THE TAX INSTITUTE

THE MARK OF EXPERTISE

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Dear Ms Trebilcock,

Revised PSLA 2005/24 Application of General Anti-Avoidance Rules

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to the revised *PSLA 2005/24 Application of General Anti-Avoidance Rules* (**Draft PSLA**).

We set out below a number of issues for your consideration.

Substantive issues

1. Narrow interpretation of the "tax benefit" test

The Draft PSLA recognises that there is uncertainty concerning impact of the 2013 amendments on the application of Part IVA. In particular, the Draft PSLA asks whether section 177CB of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**) merely provides a further limit on the "tax benefit" concept, while otherwise leaving the operation of section 177C as previously understood intact and concludes that it does not. We contend that the Draft PSLA position is not the better view. The contrary view is the correct interpretation of the effect of the amendments to the general anti-avoidance rule and is supported by the proper approach to statutory interpretation.

At paragraph 76 in the Draft PSLA, the ATO acknowledges that a literal interpretation of sections 177C and 177CB is open such that "the sole effect of new section 177CB is to provide a further restriction, or condition, on what can be a tax benefit".

However, at paragraph 77, the ATO identifies its preferred approach which is that section 177CB, specifically subsections 177CB(2) and (3), replaces rather than adds to the "tax benefit" test in section 177C. The ATO grounds its preferred approach by

recourse to extrinsic materials (although none are directly referenced in PSLA 2005/24).

As a consequence of this position, at paragraph 75 the ATO notes previous case law on the "tax benefit" tax is taken by the ATO to no longer be authoritative on this element of Pt IVA ("the tax benefit test").

As an example of this issue, we refer to paragraph 82 of the Draft PSLA which addresses the question whether there is more than one reasonable postulate that satisfies subsections 177CB(3) and (4) in a given case. In our view, the position taken by the ATO in paragraph 82 will be affected by whether the old case law, such as *FCT v AXA Asia Pacific Holdings Ltd* 2010 ATC 20-224 has a residual relevance. If it does, then arguably "a reasonable" postulate under section 177CB must still reflect "what particular activity … might reasonably have been… undertaken if the scheme was not entered into" (per the *AXA* case at paragraph 132) as has been held in respect of section 177C.

We submit that the ATO has overstated the re-write of the "tax benefit" test. It is evident there is some overlap between the operation of section 177C and the newly inserted section 177CB. However we see no basis in the reading of the provisions themselves or the extrinsic material (to the extent recourse to this material is permitted) which supports the view that the tax benefit test has been replaced in its entirety by section 177CB. Rather, our view is that section 177CB places guidance and controls on the tax benefit enquiry under Part IVA, in particular, to eliminate the "do nothing" defence and to eliminate the consideration of Federal income tax in the alternate postulate enquiry. Support for this view is detailed as follows.

Section 15AA of the *Acts Interpretation Act 1901* (Cth) (**Interpretation Act**) states "in interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act…is to be preferred to each other interpretation". By inserting section 177CB in the 2013 amendment, and choosing not to repeal section 177C, it is clear Parliament intended the operation of section 177C to "define the kind of tax outcomes…if Part IVA is to apply" to remain operative, with section 177CB addressing the perceived "weaknesses" arising from the operation of section 177C[1]. An interpretation where sections 177C and 177CB work in conjunction would best achieve the purpose of the Act and was clearly intended by the legislature in retaining section 177C.

Furthermore, according to the majority judgement of the High Court in *Project Blue Sky Inc v ABA* [1998] HCA 28, "a court construing a statutory provision must strive to give meaning to every word of the provision" [52], and in the event of conflict, "the conflict must be alleviated, so far as possible, by adjusting the meaning of the competing provisions to achieve that result which will best give effect to the purpose and language of those provisions while maintaining the unity of all the statutory provisions" [50].

[1] See the Explanatory Memorandum for *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* at paragraphs 1.27 and 1.72.

Therefore, in accordance with the statutory interpretation approach as prescribed in the Interpretation Act and the *Project Blue Sky* case, it is apparent that the ATO's approach in characterising section 177CB as a replacement to the tax benefit test is incorrect. In order to give effect to a harmonious construction of both sections 177C and 177CB, as well as the overall purpose of the anti-avoidance provisions, the best reading would be that section 177CB serves to elaborate and direct the operation of section 177C. The only restrictions imposed concern the reconstruction approach under section 177CB(3). These include a requirement to consider the commercial and economic substance of the scheme examined as distinct from its legal form or shape, and a requirement that tax cost considerations are disregarded.

Under this interpretation of sections 177C and 177CB, pre-2013 amendment case law on the "tax benefit" test remains authoritative except to the extent that case law concerns a restriction on the reconstruction approach under section 177CB.

We urge the ATO reconsider its interpretation of sections 177C and 177CB to be in line with the Interpretation Act and the *Project Blue Sky* case approach to statutory interpretation.

In addition, it would be useful if the ATO could consider including an express statement that, even if the criteria in section 177CB for identifying "a reasonable alternative" are regarded as unqualified by section 177C, the requirement of reasonableness still means that not every case where the taxpayer could conceivably have paid more tax will give rise to a tax benefit**.**

2. Clarification on the treatment of tax benefit in light of the discussion on *Lenzo* and Trail Bros cases in paras 59 and 60

The discussion in paragraphs 59, 60 and 92 with respect to how the pre-2013 amendment law applied to determining a "tax benefit" under section 177C requires further clarification. Specifically, *FCT v Lenzo* (2008) 167 FCR 255 and *FCT v Trail Bros Steel & Plastics Pty Ltd* (2010) 186 FCR 410 are presently introduced in paragraphs 59 and 60 in the context of a discussion concerning section 177C(1)(a), which relates to "an amount not being included in the assessable income of the taxpayer". The cases are introduced in this context notwithstanding that they both involved an allowable deduction as the relevant tax benefit in accordance with section 177C(1)(b), rather than assessable income under section 177C(1)(a). By combining together its discussion of tax benefits involving assessable income and allowable deductions, paragraphs 59 and 60 of the Draft PSLA fail to acknowledge the different ways in which the courts have approached the task of identifying a tax benefit by reference to an alternative postulate under subsections 177C(1)(a) and (b).

In addition, because *Lenzo* is initially introduced in paragraph 59 in the context of a discussion about assessable income, the Draft PSLA does not explain clearly the uncertainty that was created by the two decisions of the Full Federal Court, *Lenzo* and *Trail Bros*, with respect to tax benefits involving allowable deductions. This is

notwithstanding that the ATO appears to express a preference for the approach taken in *Lenzo* as the Draft PSLA:

(a) describes *Lenzo* in paragraph 59 as being "consistent" with the ATO view (albeit in the context of tax benefits involving assessable income); and
(b) suggests in paragraph 92 that it is not entirely clear that *Lenzo* is bound to be rejected notwithstanding the adverse judicial comments on the approach adopted in *Lenzo* in each of *Trail Bros*, *FCT v AXA Asia Pacific Holdings* (2010) 189 FCR 204 and *FCT v Ashwick (Qld) No 127 Pty Ltd* [2011] FCAFC 49.

To the extent that the ATO is expressing a preference for the approach adopted in *Lenzo* rather than the approach taken in subsequent cases, the Draft PSLA should explicitly state the basis for the ATO's preference and the implications of that preference for how the ATO will administer the law.

3. Interaction between Part IVA and tax consolidation rules

The Draft PSLA provides limited reference to schemes which necessarily require consideration of the Tax Consolidation Regime. Paragraphs 104 and 105 highlight the point that tax consolidation is not an impediment to the application of Part IVA per *Channel Pastoral Holdings Pty Ltd v FCT* [2015] FCAFC 57, however goes no further.

The entry into tax consolidation is now commonplace for groups and the potential for a "tax benefit" (being a single element of Part IVA) to arise is not extraordinary or reflective of an avoidance motive. In fact, while the *Channel Pastoral* decision helped address important questions on the interaction of Part 3-90 of the *Income Tax Assessment Act 1997* (Cth) and Part IVA arising from the *Macquarie Bank Limited v FCT* [2011] FCA 1076 decision, it is important not to lose sight of the fact that the necessary avoidance purpose could not be established in that case.

We consider it important that the ATO provide additional guidance in the Draft PSLA on the types of scenarios involving tax consolidation that are likely to require consideration of Part IVA. We recommend that emphasis be put on the fact that tax consolidation is an ordinary part of tax structuring and cases should be limited to those involving steps (likely of an artificial or contrived nature) to gain access to the tax consolidation regime (and associated benefits). We acknowledge that some relevant guidance exists in the Consolidation Reference Manual at C9-1-220. However, as the Manual will no longer be updated, it would be useful if the relevant guidance could be updated and expanded in light of the *Channel Pastoral* case and incorporated in the Draft PSLA so all relevant guidance is contained in one place.

4. Penalties (paragraphs 168-173 of the Draft PSLA)

The area of penalties in a General Anti-Avoidance Rules (**GAAR**) context is extremely difficult in cases involving multiple participants or existence of compensating adjustments. In practice, it is often the case that a 50% penalty (or 25% in the case of a

Reasonably Arguable Position) is imposed against the relevant tax benefit identified as the scheme shortfall. There may be significant issues regarding quantum of tax benefit and the net tax outcomes of a scheme that mean penalties assessed can in some instances exceed the total levels of tax actually avoided across all participants.

Given the significant quantum of penalty that may result, this can create significant tension between the ATO and taxpayers in seeking to address or resolve the matter. We submit that the ATO consider whether other options such as deferral of consideration of penalties be provided for in the Draft PSLA. Naturally, where issues of security for liabilities are in question, a deferral may not be appropriate.

While a penalty will ultimately be limited to the scheme shortfall for a particular participant, ATO guidance on the relevance of issues such as compensating adjustments to one or more participants as a potential basis for remission to other participants (for example, in a related party situation) would be beneficial.

5. GAAR and anomalous outcomes under the law

It is not uncommon for a situation to arise where the most common or usual method of achieving a particular outcome would give rise to an anomalous or unintended outcome, but due to the words of the law being clear, it is not possible to interpret the law favourably. In some such cases, the anomalous outcome can be avoided by adopting a different series of steps or changing the method of implementation, often with no materially different tax outcome. On one view of the law, the adoption of the different series of steps gives rise to a scheme, and the only purpose of undertaking that scheme is to achieve a more favourable tax outcome.

As a matter of policy however, it would appear desirable to facilitate taxpayers and tax advisers devising solutions to anomalous outcomes, rather than having to suffer the significant cost and uncertainty associated with advocating for law change. We appreciate that consultation is taking place to implement rules allowing the Commissioner discretion to solve certain such problems[2]. However, these rules are some time away from becoming law, and in any event will not in many cases be a viable solution (e.g. in time sensitive transactions, there may be no scope to obtain a Commissioner's ruling).

GAAR and tax planning

In many cases, the GAAR could be construed as applying to relatively straightforward tax planning decisions. For example, the section 128F exemption in the 1936 Act applies to certain debenture issuances, and also certain syndicated loan offerings. However, the two modes of issuance carry very different eligibility requirements, e.g. a syndicated loan facility must be at least $100 million. It is not uncommon for a syndicated loan facility that will be less than $100 million to be drafted as a loan note

[2] The proposed statutory remedial power

facility, so as to come under the debenture issuance exemption (this was common practice before the syndicated loan facility exemption was introduced).

On one view of the law, it would reasonably be expected that a syndicated loan facility would not be drafted as a loan note facility, and the only reason for adopting the loan note facility structure is to obtain an exemption that would not otherwise be available. The Draft PSLA should confirm that making planning decisions to take advantage of concessions specifically provided for in the law will not be subject to the GAAR.

Similarly, it should be made clear that the GAAR will not apply to other simple planning decisions, such as selectively selling a package of shares that have been held for 12 months, as opposed to selling a package of shares held for less than 12 months, notwithstanding that the only reason to do so would be for a tax advantage in the form of the CGT discount.

The Draft PSLA should also make clear that the mere careful ordering of a set of transaction steps to ensure that a particular tax outcome is achieved (e.g. the availability of rollover relief) should not fall foul of Part IVA, notwithstanding that on another possible ordering, the desired tax outcome is not available.

6. Inclusion of examples arising from 2013 NTLG workshop

We believe the Draft PSLA would benefit from the inclusion of more examples of specific situations in which Part IVA would be considered to apply or not apply. This could be achieved by inserting the examples from the 2013 NTLG Consultative Workshop on Part IVA amendments[3], and any other examples where the ATO has developed a clear view that illustrates a point of principle.

Minor Procedural matters

1. Paragraph 10

It would be useful to include some guidance in the paragraph to assist a business line to determine when an application for a private ruling or a Product Ruling involving a decision whether GAAR should apply should be referred to the Tax Counsel Network.

2. Paragraph 22

In our view, where a Tax officer seeks preliminary advice from the Panel, the Tax office should prima facie inform the taxpayer. In this regard, the word 'may' in the sentence beginning 'While there is no requirement to do so…' should be changed to 'should'. If some "important, sensitive, novel or complex" circumstances give rise to secrecy concerns, meaning that the taxpayer cannot be notified, then the criteria for identifying

[3] https://www.ato.gov.au/general/consultation/in-detail/technical-and-special-purpose-working-groups---minutes/part-iva-amendments/ntlg-consultative-workshop-on-part-iva-amendments/)

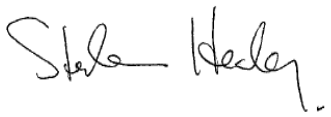
those circumstances should be identified as an exception to the general proposition that the taxpayer “should” be notified.

3. Paragraph 25

Paragraph 25 notes that a taxpayer ‘will usually be invited to attend a Panel meeting and address the Panel’. We query why a taxpayer could not be invited to address the Panel when the matter is referred for preliminary advice. Presumably this is a matter for the Panel rather than the officers to whom the Draft PSLA is addressed. On that assumption, for the purposes of the Draft PSLA we suggest that paragraph 25 should say only that the Panel does not normally invite taxpayers to preliminary hearings.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely



Stephen Healey
President