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Part IVA - How's your Postulate?

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1 Overview

Words matter

Changes to words matter even more.

Parliament is presumed not to have acted idly when moving words around on the page.

The new Part IVA will be read according to its terms, not under the influence of "muffled echoes" of old arguments, concerning old legislation.[1]

Parliament was told by the Minister that the changes had these objects (and I will paraphrase):

First, the changes would "reinforce the view" that there are two limbs to the concept "tax benefit". These are alternative tests, not simply one test spanning a spectrum of likelihood.

The amendments do emphasise the two limbs.

The first limb concerns a tax advantage that would not have been obtained without the scheme, and the Minister said that this limb deals appropriately with cases where simply removing the scheme reveals a coherent taxable situation consistent with the substance of what happened: paraphrasing the second reading speech.

The second limb concerns a tax advantage that "might reasonably be expected" not to have been obtained absent the scheme.

The Minister said that this deals with cases where what is left after simply removing the scheme "would not make sense or would be inconsistent with the taxpayer's actual commercial objectives" and instead "requires a prediction about alternative ways that the substance of what happened might reasonably have been achieved".[2]

The second object of the amendments, emphasised by the Minister in his second reading speech, is to *ensure, in deciding whether an alternative to the scheme is reasonable, that regard is had both to the substance of the scheme and to the non-tax results or consequences for the taxpayer that the scheme achieved* and that *the tax consequences of the alternative are ignored*.

A third, related, object is that it would no longer be possible for a taxpayer, *having achieved something from a scheme (tax results aside)*, to say the taxpayer *did not obtain a tax benefit by arguing that, absent the scheme*, [the taxpayer] *would have pursued completely different objectives, or done nothing at all*. The latter is the so-called "do nothing" counter-factual.

The first objective of this paper is to see whether, in fact, these objectives have been achieved.

In doing so, I will digress, looking at whether a number of recent cases might have been decided differently had the new Part IVA governed.

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1 Paraphrasing *Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, page 414.

2 Second Reading Speech.

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The second objective of this paper is to look at the impact of a non-statutory development, a recent decision about the scope of the exception from the definition of "tax benefit", where a tax benefit results from a choice made by the taxpayer.

This arose from a GST appeal, *Commissioner of Taxation v Unit Trend Services Pty Ltd*.[3] The income tax wording is different. Thus it is necessary to judge whether there is a spill over from the realm of GST to income tax.

3 (2013) 87 ALJR 588; [2013] HCA 16.

2 Postulate

The only four occurrences of this word in the 1936 Act, and possibly the entire Commonwealth statute book, are in new s.177CB:

> *(2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).*
>
> *(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.*
>
> *(4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:*
>
> *(a) have particular regard to:*
>
> *(i) the substance of the scheme; and*
>
> *(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but*
>
> *(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).*

It is an odd word, but there will not be much trouble over its use.

Leaving aside ecclesiastical terminology, the OED Online gives these meanings of it as a noun:

> ***II.*** *A postulated proposition.*
>
> *a. A fundamental principle, presupposition, or condition, esp. one assumed as the basis of a discipline or theory; (also) a proposition that is (or is claimed should be) taken as granted; esp. one (to be) used as a basis for reasoning or discussion, a premise.*
>
> *b. An unfounded or disputable unproved assumption; a hypothesis, a stipulation, an unproven theory.*
>
> *c. A proposition or assumption taken to be self-evident or obvious; an axiom.*
>
> > *Not always clearly distinct from sense 2a.*
>
> *3.* Math. *A simple (esp. geometrical) operation whose possibility is self-evident or taken for granted, e.g. the drawing of a straight line between two points in space. Cf. axiom n. 3, petition n. 5.*
>
> *4. Something required as the necessary condition of some actual or supposed occurrence or state of things; a prerequisite. Now* rare.

All this is unpromising, where it was hoped to bring precision to discourse.

But the word had entered the judicial lexicon before these changes.[4]

It appears to have a meaning blended from the OED's senses 2 a. & b. This is because the Commissioner's tender of the assessment in his case removes the proposition from the realm of "unproved", but does not render it indisputable in Part IVC proceedings.

The real question was – what was wrong with the postulate?

This is the dynamic.

The Commissioner, an outsider to the transaction, must advise the taxpayer, before trial[5], of the scheme, and of the (alternative) postulate.

The Commissioner tenders his assessment in evidence.[6] He may choose to call no other evidence.

The assessment is conclusive evidence of the due making of the assessment.[7]

In a Part IVC proceeding, it is not evidence that the amount and all the particulars of the assessment are correct. But rather the taxpayer bears the onus of showing that the *assessment is excessive or otherwise incorrect and what the assessment should have been*.[8] So it is as good as being *prima facie* evidence of the opposite of those things.

It should then be evident from the s.177F determination what alleged *tax benefit* flows.

It is then for the taxpayer to show that there was no such tax benefit, or that another element (such as purpose) for making the s.177F determination fails.

2.1 "Would"

Formerly, the law as to <u>disproof</u> of the alleged tax benefit was that:[9]

> *How the taxpayer does that is a matter for it. It may ... lead evidence that the taxpayer would have undertaken a particular activity, or adopted a particular course, in lieu of the scheme. It is also conceivable that a taxpayer may not lead positive evidence of an alternative postulate because, for example, the result of any objective enquiry of the alternative postulate is inevitable. In the end, the Court will decide what would have been done, or might reasonably be expected to have been*

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4 "The <u>counterfactual</u> (also referred to in case law as the "<u>alternative hypothesis</u>" or the "<u>alternative postulate</u>": see *Federal Commissioner of Taxation v Ashwick (QLD) No 127 Pty Ltd* [2011] FCAFC 49; (2011) 192 FCR 325 at 371 per Edmonds J; Bennett and Middleton JJ agreeing) ...": *Commissioner of Taxation v Macquarie Bank Limited* 2013 ATC ¶20-373, per Middleton & Robertson JJ, para 152 (emphasis added).

5 *Bailey v Commissioner of Taxation* (1977) 136 CLR 214

6 In the AAT, the Commissioner seems to rely simply on the assessments in the s.37 documents.

7 A recent example of this power of this was *Lis-Con Concrete Constructions Pty Ltd v Commissioner of State Revenue* (2011) 85 ATR 769, para 23 (QSC, de Jersey CJ)

8 Sections 14ZZK & 14ZZO *Taxation Administration Act* 1953

9 *Commissioner of Taxation v Macquarie Bank Limited* 2013 ATC ¶20-373, per Middleton & Robertson JJ, para 154

> *done, in lieu of the scheme having regard to all of the evidence that is led. If a taxpayer has given evidence of what he or she would have done but for entering the scheme, that evidence will be relevant and useful to the extent to which it reveals facts or matters that bear upon the objective determination of the alternative postulate.*

The Commissioner's concern is that this did not give effect sufficiently to the word: "would".

Thus, s.177C(1)(a) said:

> *... an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out;*

New section 177CB makes it clear beyond doubt that "would" does not lie on a spectrum of likelihood with "might reasonably be expected".

Rather it is a separate basis for determining a tax benefit.

Thus s.177CB(2) requires the tax benefit to be identified:

> *... based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme)*

This works well with deduction schemes. You simply delete the incurrence of the loss or outgoing.

It is harder to come up with reasonable examples of income schemes.

One that came to mind was the valid appointment that a beneficiary of a trust should be entitled to income. If the appointment is deleted, the trustee has nevertheless derived the income (albeit as trustee), and there will be a question as to whether the trustee or a default beneficiary is assessed.[10]

I am not suggesting that, without more, Part IVA applies to every appointment of income. But it is an example that generates a tax benefit in almost every case. The focus is then on s.177D, as to purpose.

That is as the Commissioner apparently desired.[11]

It remains to see whether "would", in s.177C(1), and "would have occurred", in s.177CB(1) & (2), have some greater operation than a slavish application of the assessing provisions to the facts that remain, the scheme having been annihilated. The OED definitions of "will", of which "would" is a grammatical part, express shades of meaning that could occupy a morning's argument.

Doubtless the Commissioner will read passages from the explanatory memorandum to the Court or AAT.

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[10] Section 99A or, for example, s.97.

[11] EM for *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill* 2013, para 1.22.

> *1.37 One approach to the first limb has been to view it as satisfied in cases where a relevant tax advantage is exposed by applying the taxation law to the facts remaining once the statutory postulate has done its work in deleting the scheme. In those cases, a tax benefit exists if it can be demonstrated that the relevant tax advantage flows, as a matter of law, once the scheme is assumed not to have happened. This may be referred to as an 'annihilation approach'. Although this approach involves an alternative postulate, that postulate consists solely of deleting the scheme.*
>
> *[Discussion of a second approach to the first limb.]*
>
> *1.44 ... To achieve the intended outcome, these amendments include provisions which put it beyond doubt that the 'would have' and 'might reasonably be expected to' limbs of each paragraph of subsection 177C(1) represent separate and distinct bases upon which the existence of a tax benefit can be demonstrated.*

I consider the statute plain enough on its face, without resort to this extrinsic material. But this will be argued.

2.2 Might (un)reasonably have been expected to

This leaves the modified second limb of tax benefit.

There are times when the words of a statute become an abuse of english.

Although the context differs, I am reminded of Lord Atkin's cutting, lone dissent in *Liversidge v Anderson*:[12]

> *I know of only one authority, which might justify the suggested method of construction. 'When I use a word,' Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean, neither more nor less'. 'The question is,' said Alice, 'whether you can make words mean so many different things.' 'The question is,' said Humpty Dumpty, 'which is to be the master, that's all.' ("Through the Looking Glass," c. vi.)*

Plainly the legislature is the master.

Consideration of a postulate is now constrained.

An ordinary cost of doing business is ignored.

The words:

- "might reasonably be expected to have occurred"; and
- "a postulate that is a reasonable alternative",

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[12] [1942] AC 206, page 245

do not have their usual meaning.

This is because, under s.177CB:

> *(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.*
>
> *(4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:*
>
> > *(a) have particular regard to:*
> >
> > > *(i) the substance of the scheme; and*
> > >
> > > *(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but*
> >
> > *(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).*

[emphasis added]

This amendment was dictated by the reasoning in *RCI Pty Ltd v Commissioner of Taxation*. The Full Court held that:[13]

Gainsaying the Commissioner's postulate?

- It was not sufficient that the Commissioner identify one reasonable alternative postulate.
- It was not correct, to decide against the taxpayer, simply to say he had failed to prove that the Commissioner's postulate was "unreasonable".
- Rather, the statutory question was what the taxpayer might reasonably be expected to have done if he had not entered into the scheme.

Tax cost relevant under the old Part IVA

- An additional tax cost of greater than $172M would, on the facts presented, have scuttled the transaction. (This is the "do nothing" alternative.)

I do not consider that the former issue has been resolved, by these amendments. Section 177C still operates on the same formula, of "might reasonably be expected".

The decision in *Futuris*[14], if it was intended to be reversed by this amendment, would illustrate the illogicality of that view.

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[13] 2011 ATC ¶20-275 (Full Court), at para 140

[14] *Commissioner of Taxation v Futuris* 2012 ATC 20-306 (Full Court)

Section 177CB only governs identification of an alternative postulate.

But s.177CB(4) does prevents the latter argument, as to the relevance of the tax savings.

It does not entirely rule out the argument, for example where tax savings factor into other transaction costs. But this takes the parties and intermediaries into dangerous waters.[15]

I am more concerned here with the practical consequences of taking that argument out of play.

Gordon Cooper and Tim Russell[16] give a stark example:

- A multinational corporate identifies business synergies from a potential restructure with present value $100M.
- It determines that there are two ways of proceeding, to the same commercial result.
- Scheme A has tax costs of $30M.
- Scheme B has tax costs of $120M.
- It enters into Scheme A, with net cost of $70M.
- The Commissioner determines under Part IVA that it has a tax benefit of $90M (the tax difference, $120M - $30M).

They conclude that the operation of Part IVA has been compromised, by the:

> *requirement that taxpayers posit unrealistic, non-objective and fanciful assumptions that bear no relationship to the real world.*

There is something to this.

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15 Intermediaries' fees for arranging transactions would need to be studied. There is a danger here, as well, given the promoter penalty regime (esp. s.290-60 of Sch 1 to the *Taxation Administration Act* 1953). The law about the promoter penalty regime is developing, and questions of counterfactual may differ from under Part IVA: *Commissioner of Taxation v Ludekens* (2013) 214 FCR 149; [2013] FCAFC 100, paras 229-236

16 "The new 'improved' Part IVA – with extra benefits" (2013) 42 AT Rev 234, 250

3 Running cases - annihilating or reconstructing?

I come back to the distinction plainly now made by s.177CB, between the two limbs of *tax benefit*.

A distinction was always there in the definition of "tax benefit". For example, section 177C(1)(a) has always read:

> *… an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out …*

[Emphasis added]

Note the difference between "would have been included" and "might be reasonably be expected to have been included".

It is not productive to enquire whether the Commissioner correctly perceived that the distinction between these two limbs had become blurred.[17]

Section 177C is now supplemented by section 177CB, a new section which is headed "The Bases for Identifying Tax Benefits".

After listing various "tax effects", such as an amount not being included in the assessable income of the taxpayer, and so forth, section 177CB then deals with two situations.

It first deals with the "would have occurred" situation.

To decide whether a tax effect "would have occurred" if a scheme had not been entered into or carried out, your decision must be based on a "postulate" that "comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme)".

This is the "annihilation" limb.

The "postulate" is the comparative situation used to judge whether there has been a tax benefit under s.177C.

The draftsman's intent is that you look at the events and circumstances that actually happened or existed, but exclude those "that form part of the scheme", and see if a "tax effect" would have occurred.

Classically, this works best for a deduction scheme. The transaction for the loss or expense is simply eliminated.

It works less certainly for an income scheme. Eliminating the impugned transaction does not necessarily leave facts that include derivation of income in other hands, of another amount, or at all.[18] Reconstruction is in order for that.

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[17] The Full Court in *AXA* grasped the possibilities inherent in the former statutory formulation: paras 130-133.

[18] Above, I have identified the kind of income scheme that could be caught, to give a tax benefit under annihilation.

In practical terms, the terms of the annihilation limb place new responsibility on the Commissioner to identify his scheme with precision. The Commissioner will be doing so, not knowing for sure what other events or circumstances will be put against the Commissioner as remaining, after cancellation of the scheme.

The Commissioner was formerly tempted to run different "schemes" under Part IVA.

Given the new, negative, significance of the scheme, doing so may now become unmanageable. How that actually plays out in terms of case management will probably only be known in four or five years.

Of course a man may plead cases in the alternative.

But not to the point where his opponent is embarrassed to know the case he must answer.

Whilst this did not seem to feature in the case law under s.260, I can imagine how it might play today. Efficient case management features large in courts' consideration of fairness.

The second limb is about a tax effect that "might reasonably be expected to have occurred" if the scheme had not been entered into or carried out.

Under section 177CB(3), this must be based "on a postulate" that is a reasonable alternative to entering into or carrying out the scheme". As noted above, that sounds reasonable, until the constraint in section 177CB(4) is taken into account.

But I do not see the same kinds of case management issues arising, unless the Commissioner boldly tries to run a reconstruction case as an alternative to an annihilation case.

That has the attraction of avoiding the traps of annihilation cases that fall flat, the facts annihilated leaving nothing on which the tax law operates adversely.

But it does have the potential to embarrass the taxpayer, in the technical sense used in litigation.

4 Attempted refocusing of s.177D

Section 177D was re-enacted. As we shall see in a moment, the 8 factors remain intact.

But the purpose of re-enactment was to refocus the central provision, which is about purpose, on determining whether the persons concerned had the proscribed purpose.

It is best to see this laid out on the page. I will stop at subsection (1) in the new law:

Old law:

> *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: ... [the 8 factors]*
>
> *... 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*

New law:

> *This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) 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:*
>
> *(a) enabling a taxpayer (a* **relevant taxpayer** *) to obtain a tax benefit in connection with the scheme ...*

The short point here is that this shuffling of words on the page has proved too subtle for all but its designers. The point was to put the focus on purpose, not tax benefit.

But without a tax benefit, there is no forensic focus: and no intelligible scheme.

The EM will repeatedly be read to Courts, on the instructions of the Commissioner. The Courts will not appreciate the cleverness and subtlety of this reverbalisation. I predict that this aspect of the reforms will not achieve its purpose.

5 New words leave 8 factors intact

Section 177D was replaced.

The 8 factors in s.177D remain intact.

The taxpayer may still show that, having regard to those factors, no specified person entered into (or carried out) the scheme (or part of it) for a proscribed purpose.

The requirement of dominant purpose remains, in s.177A(5).

It is difficult to predict how the dynamics of recent cases might have changed, if the present Part IVA had governed. Forensic choices, including the shape of the scheme, may have been affected.

So it is unfair, in one sense, to ask whether cases would have been decided differently. The Court decides the case on the basis of what is presented. What is presented is governed by the forensic choices, which may have differed on both sides.

However, it is useful to note which of the schemes presented and tested in recent cases fell foul of the 8 factors.

Cases where the scheme as propounded by the Commissioner did not pass the purpose test were:

- *Noza*.[19] Gordon J, having found no tax benefit, went on to reject the application of Part IVA on the purpose test.
- *Macquarie*.[20]
- *Ashwick*.[21]

Cases where there was a finding, whether determinative or not, that the scheme propounded by the Commissioner did cross the purpose threshold, were:

- *British American Tobacco Australia.*[22] The Commissioner succeeded.
- *Citigroup.*[23] The Commissioner succeeded.

Some cases did not get to that point:

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[19] Gordon J found against the Commissioner: *Noza Holdings Pty Ltd v Commissioner of Taxation* (2011) 82 ATR 338, para 444. The Commissioner gave up on Part IVA in the course of the appeal, but was partially successful on other appeal grounds: 2012 ATC ¶20-313 at paras 3 & 93.

[20] *Commissioner of Taxation v Macquarie Bank Ltd* 2013 ATC ¶20-373 (Full Court)

[21] *Commissioner of Taxation v Ashwick (Qld) No. 127 Pty Ltd* 2011 ATC ¶20-255 (Full Court)

[22] *British American Tobacco Australia Services Limited v Commissioner of Taxation* 2010 ATC ¶20-222; [2010] FCAFC 130 (Full Court)

[23] *Commissioner of Taxation v Citigroup Pty Ltd* 2011 ATC ¶20-262 (Full Court)

- There was no tax benefit in *AXA.*[24] The Court concluded that the postulate ultimately relied upon by the Commissioner would not have occurred, since it assumed (amongst other things) that a bank would give up a fee.

- There was no tax benefit in *RCI*.[25] The tax costs of the alternative postulate were so large, in a transaction where there was already proved sensitivity to transaction costs, that the *reasonable expectation [was] that the relevant parties would have either abandoned the proposal, indefinitely deferred it, altered it so that it did not involve [the problematic transfer], or pursued one or more of the alternatives referred to in the Information Memorandum.*[26]

- Likewise, in *Futuris*.[27]

How would these cases have been decided under the new Part IVA. Doing a rough estimate, based only on those parameters, it appears that:

- The following cases would remain lost to the Commissioner: *Noza*, *Macquarie*, *Ashwick*, & *AXA.* The first three did not get over the purpose test. The last involved a postulate that was unreasonable.

- It hardly seems possible that the taxpayer could have done better, now, in *British American Tobacco Australia* and *Citigroup.*

- *RCI* and *Futuris* are the obvious targets of the new rules, restricting the construction of an alternative postulate, and excluding tax costs. It is likely they move from the taxpayers' camp into the Commissioner's.

That is rough and ready speculation. As noted elsewhere, we actually do not know what other evidence and arguments might have been available, or how the new provisions might have affected forensic choices (eg taking less risks, in a novel legislative environment).

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[24] 2009 ATC ¶20-151 (Jessup J); 2010 ATC ¶20-224 (Full Court).

[25] *RCI Pty Ltd v Commissioner of Taxation* 2011 ATC ¶20-275 (Full Court)

[26] Quoting in part from para 150, per Edmonds, Gilmoour & Logan JJ

[27] *Commissioner of Taxation v Futuris Corporation Ltd* 2012 ATC ¶20-306; [2012] FCAFC 32 (Full Court)

6 Words won't fix some things

6.1 A forensic choice

When you are called to the Bar, you take two mentors, your Masters, for a year. As my Senior Master, a military man, told me that year:

No plan survives contact with the enemy. And yet there must be a plan.

The advocate's work is the stuff of: split second choices and late-breaking instructions. I am not critical here of the advocates involved. No one who has run a trial could be.

I noticed these forensic issues that arose in the Commissioner's cases:

- If you run no evidence, to contradict the independent expert run by the taxpayer, you are left sniping from the sidelines.[28]
- Having been told that the taxpayer is not calling a witness, you cannot assume there will be an inference in your favour that the evidence of the witness would have been adverse to the taxpayer. Sometimes, the Commissioner has to approach, and possibly call, the witness himself.[29] If this means applying for an adjournment, and acting quickly to subpoena someone, so be it.
- If you fail to cross-examine on the scheme that you propound against the taxpayer, chances are that you will not be allowed to address on that scheme.[30]
- There is no point mincing words. If you are going to accuse the trial judge of bias, use that word.[31] If you do not, it should be concluded that you could not.

6.2 Who actually knows the facts best

The reason why the Commissioner does not bear the onus is that the taxpayer usually best knows the facts.

Above, I postulate that a consequence of an annihilation case for the Commissioner is the need to set out the scheme – the facts to be annihilated – with precision.

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[28] *Commissioner of Taxation v Futuris Corporation Ltd* 2012 ATC ¶20-306; [2012] FCAFC 32 (Full Court)

[29] *Commissioner of Taxation v Macquarie Bank Ltd* 2013 ATC ¶20-373, at paras 316-317 (Middleton & Robertson JJ), para 24 (Emmett J agreeing).

[30] *Noza Holdings Pty Ltd v Commissioner of Taxation* (2011) 82 ATR 338, paras 311-313. Gordon J does not appear to have acted solely on the basis of *Browne v Dunn* (1893) 6 R. 67 (HL). Rather, her Honour took into account cogent evidence concerning the risk of restructuring the transaction, in the way postulated by the Commissioner, given that a foreign tax ruling had already been given on another structure being pursued.

[31] *Commissioner of Taxation v Macquarie Bank Ltd* 2013 ATC ¶20-373, at para 309 (Middleton & Robertson JJ), para 24 (Emmett J agreeing).

But the taxpayer actually did the transaction. Realistically, the Commissioner's chances under an annihilation case, with reasonably complex facts, are probably not much better today.

7 Unit Trend

This is the High Court's decision about the analogue of s.177C(2). This is the exception to the definition of "tax benefit" in case the benefit resulted from an election etc. I set out the words from s.177C(2)(a), for an income case:

> *(i) the non-inclusion of the amount in the assessable income of the taxpayer is attributable to the making of an agreement, choice, declaration, agreement, election, selection or choice, the giving of a notice or the exercise of an option (expressly provided for by this Act or the Income Tax Assessment Act 1997) by any person, except one under Subdivision 126-B, 170-B or 960-D of the Income Tax Assessment Act 1997; and*
>
> *(ii) the 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 declaration, agreement, election, selection, choice, notice or option to be made, given or exercised, as the case may be; ...*

Division 165 of the GST Act did not have, until recent times[32], an equivalent of para (ii).

The key to the gate, for the taxpayer, was the requirement that the benefit not be "attributable" to an election etc. I notice that the words in GST are still "not attributable", whereas s.177C speaks of "attributable". This seems a small difference, but the weight of the High Court's reasoning in *Unit Trend* seemed to swing on that difference, between s.165-5(1)(a) of the GST Act, and former s.160K of the ITAA 1936. The latter (from which the taxpayer had drawn solace, in light of the High Court's decision in *Sun Alliance*[33]), was said to be distinguishable because it used the word "attributable", as opposed to "not attributable".

7.1 Something about the development

The facts are complex. At the heart of the controversy were elections for companies to be grouped for GST purposes; to sell part-completed residential towers to each other as going concerns; and to complete sales to the public under the margin scheme. The Commissioner was concerned that this gave a higher basis for determining the margin, under the margin scheme.

Subsequently, and indeed during the completion of retail sales, the margin scheme was amended to prevent some of the concerns arising.

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[32] An amendment occurred by insertion of section 165-5(3), applicable to choices, elections, applications and agreements made on or after 9 December 2008. It now prevents schemes to take advantage of an election.

[33] (2005) 225 CLR 488

7.2 History of Amendment of s.165-5

Importantly, section 165-5(1) provided that the division operated if, relevantly, an entity got a GST benefit from a scheme, and the "GST benefit is not attributable to the making, by any entity of a choice, election, application or agreement that is expressly provided by the GST law …".

Only operative from 9 December 2008, new subsection (3) provided that a GST benefit from a scheme was not to be taken to be attributable to such a choice etc. if:

- The scheme, or part of the scheme, was entered into or carried out for the sole or dominant purpose of creating a circumstance or state of affairs; and
- The existence of the circumstance or state of affairs is necessary to enable the choice etc.

7.3 Unit Trend Services

Unit Trend Services concerned tax periods prior to the effective date of the insertion of section 165-5(3).

It was thus a curiosity that the Commissioner sought special leave to appeal from the decision of the Full Federal Court, but the Commissioner was able to show that the change did not limit the utility of his appeal.[34]

The application for special leave to appeal highlighted the following as grounds:

- The majority of the Full Court erred in their interpretation of s.165-5(1)(b), and should have given that provision the interpretation arrived at by Dowsett J (who dissented).
- On the findings of fact made by the Tribunal, the Full Court should have decided the GST benefit was not "attributable to the making of a choice" provided by the GST law.
- There was an error in concluding that section 165-5(1)(b) "excluded the application on Division 165 when the elements of the scheme which produced the GST benefit included an element … which is not a choice expressly provided for by the GST law … and … absent which the GST benefit would not be produced or would be different".

Section 165-5(1)(b) "excluded the application of Division 165 when a GST benefit is produced by a scheme, the elements of which include more than one choice expressly provided for by the GST law".

As we now know, that side of the argument prevailed.

[34] (2013) 297 ALR 190 paragraphs 66-67

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7.3.1 The Dissent in the Full Federal Court – Dowsett J

In dissent in the Full Federal Court, Dowsett J focused on the word "attributable" and cited *Sun Alliance*, to which I have referred above.

> *His Honour said, in construing the word "attributable", it was necessary "to consider the purpose of Div 165 as a whole": paragraph 39. He began with the objects provision, section 165-1. Curiously, his Honour pointed to the lack of congruity between the objects provision, and what the substantive provisions set out to achieve: paragraph 40.*

The OED definition of "attributable" meant "capable of being attributed or ascribed, esp. as owing to, produced by": paragraph 43. His Honour then framed the question in these terms: (paragraph 43)

> *For present purposes, then, the question is whether or not the reduction in Unit Trend's GST liability, effectively as the result of the intermediate sales by Simnat to Blesford and Mooreville, was attributable to the identified scheme or to a choice expressly provided for in the GST law.*

His Honour doubted that the GST benefit could be seen "as the product of a number of choices expressly provided for by the GST law". His Honour read section 165-5(1)(b) as contemplating "a direct link between the benefit and the relevant choice": paragraph 46.

His Honour found that the scheme which produced the benefit: (paragraph 48)

> *... included the intermediate sales by Simnat to Blesford and Mooreville. Such sales lay at the heart of the scheme, even if the various choices were also necessary integers of it. In my view, the GST benefit was attributable to the events of which such sales were necessary parts, in other words, the scheme. In those circumstances, the benefit was attributable to the scheme, and not to any particular choice expressly provided for by the GST law.*

His Honour expressly rejected the argument, still maintained by the Commissioner in the application for special leave, that section 165-5(1)(b) could only apply where the particular scheme only involved one choice, election, etc.: paragraphs 46-47.

7.3.2 Majority Approach – Full Federal Court

Bennett and Greenwood JJ noted the Commissioner's contention that "the GST benefit arose out of a combination of factors including the transfer of ownership of [the two towers to related companies] and sales by those companies under the margin scheme contract": paragraph 136.

Their Honours found that there was no reason that the words "attributable to" should bear anything other than their ordinary meaning. They also referred to *Sun Alliance*: paragraphs 181-182.

Their Honours determined that the "... statutory purpose of the provision in excluding the operation of the anti-avoidance Division is to preserve the entitlement to and effect of the specific legislative options, choices, elections, etc. expressly provided for under a GST law". This was to preserve "...

benefits that might otherwise be defeated by an unintended operation of Division 165", and so section 165-5(1)(b) "... ought to be construed in a way that gives effect to that purpose": paragraph 192.

Thus s.165-5(1)(b) prevents Division 165 "... operating if the GST benefit has the relevant degree of connection with the making of expressly conferred choices, etc.": paragraph 193.

The Majority's reasons then become quite difficult to follow, from paragraph 194.

Doing the best that I can, I consider that these are the relevant principles to be derived:

- The exclusionary provision, section 165-5(1)(b), turns on whether the GST benefit "... is caused in an allocative sense by the choices made by the taxpayer in the sense of belonging to the choices, elections or agreements expressly provided for by the GST law": paragraph 196.
- The meaning of "allocative sense" is explained, to paraphrase paragraph 194, as asking whether the nexus between the GST benefit and the exercise of the statutory choice is sufficiently close to provide an answer to the question, is the choice etc. made by the taxpayer as expressly provided by a GST law, the predominant cause or the direct cause of the GST benefit?
- The term "allocative sense" does not allow for "... a concept of causation in which the relevant choice etc. is simply one of a number of contributory factors": paragraph 194.

Their Honours found that, had the various choices not been made, and particularly to apply the margin scheme, the GST benefit calculated on the end-purchaser transaction would not have arisen: paragraph 199.

Thus the GST benefit was attributable to the choices.

7.3.3 Arguments on Appeal to the High Court

The construction put forward by the Commissioner of the meaning of "attributable" would call for:35

> *… some sufficient relationship to exist between the tax benefit and the choice and, while the degree of sufficiency may still be an area for debate or exploration, it is unlikely that the requirement that the tax benefit be attributable to the choice will be satisfied merely by saying the "but for" test*".[36]

Pagone J's paper at the TEN GST symposium in 2012 year was relied upon, saying:

> *The use of the words "expressly" preceding the word "provided" is presumably intended to require the identification of some legislative purpose for the advantageous GST consequence and not merely something which was part of the general structure within which manipulation might be possible …*"

[35] The Commissioner's argument is available for download from the High Court of Australia's website. It is difficult to do justice to a complex document and a few lines.

[36] Submissions, paragraph 37, quoting from a paper by the then Mr Pagane QC written in 2004.

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The Commissioner, while critical of the majority's decision below, in failing to use precise language, did not himself settle upon particularly precise language (at paragraph 39 of his submissions).

The matter was heard, both for the adjourned special leave application and the substantive appeal, on 14 March 2013. The decision, granting special leave and allowing the Commissioner's appeal, was made on 1 May 2013.

7.3.4 Decision of HCA[37]

The High Court unanimously (French CJ, Crennan, Kiefel, Gageler & Keane JJ) gave the Commissioner special leave to appeal, and allowed the appeal with costs, remitting one aspect of the matter concerning penalty to the Tribunal for further consideration.

The Commissioner argued that the Full Federal Court's approach did not achieve the purpose or object of Division 165 in that the purpose of section 165-5(1)(b) "was to prevent the anti-avoidance provisions in Div 165 applying to a person merely by reason of the exercise of a right to make a choice expressly provided for by the GST Act": at paragraph 40. "Scheme" encompasses the making of a choice expressly provided by the Act. The argument was that section 165-5(1)(b) was "intended to make Div 165 inapplicable where the GST benefit is produced by an individual statutory choice, taken discretely, but only in such a case".

The Commissioner also said that a mere "contributory causal connection with a statutory choice" was not sufficient to remove a scheme from Division 165. The connection between the statutory choice and the GST benefit must be closer than simply satisfying a "but for" test. The relationship of proximate or immediate cause and effect between the making of a choice and getting the GST benefit, must exist: at paragraph 41.

Arguing for a less stringent required relationship between the exercise of a choice, and the tax benefit, the taxpayer relied on *Commissioner of Taxation v Sun Alliance Investments Pty Ltd* (above) in which the High Court had spoken about the key word, "attributable", in the context of a CGT provision. Recall that the High Court had said in that case that the words "attributable to" simply involved "some causal connection", and that the connection "need not be the sole, dominant, direct or proximate cause and effect", so that a "contributory causal connection" was quite sufficient.

The taxpayer's second argument was that a GST benefit only arose on the making of each choice to apply the margin scheme, to an end sale, so that the relationship between the choice to apply the margin scheme and the GST benefit, satisfied even a test of proximate or immediate cause as argued by the Commissioner: at paragraph 45. In other words, it was said that the GST benefits were not got from the scheme identified by the Tribunal, but directly from the choices to apply the margin scheme after the sales of the developed product were complete.

Finally the taxpayer argued that the addition of section 165-5(3) since the transaction reflected an appreciation on the part of Parliament that, without that subsection, section 165-5(1)(b) "was not apt to exclude GST benefits of the kind in question": at paragraph 46.

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[37] *Commissioner of Taxation v Unit Trend Services Pty Ltd* (2013) 297 ALR 190; 2013 ATC 20-389.

The High Court's decision continues its tradition of close scrutiny of the text of the legislation.

To begin, before one reaches the question of whether a benefit is "not attributable" to the making of a choice etc., one must go through an initial enquiry in an earlier subparagraph, section 165-5(1)(a), as to whether the entity got a GST benefit from a scheme.

The High Court observed that, under the scheme found by the Tribunal, the amount of GST payable by the taxpayer was smaller than it would be without the scheme because of the intermediate sales, prior to the consumer sales. Here the GST benefit from the scheme, which Division 165 was invoked to negate, was a benefit obtained as a result of intermediate sales, noting that the GST benefits associated with the choices to effect the sales as intra-group sales of a going concern were not in issue. (The benefit was realised on the final sale.) See paragraph 48.

One only gets to section 165-5(1)(b) once there has been an identified GST benefit "got … from a scheme".

The High Court then noted that the language around the word "attributable" in this provision was different from the language used in *Sun Alliance*, so that the question under the GST law was whether the GST benefit was "not attributable to" the choice or election.

In Sun Alliance, the question was whether the amount of the distribution was attributable to profits.

Thus, the High Court now said that the difference in language meant that section 165-5(1)(b) did not "invite an enquiry as to causality to differentiate the effect of the scheme from the exercise of a statutory choice.

Rather, the phrase is concerned with whether the GST benefit in question, which … has been got from the scheme, is not one to which the exercise of a statutory choice has entitled the taxpayer": paragraph 50.

The High Court drew an analogy with the so called "choice principle" which affected the application of the old section 260 Income Tax Assessment Act 1936, which was said to be designed "to protect the general provisions of the Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them": at paragraph 52. Section 165-5(1)(b) did have a purpose, to ensure "that those GST benefits got from a scheme, but not attributable to the making of a statutory choice, are not immunised against the possible operation" of Division 165.

It is also instructive to see how much the High Court is looking at Explanatory Memoranda nowadays, despite the Court's focus on the text of the legislation. In the Supplementary Explanatory Memorandum, which dealt with the introduction of section 165-5(1)(b), a few examples were given of choices and elections which were not intended to be caught, noting that the Supplementary Explanatory Memorandum was speaking of an era just before commencement of the GST:

- An exporter electing to have monthly tax periods in order to bring forward entitlement to input tax credits.
- A supplier of child care applying to register under the Child Care Rebate Act, the effect of which would be to make supplies of child care GST free.

- A supplier choosing for WET purposes to use the average wholesale price method for working out the taxable value of retail sales of grape wine.
- A bank (which would have limited access to input tax credits after the commencement of GST) bringing forward fleet servicing for its cars.

The Court concluded that the choices etc. made along the way toward the final sale to consumers, which involved intra-group sales and sales under the going concern concession, were not choices or elections that created a GST benefit under the scheme. The GST benefit grew out of sale by some entities to another entity after the substantial increase in the value of the properties, so that there was an uplift in the intermediate cost base from which the GST benefit was got: paraphrasing paragraph 58.

The High Court also said that the choice to apply the margin scheme was the very same choice that would have been made by the original owners of the land, without the scheme: at paragraph 62. No GST benefit was attributable to that.

The second, and quite interesting reactive argument, on the part of the taxpayer was that the GST benefit was got from the decision to apply the margin scheme at the conclusion of sales of the developed product. I say this is a reactive argument, because it appeared to grow out of the focusing of the Commissioner's argument when the matter came before the High Court. The difficulty with this argument was that section 165-10(1)(a) requires you to focus on the benefit as "a matter of monetary value got from the scheme, rather than of legal forms or the timing of the getting of the benefit": paragraph 65. Thus the GST benefit here could not be identified in terms of monetary value "without recognising the decisive effect of the uplift from the sales" by the original owners of the land, on the intermediate cost base: at paragraph 65.

Finally, and as material both to grant of special leave and the appeal proper, the taxpayer pointed to the insertion of section 165-5(3), mentioned above, and said the insertion of that provision should be regarded as an acknowledgement that, without it, a situation such as the present was excluded from the operation of Division 165 by section 165-5(1)(b).

The High Court agreed with the Commissioner's argument that sections 165-5(1)(b) and 165-5(3) had independent operation. You must address the first of those subsections before addressing the second subsection. The second then addresses "whether it was the purpose of the scheme to create the occasion for the exercise of that choice": see paragraph 66.

7.3.5 Disposition

The question of remission of penalty in relation to the Division 165 declaration has been sent back to the Tribunal for further consideration. Some parts of the Full Federal Court's orders were also left untouched, remitting the matter (so far as it related to supplies made on or after 17 March 2005) to the Commissioner for reconsideration in light of any further valuations for the margin scheme.[38]

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[38] See the report in the Australian Tax Cases, 2012 ATC pages 14, 027-2 to 14,027-3. I do not know what is in fact happening.

7.4 Implications for income tax

The most interesting feature of *Unit Trend* is that the High Court deliberately distinguishes the language "not attributable", as used in the GST Act, from the word "attributable" in the income tax law.

The width of the word "attributable" is noted above.

7.4.1 What alleged "tax benefits" are sheltered?

Exact scrutiny of the relationship between the election etc, and the tax benefit is required.

First the election etc must be expressly provided by the Act. As Hartigan J said:[39]

> *The lynch-pin of sub-section 177C(2) is undoubtedly the words "expressly provided". The clear intention of those words and the structure of the ITAA itself is that it is not sufficient that the ITAA merely recognize that there are certain legal relationships which might produce an effect on the income of a taxpayer but rather, the ITAA must itself expressly give a choice which has the result, when taken advantage of, of producing a tax benefit.*

In *Noza*, the taxpayer pointed to the election to consolidate, and claimed that the disputed deduction was not attributable to the election to consolidate. This was rejected. All the election to consolidate had done was move the availability of the deduction up the corporate chain, to the head company of the group.[40]

7.4.2 Schemes to put the taxpayer in the position to elect

Unit Trend only indicates that one of the guardians, at the door to immunity of a "tax benefit", may be sleeping. It deals with provisions like those discussed under the last sub-heading, 6.4.1.

Section 177C(2) has always had an additional provision.

It is aimed at preventing a tax benefit from being sheltered, if it resulted from a scheme to enable the election etc to be made.

The provision for most types of income, in s.177C(2)(a)(ii), says:

> *the 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 declaration, agreement, election, selection, choice, notice or option to be made, given or exercised, as the case may be ...*

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[39] *TT87/153 and 199 and Commissioner of Taxation* [1989] AATA 152; *AAT Case 5219* (1989) 20 ATR 3777; *Case W58* 89 ATC 524, para 63

[40] *Noza Holdings Pty Ltd v Commissioner of Taxation* (2011) 82 ATR 338, paras 289-290 (Gordon J)

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This has rarely been tested.[41]

An AAT case excluded this exception to the definition of "tax benefit", Mr McCabe (Senior Member) deciding:[42]

> *48. The applicants say an election under s 122-A ITAA97 is an election referred to in s 177C(2)(a)(i). The elections in these cases meant each of the wholly-owned companies took the rolled-over asset subject to the same cost basis it had in the hands of the applicant who transferred the share. When each company sold its share in due course, the capital gain (if any) made by the company on the sale would be calculated subject to the same cost base as that of the applicant (ie, $1). The applicants would not be obliged to pay tax on any gains following those sales since the gains were made by someone else. The applicants say that whatever happens to the assets after they were rolled-over has no tax consequences for them.*
>
> *49. The difficulty here is that the applicants did contrive to receive the proceeds of the sale of the shares to their in-laws. In particular, they each received $349,999 more than they paid for the shares in the first place. Yet they claimed they did not make a taxable capital gain.*
>
> *50. That cannot be right. While it is true the applicants did not make an assessable capital gain on the sale to the wholly-owned companies by reason of the election, the tax benefit in question here arises out of the subsequent steps in the scheme that led to an uplift in the cost base of the share – namely (in the case of Mr QT2004/186) the sale of the share by AH Company on behalf of the A Trust to the trustee of the D Company trust for a deemed price of $350,000. (In the case of Mrs QT2004/187, it was the sale of the share by AH Company as trustee of the A Trust No 2 to the trustee of the D Company No 2 trust at the same deemed price.)*
>
> *51. It follows the applicants are unable to bring themselves within the exception provided for in s 177C(2)(a)(i). I am therefore satisfied they have derived a tax benefit within the meaning of the legislation in the amount of $349,999. …*

Greenwood J affirmed Mr McCabe's decision.[43]

This type of provision is not uniform.

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[41] At first instance in *Ashwick*, Ryan J held that the deductions in question arose out of the loss transfer agreements, and that there was no scheme to put the taxpayers in a position to make those agreements: *Ashwick (Qld) No 127 Pty Ltd v Commissioner of Taxation* (2009) 77 ATR 92 at para 237. The Full Court found, however, that there was a tax benefit, but did not deal with s.177C(2).

[42] *Taxpayers and Commissioner of Taxation* [2005] AATA 1251; (2005) 61 ATR 1132; 2006 ATC 101 at paras 48-51

[43] *Walters v Commissioner of Taxation* [2007] FCA 1270; (2007) 162 FCR 421; (2007) 67 ATR 156

Section 177C(2A) concerned intra-group asset and loss transfers. It was the provision relevant to *British American Tobacco Australia Services Ltd v Commissioner of Taxation.*[44] The guardian provision read:

> *... the scheme consisted solely of the making of the agreement or election ...*

It was tested in *British American Tobacco Australia.*

The taxpayer had argued that the term "scheme" in that provision should be confined to making the choice, in the face of the wide definition of "scheme". The argument was rejected.[45]

The Full Court said in *British American Tobacco Australia:*

> *34 If the scheme did consist solely of the making of the choice, as commonly occurred at the end of a financial year between group members in the period prior to consolidations, the exclusion would apply. That is not this case. Here, contrary to the Appellant's submissions, there were relevant steps that took place both before ... and after the rollover ... Those steps were not "merely context" but part of the scheme. .... The Scheme did not consist solely of the making of the choice. The making of the choice was part of a wider scheme.*

I conclude that:

- *Unit Trend* tends to open the door a little to an argument that a tax benefit is sheltered where "attributable" to an election etc; but
- *Walters* and *British American Tobacco Australia* remind us that income tax has always had a second guardian on the door to immunity of a tax benefit on this ground. Whether worded as preventing a scheme for taking advantage of the election etc, or worded as a scheme comprising solely the making of the choice, this guardian is effective.

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[44] 2010 ATC ¶20-222; [2010] FCAFC 130 (Full Court)

[45] At paras 28, 31.

8 Conclusions

The amendments do make a difference, so far as they tighten the determination of tax benefit.

There is new clarity around the two old limbs of s.177C, "would", and "might reasonably be expected to".

The reworking of the former, through s.177CB, does pose forensic (and potentially case management) issues for the Commissioner. The way the annihilation arm works in practice has potential for all but the most disciplined litigant to become entangled.

The latter limb leads to surprising results.

The refocussing of s.177D, on purpose instead of tax benefit, must have been done through a lens coated with Vaseline. The new wording seems to have been the result of the same design techniques that gave us the camel.

Surprisingly, *Unit Trend* opens new enquiries about the scope of the exception to s.177C, where the tax benefit results from an election etc. I caution that this exception has another, rigorous guardian.

Exciting times lie ahead.

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