SH1 as an entity connected with VCE and concluded that SH1’s income would reduce as a result of the scheme but as SH1 was the sole director of VCE who has got the benefit of the $70,000 input tax credit he could control where those funds were directed or employed. In other words the Tribunal was suggesting that the benefits from the scheme really came home to SH1.

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127 2003 to 2018.
128 Case 14 ATC at paragraph 210.
129 Case 14 ATC at paragraph 210.
Section 165-15(1)(i): "any other consequence for the avoider or connected entity of the scheme having been entered into or carried out"

The Tribunal reviewed the delayed liability that SH1 would attract because of the nature of the scheme and the cash flow advantage that VCE would enjoy because it received the $70,000 input tax credit in 2003 and concluded that in essence what was achieved by the scheme was the receipt of an interest free loan for a period of 15 years. The Tribunal considered that this was a significant advantage to SH1 and VCE. The Tribunal stated its opinion as follows:130

>It is an outcome that favours SH1 as the net present value of money in 2003 in the hand is significantly greater than the same amount promised for payment five and ten years, let alone fifteen, years later. In the meantime, VCE will have had the advantage of being able to use the $70,000 paid as a refund by the Commissioner.

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

The Tribunal was substantially concerned by the fact that the parties were not dealing with each other at arm’s length and this pointed to a dominant purpose of tax avoidance:131

>On the material that is available, it is outside the range of normal commercial dealings. The time between the date of the Agreement and the date of settlement is unusually lengthy. Dr Orow submitted that the period enabled VCE to generate finance to pay for the Property. That suggests an unduly generous vendor but SH1’s evidence is that the purchase price has been adjusted to take account of the delayed consideration. In the meantime, SH1 does not have access to the monies from the sale, or any significant part of it, for a lengthy period of time. Assuming VCE does not default on the interim payments, he cannot take advantage of any other offer he might receive in the next eighteen years to sell the Property. He does not receive the lease payments from the Property and yet continues to pay the mortgage.

In essence the Tribunal concluded that the transaction was not commercial from SH1’s perspective and similarly the Tribunal considered that the transaction was not commercial from VCE’s perspective. In fact the Tribunal was unable to be persuaded that VCE could ever pay for the property.

Section 165-15(1)(k): "the circumstances surrounding the scheme"

The Tribunal considered that proper notifications were not made to mortgagee of the property and certainly notifications were not made on time. It would appear that the Tribunal considered that SH1 was tardy in its notifications.

Section 165-15(1)(l): "any other relevant circumstances"

The Tribunal reviewed SH1’s contention that he transferred the property to VCE for the purpose of limiting his and his wife’s personal liability despite the fact that the property was fully insured. The Tribunal was not persuaded fully by this argument because as SH1 remained owner of the property he still retained an interest in the property.

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130 Case 14 ATC at paragraph 211.
131 Case 14 ATC at paragraph 212.
The Tribunal went on to review the arguments put forward by Council for SH1 and VCE:132

*Dr Orow submitted that the Agreement represented an ordinary commercial or family dealing. VCE was established in order to facilitate the sale of an income producing asset. Had the sale of the Property never taken place, there would have been no need to have established VCE at all. The purpose of the arrangement was to limit taxation on the rent received from the medical practitioner at the rate of 30%, stream all of the income to SH2 and limit SH1’s exposure to public liability. The higher price was justified by reference to VCE’s not having to obtain finance or to pay regular interest payments.*

The reasons that are put forward appear, on the evidence, to be internally inconsistent. The inconsistency arises from the fact that the sale is intended to benefit SH1 and his wife and yet continues to leave SH1 exposed to the public liability he wants to avoid and, if SH2 is to receive any benefit, leaves VCE without funds to meet its liabilities to pay parts of the consideration in 2008, 2013 and 2018.

The Tribunal was concluding that the transaction did not add up and from this perspective the Tribunal concluded that:133

*Taking all of the criteria specified in s 165-15(1), I am satisfied that it is reasonable to conclude that both VCE and SH1, or either of them, entered, or carried out the scheme with the sole or dominant purpose of its getting a GST benefit under the scheme.*

**Should the scheme be disregarded?**

The Tribunal went on to discuss whether the scheme should be disregarded and in doing so looked to the object of the GST Act being the balancing of GST liabilities and input tax credits and provided some insightful discussion on the availability of input tax credits:134

*An input tax credit is dependent on there having been, among other matters, a taxable supply. There is an assumption that there will be some correlation between payment of GST and an input tax credit. After all, the consideration paid, or to be paid, for the goods or services will generally include that burden. ... An input tax credit does not represent some sort of bounty that the Commissioner bestows upon a person. It is more appropriately regarded as an alleviation of the burden that a person has borne in paying the price of the goods and services. ... In this case, the burden and its alleviation have not fallen as the GST Act intended. It has not done so because of a scheme embarked upon by SH1 acting both for himself and for VCE. SH1 would have me accept that the consequences under the GST Act are incidental to his intention to provide for his family through VCE and to protect himself from damages claims in relation to the Property.*

The Tribunal rejected the taxpayer’s grounds as follows:135

*I do not accept that. Instead, I find that he set out on a deliberate course of action that had the acquisition of a substantial input tax credit with minimal outlay as one of its central aims. His actions in April 2003 were all directed to that end.*

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132 Case 14 ATC at paragraph 213 and 214.
133 Case 14 ATC at paragraph 214.
134 Case 14 ATC at paragraph 214.
135 Case 14 ATC at paragraph 215.
The Tribunal provided some final comments on what it considered would have happened if the current transaction did not occur:136

That view is that the sale of the Property would never have occurred at all. That is a view I can take by relying on s 165-55(1) to treat an event that has occurred (the sale) as not having occurred. That would leave VCE with an input tax credit of zero and a net amount of zero. It would not have been entitled to a refund of any amount from the Commissioner.

In making this statement the Tribunal was affirming the Commissioner’s decision that no input tax credit was available to VCE.

**Penalty**

The amount of the penalty is worked out in Schedule 1 of the TA Act under s 284-160 in the case of a scheme. If the base penalty amount is not increased under s 284-220 or reduced under s 284-225, that is the amount of the penalty.161 The "base penalty amount" in relation to a scheme under s 284-145(1) is:

(i) 50% of your scheme shortfall amount; or
(ii) 25% of your scheme shortfall amount if it is reasonably arguable that the adjustment provision does not apply.

"A matter is reasonably arguable if it would be concluded in the circumstances, having regard to the relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect."137

The Tribunal made some interesting comments in relation to whether a taxpayer needs to know the authorities that he relies in determining a reasonably arguable position:138

SH1 is in a position where he could be expected to have some knowledge of GST but it does not follow that he would necessarily know about such an authority. Whether he would necessarily know about it or not is not to the point. The question is whether VCE’s argument is about as likely as not correct, when regard is had to the authorities and not whether SH1 or VCE knew about those authorities. In any event and whether he knew about them or not, at the time that SH1 and VCE established the scheme, there had been a number of cases in the Australian courts considering Part IVA of the ITA Act.

Taking all relevant matters into account including existing authorities (or lack of authorities), the court was not satisfied that VCE’s argument in support of the scheme is about as likely as not correct.

**Conclusions**

This paper has reviewed the concepts of tax avoidance and tax planning and concluded that while the definitions of each were clearly different it was not always simple to apply the tests to a particular factual situation. An objective test in Part IVA is used to clarify the difference in practice. This paper reviewed the operation of the purpose test in the general deduction provision139 to provide some direction in applying a purpose test. This review concluded that the purpose test in the general deduction provision was primarily an objective test but where expenditure was voluntary or exceeded income the subjective purpose of the

136 Case 14 ATC at paragraph 215.
137 Case 14 ATC at paragraph 215 and 216.
138 Case 14 ATC at paragraph 217.
139 Section 8-1 ITAA 97.
taxpayer needed to be determined. For the subjective purpose test to be of any use it was concluded that the subjective purpose needed to be determined objectively.

The paper then went on to discuss the application of the objective purpose tests in Part IVA (ITAA 36) and Division 165 (GSTA 1999) and reviewed the framework in those provisions which enabled an objective purpose to be determined. The paper undertook the review with the benefit of two recent cases (one case decided under each of the provisions). The paper concluded that the framework used in those provisions assisted the courts and the Commissioner to determine the objective purpose of the relevant scheme in each of these two cases.