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2018 Private Business Tax Retreat
Managing Part IVA

Cameron Blackwood and Chris Aboud

Greenwoods & Herbert Smith Freehills

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Overview

- History of Part IVA
- Basic principles of Part IVA
  - The provisions
  - Part IVA framework
  - Tax benefit and importance of counterfactual
  - Purpose
- ATO warning signs
- Overview of situations where you may or may not be ok

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JACOBELLIS v. OHIO

Justice Steward in the US Supreme Court

In considering whether a film was protected by the US Constitution guarantees of freedom of speech, or not turned on whether the film was “obscene”:

> …[I]n *those cases was faced with the task of trying to define what may be indefinable. I have reached the conclusion, which I think is confirmed at least by negative implication in the Court's decisions since Roth and Alberts, that under the First and Fourteenth Amendments criminal laws in this area are constitutionally limited to [obscene material].*
>
> *I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.*

Or in the word of a Head of Tax I used to work for: *Pigs get fat and Hogs get slaughtered*

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Some history

Part IVA introduced in 1981 and replaced section 260:

Section 260	Issues with section 260
Operated to automatically void any tax avoidance transaction Every contract, agreement, or arrangement made or entered into … shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly: (a) altering the incidence of any income tax; (b) relieving any person from liability to pay any income tax or make any return; (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or (d) preventing the operation of this Act in any respect; be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act	Part IVA EM: 'Four broad categories of limitation on the scope of section 260, as exposed by judicial decisions, can be identified: (a) The '**choice principle**' is an interpretative rule according to which section 260 will not apply to deny to taxpayers a right of choice of the form of transaction to achieve a result if the Principal Act itself lays open to them that form of transaction. To do so does not alter the incidence of tax and this is so notwithstanding that the transaction in question is explicable only by reference to a desire to attract the operation of a particular provision of the Act and so achieve a reduction in liability to tax below what it would have been if that course had not been taken. (b) The section is expressed in such a way that the purposes or motives of the persons entering into an arrangement are not to be enquired into in deciding whether the section applies to the arrangement. Rather, the **'purpose' of an arrangement** is to be tested only by examining the effect of the arrangement itself. (c) It is unclear whether an arrangement to which the section is found to apply must be treated as wholly void or whether it can be treated as only **partly void**, i.e., to the extent necessary to eliminate the sought-after tax benefit. (d) The section does not, once it has done its job of voiding an arrangement, provide a **power to reconstruct** what was done, so as to arrive at a taxable situation.

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What did the EM say?

1981 EM: The proposed new Part IVA, which this Bill will insert into the Principal Act, is designed to overcome these difficulties and provide - with paramount force in the income tax law - an effective general measure against those tax avoidance arrangements that - inexact though the words be in legal terms - are blatant, artificial or contrived. In other words, the new provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered *into* for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income.

That test for application of the new provisions is intended to have the effect that arrangements of a normal business or family kind, including those of a tax planning nature, will be beyond the scope of Part IVA.

Howard as Treasurer:

We are acutely aware that the term "tax avoidance" means different things to different people.

Reasonable men and women are bound to differ on this crucial question and on the subsidiary matter of the appropriate tests for determining what behaviour a general anti-avoidance provision ougt to proscribe.

The proposed provisions - embodied in a new Part IVA of the Income Tax Assessment Act - seek to give effect to a policy that such measures ought to strike down blatant, artificial or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayer legitimately take advantage of opportunities available for the arrangement of their affairs.

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Part IVA is not a unicorn

Section 67 FBTAA

Div 165 GST Act

- like 1981 version of Part IVA – ie, without 2013 amendments
- but with ‘sole or dominant purpose’ or ‘principal effect’ alternative

Div 45 – Tax Admin Act

Art of the MLI art 6

State taxes

- ch 11A Duties Act (NSW)
- s. 47 Payroll Tax Act (NSW)

Note that prediction test still lives on

- s. 67 FBTAA
- Div 165 GST Act

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Experience with Part IVA

- About 150 Part IVA cases to 2016
- Divided …
  - about 30 are MNE-related
  - balance are SME issues
  - about 20 involve procedural issues about determinations / amended assessments / information etc
- Most cases involve
  - marketed agricultural schemes
  - marketed employment-based schemes
  - income splitting

LBI cases are rare; ATO wins only about 50%

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But a provision of last resort

Getting the **deal** right

- Implementing the transaction
- Try to be sure what is being alleged to be done can be done

Getting the **basic tax** right

- Incurred in being in business
- Necessary connection in earning business
- Sole purpose tests

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But a provision of last resort

Remembering **specific tax rules**

- Prepayment rules
- PSI rules
- Corporate law and trust loss rules
- Section 6-5 and s.8-1

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The provisions

Structure. Part IVA is a collection of 5 anti-avoidance provisions:

- GAAR: s. 177F(1)
- Dividend stripping: s.177E (which works via s. 177F) – s. 177E(1)(f)
- Dividend streaming: s. 177EA (which operates independently of s. 177F) – s. 177EA(5)
- Consolidated groups and franking credits: s. 177EB (which operates independently of s. 177F) – s. 177EB(5)
- Diverted profits tax: s. 177DA (which works via s. 177F)

This means Commissioner might make separate determinations under 3 provisions

Triggering event – the making of a determination under …

- non self-executing nature of s. 177F; cf s. 260 – deemed contract etc to be void
- which meant that s. 260 could be raised as an argument at late stages of proceedings; Part IVA cannot

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The provisions

Triggering event

The making of a determination under …

- non self-executing nature of s. 177F; cf s. 260 – deemed contract etc to be void
- which meant that s. 260 could be raised as an argument at late stages of proceedings; Part IVA cannot

Determinations

- Section 177F(1) – six possible determinations:
  - add amount to assessable income
  - deny deduction
  - capital loss not incurred
  - FITO not allowable
  - innovation offset / exploration credit
- Additional determinations in relation to dividend and franking credit stripping – s. 177E; 177EA; 177EB
- Typically also related machinery aspects:
  - whole or part of amount
  - add to particular year
  - under particular provision
- Compensating adjustments?

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The framework

1. Scheme

2. Tax benefit

3. Purpose

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Scheme

- Definition in s. 177A(1). Scheme means:

  (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and

  (b) any scheme, plan, proposal, action, course of action or course of conduct.

- So definition captures
  - 2-party arrangements – 'agreement …' etc
  - single actor decisions – 'plan … course of conduct' etc.

Confirmed in s. 1777A(3)

(3) The reference in the definition of scheme in subsection (1) … shall be read as including a reference to a unilateral scheme, plan, proposal, action, course of action or course of conduct, as the case may be.

Narrow v broad? Does it matter?

2013 amendments

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Tax benefit

GAAR

1. amount not include in assessable income – para (a)
2. amount being allowable as a deduction – para (b)
3. capital loss [added in 1997] – para (ba)
4. FITO [added in 1999] – para (bb)
5. an amount on which taxpayer could be expected to pay WT [added in 1996] – para (bc)
6. [also innovation tax offsets and exploration credits]

Others

1. Notional amount not being included in income under a dividend stripping scheme – s. 177E(1)(f)
2. Imputation benefit' – s. 177EA(3)(d), (16)
3. Credit' in franking account of head company – s.177EB(3)(c), (5)

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Tax benefit

- Compare provisions directed to paying no / less income tax – eg, s. 45B(9), s. 100A
- So, does a ‘tax benefit’ arise from
  - timing games
  - re-characterisation games
  - re-sourcing games
  - status games
  - access to other kinds of tax offsets
  - no PAYG withholding on wages / interest / dividend / royalty
  - no / lower PAYG instalment
  - treaty shopping – ie, non-resident from non-DTA country makes investment into Australia via letterbox

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Tax benefit and the counterfactual

Pre November 2012

Notion of 'tax benefit' is also used to create the analogy – ie, the action against which the taxpayer's actions are compared

> 'the amount that would have been … if the scheme had not been entered into or carried out'

The courts: 2009-2012

- Since 2009, fights over counter-factual became very important
- *AXA Asia Pacific*
- *Futuris*
- *Noza Holdings RCI*
  - taxpayer wins on basis that alternative with tax cost of $207m (instead of $35m) was so unlikely that 'there is no possibility that it would have occurred'

ATO response

Take tax benefit off the table as an out to being subject to Part IVA

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Tax benefit and the counterfactual

Response from Government

- New section 177CB leaves existing s. 177C law in place but builds on it !!!!
- New model works by constraining speculation in one of 2 ways
  - (probably) supplanting speculation entirely – s. 177CB(2)
  - redirecting how speculation is to be done – s. 177CB(3), (4)
- So, how much of s. 177C speculation survives? Do constraints change the test from
  - 'tax the taxpayer on what they would have done instead'
  - to either
    - 'tax the taxpayer on exactly what they did (minus the scheme),' or
    - 'tax the taxpayer on something with similar commercial consequences'?

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)

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.

177CB(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).

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Purpose

177D

- Purpose is made relevant through notion of a ‘scheme to which this Part applies …’ in s. 177D
- Schemes which are subject to Part IVA are those where:
- ‘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 … other taxpayers each to obtain a tax benefit in connection with the scheme

Some exceptions

s. 177C(2) – no ‘tax benefit in connection with a scheme’ if making an election specifically provided for in legislation

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Determining purpose

The conclusion about purpose is to be drawn 'having regard to …' the 8 factors in s. 177D(b)

(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)

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Determining purposes

The 8 factors

Notice that the 8 factors are all trying to isolate objectively observable facts / circumstances – eg,

- what was done under the scheme
- how was it done
- when it was done
- how long it took
- are any of the players related

Design features

- The inference is meant to be objectively drawn – ‘it would be concluded that …’
- The scheme is carried out by someone; the tax benefit is enjoyed by ‘the taxpayer’; who may be the same, but need to be
- In fact, the taxpayer need not even be the primary beneficiary; taxpayer will still lose benefit if purpose was to generate tax benefit for someone else and taxpayer tagged along
- The actor needs only carry out a part of the scheme, but the conclusion as to purpose is drawn in relation to ‘the [entire] scheme’

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The bad email…

Gummow and Hayne in Hart

In these matters, it is, of course, true that the money was borrowed to finance and refinance the two properties. Of course the loan was structured in the way it was in order to achieve the most desirable taxation result. But those are statements about why the respondents acted as they did or about why the lender (or its agent) structured the loan in the way it was. They are not statements which provide an answer to the question posed by s 177D(b). ***That provision requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any inquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.***

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The counterfactual and purpose

Yes?	No?
Hart?	Orica
BAT	The parties agreed, in my view correctly, that **the conclusion called for by s 177D about dominant purpose did not depend upon considerations about alternatives** that may need to be considered to determine whether a taxpayer obtained a tax benefit under the former terms of s 177C
Macquarie	
EM	
ATO	

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Warning signs: Case Law

	Theme	Examples
1	steps + beneficial provision activated	*RCI, BAT, Futuris*
2	steps + detrimental provision not activated	*CPH, AXA, Peabody*
3	tax consequences + no change in financial position	*RCI, Noza, Orica*
4	a simpler commercially equivalent transaction produces a worse tax outcome	*News Australia*
5	transaction doesn't make commercial sense without the tax benefit	*Citibank, Orica*

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Warning signs: ATO

	Item	Examples
1	out of step with ordinary dealings	n/a
2	more complex than necessary to achieve commercial purpose	interposed entities, intra-group dealings
3	certain steps serve no commercial purpose but deliver a tax advantage	round robins
4	tax and commercial outcomes diverge	tax loss on profitable transaction
5	uncommercial/non-arm's length terms	financial transaction above market rates

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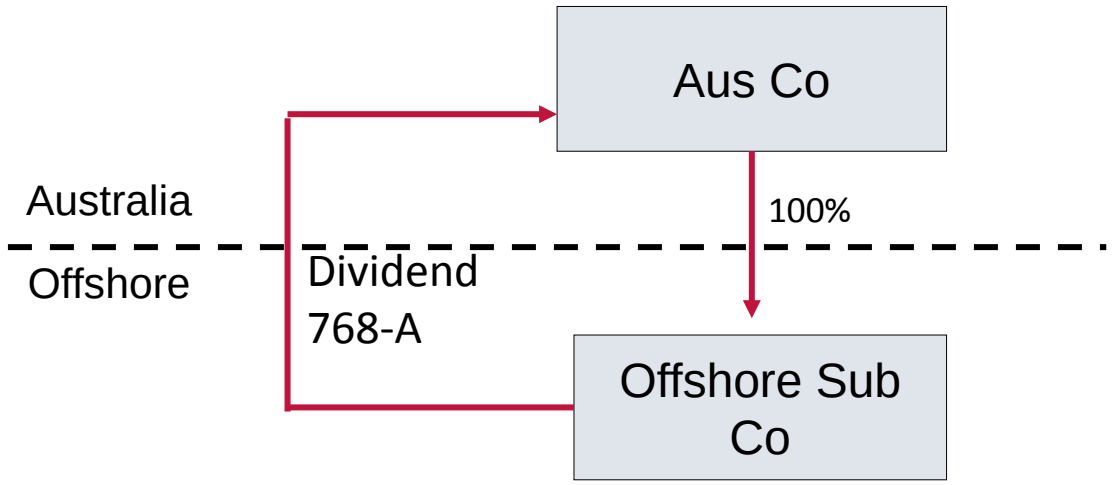
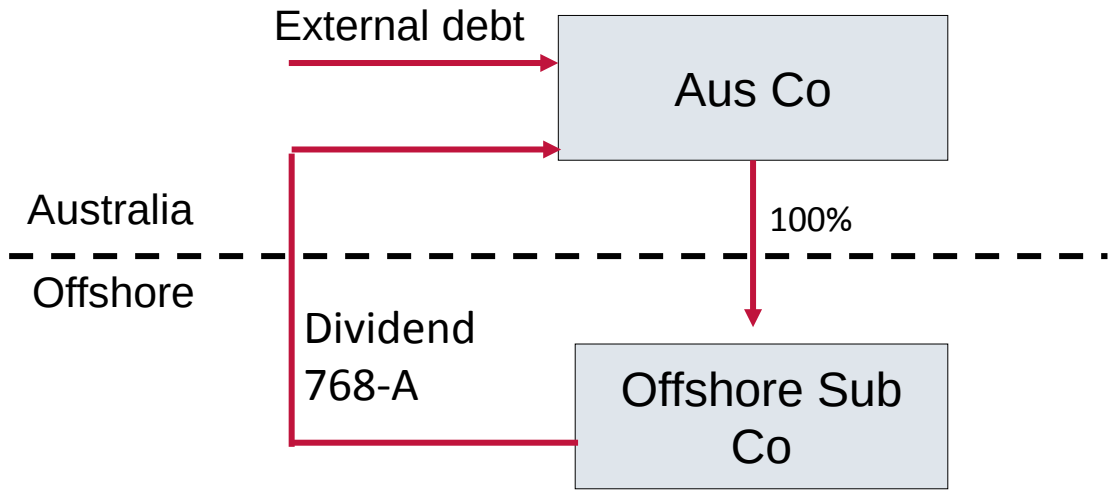
I don’t have an issue, do I?

- No abuse of tax policy

Example 1: Pre sale dividend	Example 2: Borrowing to acquire foreign shares
	
• RCI and NTLG Minutes	• Taxpayer Alert 2016/10

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I don’t have an issue, do I?

- Avoiding unintended tax outcomes
  - NTLG Minutes – ATO’s discretion
- Tax benefit arising under an integrity provision
  - Market value substitution rules, value shifting, off-market share buy backs rules s.47A, s.45B
  - Part IVA can apply to reconstruct tax outcome
- Takeaways?

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I do have an issue, don't I?

- Change of plans
  - Consider the following scenario:
    - A taxpayer proposes entering into transaction A
    - Subsequent due diligence establishes that transaction A would produce an unexpected adverse Australian outcome for the taxpayer
    - on advice, the taxpayer either modified or abandons transaction A and instead implements transaction B
    - transaction B produces a lower Australian tax cost for the taxpayer than Transaction A
    - there is a "smoking gun email" explaining that transaction A was abandoned for transaction A for Australian tax reasons.

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I do have an issue, don't I?

- Change of plans (continued)
  - ATO view on scheme / tax benefit / purpose

- Commercially equivalent options
  - Examples:
    - choice to sell shares in a foreign parent rather than its Australian assets
    - the choice to have a third party subscribe for shares in a subsidiary rather than the parent selling shares to that third party
    - the choice to raise funding by way of sale and lease back instead of entering into a loan

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I do have an issue, don't I?

- Commercially equivalent options
  - s.177D(2) maters
  - relevance of counterfactual?
- Arbitrating a bright line statutory test
  - Examples: 10 year borderline in Division 974, "safe harbour" for thin capitalisation purposes, 10% Subdivisions 768-A and 768-G tests etc.
  - Debt equity arbitrage: ATO relaxed
  - Small business CGT concessions: ATO not relaxed
- Accessing intended benefits

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Thank you

Please complete your evaluation forms.

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Tim Kyle and Cameron Blackwood
Directors
Greenwood & Herbert Smith Freehills

Presented by:
Cameron Blackwood and Chris Aboud
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CONTENTS

1 Overview

The topic of this paper is “managing Part IVA”.

This topic could potentially cover the full life cycle from transaction inception, through transaction implementation, ATO investigation and the litigation process.

But that is too much for a single paper to cover.

This paper focuses on the most important phase: the period of transaction design before transaction implementation and is based largely on a paper presented by Tim Kyle to the NSW Tax Forum in 2017.

This paper deliberately takes a practical approach by addressing the following questions:

- What context is relevant?
- Does the proposed transaction raise any Part IVA warning signs?
- What are the common situations where taxpayers think they are OK, but they may be exposed?
- What are the common situations where taxpayers think they have Part IVA exposure, but they probably are OK?
- What particular considerations apply to group restructures?
- What comfort can realistically be obtained on Part IVA?

Note that this paper focuses only on the core operation of the s.177D general anti-avoidance provision. It does not address the more specific aspects of Part IVA such as s.177DA (MAAL), 177E (dividend stripping), 177EA (franking credit anti-avoidance), 177EB (franking and tax consolidated groups) and s.177J (DPT).

For ease of reference, full citations for the cases referred to in this paper are set out in the appendix rather than in footnotes.

The views expressed in this paper are the authors’ personal views.

With the permission of Graeme Cooper, we have attached a paper from 2014 WA State Convention “Part IVA for SME Practitioners”.

2 Context

2.1 The Tax Act structural divide

The Australian income tax system draws a structural distinction between:

- permissible tax planning/mitigation – to which Part IVA does not apply;
- tax avoidance – to which Part IVA does apply; and
- impermissible tax evasion – to which criminal sanctions apply.

But how should the border between the first two of these behaviours be delineated?

Regard must be had to the following:

- the legislative text
- extrinsic materials
- case law
- ATO guidance

2.2 The legislative text

If certainty of outcome were the main goal of an anti-avoidance provision, it could easily be circumvented and so would not provide much deterrence.

As a result, most anti-avoidance provisions are deliberately drafted broadly.

Part IVA is no exception - the explanatory memorandum accompanying the 2013 amendments to Part IVA (**2013 EM**) observes at paragraph 1.10, the words of the provision are "inexact … in legal terms".

In his excellent paper,[1] Anthony Portas considers in detail the many decisions on Part IVA purpose. While a number themes can be extracted from these cases, no single coherent principle emerges.

This means that reasonable minds can (and do) differ about whether Part IVA applies to any given fact pattern.

Accordingly, many fact patterns fall in a "grey zone": they are neither clearly caught by, nor clearly out of, Part IVA.

[1] Portas, *Part IVA: Dominant Purpose – an Analysis of the Eight Factors*, The Tax Institute 2016 Queensland Tax Forum

2.3 Extrinsic materials

The explanatory memorandum and second reading speech that accompanied the introduction of Part IVA contain statements to the effect that:

- Part IVA was directed towards "blatant, artificial or contrived" schemes; and
- arrangements of a normal business or family kind, including those of a tax planning nature are beyond the scope of Part IVA.

These comforting statements were repeated in the 2013 EM.

But how much regard can permissibly be had to these statements in construing Part IVA?

The judicial appetite for resort to extrinsic material - such as explanatory memoranda and second reading speeches – waxes and wanes.

The period following *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 was marked by a greater focus on the role of context (including extrinsic material) in statutory construction.

However, this approach has been superseded (at least for the time being) by the more "black letter law" approach reflected in *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27. There, Hayne, Heydon, Crennan and Kiefel JJ stated at [47]:

> *"This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide to legislative intention. The meaning of the text may require consideration of the context, which includes the general purpose and policy of a provision, in particular the mischief it is seeking to remedy."* [Footnote references omitted]

Later in their joint judgment (at [51]), their Honours quoted with evident approval these observations made by Gleeson CJ in *Carr v Western Australia* (2007) 232 CLR 138 at [6]:

> *"[I]t may be said that the underlying purpose of an Income Tax Assessment Act is to raise revenue for government. No one would seriously suggest that s 15AA of the Acts Interpretation Act has the result that all federal income tax legislation is to be construed so as to advance that purpose. Interpretation of income tax legislation commonly raises questions as to how far the legislation goes in pursuit of the purpose of raising revenue. In some cases, there may be found in the text, or in relevant extrinsic materials, an indication of a more specific purpose which helps to answer the question. In other cases, there may be no available indication of a more specific purpose. Ultimately, it is the text, construed according to such principles of interpretation as provide rational assistance in the circumstances of the particular case, that is controlling."*

Interestingly, the current approach to statutory construction recalls the 1992 judgment of O'Loughlin J in *Peabody* at first instance – where his Honour rejected outright the taxpayer's argument that regard should be had to whether the transaction was "blatant, artificial or contrived".

It is also difficult to recall any Court placing too much emphasis on these words in construing Part IVA.

2.4 Case law

There is now a considerable body of Part IVA case law.

Despite this, the result of many Part IVA cases cannot be predicted with confidence.

That's because Part IVA cases tend to be fact specific - and they generate few general propositions that can readily be applied in different fact patterns.

Moreover, the logic underpinning many judgments is opaque. For example, it is rare that a Court gives any meaningful guidance as to:

- the relative probative value of the individual s.177D(2) factors
- what scheme differences would have produced a different outcome

Nevertheless, some lessons can be synthesised from case law (for example, see section 3.2 below).

2.5 ATO guidance

2.5.1 Overview

There is a lot of ATO published material on Part IVA.

Searching "177D" and "Part IVA" on the ATO legal database reveals:

- over 200 rulings and determinations
- over 80 taxpayer alerts
- almost 100 ATO IDs
- hundreds of private rulings on the private rulings database

But identifying coherent themes in all this material is challenging.

PS LA 2005/24 is the central ATO guidance product on Part IVA. However, as discussed in 2.5.2 below, it is short on practical guidance.

Greater practical guidance on the ATO approach to Part IVA is found in the minutes to the NTLG consultative meeting held in July 2013 (**NTLG Minutes**)[2] which are discussed further in the sections below.

[2] 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/

2.5.2 PS LA 2005/24

Preliminary

Although over 10 years old, PS LA 2005/24 was updated in 2016.

Broadly, the 2016 update does 3 things:

- addresses *certain only* of the interpretative issues that have been identified as arising in respect of the 2013 amendments to Pt IVA, which deal mainly with the "tax benefit" element;
- general updating, including for case law in the intervening 10 years; and
- relocates much of the purely internal ATO administrative aspects from PS LA 2005/24 to an internal ATO link.

As a result, PS LA 2005/24 provides only limited practical guidance on Part IVA.[3]

The role of practice statements

PS LA 2005/24 is a law administration practice statement (**PS LA**).

It is important to keep in mind that:

- PS LAs are not rulings and so do not bind the ATO to apply the law in a particular way – they provide no protection from primary tax and little protection against tax shortfall penalties;
- PS LAs are *not* designed to express precedential ATO views; and
- rather, practice statements are corporate policy instructions to ATO officers on the way in which they should apply the law.

Testing PS LA 2005/24 against its role

Consistent with the above, the stated purpose of PS LA 2005/24 is to "provide instruction and practical guidance to tax officers on the application of Part IVA and other general anti-avoidance rules".

However, PS LA 2005/24 has always been different to most PS LAs: rather than providing *practical* guidance to ATO officers, it provides *technical* guidance – and this almost exclusively involves summarising existing case law on the various elements of Part IVA, rather than expressing ATO views or directing ATO officers how to apply the provisions in particular scenarios.

In that regard, PS LA 2005/24 fares poorly when contrasted with the practical guidance issued in relation to the UK and New Zealand general anti-avoidance provisions.

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[3] Tim Kyle and Tim Neilson, "Draft update to PS LA 2005/24 on Part IVA " Thomson Reuters Weekly Tax Bulletin 42, 2 October 2015

It is unfortunate that the 2016 update to PS LA 2005/24 did not take the once in a decade opportunity to provide practical Part IVA guidance.

2.6 Practical considerations regarding Part IVA litigation

Taxpayers are at a particular disadvantage when it comes to litigating Part IVA matters.

2.6.1 Onus of proof in challenging amended assessments

In a Part IVC challenge to an amended assessment issued pursuant to a Part IVA determination, the taxpayer bears the onus of proving on the balance of probabilities that the amended assessment is excessive: s.14ZZO of the *Taxation Administration Act 1953* (Cth).

Effectively, the burden of this onus of proof requires the taxpayer to disprove the Commissioner's case.

As Carr J explained the position in paragraph 86 of *Eastern Nitrogen*:

> *In the terms of s 14ZZ0(b)(i), the appellant had the burden of proving that the respondent's assessments were excessive. In evidentiary terms, I think that means that if the appellant failed to establish objective facts, under the various categories set out in par (b) of s 177D, from which a reasonable person would not conclude that its dominant purpose in entering or carrying out the scheme was to obtain a tax benefit, it failed to discharge its statutory onus of proof.*

In practice, this onus can prove a considerable challenge for taxpayers.

2.6.2 Changing judicial attitudes

Taxpayers are at an additional disadvantage in Part IVA litigation because:

- parties enter into transactions based on their current understanding of the judicial approach to the application of Part IVA
- the Part IVA case may be heard many years after the transaction is implemented (eg, around 15 years in *Orica*)
- the judicial approach to the application of Part IVA is likely to have shifted significantly over that time
- consequently, what may have been regarded as acceptable tax planning at the time of implementation may turn out to be unacceptable tax avoidance when later reviewed by the courts

While the above is true of all tax provisions, Part IVA cases tend to have a long gestation period and there have been significant swings in judicial approach over time.

2.6.3 Time, cost and reputation

Part IVA litigation consumes considerable internal and external resources.

Moreover, the current public rhetoric about the need for corporates to pay their “fair share” of tax (whatever that means) has made boards increasingly hesitant about engaging in Part IVA litigation.

2.7 What can taxpayers do to manage Part IVA?

In summary, when it comes to Part IVA litigation, taxpayers are confronted by inexact legislation, extrinsic materials that are of potentially limited assistance, fact specific case law and decentralised/incomplete ATO guidance. Taxpayers are also at a particular disadvantage when it comes to litigating Part IVA matters.

Given this, prevention is far more preferable than cure - the most effective way for prudent taxpayers to manage their Part IVA risk is by ensuring that the transaction design phase does not produce a fact pattern that is known to be contentious.

Taxpayers can achieve this outcome by:

- ensuring that no known Part IVA warning signs apply to the proposed transaction (see section 3)
- testing whether their assumptions about where part IVA should not apply are correct (see section 4)
- testing whether their assumptions about where part IVA may well apply are correct (see section 5)
- considering what form of comfort as to the non-application of Part IVA is appropriate (see section 7)

Lessons derived from the case law dealing with group restructures are set out in section 6.

3 Part IVA warning signs

3.1 Overview

The Part IVA warning signs identified in this section are derived from two main sources:

- case law and dealings with the ATO (see section 3.2)
- PS LA 2005/24 (see section 3.3)

3.2 Themes emerging from case law

As discussed in section 2.4 above, Part IVA cases tend to be fact specific, which limits the ability to draw broad propositions from them.

Nevertheless, it is possible to extract certain themes that have proven contentious in Part IVA cases decided in a commercial context (ie, outside the mass marketed schemes and individual taxpayer contexts).

However, note that the presence of the themes identified below will not always lead to Part IVA being applied.

	Theme	Examples
1	The taxpayer takes preparatory steps so that the beneficial effect of a primary taxing provision is activated	• *Futuris*: the taxpayer took steps to activate value shifting provisions to increase cost base in an entity before floating it • *RCI*: a s.23AJ pre-sale dividend was facilitated by a revaluation of assets • *BAT*: the asset sale occurred after the merger and internal transfer so as to allow utilisation of losses • a corporate group takes steps to include or exclude particular entities from the consolidatable group before making a consolidation choice – as discussed in the ATO consolidation reference manual • a taxpayer takes preparatory steps in order to utilise CGT roll-overs – especially where successive rollovers are used[4]
2	The taxpayer takes preparatory steps so that the detrimental effect of a primary taxing provision is not activated	• *CPH*: the deduction quarantining provision was circumvented • *AXA*: the cost base transfer provisions in the scrip for scrip CGT rollover rules were circumvented • *Peabody*: the minority interests were devalued, ensuring that a subsequent sale (had it occurred) would not activate s.26AAA
3	Tax consequences arise	• *RCI*: all but $20m of the $318m dividend was satisfied by the issue of a

[4] See for example Class Ruling 2018/4.

	without a meaningful change in financial position	promissory note • *Noza*: the asset acquisition was routed through Australia, leaving back-to-back inbound/outbound RPS in place - and the RPS dividends were satisfied by the issue of promissory notes • *Orica*: an Australian company subscribed for shares in a US subsidiary which placed the subscription proceeds on deposit with the Australian company
4	A simpler commercially equivalent transaction produces a worse tax outcome	• *News Australia:* the share buy-back and fresh share issue produced a capital loss, whereas a transfer of shares would not have produced a capital loss
5	The transaction doesn't make commercial sense without the tax benefit	• *Citibank* • *Orica*

3.3 ATO's stated Part IVA warning signs

In paragraph 151 of PS LA 2005/24, the ATO sets out a number of matters that it regards as Part IVA warning signs.

The ATO explains the warning signs this way:

> ***Part IVA Warning Signs***
>
> *151. The presence of any of the following features whether alone or in combination in an arrangement may suggest that Part IVA applies to the arrangement. These features represent warning signs that the arrangement may be 'tax driven' and lead to a conclusion that the arrangement was entered into for the dominant purpose of enabling a taxpayer to obtain a tax benefit. The list of features is not meant to be exhaustive or exclusive and is provided only by way of guidance to officers who must consider and apply the provisions of Part IVA. The purpose in subsection 177D(2) can only be objectively ascertained by reference to the eight factors. Where any of the following features are present officers must consider the possible application of Part IVA in undertaking audits or issuing rulings to taxpayers:*

The warning signs are set out in the table below.

	Warning sign	Example given
1	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	• no example given

2	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	• transactions which interpose an entity to access a tax benefit • intra-group or related party dealings that merely produce a tax result • arrangements involving a circularity of funds or no real money
3	The tax result of the arrangement appears at odds with its commercial or economic result	• a tax loss is claimed for what was a profitable commercial venture or transaction
4	The arrangement results in little or no risk in circumstances where significant risks would normally be expected	• use of non-recourse or limited recourse loans which limit the parties' risk or actual detriment in relation to debts/investments • arrangements where the taxpayer's risk is significantly limited because of the existence, for example, of a 'put' option
5	The parties to the arrangement are operating on non-commercial terms or in a non-arm's length manner	• 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
6	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	• arrangements where a series of transactions taken together produce no economic gain or loss, such as where the whole scheme is self-cancelling

4 Where many expect to be OK - but may not be

4.1 Overview

There are a number of situations in which many taxpayers think that Part IVA shouldn't apply, such as:

- where the transaction does not involve abuse of tax policy
- where the transaction avoids what is clearly an unintended tax outcome
- where a tax benefit arises under an integrity provision

However, these circumstances do not involve a "get out of jail free" card for Part IVA.

Particular insights on the ATO approach to these issues come from the NTLG Minutes.

4.2 Abuse of tax policy is not a cumulative requirement of Part IVA

The general anti-avoidance rules in many other jurisdictions are only activated if there has been an intentional abuse of tax policy[5].

However, abuse of tax policy is not expressly a cumulative requirement of Part IVA.

Moreover, the ATO has indicated that it will not apply Part IVA as if abuse of tax policy were a cumulative requirement.

The ATO approach can be demonstrated through examples.

Example: pre-sale dividends

Pre-sale dividends can expose taxpayers to Part IVA risk.

For example:

- a foreign subsidiary pays a dividend to its Australian parent
- the dividend is s.768-5 NANE income
- shortly afterwards, the Australian parent sells the foreign subsidiary
- the Australian parent makes a taxable capital gain on sale (ie, the capital gain is not entirely disregarded by operation of Subdivision 768-G).

[5] Refer to the general anti-avoidance rules of Canada and the United Kingdom.

It is a deliberate and long-standing structural feature of the Australian income tax system that dividends from foreign subsidiaries can be dividended tax-free to Australian corporates.

Accordingly, it is difficult to discern any tax policy issue where a pre-sale dividend is paid out of profits (whether realised or unrealised) that accrued on the Australian parent's "watch".

The caveat to that proposition is where dividend stripping is involved (ie, where pre-sale dividends are paid out of profits that accrued before the Australian parent's "watch") – in which case the specific s.177E anti-dividend stripping provision should be activated.

Yet clearly in *RCI* the ATO considered the pre-sale dividend inflammatory.

And it is clear from the NTLG Minutes that the ATO still regards pre-sale dividends as fertile ground for the application of Part IVA.

The examples considered in the NTLG Minutes were designed to test the impact that a number of variables in relation to pre-sale dividends had on the ATO approach – including whether the Part IVA position improved if:

- the sale is to a third party rather than under a group restructure
- the dividend is paid out of realised profits rather than unrealised profits

Unfortunately the NTLG Minutes don't provide any clear guidance as to what particular features the ATO considers incline for or against activation of the s.177D(2) factors. Rather, the stated ATO view is that distinctions between group restructures and external sales and between realised and unrealised profits "are not particularly decisive".

Moreover, the ATO expresses the view that the finding in *RCI* (ie, that the requisite dominant purpose was not present) is confined to its facts.

Consequently, caution should be exercised when considering any pre-sale dividend.

Clearly, paying a dividend before a sale involves an "extra" step compared to a counterfactual of a sale without a pre-sale dividend. However, for the reasons given in section 5.3.3 below, the counterfactual should not be relevant to the purpose test.

Borrowing to acquire foreign shares

It is also a long-standing structural feature of the Australian tax system that interest on borrowed funds that are applied to acquire shares in foreign companies is prima facie deductible.

Section 25-90 was introduced because:

- given the fungibility of money, taxpayers were generally able to organise their affairs so that interest bearing debt had sufficient nexus to assessable income; and
- thin capitalisation limits were introduced simultaneously to prevent excessive gearing.

Moreover, the ongoing role of s.25-90 in the Australian tax system has recently been reinforced: the 2013 Federal Budget announced repeal of s.25-90 was abandoned following vigorous consultation.

Nevertheless, the ATO has shown through its actions and through the issue of TA 2016/10 that it is quite prepared to apply Part IVA when a taxpayer borrows to acquire shares in a foreign company – despite there being no abuse of tax policy.

Sometimes the ATO's attempts to apply Part IVA are successful (eg, *Orica*). Sometimes they are not (eg, *Noza* at first instance – the ATO abandoned the issue on appeal).

4.3 Avoiding unintended tax outcomes

Often particular steps may be taken in order to ensure that clearly inappropriate and unintended outcomes do not arise under primary tax provisions.

Again, no abuse of tax policy is revealed.

And many taxpayers would intuitively feel that Part IVA should not apply.

Nevertheless, the ATO approach reflected in the NTLG Minutes is that Part IVA can apply where taxpayers engage in an artificial or contrived scheme in order to avoid an unintended or capricious outcome produced by the primary taxing provisions.

Further, the ATO position is that, where the elements of Part IVA are present, it does not have an overarching discretion as to whether or not to apply Part IVA. There is some doubt about the accuracy of this ATO position.

Accordingly, if a taxpayer takes steps to "work around" an outcome that is "undesirable or unintended", the ATO position is that the s 177D(2) factors will be applied mechanically.

4.4 Where tax benefit arises under an integrity provision

There are many "integrity" rules in the primary tax provisions (ie, outside Part IVA) which alter/reconstruct the tax outcomes prima facie applying to particular transactions. For example:

- the many market value substitution rules
- the value shifting provisions
- the off-market share buy-back rules which bifurcate the purchase price
- s.47A which recharacterises as dividends transactions which extract value from CFCs
- s.45B which can recharacterise capital amounts as dividends

Typically these integrity provisions apply in a way that is unfavourable to taxpayers.

But sometimes they operate beneficially for taxpayers.

And if they do, Part IVA can apply to reconstruct for tax purposes the (already reconstructed) tax outcome.

For example, in *Futuris*:

- as a result of a series of transactions, the taxpayer received an $83m step up in the cost base of a subsidiary by (automatic) operation of the then value shifting rules – and so its capital gain on sale of that subsidiary was $83m lower than it would otherwise have been
- the ATO asserted that the taxpayer obtained a tax benefit equal to the cost base step up
- the taxpayer argued that it was nonsensical for a series of transactions that enlivened an integrity rule to be undertaken for the sole or dominant purpose of securing a tax benefit
- the Court held that the requisite dominant purpose was present because the transactions were undertaken in order to activate the value shifting rules and reduce the subsequent gain on sale

5 Where many think they are not OK - but probably are

5.1 Overview

The following fact patterns concern taxpayers and come up relatively regularly in practice:

- change of plans
- choosing between commercially equivalent options
- arbitraging a bright line statutory test
- accessing intended benefits

However, without more, these fact patterns should not of themselves cause Part IVA to apply.

5.2 Change of plans

5.2.1 The situation

In corporate life, transactions almost always evolve during the design phase.

Sometimes tax considerations contribute to the evolution process.

For example:

- a taxpayer proposes entering into transaction A
- subsequent due diligence establishes that transaction A would produce an unexpected adverse Australian tax outcome for the taxpayer
- on advice, the taxpayer either modifies or abandons transaction A and instead implements transaction B
- transaction B produces a lower Australian tax cost for the taxpayer than transaction A
- there is a discoverable "smoking gun" email explaining that transaction A should be abandoned in favour of transaction B for Australian tax reasons

Taxpayers in this position would typically be concerned about the application of Part IVA on the assumption that both the tax benefit and purpose requirements are satisfied.

5.2.2 Public ATO view on change of plans

The NTLG Minutes considered the change of plans issue in some detail.

It is of considerable comfort that the publicly stated ATO position attaches very little significance to the impact of changes of plans on the Part IVA analysis.

Rather, for the reasons summarised below, the emphatic ATO view expressed in the NTLG Minutes is that taxpayers merely changing schemes to produce a more advantageous tax result will not normally activate Part IVA.

Nevertheless, even if that is the correct technical position, caution should still be exercised.

Scheme

The ATO view is that the relevant scheme is confined to transaction B as actually implemented.

Restated, the ATO does not consider the relevant scheme to comprise all of planning transaction A, obtaining tax advice, changing plans to transaction B and implementing transaction B.

Tax benefit

A taxpayer's subjective purpose is irrelevant to the formulation of the objectively determined counterfactual - and so it will not automatically follow that transaction A is a permissible counterfactual.

However, despite this technical position, it would be difficult for ATO officers - and judges - to be so disciplined as to completely disregard transaction A in formulating the counterfactual for transaction B – and so, as a practical matter, a change of plans is likely to have some relevance to the counterfactual analysis.

Purpose

There are two relevant points to be made in relation to the purpose requirement.

The first is that the taxpayer will have abandoned transaction A and switched to transaction B with the subjective purpose of producing a lower tax outcome. However, it is well settled that the taxpayer's subjective purpose is not relevant to the (objective) Part IVA purpose requirement.

The second is that, as the ATO view is that abandoning transaction A in order to switch to transaction B does not form part of the relevant scheme, doing so cannot activate the s.177D(2) factors – and so a change of plans has no impact on the objective purpose requirement.

However, the ATO cautions that changing plans may introduce elements of complexity and contrivance which are capable of activating s 177D(2) factors. For example, Part IVA may be activated if transaction B involves additional steps for no readily explicable commercial reason.

5.3 Choosing between commercially equivalent options

5.3.1 The situation

One recurring situation is where:

- a taxpayer could implement a particular commercial transaction by one of two methods
- both methods start from the existing state of affairs and involve the same number of steps/parties
- neither method involves any particularly unusual or uncommercial steps
- method B produces a materially better Australian tax outcome for the taxpayer method A

It is common in this situation for taxpayers to be concerned about the potential application of Part IVA if they implement the transaction using method B.

Examples of this type of choice include:

- the choice to sell shares in a foreign parent rather than its Australian assets
- the choice to have a third party subscribe for shares in a subsidiary rather than the parent selling shares to that third party
- the choice to raise funding by way of sale and leaseback as opposed to a loan

5.3.2 Initial observations

Part IVA case law does not, on any view, stand for the proposition that taxpayers can only immunise themselves from the application of Part IVA by choosing the highest possible tax method.

Rather, the general proposition emerging from case law is that it should be perfectly legitimate for the taxpayer to choose method B.

This general proposition is clearly illustrated in *Hart*:

> *[20] "… the fact that a particular commercial transaction is chosen from a number of possible alternative courses of action because of tax benefits associated with its adoption does not of itself mean that there must be an affirmative answer to the question posed by s 177D. Taxation is part of the cost of doing business, and business transactions are normally influenced by cost considerations. Furthermore, even if a particular form of transaction carries a tax benefit, it does not follow that obtaining the tax benefit is the dominant purpose of the taxpayer in entering into the transaction. A taxpayer wishing to obtain the right to occupy premises for the purpose of carrying on a business enterprise might decide to lease real estate rather than to buy it. Depending upon a variety of circumstances, the potential deductibility of the rent may be an important factor in the decision. Yet, if there were nothing more to it than that, it would ordinarily be impossible to conclude, having regard to the factors listed in s 177D, that the dominant purpose of the lessee in leasing the land was to obtain a*

> *tax benefit. The dominant purpose would be to gain the right to occupy the premises, not to obtain a tax deduction for the rent, even if the availability of the tax deduction meant that leasing the premises was more cost-effective than buying them."*
>
> *[53] "The bare fact that a taxpayer pays less tax, if one form of transaction rather than another is made, does not demonstrate that Pt IVA applies. Simply to show that a taxpayer has obtained a tax benefit does not show that Pt IVA applies."*

Nevertheless, some pressure is brought to bear on this general proposition if regard can be had to the counterfactual in the Part IVA purpose inquiry.

5.3.3 Relevance of counterfactual to the purpose inquiry

Context for the purpose inquiry

The question posed by Part IVA is this: did a scheme participant have the objectively determined dominant purpose of obtaining the tax benefit for the taxpayer?

Given that the tax benefit is generated having regard to the counterfactual, intuitively one would expect the focus of the Part IVA purpose requirement should be on why scheme participants implemented the scheme rather than implementing the counterfactual instead.

However, that is demonstrably not how the purpose requirement is tested.

How purpose is required to be determined: the s.177D(2) matters

It is a deliberate Part IVA design feature that, in determining whether the requisite dominant purpose is present, regard must be had to the eight specified s.177D(2) matters.

On their face, none of those matters refers to the counterfactual.

Moreover, the s.177D(2) factors focus exclusively on how (rather than why) the scheme was implemented.

As Graeme Cooper succinctly put it[6]:

> *"… the relevant questions are, 'what was done, and how was it done?'; not why was it done?' So, once the facts have been adduced and proven to show what was done, the only remaining question is, just how artificial were the steps involved? Was it easy to do or did it require contrivance and artifice."*

Two significant points can be taken from this deliberately constructed statutory drafting:

- first, as we know, the inquiry is to objective purpose rather than subjective purpose
- second, the purpose inquiry does not involve a consideration of the counterfactual

[6] Graeme Cooper, Part IVA – with Small Business Slant, The Tax Institute 47th South Australian Convention

Case law

Perhaps the clearest judicial support for the second point is to be found in the Full Federal Court decisions in *Eastern Nitrogen* and *Metal Manufactures* where, in each case:

- the taxpayer obtained funding by implementing a sale and leaseback of plant and equipment
- the taxpayer deducted the full amount of rental payments
- effectively, the counterfactual was that the taxpayer would have obtained funding by borrowing under a loan
- under that counterfactual, the taxpayer would have only been able to deduct the interest payments
- the rental payments were larger than the interest payments would have been under the borrowing counterfactual

But neither of these Full Federal Court decisions placed significance on the results produced under the counterfactual.

As Lee J put it in *Eastern Nitrogen*:

> *17 On the facts found by his Honour the "after-tax cost" of finance was always of importance to the appellant in the conduct of its business, whatever line of finance was under consideration. Due and proper management of the business required assessment to be made of the net cost of finance after taking into account the extent to which any outgoings associated with that cost were allowable deductions from assessable income. In the circumstances of this case, to say that the appellant was attracted by a proposal that provided finance at a lower after-tax cost than another means of obtaining funds for the business would not, without more, support an objective conclusion that the appellant obtained finance for the dominant purpose of obtaining the tax benefit constituted by the deductibility from assessable income of the outgoings incurred in connection with the obtaining of that finance.*
>
> *18 To show that a business which depends upon financiers to provide the recirculating capital needed for the operation of the business, has obtained that finance at a net cost, after taking into account provisions of the Act, that is less than the net cost of obtaining finance by another method, will not, in itself, show that the dominant, ruling or supervening purpose of the operator of the business is to obtain the tax benefit constituted by the extent to which deductible outgoings incurred in respect of that borrowing will be greater than the deductible outgoings that would have been incurred under another method of obtaining finance. That is to say, something more must be shown than that the business has obtained finance at best available net cost after-tax before it can be said that a tax benefit has arisen to which s 177C(1)(b) applies.*
>
> *19 None of the matters referred to by his Honour suggests an objective conclusion that by obtaining finance at the best "after-tax cost", the appellant had a dominant purpose in entering the transaction for the provision of finance of obtaining a "tax benefit". To so conclude involved misapplication of the law to the relevant facts. ….*

> *20 …. In applying s 177D it is important not to elide the question posed by Part IVA, namely, what was the dominant purpose of a relevant party in entering the transaction (or scheme), with the inquiry, would the transaction (or scheme) had been entered into "but for" the tax benefit? The dominant purpose of the appellant was to obtain funds on the best available terms for use in the conduct of the appellant's business. The fact that the arrangements entered into to provide those funds included outgoings deductible under the Act was incidental to the purpose, but not the dominant purpose, of the transaction.*

However, a number of judges appear to believe that some regard can be had to the counterfactual:

- *Hart* at [66] per Gummow and Hayne JJ:

  > *When [s 177C(1)] is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed.*

- *Hart* at [94] per Callinan J:

  > *An aspect of the question to which s 177D(b)(ii) gives rise, is whether the substance of the transaction (tax implications apart) could more conveniently, or commercially, or frugally have been achieved by a different transaction or form of transaction.*

- *BAT* at [53]:

  > *"As was said in Hart, "to draw a conclusion about purpose from the eight matters identified in s 177D(b) ... require[s] consideration of what other possibilities existed": at [66] and [94]. In addressing s 177D(b)(i)--(v) and (vii), the trial judge compared the Scheme as carried out with the counterfactual: see [42] above. Such an approach was not only open but is usually required in assessing the dominant purpose of a scheme. A comparison between the Scheme carried out and the counterfactual was important in the present case because it revealed that the manner in which the Scheme was formulated and carried out was, when compared with the counterfactual, explicable only by taxation consequences: s 177D(b)(i)".*

- *Macquarie Bank (Mongoose)* at [211]*:*

  > *"In light of this authority, it is clear that, where appropriate, regard may be had to the other possibilities that existed for the purpose of conducting the s 177D analysis … from a practical perspective, if the s 177D(b) analysis were to be carried out without any consideration of the other possibilities that may have been open to the relevant taxpayer/s at the relevant time, the analysis would risk being artificial and sterile. Accordingly, we consider that reference to such other possibilities as may have existed at the relevant time is a necessary constituent of a number of the factors set out in 177D(b) …"*

Nevertheless, more recently, in *Orica,* Pagone J was clearly not convinced that counterfactual had any role in determining Part IVA purpose :

> *20 The parties agreed, in my view correctly, that the conclusion called for by s 177D about dominant purpose did not depend upon considerations about alternatives that may need to be considered to determine whether a taxpayer obtained a tax benefit under the former terms of*

> *s 177C. … The evaluative judgment to be made under s 177D about dominant purpose is one to be made by application of the words of s 177D and, specifically, by having regard to the matters to which the section compels, and confines, attention. It is by a consideration of those matters that the conclusion is to be made about whether obtaining the tax benefit was the 'ruling, prevailing, or most influential purpose': Spotless Services at 416; see also at 423. The dominant purpose of obtaining a tax benefit may be revealed, as was decided in Spotless Services, by 'the particular means adopted by the taxpayers to obtain the maximum return on the money invested after payment of all applicable costs, including tax': Spotless Services at 423. It may also be revealed by consideration 'of what other possibilities existed' by reference to the eight matters in s 177D(b): Hart at 243 [66]; see also British American Tobacco Australia Services Ltd v Federal Commissioner of Taxation (2010) 189 FCR 151, 163, [53]. In Hart the dominant purpose of obtaining a tax benefit could be seen by comparing what was done to borrow funds with how else funds could be borrowed, and, therefore, as in Spotless Services, the dominant purpose was revealed by consideration of the eight factors in s 177D(b) in the particular means adopted by the taxpayer. It is not relevant to consider, therefore, whether Orica might have done something else, such as to borrow funds from an external source. In any event, if it be relevant, the evidence is that Orica rejected such an option and there is insufficient evidence to conclude that Orica's directors would have funded OUSSI from external sources. The inquiry called for by s 177D is, rather, what was the dominant purpose of entering into the transactions that Orica did choose. It is an inquiry that must be undertaken by having regard to the eight matters in s 177D(b) and, as a conclusion about purpose to be drawn from those matters, will require an evaluation of inference and degree.*

Conclusion

In the author's view, if it were intended that dominant purpose be determined having regard to the counterfactual, then the counterfactual would expressly be included as a s.177D(2) matter.

Accordingly, in the author's view, for all the reasons referred to above, the clearly better view is that the Part IVA purpose inquiry does not involve a consideration of the counterfactual.

On this view, it should reasonably be expected that Part IVA should not be activated by the situation described in section 5.3.1 provided that:

- the taxpayer has not first manipulated the circumstances so that the lower tax method is able to be implemented; and
- the lower tax method does not involve a "shaping" of the transaction to achieve the lower tax outcome.

5.3.4 ATO guidance

The modest amount of public ATO guidance on point is consistent with the author's view expressed in section 5.3.3 above.

The issue is discussed at paragraphs 131 and 132 of PS LA 2005/24.

Moreover, clear support for the view is found in the speech made in 2005 by the then Commissioner of Taxation which are set out in Attachment 2 of PS LA 2005/24:

> *The objective conclusion reached has to be determined by reference to the eight factors in s.177D(b), and only to these eight factors. These factors are designed to make you focus on what it is that, in Parliament's view, makes unacceptable or acceptable the way in which a taxpayer obtains a tax benefit. This is what the Explanatory Memorandum said:*
>
> > *'In order to confine the scope of the proposed provisions to schemes of the 'blatant' or 'paper' variety, the measures in this Bill are expressed so as to render ineffective a scheme whereby a tax benefit is obtained and an objective examination, having regard to the scheme itself and to its surrounding circumstances and practical results, leads to the conclusion that the scheme was entered into for the sole or dominant purpose of obtaining a tax benefit.'*
>
> *In order to get the right answer for a particular case, one has to apply those eight factors properly using their actual words. They contain a built-in logic, as it were; they are not just a list.*
>
> *To highlight this point, take as the starting point the proposition that a taxpayer seeking certain commercial ends in a transaction often has a choice of means by which to achieve those ends; and it is possible, in the words of the court in Spotless, to 'shape' the transaction in several ways according to the means chosen. Prima facie, how taxpayers arrange their affairs, or shape their transactions, is of no concern to the Commissioner. However, when the manner in which they go about establishing or implementing the transaction, when there is a divergence between the form of the transaction and its substance, and/or when the transactions' timing and so on, indicate that they have carried out a scheme in that particular way (or shaped it in particular way) mainly or solely to obtain a tax benefit, Part IVA is applicable, even when the tax benefit is the means of obtaining some further commercial goal. Conversely, however, when the manner in which the scheme is established or implemented, when there is congruence between form and substance, and the timing and so on do not point to the transaction as having been carried out in that particular way so as to obtain the tax benefit, Part IVA is inapplicable, even though a reduction of tax is a substantial effect of the scheme, and even though the actual subjective purpose for doing in that way was to get a tax break.* [emphasis added]

5.4 Arbitraging a bright line statutory test

5.4.1 Context

The Tax Acts contain a number of “bright line” statutory tests.

Fall on one side of the line and a particular tax outcome follows. Fall on the other side of the line and a different tax outcome follows.

Examples of these bright lines include:

- the 10 year borderline in the Division 974 debt test between valuing financial benefits in nominal or present value terms
- the “safe harbour” debt amount for thin capitalisation purposes
- the 10% Subdivisions 768-A and 768-G tests
- the 50% s.855-30 principal asset test
- the $6m net asset test for accessing the small business concessions

5.4.2 Observations

Parliament provides bright line statutory tests in order to provide certainty of tax outcomes.

If this certainty goal is to be achieved, one would reasonably expect that Parliament also intended that taxpayers are generally able to structure their affairs so that they fall on one side of the statutory line or the other - and be subject to the relevant tax outcome – without Part IVA being activated.

Nothing in the s.177D(2) matters indicates that, of itself, this should activate Part IVA.

Nevertheless, as always, the s.177D(2) matters must be considered to see if any artificiality or contrivance is revealed in the scheme as implemented.

5.4.3 ATO guidance

Debt/equity arbitrage

The NTLG Minutes considered the potential application of Part IVA to a number of fact patterns (Examples 1.1 to 1.4) involving the issue redeemable preference shares with a term either just shorter than or just longer than 10 years, depending on whether Division 974 debt or equity treatment was more beneficial to scheme participants in the circumstances (eg, in terms of deductibility and withholding tax outcomes).

The ATO was remarkably sanguine about this type of arbitrage.

The ATO view acknowledges that different outcomes will arise under different funding mixes and focusses attention on the precise way in which the funding mix was implemented:

> *“To fall within Part IVA, it must be possible to conclude that the sole or dominant purpose of one or more of the persons who interfered into or carried out a scheme was to enable a taxpayer to obtain a tax benefit in connection with the scheme. In these examples, on the limited facts, the factors in subsection 177D(2) appear to point decisively away from such a conclusion.*
>
> *When one compares the issue of RPS with other possible means of raising the relevant finance, one cannot, having regard to the 8 factors in subsection 177D(2), conclude that the particular means chosen is explicable only by tax considerations. RPS of a conventional*

nature are a standard and common means of raising finance which of themselves could not be said to be contrived or artificial in this context. They differ in commercial substance from ordinary shares and represent a legitimate commercial choice available to a company.

In these examples, nothing about the manner in which the finance is raised suggests a tax avoidance purpose. The form and the substance are congruent. The only point to note about timing is that term of the RPS at 9 years is just a little shorter than the relevant threshold under the debt/equity rules in Division 974 (10 years), but that fact alone would not be sufficient in this context to found the relevant conclusion of a tax avoidance purpose.

The fact that the company might have changed the proposed term from 12 years to 9 years in light of its tax advice does not significantly alter the analysis here. That change in the term is a genuine alteration to the commercial substance of the transaction. It might be different if the term were ostensibly changed to 9 years, but by some additional contrivance the economic substance of the arrangement was that the funds were in fact committed for 12 years. (But any such arrangement would have to withstand scrutiny under Division 974 before Part IVA came into play in any case.)" [emphasis added]

Small business concessions

The NTLG minutes considered Example 3 in relation to the potential application of Part IVA where a taxpayer changes plans in order to access the small business concessions.

More specifically:

- a business owner sells his business
- he rejects an offer above the $6m threshold for the small business rollover concession
- he makes a counter offer to the purchaser for a sale price just below $6m

Alternatively, the business owner makes a charitable donation before entering into the sale contract.

In both cases, the taxpayer's action would significantly reduce his tax liability.

The ATO does not reach a clear position on Part IVA. However, it is clear that the ATO sees Part IVA as having a role to play.

Nevertheless, the following observations can be made:

- it is unclear why the ATO does not apply the more relaxed approach it generally takes to concessions (see section 5.5 below)
- despite the example clearly involving a change of plans, the ATO does not apply its general approach to change of plans fact patterns discussed in section 5.4 above. In that regard, if the ATO was to consistently apply its stated position on change of plans, one would have thought that:
    - the relevant scheme is (only) a sale of the business at a particular price (ie, under the $6m threshold);

- the initial offer would not form part of the relevant scheme; and
- a sale at a particular price is a very simple scheme and does not reveal artificial or contrived features of the kind that would activate the s 177D(2) factors.

5.5 Accessing intended benefits

5.5.1 Context

There are a number of Tax Act regime concessions, including:

- R&D credits which are available for certain activities
- deductions for certain charitable donations

5.5.2 Observations

By providing these concessions, Parliament is clearly encouraging particular taxpayer behaviour.

Accordingly, one could reasonably expect that Parliament intended that taxpayers be able to engage in that behaviour and take advantage of the concessions without Part IVA being activated.

Of course the s.177D(2) matters must be considered to see if any artificiality or contrivance is revealed in the scheme as implemented. But nothing in those factors should necessarily be triggered merely by engaging in the relevant behaviour.

5.5.3 ATO guidance

The NTLG minutes considered Example 5 in relation to the potential application of Part IVA where a taxpayer changes plans and incurs expenditure that is eligible for the R&D credit.

More specifically:

- an employee of the taxpayer proposes developing software for extra money
- the proposal is initially rejected on a cost/benefit basis
- however, tax advisers advise that the R&D credit will be available if the product is provided to external users (ie, the software is made generic)
- the taxpayer changes its plans and proceeds with the software development on that basis and claims an R&D credit

The NTLG Minutes reveal a very relaxed ATO general approach to schemes involving access to concessional tax treatment:

> "*… notwithstanding that the entity might not have entered into the arrangement but for the credit, this was nonetheless in line with the intended operation of the R&D credit. That is, the object of the credit, as stated in section 355-5, is to encourage industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities. Based on those facts, having regard to the eight factors in section 177D, it seemed unlikely that a conclusion of a dominant tax avoidance purpose could be reached*."

This approach suggests that underlying policy considerations trump artificiality or contrivance in this scenario.

However, there are limits to this approach – as was seen in section 5.4.3 above in relation to the small business concessions.

6 Particular issues with group restructures

6.1 Context

Group restructures are almost an inevitable part of corporate life.

Often group restructures involve asset movements across borders or otherwise outside the relevant tax consolidated group, potentially giving rise to tax issues under the primary tax provisions – and so to Part IVA considerations.

There is also a significant body of case law dealing with group restructures.

A number of the pre-2013 cases were decided on the basis that tax benefit requirement was not satisfied. Although these cases have been superseded by the 2013 amendments to Part IVA on this issue, those cases also contained significant obiter dicta observations on the dominant purpose requirement.

6.2 Observations on group restructures

From a subjective motivations point of view (which is different to the s.177D purpose test), group restructures are typically undertaken for one or more of the following reasons.

Subjective motivation for group restructure	**Case law examples**
To ameliorate an existing structural inefficiency	• the US–Australia–US "sandwich" in the *News Australia* case that was resolved by the Second Spin aspect of the restructure
To ready part of the group for sale, demerger or co-investment	• the collection of Bristile assets under Walshville, which was floated in *Futuris* • the presale dividend in RCI • the structuring to facilitate the disposal of AXA Health in AXA and Mongoose/Minara shares in *Macquarie Bank*
To reduce a (generally foreign) tax burden	• the Illinois state income tax reduction scheme in Noza • the UK exit in *CPH Property*
To satisfy regulatory divestment requirements	• the divestment of certain assets considered in the *BAT* case in order to satisfy ACCC imposed merger conditions

To create a preferred acquisition structure	• the establishment and funding of the ownership chain for the proposed foreign share acquisition in *Murray Leisure Group*
To raise funds and deploy them within the group effectively	• the loss centralisation arrangements in *Spassked* • the in-house financing arrangements in *BHPB Finance* and *Ashwick*
To provide employee remuneration	• the employee share trust contributions in *Trail Bros* and *Spotlight Stores*

It is certainly the case that the actuating subjective purpose of conducting all or part of certain group restructures (in the sense of why bother to do it at all) may well have been to reduce Australian income tax. One might put offshore captive insurance arrangements of the type considered in *WO & HD Wills* in that category.

However, case law and real world experience indicates that purely Australian income tax motivated group restructures are at the periphery.

6.3 Group restructures and dominant purpose

Case law on the dominant purpose requirement in a group restructure context reveals a number of judicial decisions and comments on the s.177D(2) matters that are of considerable assistance to taxpayers.

However, this relatively lenient body of case law is undermined to an extent by the more recent approach taken by Pagone J in *Orica*.

Matter #1: Manner in which the scheme was entered into/carried out

There is judicial recognition that group restructures are often significant undertakings that accommodate a complex interaction of considerations across a number of jurisdictions. And so it is entirely normal that a group restructure will involve complexity, multiple steps and even transactions that look slightly odd - and which would not necessarily be entered into between unrelated parties.

But where there is an overall non-tax commercial explanation for the group restructure, then, without more, this will not lead the courts to conclude that the first matter inclines towards a conclusion that the requisite dominant purpose is present.

The clearest expression of this view is in the AAT decision in *News Australia*.

Gordon J in *Noza* was also very sympathetic to the peculiar demands of cross border group restructures.

Nevertheless, there will be a tipping point beyond which various steps are insufficiently explicable by the overall commercial nature of the transaction and are more readily explicable by the obtaining of a tax benefit: see Besanko J in *Futuris.*

Unfortunately, despite the general case law position described above, Pagone J focussed heavily at paragraph 22 of *Orica* on the intragroup nature of the arrangements in concluding that this matter pointed towards the requisite dominant purpose being present.

Matter #2: Form and substance

As discussed above, group restructures often involve slightly odd-looking transactions which would not necessarily be entered into between unrelated parties.

However, judges have generally shown considerable reluctance to conclude that particular steps in group restructures have a substance that diverges from their form.

For example:

- in *RCI*, Stone J at first instance held *that the form and substance of the dividend coincided "*even though only $20m of the $318m was paid in cash on the basis that *"a significant amount of capital was nevertheless repatriated to Australia with a commensurate reduction in the dividend paying company's capital*"
- in *Eastern Nitrogen*, the Court held that the form of the relevant scheme – a sale and leaseback – coincided with its substance
- in *News Australia,* the target company bought back its shares from the taxpayer then, later that day, a related US company subscribed for the exact same number of shares in the target. The ATO argued that the substance of the arrangement was a transfer. However, the AAT held that the substance of the arrangement was nevertheless a buy-back

However, balancing this, at paragraph 25 of *Orica,* Pagone J held that the form and substance of the scheme pointed towards the requisite dominant purpose being present because (among other things):

- *The effect of the transactions within the group was substantially neutral except to the extent that the rebooking of the US tax losses recorded the use of those losses against the internally generated income derived by OUSSI equal to the deductions claimed by OFL for Australian tax purposes.*
- *The form of the schemes was a complex series of loans, transfers and share subscriptions but their substance was to create outgoings within the group that were deductible for Australian tax purposes to enable the group to enjoy the economic benefit of the US tax losses by the tax benefits in Australia from the deductions for the interest payments.*

Matter #3: Timing

Generally the timing of a group restructure is dictated by matters other than Australian tax – and so points away from a conclusion that the requisite dominant purpose is present.

Moreover, there is recognition in *News Australia* that no adverse conclusions can be drawn from multiple steps occurring in one day. (Compare this approach with that of courts regarding the pre-30 June "flurry of activity" which tells against the taxpayer in many mass marketed scheme cases.)

Matter #7: Any other consequence

This matter allows taxpayers to list all the commercial advantages secured by the group restructure.

For example, in *News Australia*, the AAT referred to "substantial commercial benefits" of the transaction, including:

- better access to US capital markets
- a simpler and more logical corporate structure
- the elimination of potential accounting, treasury and taxation complexity and duplication
- the removal of the US and UK groups from Australia's CFC regime

Matter #8: The nature of any connection between the parties

Naturally, most, if not all, of the participants in a group restructure are related parties.

Accordingly, this matter would generally be detrimental for taxpayers in group restructures.

However, in the group restructure cases, courts have not generally chosen to attach any significant probative value to this factor.

The principal exception to this relatively consistent body of case law is *Orica* where, on the facts, Pagone J held at paragraph 31, that this matter pointed towards the requisite dominant purpose being present:

> *… In this regard all companies were connected to the relevant taxpayer in their capacity as members of the same wholly owned group of companies and were controlled from a common source and by the same people. The nature of that connection was one of common control and not of independent commercial or arms length dealings. The nature of such a connection need not always point to the obtaining of a tax benefit as the dominant purpose amongst related entities. Related companies may frequently act for the benefit of the group as a whole, or for the benefit of a related company, without necessitating in all cases that the dominant purpose was for a taxpayer to obtain a tax benefit, but in this case the connection between the parties does point to that as the dominant purpose by showing the role played by that connection as the means by which the schemes were implemented and carried out.*

7 Obtaining Part IVA comfort

7.1 Overview

Varying degrees of comfort can be obtained as to the non-application of Part IVA to a proposed transaction. For example, the taxpayer could:

- perform the analysis itself
- seek opinions from external tax advisers
- obtain a risk rating from its ATO audit team
- apply for a ruling

There is no "one size fits all" solution.

The first two methods (internal and external advice) are self-explanatory.

The third method (ATO risk rating) provides a degree of administrative comfort. However, it does not legally bind the ATO – and so there is no impediment for the ATO later challenging the transaction under Part IVA if its administrative stance on particular issues or transactions changes.

The fourth method (ruling) raises a number of interesting questions and is the focus of section 7.2.

7.2 Rulings and Part IVA

If taxpayers are applying for a ruling on the proposed transaction they must decide whether to confine the questions asked of the ATO to primary taxing provisions or whether to specifically include a question seeking confirmation that the ATO will not apply Part IVA.

7.2.1 Rulings not asking for Part IVA comfort

PS LA 2005/24 sets out internal ATO protocols on how officers should deal with ruling requests that do not ask for Part IVA to be addressed.

> *9. If a taxpayer applies for a private ruling in respect of an arrangement but has not requested a ruling on whether Part IVA applies to the arrangement, Tax officers must consider whether Part IVA may apply to the arrangement based on the information provided in connection with the ruling application. This must be done whether or not the taxpayer has advised in their ruling application that Part IVA need not be considered by the Commissioner.*
>
> *10. If the Tax officer considers that on the basis of the information provided in connection with the ruling application it is either not clear whether Part IVA applies, or it seems that Part IVA may apply to:*

> *· the particular arrangement for which the private ruling is requested; or*
>
> *· an associated arrangement(s) or a wider arrangement of which the particular arrangement for which the ruling is requested is part,*
>
> *then the Tax officer should consider whether the private ruling should include an appropriate message or warning about the potential application of Part IVA.*
>
> *11. If the Tax officer proposes to request additional information from the taxpayer to determine whether Part IVA may apply to the arrangement or an associated arrangement, then the Tax officer should disclose to the taxpayer that Part IVA may be in contemplation. Where Part IVA is in contemplation, the Tax officer should consider referring the matter to TCN, as per paragraphs 14 to 17.*
>
> *12. If there is no reason to think on the basis of the information provided in connection with the ruling application that Part IVA may apply, then any ruling that is given does not need to refer to Part IVA.*

As can be seen, taxpayers will obtain some practical comfort on the non-application of Part IVA if they lodge a ruling request that does not ask for Part IVA to be addressed and the issued ruling does not refer to Part IVA.

However, the more common outcome is that the issue ruling contains a Part IVA caveat – in which case taxpayers obtain no practical Part IVA comfort.

Nevertheless, in both cases, the issue of the ruling does not legally bind the ATO in relation to Part IVA – and so there is no impediment for the ATO later challenging the transaction under Part IVA if its administrative stance on particular issues or transactions changes.

7.2.2 Rulings asking for Part IVA comfort

In the past, there has been considerable taxpayer reluctance to seek Part IVA rulings.

There was a widely held impression that Part IVA rulings took a long time to issue, if they were issued at all. And there are plenty of war stories about being inundated with ATO requests for information - or even s.264 notices - which delay the ruling process.

Often commercial timeframes meant that the Part IVA question had to be decoupled from the primary provision questions – and quite often the Part IVA question was left unresolved.

There appeared be an ATO perception that, in order to rule favourably on Part IVA, it was necessary to have a complete understanding of all the facts – including as to the subjective reasons for implementing the relevant transaction - and a concern that, no matter how much information the taxpayer provided, there may be more “iceberg” sitting below the water.

Certainly it is the case that many transactions were implemented in the 1990s and 2000s without Part IVA rulings (or ATO dialogue) and what followed was lengthy audits and even lengthier Part IVA litigation.

However, it may be that the ATO is now better placed to rule on Part IVA questions:

- the view expressed by a number of senior ATO officers is that Part IVA is just another provision in the Tax Acts – and one the ATO has a statutory duty to rule on
- the practical views expressed in the NTLG Minutes (which have been discussed elsewhere in this paper) signal a more targeted ATO approach to Part IVA

One factor that can impact timing is whether tax counsel network (**TCN**) is engaged in the ruling process. It is understood that TCN will be engaged if considered appropriate in light of the ATO business line applying a risks based analysis – but there is no requirement that TCN be engaged on every Part IVA issue. (Having said that, experience indicates that group restructures with significant dollar values will almost inevitably result in TCN being engaged.)

TCN involvement can result in delay to the ruling process due to constrained availability. However, balancing this, involvement of a number of senior TCN figures can also significantly shorten the ATO Part IVA decision making process.

7.2.3 Relevant considerations

The decision to seek a Part IVA ruling isn't one to take lightly.

Relevant considerations include:

- how "close to the line" the matter is
- the relative strength (or otherwise) of external advice
- the corporate group's tax risk appetite
- whether implementation of the group restructure is time sensitive
- the factual complexity involved
- the dollars of potential tax involved
- expectations about the particular ATO officers likely to be involved

Essentially, applying for a Part IVA ruling involves "opening the kimono" to the ATO.

And, of course, you don't always get the answer you want.

8 Part IVA case abbreviations and citations

Abbreviation	Taxpayer name and citation
Ashwick	*Ashwick (Qld) No 127 Pty Ltd* [2009] FCA 1388; [2011] FCAFC 49
AXA	*AXA Asia Pacific Holdings Ltd* [2009] FCA 1427; [2010] FCAFC 134
BAT	*British American Tobacco Australia Services Limited* [2009] FCA 1550; [2010] FCAFC 130
Citibank	*Citigroup Pty Ltd* (2011) ATC 20
CPH	*Consolidated Press Holdings Limited* [1998] FCA 1276
Eastern Nitrogen	*Eastern Nitrogen Ltd* [1999] FCA 1536; [2001] FCA 3
Futuris	*Futuris Corporation Limited* [2010] FCA 935; [2012] FCAFC 32
Hart	*Hart* [2004] HCA 26
Macquarie Bank (Mongoose)	*Macquarie Bank Limited* 2013 FCAFC 13
Metal Manufactures	*Metal Manufactures Ltd* [1999] FCA 1712; [2001] FCA 365
News Australia	*News Australia Holdings Pty Limited* [2009] AATA 750; [2010] FCAFC 78
Noza	*Noza Holdings Pty Ltd* [2011] FCA 46
Orica	*Orica Limited v Commissioner of Taxation* [2015] FCA 1399; 2015 ATC 20
Peabody	*Peabody v Commissioner of Taxation* (1992) 24 ATR 58
RCI	*RCI Pty Limited* [2010] FCA 939; [2011] FCAFC 104
Spassked	*Spassked Pty Ltd (No 5)* [2003] FCA 84; [2003] FCAFC 282
Spotless	*Spotless Services Limited* [1993] FCA 276; [1996] HCA 34

9 G Cooper Article

