

EDITORIAL MESSAGE



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The shortcut to applying part IVA - go straight to fiscal nullity and pay \$200

Tax avoidance has been defined as "... the art of dodging tax without actually breaking the law!"

For those who impose tax, and those charged with its collection, avoidance cannot be allowed to thrive unchecked. In the United States, the Supreme Court has adopted, since 1935² two doctrines protective of the tax base viz: the "business purpose" doctrine and the doctrine of "substance over form". The former will see the Courts disregard a transaction which has "no substantial business purpose other than the avoidance or reduction of tax".

In the United Kingdom the principle adopted, again by the Court rather than the legislature, is known as "the principle of fiscal nullity"³ This was explained by Lord Brightman as follows:

"First there must be a pre-ordained series of transactions; or if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end... secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax – not 'no business effect'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result".

According to the High Court of Australia there is no room for such judge-made principles in Australia⁴ Thus the "Act, in S.260 and now in Part IVA, makes specific provision on the topic of what may be called tax minimization arrangements and thereby excludes any implication of a further limitation upon that which a taxpayer may or may not do for the purpose of obtaining a taxation advantage". Accordingly, Part IVA must "be construed and applied according to its terms"⁵. "Always the question must be whether the terms of the Act apply to the facts and circumstances of the particular case".⁶ Be that as it may the one term to which most attention would seem to have been devoted by the High Court is that in S177D(b)(i) which, in the context of ascertaining purpose, requires that regard be had to "the

manner in which the scheme was entered into or carried out".

If one examines the last three decisions of the High Court construing Part IVA⁷ it is interesting to see the parallels with the judge - made principles elsewhere – especially the U.K. principle of fiscal nullity. In Hart – the most recent decision - Gleeson CJ and McHugh J express the view that "the fact that a particular commercial transaction is chosen from a number of possible alternative courses of action does not of itself mean that there must be an affirmative answer to the question posed by S177D". To the same effect is the judgment of Gummow and Hayne JJ at 240 [53].

However, it is evident from these decisions that it is the manner in which that very choice is availed of which will be critical. In *Spotless* the majority said (at 416) "... if the taxpayers took steps which maximised their after-tax return and they did so in a manner indicating the presence of the 'dominant purpose' to obtain a 'tax benefit', then the criteria which were to be met before the Commissioner might make determinations under S177F were satisfied" and later (at 423) "it was the obtaining of the tax benefit which directed the taxpayers in taking steps they otherwise would not have taken by entering into the scheme".

In *Consolidated Press* the "interposition" of a company between two others in a chain was held to be explicable only by a desire to avoid the tax consequences of the application of a section which would otherwise have denied a deduction. It was held that Part IVA would be applied to deny the deduction.

In *Hart* the taxpayer borrowed money to be used for two purposes, one business, the other private. The monthly repayments of principal and interest were allocated wholly to the private part of the loan. Interest on the business part of the loan was not paid but was allowed to capitalise; it was held that the deduction claimed for the latter would be denied by Part IVA. Gleeson CJ and McHugh J were of the view that it was the terms of the loan which enabled the payments to be so allocated "that constituted the scheme"; Gummow and Hayne JJ said that "the terms upon which the

loan was made available were explicable only by the taxation consequences for the taxpayer".

One can extract from these cases the propositions that Part IVA:

- (1) will not apply where there is a "mere" choice of the more tax effective structure eg a lease of a computer in preference to its purchase;
- (2) will be more likely to apply if there are steps which are non-commercial and which have the effect of putting the taxpayer in a position to enjoy the more tax efficient structure, those steps being explicable by reference to the obtaining of the tax benefit which flows.

The difficulty, of course, lies in knowing where to draw the line. In this regard it is worth noting that full courts of the Federal Court have not limited the first of the above propositions to simplistic situations like that exemplified; recognizing that in business, more complex facts will necessarily exist.⁸ But where Part IVA has been held by the High Court to apply, the only difference in practice between the principle of fiscal nullity and Part IVA would seem to be that, in the case of Part IVA, the impugned steps will not be disregarded in such a way that the taxation consequences, if any, will be determined by reference to what is left standing; rather the existence of the impugned steps will, in every case, justify a denial of the "tax benefit" which they were directed to achieving.

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Reference notes

- 1 *The Oxford Companion to Law* by David Walker 1980 pp1207-8
- 2 *Gregory v Helvering* 293 U.S. 465
- 3 *Furniss v Dawson* (1984) AC 474 at 527.
- 4 *John v FCT* 1989) 166 CLR 417 at 434-5
- 5 *FCT v Spotless Services Ltd* (1996) 186 CLR 404 at 414
- 6 *FCT v Hart* (2004) 217 CLR 216 at 240 per Gummow and Hayne JJ at 240.
- 7 *Spotless, Hart, FCT v Consolidated Press Holdings*(2001) 207 CLR 235 at 227.
- 8 *Eastern Nitrogen Ltd v FCT* (2001) ATC 4164 at 4168 [18]; *Macquarie Finance Ltd v FCT* (2005) ATC 4829 at 4873 [213].