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Internal restructures – ATO and practical perspectives

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Introduction

This paper contemplates the evolution of general anti-avoidance provisions in Australia.

It does so more specifically in the context of the recent run of cases involving complex corporate restructures in which the Commissioner has unsuccessfully sought to maintain application of Part IVA in cases of internal corporate restructure and restructuring in contemplation of disposal of assets to third parties. Limitations in relation to the construct of tax benefit and the counterfactual have arisen from the Commissioner's perspective.

It does so more specifically in the context of the current Government having been persuaded to respond to that recent run of cases by announcing amendment of Part IVA as it is proposed to apply to schemes entered into or carried out after 1 March 2012.

This Paper is written in the shadows of release of those proposed amendments in Exposure Draft which are to confirm the "intended effect" of Part IVA ITAA 1936 "without unintentionally affecting genuine commercial and business activity".

It is submitted that the risk of the proposed amendments having such unintended effect is greatest in relation to internal corporate restructures of all kinds particularly where no disposal of assets to third parties is in contemplation.

To add to the complexity and uncertainty created by the proposed amendments the Government has sought to "confirm that Part IVA always intended to apply to commercial arrangements which have been implemented in a particular way to avoid tax" including "steps within broader commercial arrangements" begging the extent to which commercial purpose may predominate over the purpose of obtaining a tax benefit having regard to

particular steps in a scheme which may be asserted to have only been undertaken in a particular way relative to others because of tax consequences.

A close reading of the Second Reading Speech by then Treasurer John Howard introducing Part IVA in 1981 may call this stated intent into question:

"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 cause unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs."

It is to be recalled that Part IVA was itself introduced in 1981 following a run of cases which revealed limitations to the scope of former Section 260 ITAA 1936 in the context of successive losses by the Commissioner – history repeating.

In fact it was a trilogy of cases in 1976 and 1977 – Mullens, Slutzkin and Cridland: 76ATC 4288; 77ATC 4078 –and 77ATC 4538.

Revisiting the history of judicial consideration of Section 260 has proven more insightful than might be imagined – history does repeat and can be learned from. Such jurisprudence informs of the limitations with Section 260 that Part IVA was intended to address and how those limitations were perceived at the time of repeal relative to four years later. Judicial consideration of provisions generally continues despite their repeal and did so in the case of section 260 in 1985.

When it is observed that contemporaneous with the introduction of Part IVA in 1981 the Government was also acting to strengthen the Transfer Pricing provisions in the context of avoidance of Australian tax in international

business transactions and the economy was at that time in recession, a pattern is recognizable in the wake of jurisprudence highlighting possible outlining legislative limitation in giving effect to tax administration policy

It is coincidence that thirty years later we find ourselves again contemplating amendment to our general anti-avoidance provisions and amendment to transfer pricing provisions in times of economic fragility on a global scale? Me think not.

Allowing that history has been observed to repeat it is worth recounting that the ATO was actually successful in maintaining application of Section 260 in another trilogy of cases in 1985, four years following repeal of section 260 and replacement with Part IVA ITAA 1936 in responding to the observed limitations of Section 260 in Mullens, Slutzkin and Cridland: in the attempted income splitting by Doctors Gulland, Watson and Pincus (85 ATC 4765)

If the jurisprudence leading up to and in the wake of the repeal of Section 260 tells us anything it tells us that knee jerk reaction to lack of certainty in applying general anti-avoidance provisions in the area of revenue law should be undertaken with great care, particularly if the parliamentary intent of unnecessarily inhibiting normal commercial and family transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs.

Particularly when it is observed that the first judicial guidance did not come forward in relation to Part IVA until 1994, some fifteen (15) years after introduction in 1981, and, in that first case, it is well recognized that the Commissioner had sought to assess the wrong taxpayer in relation to a recognizable scheme and tax benefit being obtained.

When regard is had to the recent run of Part IVA cases that have prompted the present Government to propose amendment to Part IVA it is disconcerting indeed to observe that those touching on corporate

restructures concerned arrangements entered into in the years of income 1998 – 2005 and in most cases, came to be entered into after a number of prior years of contemplation.

History tells us that the current state of jurisprudence in relation to the application of Part IVA at the time of its proposed amendment will continue to evolve as the Courts turn their mind to the determinations by the Commissioner to apply Part IVA as currently enacted in relation to cases involving schemes entered in to and or carried out on or before 1 March 2012. The limitations of the existing provisions can be refined by cases on the application provisions subsequent to their amendment.

Over the 7 year term of the newly appointed Commissioner, Mr Chris Jordan, we will observe that bubble of uncertainty and complexity work its way through tax administration in current audits by the ATO and subsequently through the Courts perhaps to once again find that the “limitations and shortcomings” in relation to Part IVA prompting its amendment are not as seen in the future as they are today.

We will also see that same bubble of uncertainty and complexity in current and future risk reviews and audits and grapple with it in information requests, GAAR Panels and beyond. We will also see a new bubble of complexity and uncertainty emerge in tax administrative of risk reviews and audits in relation to “schemes” entered into or carried out after 1 March 2012, following release of the Exposure Draft for the proposed amendments to Part IVA emerge over that same time period of seven years.

In contemplating this paradigm in the context of internal restructures in the current economic environment in increasing fiscal pressure, the increasing introduction of real time compliance interaction pre-lodgment and piloting of Reportable Tax Position Schedules the writer has been unable to resist the urge to enter the vortex of the Tax, Space and Time Continuum to revisit the previous occasion on which we saw the need to address the limitations of our general anti-avoidance provision following a series of cases in which the Commissioner was unsuccessful in maintaining their application if only to predicate whether history is indeed repeating!

Before “moving forward” in the lexicon of the present Government we owe it to our business community (local and global), to investors in Australia Inc., those who follow us in the tax profession and those we work with in the ATO to do all that we can to ensure that the level of uncertainty we have been burdened with for the last thirty years is not maintained for the next thirty years, allowing that we in Australia have lived under the umbrella of a general anti-avoidance provision in our revenue law more than any other country on earth!

The writer attributes this notable predilection to our love of sport and in embarking upon this journey it might serve us well to consider that the identification of tax avoidance for the purpose of a general anti-avoidance provision might just as well be served by:

- The Elephant Test – it’s hard to describe but we all know it when we see it;
- The Duck Test – if it looks like a duck, walks like a duck, swims like a duck and quacks like a duck – then it probably is a duck; or
- The Smell Test – before we had “use by dates” we used our noses!

As hard as tax avoidance may be to define the conceptualization of “ordinary business or family dealing” has proven just as illusive. The analysis that follows in this paper demonstrates the difficulty in finding language to describe “tax avoidance” on the one hand and “ordinary business or family dealing” on the other is at the “hart” (“pun intended”) of jurisprudential consideration of general anti-avoidance in this country and the identification of ‘schemes’ to which Part IVA is or former section 260 was “intended to apply” including commercial arrangements implemented in a particular way or steps within such arrangements implemented in a particular way to obtain a tax benefit.

It is somewhat paradoxical in contemplating application of general anti-avoidance provisions for income tax to corporate restructures to contrast the approach adopted in affording corporate reconstruction relief from stamp duty in our various States and Territories. The underlying theme of those forms of relief is to remove the

imposition of stamp duty as an inappropriate impediment to corporate restructuring and obtaining associated efficiencies and economic benefits?

When should a commercial transaction implemented in a particular way or particular steps within such arrangements offend general anti avoidance provisions such that they should operate to prevent associated efficiencies and economic benefits.

The consideration of the definition of a ‘scheme’ and the meaning of tax benefit (specifically contemplation of the alternative postulate or counterfactual) before the Courts beg that question acutely in assessing the impact of the imminent Exposure Draft on corporate restructures (The Exposure Draft was so imminent that it was released before this paper was presented.)

1. How did we get here?

1.1 The Grand Old Duke of Westminster

The contemplation of substance over form has been a long standing judicial approach in the absence of a general anti-avoidance provision in the law but it was preceded by a fundamental tenant of revenue law described by Lord Tomlin in the House of Lords in Duke of Westminster v Commissioners of Inland Revenue 1936 AC 1:

> *"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of "the substance" seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."*

In Lord Tomlin's view the Commissioners of Revenue had regard to the substance of the arrangements with those in the Duke of Westminster's service in disregarding the legal contractual form of the arrangements which were clearly intended to achieve a specific tax treatment for the Grand Old Duke.

The doctrine said to apply in revenue cases is that the legal position can be ignored and regard had to the substance of arrangements in determining their correct revenue treatment.

The Grand Old Duke had arranged for payment of an annuity to his servants which was deductible to him relative to its characterization as salary and wages paid to his employees. Acknowledging that there may be cases in which the form of a transaction in its documents is not bona fide to cloak or conceal a different

intended transaction was not evidenced in the particular matter before him, Lord Tomlin maintained that support for the so-called “doctrine” rested on a misunderstanding of language used in earlier cases.

Lord Tomlin’s contempt for this “doctrine” was clearly evident when he asserted that the “doctrine” seemed to involve substituting “the uncertain and crooked cord of discretion’ for ‘the golden and straight meter wand of the law”!

That thinking has underpinned the preference in the United Kingdom (UK) for enactment of specific integrity measures in response to recognized abuse than a general anti-avoidance provision at least until now – it will be informative to observe where the UK land in relation to the debate for introduction of a general anti-avoidance provision in the current economic and fiscal circumstances they confront.

In the writer’s opinion the principles articulated by Lord Tomlin in dispelling the misunderstanding in the so-called ‘doctrine’ and his calling for the ‘doctrine’ to be given its “quietus” played their part in the construction of the “choice principle”, the demise of Section 260 ITAA 1936 and the recognition of need for introduction of Part IVA ITAA 1936 to address the recognized shortcomings of Section 260 ITAA 1936 circa 1981 at least.

Despite no lesser personage than Lord Denning in the Privy Council on appeal from the High Court in Newton shining a light on the way forward to address the recognized difficulties with Section 260 ITAA the Government of the day in 1981 chose a partial adoption of his predication test. Further, the High Court subsequently reduced its authority in 1985, following repeal of Section 260: ***plus ca change, plus c’est la meme chose.***

The Duke of Westminster principle underpinned the choice principle, the development of which led to the repeal of Section 260 as a general anti-avoidance provision, and was in stark contrast and in conflict with Lord Denning’s “predication test” for tax avoidance.

1.2 The rise and fall of Section 260 ITAA, its shortcomings and the policy choice to address them

Section 260 ITAA 1936 had formed part of income tax law in Australia as a general anti-avoidance measure on introduction of ITAA 1936 but its antecedents trace back to the 19th Century in Australia – Australia has long had a preference for general anti-avoidance provisions despite the opposite being the case in the United Kingdom.

Section 260 ITAA 1936:

"Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, 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 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, but without prejudice to such validity as it may have in any other respect or for any other purpose".

It is immediately observable in contrast to Part IVA ITAA 1936 that Section 260 is a self-executing provision if the pre-conditions for its operation were satisfied i.e. it did not require a determination by the Commissioner to apply it.

Further, it voided transactions as against the Commissioner but didn't allow their reconstruction – if the offending transaction was annihilated and the remaining transactions did not yield income tax section 260 offered the Commissioner cold comfort for change.

It is clear from John Howard's second reading speech that, in speculating that history is now repeating, the introduction of Part IVA followed a series of cases before the Court demonstrating the limitations of Section 260 ITAA 1936.

When regard is had to the trilogy of cases in Mullens, Slutzkin and Cridland the short-comings of Section 260 ITAA were profoundly evident but, as noted above, the Government of the day in 1981, following extensive consultation, chose the path embodied in Part IVA ITAA 1936 as introduced.

In addition to visiting the trilogy of cases referred to above, the writer was also informed by visiting two other cases in particular:

(1) Keighery; [(1957)100 CLR 66] and

(2) Newton [(1958) 98 CLR1].

These two cases are of note firstly because they pre-dated the above trilogy by some 20 years. Secondly, Newton was decided before the Privy Council as noted earlier before a Council of Lordships including Lord Denning. Appearing for the taxpayer and no doubt informed by the experience was none other than Sir Garfield Barwick Q.C.
Sir Garfield Barwick QC was the Chief Justice of the High Court of Australia at the time of the trilogy of cases defining the limitations of Section 260 precipitating its demise.

Thirdly, and most significantly, each of these trilogies of cases, in contrast to Keighery and Newton would, in the writer's opinion, constitute schemes of a "blatant artificial or contrived kind" that the man in the street would have expected Section 260 ITAA 1936 or any self-respecting general anti-avoidance provision in tax law to have struck down.

1.2.1 Mullens

Reminiscent of Lord Tomlin's observations in the Duke of Westminster the taxpayers in Mullens were found by the High Court to have ordered their affairs so as to come within the terms of former Section 77A, contrary to the conclusions reached by the Supreme Court of NSW. Shortly stated the promoter of an Oil and Gas explorer had a large number of shares in Vamgas to their account. They became entitled to non-renounceable rights in those shares but didn't have the funds to pay for them. Had they done so they would have been entitled to a deduction under Section 77A.

There was a second arrangement which involved partly paid shares held by the promoter's entity. Payment on call on the shares would have entitled the holders to deductions under Section 77A.

The relevant taxpayers were associated with the Mullens Group, a firm of stockbrokers.

Under the first arrangement, Mullens Group paid the amount due on the shares to Vamgas to the Vamgas shareholders who executed a Deed of Trust in favour of the Mullens Group who in return gave the shareholders an option to purchase which was duly exercised.

The second arrangement involved transfer of the partly paid shares for Vamgas to a nominee of the Mullen Group who paid up the call but gave right of first refusal to Vamgas and subsequently when the price of the shares rose Vamgas purchased the shares back.

The Mullen Group got the tax deduction for the share payments under Section 77A while the Vamgas shareholders maintained their participation as promoters in the shares in Vamgas which they could not fund otherwise.

The taxpayers had arranged their affairs in such a way as to be entitled to a deduction as a matter of policy incentive for share capital contributions to oil and gas explorers but in substance did not participate as shareholders.

1.2.2 Slutzkin

Shares in a profit rich company that accumulated without attraction of Division 7 undistributed profits tax were sold free of tax.

If the company had been liquidated or a dividend declared the profits would have been taxed in the hands of the original shareholders.

The company first liquidated all its investments and was sold to an unrelated company who stripped the profits out by way of dividend on the same day as purchase.

There was evidence that the original shareholders had determined to realise and invest the company's assets in their own right – access to the assets from the company was an intended outcome. This was a particularly aggressive dividend stripping arrangement.

The High Court found no basis for application of Section 260 - it was observed that if Section 260 annihilated the sale of shares that Section 260 would not expose the original shareholders to receipt of income. The absence of a power of reconstruction was an obvious limitation emerging from this case.

1.2.3 Cridland

This was a case in which the taxpayer was one of a multitude of university students to whom the relevant scheme was promoted by "a Brisbane tax accountant versed in the arts of tax minimization", utilizing a trust arrangement involving acquisition of income units by the taxpayer in a primary production unit trust.

The High Court found Section 260 could have no application to the facts despite:

- The transactions not being those ordinarily entered into by university students;
- The transactions could not be counted as “ordinary family or business dealings”;
- The transactions were only explicable by reference to the desire to attract the averaging provisions and the tax advantage they conferred (Duke of Westminster principle).

As the taxpayer had entered the transactions as a matter of choice to which specific provisions of the tax law applied producing the legal consequences that followed, the transactions were beyond the scope of Section 260.

The choice principle left little room for the application of Section 260 and had the Duke of Westminster principle at its foundation.

The two preceding cases of Keighery and Newton are worthy of note in passing in the context of their contribution to the jurisprudence.

1.2.4 Keighery

The taxpayer had undertaken arrangements to ensure public company status to avert the need for distribution of profits to avoid undistributed profits tax under Division 7 ITAA 1936. This was found to be a choice presented by the Act and could not fall within Section 260.

1.2.5 Newton

Newton was a case involving private companies which had profits which would have been taxable at high rates in the hands of shareholders or taxed in the hands of the relevant companies as undistributed profits at the equivalent high tax rate.

The arrangement in Newton involved the following:

- Company amended articles to give special dividend rights to 80,000 ordinary shares - affordable right to special dividend of £460k.

- Post payment of special dividend shares only carried 5% fixed dividend.

- Original shareholders sold shares to Company A (controlled by Accountants) at price of £460k (= special dividend amount) – sold CUM dividend free of tax (capital account). (Note the role of professional service providers in such arrangements)

- Company P received cheque for dividend £460k from Company.

- Only able to pay for shares because of special dividend.

- Same day Company P applied for 400,000 5% preference shares and paid with cheque for £400k.

- Next day Company P sold those shares to original shareholder for £400k.

- Original shareholders paid for by cheque in favour of Company P for £400k out of £460k received for 80,000 ordinaries.

- All cheques banked simultaneously.

- Company distributed £460k as dividend, £400k back to Company as capital injection and original shareholders had £60k tax free as capital proceeds on disposal of original 80,000 shares.

- Did this with two other companies – total of £1.7m in 1951!

Kitto J at first instance found no application of Section 260 ITAA to include the relevant amounts in assessable income.

The Full High Court by majority (Taylor J dissenting) found in favour of the Commissioner and the Taxpayers appealed to the Privy Council.

Lord Denning observed at page 4 of the judgement:

"…In these days, when rates of tax are high, it is natural enough for a man to seek so to order his affairs that the tax attaching under the appropriate Acts is less than it otherwise would be. In England there is no general provision against it, but special provisions have been enacted so as to counter particular devices and to deal with particular situations. In Australia there is a general provision which is said to cover "tax avoidance" and there is a general provision which is said to cover "tax avoidance" and it comes now before their Lordships for the first time."

The transactions were accepted by all parties to be genuine and not impugned as shams.

The Commissioner maintained the arrangement had or purported to have the purpose or effect of avoiding a liability imposed on any person by the Act.

The Privy Council found that the reference to 'arrangement' envisaged something less than a binding contractual commitment but Section 260 comprehended not only the initial plan but all the transactions by

which the plan was carried into effect – if the arrangement was voided and the transactions left standing the sections would be useless.

Sir Garfield Barwick QC argued in response that if this was so Section 260 would know no boundaries – selling shares cum dividend to escape a liability that would otherwise fall on a shareholder? Selling a property to avoid tax on rental income?

Their Lordships response was that no such problem arose because Section 260 did not concern itself with the MOTIVES OF INDIVIDUALS: "It is concerned not with ***their desire*** to avoid tax, but only with ***the means*** which they employ to do it".

Their Lordships observed that Section 260 required the arrangement itself to be looked at and observe its effect. The effect of the arrangement applies regardless of the motives of the relevant persons.

Bearing in mind the following was observed in 1958 Lord Denning said at page 8 of the judgement:

*"In order to bring the arrangement within the section you must be able to **predicate** – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labeled as a means to avoid tax, then the arrangement does not come within the section. Thus, no one, by looking at a transfer of shares cum dividend can predicate that the transfer was made to avoid tax. Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Div. 7 tax, see W.P. Keighery Pty Ltd v Commissioner of Taxation (1). Nor could anyone on seeing a declaration of trust made by a father in favour of his wife and daughter, predicate that it was done to avoid tax, see Deputy Federal Commissioner of Taxation v Purcell (2). But when one looks at the way the transactions were affected in Jacques v Federal Commissioner of Taxation (3); Clarke v Federal Commissioner of Taxation (4), and Bell v Federal Commissioner of Taxation*

(5) – the same cheques were exchanged for like amounts and so forth – there can be no doubt at all that the purpose and effect of that way of doing things was to avoid tax.

Applying these principles to the present case, the first question is – Was there an arrangement? The answer is "yes". The whole complicated series of transactions must have been the result of a concerted plan; and the nature of the plan is to be ascertained by the overt acts done in pursuance of it.

Next, what was the purpose of the arrangement? It can clearly be seen to be three-fold: (i) To increase the capital of the motor companies – and to do it by ploughing back over £1,000,000 of the profits into the businesses – and to do it in a way which would attract as little tax is possible. (ii) To enable the original shareholders to receive a large sum – nearly £500,000 in cash – without paying tax on it. (iii) To enable the Pactolus company to make a handsome profit in return for its part in the affair."

Could the avoidance of tax be PREDICATED by looking at the overt acts of:

- A transfer of shares cum dividend?
- Turning a private company into a public company (Keighery)?
- A declaration of trust by a father in favour of his wife and daughter?

Lord Denning found that in contemplating the predication test in Jacques, Clarke and Beck there was no doubt the overt transactions were done in a particular way to avoid tax.

In applying the Predication Test, to the facts in Newton Lord Denning found:

(1) Was there an "arrangement"? Yes.

(2) What was the purpose of the arrangement?

Threefold:

- Increase the capital of the companies – ploughing back over £1M and doing it in a way with as little tax as possible.
- Enable the original shareholder to receive a large sum tax free.
- Enable Company P to make a handsome profit for its part in the "affair".

  [Noted that Division 7 undistributed profit tax could have been amended by changing from private to public]

(3) What was the effect of the arrangement?

- Companies received new capital.
- Original shareholders got capital payment for sale of shares but no dividend.
- Companies satisfied Division 7 requirements and not subject to undistributed profits tax.
- Company P made a profit from share dealing which it was taxable on.

Lord Denning found that from his analysis above that the avoidance of tax was not the sole purpose of the arrangement. However, for Section 260 to apply it was not necessary that the purpose and effect of avoidance of tax was the sole purpose.

Lord Denning held that looking at the whole arrangement that he and his fellow Lordships "had no doubt that it was an arrangement which is caught by Section 260".

One of the ends sought to be achieved by this concerted action was the avoidance of a liability for tax.

The Lordships then had to confront the effect of Section 260 as an 'annihilating provision observing that the ignoring of the transactions or their annihilation "does not itself create a liability to tax",

Their Lordships found that to make the taxpayers liable the Commissioner must find, having ignored the transactions, that the taxpayers received something he was entitled to treat as income.

In Newton the Commissioner had to accept the creation of special dividend rights but he was entitled to ignore the arrangement in so far as the rights were transferred to Company P.

That transaction gave a capital tax free character to the monies received by the original shareholders.

In that way the Commissioner could not ignore the declaration of the special dividends on the shares which are to be deemed by the Commissioner under Section 260 to be still held by the original shareholders not Company P.

The entirety of the arrangement was otherwise acknowledged or regarded – Section 260 was said to only authorize the Commissioner ignoring the transfer of the specific dividend rights, not their creation. As the original shareholders received the proceeds of sale he could tax them as dividends received.

It would have been a long trip back to Australia for Sir Garfield Barwick with the rejection of his arguments by the Privy Council too many to mention, ringing loudly in his ears.

In so far as John Howard favourably references the Predication Test in his second reading speech in introducing Part IVA in 1981, what happened to the Predication Test in Newton assumes significance.

The endorsement of the decision in Keighery by the Privy Council in Newton as a case where it could not be predicated that turning a private company into a public company was to avoid tax, opened the door to the construction and expansion of the “choice principle” by the Barwick led High Court and demise of Section 260, allowing that in Newton the predication test rendered Section 260 effective and without limitation on the facts of the case.

1.2.5 What did Keighery say?

It is noted that Sir Garfield Barwick QC also appeared for the taxpayer in Keighery.

Firstly, it was conceded by the taxpayer that the objective of the various arrangements to secure public company status were undertaken to avoid the familiar problem of being required to pay tax under Division 7 on undistributed profits.

The majority of the High Court made the following observations in finding that Section 260 could not have application in these circumstances at page 92.

"Whatever difficulties there may be in interpreting Section 260, one thing at least is clear: the section intends only to protect the general provisions of the Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them **(articulating the choice principle)**. *It is therefore important to consider whether the result of treating the section as applying in a case such as the present would be to render ineffectual an attempt to defeat etc. a liability imposed by the Act or to render ineffectual an attempt to give a company an advantage which the Act intended that it might be given."*

Whether a company met the characterization of private or public was within the antecedent control of the shareholders of the company.

"Whenever, as the end of a year of income approaches, it is found that facts exist in relation to a company which will make it a "private company" if they persist on the last day of the year, the persons interested in the company are presented by the Act itself with an opportunity to decide whether the consequences of its being a "private company" will be incurred or a sufficient change will be made to prevent its being incurred. If they do not wish the company to be placed in the position of having either to make a sufficient distribution or to pay Div. 7 tax, they may so act with respect to shares in the company that the public become

substantially interested in it (within the definition in par. (1) of sub-s (4) of S.105), or they may turn it into a subsidiary of a public company (within the definition of par. (b) of that sub-section) or they may bring about a sufficiently less concentrated holding of the shares or the beneficial interests therein, or of the voting power, or of rights by reason of which the company is capable of bine controlled. It is only if they do not take any of the courses thus thrown open to them that Div. 7 creates a liability. If they so alter the relevant facts that, when the last day of the year of income arrives, the company will not be a "private company", their action cannot be regarded as tending to defeat a liability imposed by the Act; it is one which the Act contemplates and allows."

The next issue to consider is the role and nature of commerciality in the application of Part IVA. In Hart [2004] HCA 26, Hill J explained why an opposite conclusion was requir4ed in Spotless from the one reached by the Full Court in Hart. His Honour explained that "*the scheme identified by the High Court in Spotless was not commercial for the simple reasons that the interest obtained on those funds was very considerably less than the interest could be derived by deposits in Australia".*

And in conclusion at pages 93 and 94 the majority of the High Court said:

Because this is so, an attempt by the Commissioner to rely upon Section 260 in the present case in order to avoid only the applications for and allotments of the redeemable preference shares would be an attempt to deny to the appellant company the benefit arising from an exercise which was made of a choice offered by the Act itself. The very purpose or policy of Div. 7 is to present the choice to a company between incurring the liability it provides and taking measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act. For that simple reason the attempt must fail, and the Commissioner cannot rely upon Section 260 in order to treat as void any more extensive set of facts, for an attempt to do so could not stop short of including the incorporation of the appellant company itself. We have not to consider whether he might have done that in order to uphold an assessment against Aquila Steel on the footing that the company should be deemed not to have distributed the £29,804 2s. 11d. at all. The Commissioner's reliance upon Section 260 in the present case cannot succeed.

1.2.6 The Predication Test in Newton revisited

In Newton the critical factor that attracted the operation of Section 260 was the transfer of the shares to which a right to special dividend had previously been attached by alteration of the Articles of the company. Thus when Section 260 annihilated the transfer of the relevant shares the proceeds of sale of the shares cum dividend to P Company were characterised as assessable income of the shareholders by way of dividend for tax purposes.

Lord Denning having stated the predication test observed that if, having observed the overt acts by which the arrangement was implemented, you cannot predicate but rather have to acknowledge that the transactions are capable of explanation by reference to ordinary businesses or family dealing without being labelled as a means to avoid tax, Section 260 cannot apply.

He then gave three examples where by looking at the overt acts of the transaction “no one” could make the necessary predication to apply Section 260:

- A transfer of shares cum dividend.
- Turning a private company into a public company (Keighery).
- A father making a declaration of trust in favour of his wife and daughter.

The outcome in Keighery is observed to have obtained despite the clear recognition that the change of status was to avoid a liability to undistributed profits tax - the structure of the Act itself envisaged a choice between a company being characterised public or private for the purpose of Division 7. It was considered inappropriate for Section 260 to operate to obviate choosing to exhibit the requirements of a public company as envisaged by the Act itself – electing which tax regime prescribed by the Act to be governed by.

The trilogy of Mullens, Slutzkin and Cridland extended the choice principle as formulated in the factual context of Keighery and consequently and successively extended the range of circumstances in which the

Privy Council in Newton conceived it could not be predicated from observing the arrangement itself and its purpose/effect that it was implemented in the particular way so as to avoid tax.

In Mullens the arrangement secured the benefit of Section 77A – the intention to access the benefit of a deduction provided by the Act would not be a predicating of an intent to avoid the evidence of tax.

In supporting this extension Barwick CJ referenced the Keighery and a series of cases in which the Court had made it plain that a taxpayer is entitled to create a situation to which the tax law attaches tax advantage. He also emphasised that the principle of the Duke of Westminster case "must always be kept in mind – "regard was had in the course of his judgement to the policy intent behind the presence of Section 77A".

The taxpayer in Slutzkin received proceeds for the disposal of shares which were not taxable - a means of realisation of an asset had been chosen which did not attract tax.

The legal form of the transaction and the choice of that form is a matter for the taxpayer - in this context Barwick CJ was again referencing the Duke of Westminster case in stating a taxpayer is fully entitled to choose that form of transaction which will not subject him to tax or subject him to less tax than some other form.

The principle of the Duke of Westminster case was said by him "too easily forgotten" and was said to be "still basic in this area of the law".

Support for this extension of the choice principle was drawn from the judgement of the Privy Council in Commissioner of IR v Europa Oil (NZ) Ltd [1971] AC 760.

The Chief Justice explained that in the circumstances of Slutzkin at page 4080:

"…It is a complete misconception of the operation of Section 260 to conclude that, because a transaction was entered into in the form which it took in order not to subject its proceeds to tax in the hands of the recipient,

Section 260 is satisfied. Further, it is fundamental that the section is, as it has been said, no more than an annihilating section. It does not itself impose tax, nor does it construct or reconstruct any transaction. It does no more than avoid a transaction. The avoidance is of no consequence unless, if the transaction were swept aside, a factual situation involving the payment of tax is exposed."

Even if the sale of shares in Slutzkin was avoided there was no basis for deeming the share sale proceeds to be a taxable dividend, in contrast to Newton.

In the words of Aickin J the choice principle in Keighery, as also applied in Mullens, applied equally in a case such as Slutzkin at page 4084:

"The principle equally applies in a case of receipts with which the Act simply does not deal, i.e. capital receipts, save such as are for the purpose of the Act deemed to be income. To adopt a course which produced a result outside the scope of the Act is not to alter the incidence of tax, or to defeat any liability to tax or prevent the operation of the Act, notwithstanding that such course is adopted with full knowledge of the provisions of the Act with which a conscious intention that the proceeds should not fall within the operation of the Act."

The High Court in Cridland through Mason J extended the choice principle further to deny the application of Section 260 to circumstances in which the taxpayer created circumstances which attracted the primary tax production income averaging provisions through participation in a mass promoted scheme.

In doing so Mason J had to limit the scope of the predication test articulated by Lord Denning's in Newton at page 4542.

"The distinction drawn by Lord Denning in Newton v F.C. of T. (1958) 98 C.L.R. at p.8, between arrangements implemented in a particular way so as to avoid tax and transactions capable of explanation by reference to ordinary business or family dealing has not been regarded as the expression of a universal or exclusive criterion of operation of Section 260. Lord Denning's observations were applied neither in the Mullens case nor in the subsequent cases of Slutzkin v F.C. of T. 77 ATC 4076."

In Cridland the High Court acknowledged that the acquisition of income units in a trust fund was not a transaction ordinarily entered into by university students.

Nor could the transactions be accounted as ordinary family or business dealings.

The transactions were, at page 4542:

"….explicable only be reference to a desire to attract the averaging provisions of the statute and the taxation advantage which they conferred. But these considerations cannot, in light of the recent authorities, prevail over the circumstance that the appellant has entered into transactions to which the specific provisions of the Act apply, thereby producing the legal consequences which they express."

The choice principle had evolved to limit the Predication Test and limit the application of Section 260 ITAA 1936 to an extent requiring of its amendment or repeal.

Subsequent to the introduction of Part IVA and repeal of Section 260 a further trilogy of cases in turn limited the evolution of the choice principle where the arrangements did not seek to attract a tax benefit as in the trilogy of Mullens, Slutzkin and Cridland but sought to divert income from one taxpayer to another in the trilogy of cases for Doctors Gulland, Watson and Pincus.

Suffice to say that in 1981 the limitations of Section 260 sought to be addressed by Part IVA were those in evidence in the wake of Cridland and not those as articulated by the High Court in the wake of its repeal in the trilogy of Doctors Gulland, Watson and Pincus.

In introducing Part IVA in his second reading speech then Treasurer John Howard asserted that the Government had taken that trouble.

1.2.7 The limitations in Section 260 sought to be addressed by Part IVA

The Explanatory Memorandum accompanying the Bill introducing Part IVA described the limitation of Section 260:

"…(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 or void whether it can be treated as only party avoid, 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 avoiding an arrangement, provide a power to reconstruct what was done, so as to arrive at a taxable situation."

The intention in introducing Part IVA was to "seek to give effect to a policy:

"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 cause unnecessary inhibitions on normal commercial transactions by which taxpayer legitimately take advantage of opportunities available for the arrangement of their affairs."

The approach taken to give effect to this policy was summarized as follows:

"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 object examination, having regard to the scheme itself and to is 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."

Having acknowledged that there may be future tax avoidance arrangements contrived that escape being struck down by Part IVA, it was further acknowledged that "tax avoidance" means different things to different people, reasonable mean and woman are bound to differ on what constitutes tax avoidance and the subsidiary questions of appropriate tests for determining what behavior a general anti avoidance provision should prescribe chose a framework to define what tax avoidance by rendering ineffective:

- a Scheme;
- whereby a tax benefit is obtained; and
- an objective assessment of the scheme; its surrounding circumstances and practical effects directed to a conclusion as to whether the scheme was entered into for the sole or dominant purpose of obtaining the tax benefit.

An alternative approach to that adopted, which was in fact considered but dismissed, was having positively identified what was within the ambit of the provisions to then provide that these provisions would have no application to "schemes" entered into in the ordinary course of business or family dealing.

Thus the Government sought to give effect to its stated policy by enacting provisions that sought to identify "blatant artificial or contrived arrangements" but not mandate exclusion where the scheme was capable of explanation by reference to ordinary business or family dealing.

In the context of the onus of proof borne by taxpayers in disputing determinations by the Commissioner that Part IVA should be applied to eliminate a tax benefit, it is worth begging the question whether the omission

of a specific exclusion from Part IVA of schemes capable of explanation by reference to ordinary business or family dealing was appropriate.

The descriptions of what embodies “tax avoidance” or “ordinary business or family dealing” may best be addressed as noted on introduction by reliance on the well-known Elephant Test – an elephant is difficult to describe but you know one when you see one. The alternative Duck Test might also have been worth of consideration – if it looks like a duck, swims like a duck and quacks like a duck – then it probably is a duck.

In Tax parlance a further alternative might have been the well-known “Smell Test” – does the arrangement pass the smell test?

Perhaps the real answer to declining to render Part IVA expressly inapplicable to ordinary business or family dealing lies in the perceived need to address schemes in the nature of dividend stripping by specifically deeming a tax benefit to have been obtained being the dividend that would have been derived if the profits stripped had been paid as a dividend.

It is informative for contemplating where we find ourselves thirty years later that from the very inception of its introduction a specific supplementary code was required to be enacted to address dividend stripping.

The ability to establish or maintain that profit would have been or might reasonably be expected to have been distributed as dividends if the scheme had not been entered into was seen to be equivocal as often as not.

In the context of the taxpayer bearing the onus of proof this was clear recognition that in cases of dividend stripping a taxpayer would as often as not, if not always, be successful in establishing that no tax benefit arose in a dividend stripping case given the language chosen to define a tax benefit.

In this context it is interesting to contemplate whether, if Part IVA had included an exclusion of application to ordinary business or family dealings, whether this would be necessary or if an assumed application of Part IVA would successfully have been maintained in Slutzkin.

Likewise in the case of Mullens and Cridland.

The requirement for the need for inclusion of Section 177E and the deeming of a tax benefit in the case of dividend stripping is that Slutzkin would have escaped being struck down under Part IVA because of inability to establish an alternative postulate /counterfactual and consequently inability to identify a tax benefit.

It is reasonable to propose that the fact patterns which would fall within the positive tests for inclusion in Part IVA but would not be excluded by a supplementary negative test having been added to Part IVA to make it inapplicable to ordinary commercial dealings.

Newton was a case in respect of which Section 177E would not have been required - the receipt of the special dividend was at least the subject of reasonable expectation.

1.3 Pause for reflection

When regard is had to the subsequent deliberations of the Courts in relation to determinations by the Commissioner to apply Part IVA it is easy to recognize the language of Lord Denning's predication test in Newton – without regard to motives of individuals and by examining the overt acts by which the scheme is implemented can it be predicated that the scheme was implemented in a particular way so as to avoid tax.

If it should be acknowledged that the transactions are capable of explanation by reference to ordinary business dealing without being labeled a means to avoid tax Section 260 or Part IVA should then not be applied.

In the context of the evolution of identification of a scheme since the introduction of Part IVA and the reasoning of the High Court in Hart, Spotless and Consolidated Press it is difficult not to allow that an express exclusion for ordinary and family dealings would not have relieved application of Part IVA in those cases. Likewise, in regard to the Macquarie Finance and British American Tobacco cases.

The more challenging question is whether the inclusion of a specific provision rendering Part IVA inapplicable to ordinary business or family dealings would have impacted the Commissioner's incorrect determination to apply Part IVA ITAA 1936 in his initial consideration in tax audits of News, RCI (James Hardie), Axa, Futuris and Noza, more specifically would he have imposed on those organizations as he did if the legislation expressly directed him not to apply Part IVA to ordinary business or family dealing.

1.3.1 Section 260 speaks from beyond the grave

Given the limitations to Section 260 presented in the trilogy of Mullens, Slutzkin and Cridland inspired its repeal and introduction of Part IVA it is worth recognizing that within three years of doing so the High Court (then free of appeal to the Privy Council) was still contributing to the jurisprudence of Section 260 by limiting the Predication test enunciated by Lord Denning in Newton, refining the expansion of the choice principle and affirmed the principles articulated by Lord Tomlin in the Duke of Westminster. The repeal of a general anti-avoidance provision does not consign it forthwith to the grave.

Section 260 and the bubble of cases in the pipeline of uncertainty of its application in relation to arrangements entered in to and carried out before 27 May 1981 remained the subject of jurisprudence after repeal of Section 260.

Given the favourable references to the Newton predication Test in the Treasurer's Second Reading Speech and the decision not to include an exclusion of application of Part IVA to "ordinary business and family dealings", contrary to the High Court's assessment of that test in Mullens, Slutzkin and Cridland, it would have been a reasonable hypothesis that the short comings of Section 260 observed in 1981 would have

continued to reflect in the continuing administration of Section 260 by the ATO for Pre 27 May 1981 arrangements and in further judicial consideration of the Newton predication test and the choice principle.

Not so, the ATO had material success in maintaining the application of Section 260 to overcome income splitting arrangements by medical practitioners when it might have been reasonably expected the Duke of Westminster principle and choice principle would have permitted the rearrangement of the medical practitioner's affairs to their advantage.

In 1985, five years after the repeal of Section 260 ITAA, a reconstituted High Court under Gibbs CJ refined the judicial perspective of the Barwick High Court as summarized by Mason J in Cridland.

The standing of Lord Dennings' predication test in Newton in jurisprudence was restored in part by reference to a principle of construction – generalia specialibus non-derogant – the general shall not overcome the specific.

Gibbs CJ described Lord Denning's predication test as a "practical test", bearing in mind it was this test that the Treasurer in 1981 clearly stated to have underpinned the policy of Part IVA:

"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 case unnecessary inhibitions on normal commercial transactions by which taxpayer legitimately take advantage of opportunities available for the arrangement of their affairs."

It is worth revisiting the reference in the Second Reading Speech to the Newton predication test:

"One possibility considered was to adopt the language of the Privy Council in the well-known decision in Newton's case, and, positive tests of inclusion having been expressed, make the new provisions inapplicable to schemes entered into in the course of "ordinary business or family dealing". It has been

decided, however, that the better test if what is "blatant", "contrived" or "artificial" is the positive one that has been adopted.

That test seems best to capture the essence of the views expressed by the privy council which, in fact, characterized and "ordinary business or family dealing" as representing a situation other than one of which it can be predicated that it was implemented in the particular way so as to avoid tax.

I have already said that one of the conditions for the application of the new Part IVA is to be that a taxpayer has obtained what the Bill terms a "tax benefit"."

The Treasurer's observations are clear and deliberate - the ESSENCE of what is "ordinary business or family dealings" – the essence is that which it is not – "a situation other than one of which it can be predicated that it was implemented in the particular way so as to avoid tax'.

Having cited Lord Denning's predication test in Newton Gibbs CJ said in Gulland at page 4771:

"The question, according to this test, is whether the arrangement, on its face, must necessarily be labeled as a means to avoid tax. That test is a useful one, and it has often been applied, but it does not provide a guide to the decision of every case. An arrangement which is not capable of explanation by reference to ordinary dealing and which on its face is obviously designed to bring about the result that less tax will be paid may nevertheless do no more than take advantage of an opportunity to reduce tax which the Act itself provides. A line of decisions illustrates that if the Act offers to the taxpayer a choice of alternative tax consequences, either of which he is free to choose, or offers certain tax benefits to taxpayers who adopt a particular course of conduct, the choice of the advantageous alternative or the adoption of the beneficial course does not mean that Section 260 is attracted……"These cases apply the principle of construction expressed in the maxim generalia specialibus non derogant. They show that Lord Denning's statement in Newton v F.C. of T. needs to be understood subject to the qualification which I have indicated, but do not otherwise detract from the authority of that statement."

Viewed in this way, it strikes the writer, that the construction of Part IVA is said to define 'ordinary business and family dealing' by describing what it is NOT!

The practical proposition put forward by Lord Denning required looking at the overt acts by which the arrangement was implemented and, having done so, being required to predicate that it was implemented in that particular way to avoid tax.

This was the conclusion reacted in relation to the Wealth Optimiser in Hart, the deposit of funds in the Cook Islands in Spotless, the interposed entity in Consolidated Press Holdings and stapled preference share and perpetual note in Macquarie Finance.

The Government of the day in 1981 in embracing Lord Denning's Predication Test articulated in Newton by its own admission could have adopted it in full but chose to only adopt it in part.

- Positive tests for what is "tax avoidance" were included in Part IVA – tax avoidance was sought to be described.

- The exclusion from application of Part IVA of schemes entered into in the course of "ordinary business or family dealing" was not expressed.

This was a test observed by the Chief Justice of the High Court in 1985 to "not provide a guide to the decision in every case".

The writer observes that the essence of the Predication Test is the "Elephant Test" – we find it difficult to describe but know tax avoidance when we see it. Likewise, we find "ordinary business and family dealing" difficult to describe but know it when we see it.

Put another way:

The Government chose to describe “tax avoidance “in Part IVA – scheme, tax benefit, sole or dominant purposes without excluding application to “ordinary business or family dealing” – the premise being that “ordinary business or family dealing” was NOT tax avoidance.

“Tax avoidance” is – refer Part IVA and “ordinary business or family dealing” is NOT “tax avoidance”.

The Government chose the difficult course of attempting to describe an Elephant in the form of “tax avoidance” on the one hand but to leave to the Elephant Test “ordinary business or family dealing” by not providing for its exclusion or describing of it in Part IVA.

Lord Denning’s Predication Test left both “tax avoidance” and “ordinary business and family dealing” to the Elephant Test.

The essence of the predication test being that we know tax avoidance when we see it (an Elephant) and we know ordinary business and family dealing when we see it (not an Elephant).

2. Conclusion

The Government of 1981 introduced Part IVA in 1981 following recognition of the limitations of Section 260 in the context of:

- reference to the Duke of Westminster principle.
- limitation of Lord Denning’s predication test in Newton.
- development and expansion of the choice principle.

In doing so it adopted Lord Denning’s predication test in part by seeking to find language to describe “tax avoidance” but not do so in regard to “ordinary business or family dealing” or not exclude application of Part IVA expressly. That test was subsequently consigned in 1985 by Gibbs CJ being a useful practical test that cannot be used to resolve every case.

After thirty years we have found this to be the case but in contemplating its amendment we risk consigning ordinary business or family dealing to tax avoidance, particularly in relation to corporate restructures.

3. Initial observations on Exposure Draft released 16 November 2012

- Only applicable to schemes entered into or commenced to be carried out after 15 November 2012 (not 1 March 2012 as previously announced).
- Inserted a new Objects clause.

  "177AA Object of this Part

  The object of this Part is to counter schemes (including schemes that are steps within or towards other schemes) that are entered into or carried out with an objectively ascertainable purpose of reducing the liability of a taxpayer to tax or withholding tax.

  Note: The ascertainable purpose must in most cases be the sole or dominant purpose (see Sections 177E, 177EA and 177EB for the exceptions)".
- Including Withholding Tax in defining a tax benefit in Section 177C.
- Specific assumptions to be made in deciding if a tax benefit on the basis of an alternative postulate to entry into or carrying out of the scheme:
  - Assume acted/refrained from acted without regard to any person's liability or potential liability to tax or withholding tax (disregard tax cost of alternative postulate).
  - Assume acted/refrained from acting intending to achieve for the taxpayer the same "non-tax effect" achieved/would be achieved under the scheme and achieved/would be achieved for the taxpayer in connection with the scheme.
  - In the event the scheme does not or would not achieve any tax effects for the taxpayer and events or circumstances that actually happened/existed not forming part of the scheme would still have happened/existed.

- In making assumptions re non-tax effects have regard to maters under 177D(1) and (2) in deciding if Part IVA applies to the scheme, as far as they relate to the taxpayer.

- 177D restated by reference to application of Part IVA to scheme if concluded sole and dominant purposes of a person or taxpayer obtaining a tax benefit.
- Confirms tax benefit must be obtained in connection with a scheme to which Part IVA applies.
- Reinstates critical question of sole or dominant purpose of a person as "the fulcrum".
- A single enquiry into whether a taxpayer has obtained a 'tax benefit' directly or indirectly from a scheme in which a person participated for the sole or dominant purpose of obtaining a 'tax benefit' for the taxpayer.
- Alternative postulate has two roles:
  - Identifying and quantifying tax benefit;
  - Providing a basis upon which to conclude purpose – consideration of other ways in which participants could have achieved their non-tax purposes relative to tax purposes.
- Tax benefit comprises two limbs:
  - Would have revisited if scheme not occurred.
  - Might reasonably be expected to have resulted if scheme not occurred – located in the commercial end being pursued.
- Impact of recent cases:
  - Unrestrained inquiry about alternative postulates, unconstrained by limit of scheme as defined or the matters prescribed by 177D and not limited by reference to non-tax effect of scheme:
    - Futuris;
    - Axa.
- Together with RCI – only turn to 177D if a tax benefit identified under 177C. Futuris and RCI did not require consideration of purpose of 177D. Should start with 177D (overt acts comprising the scheme).
- Relevance of tax costs to alternative postulate – been rejected as unreasonable because tax costs would have led to abandonment or defer indefinitely – RCI.

"1.68 The fact that a taxpayer would not have entered into a transaction if it had known, in advance, that it would be subject to tax can be no answer to Part IVA. To accept such a proposition would be to accept that there are situations in which it is reasonable for a taxpayer to avoid the ordinary operation of the taxation law on the substance or reality of what they have actually done."

- Whether would have/might reasonably expected to have occurred not a composite phrase but disjunctive – not two ends of a spectrum of certainty but separate and distinct basis upon which the existence of a tax benefit can be demonstrated (scheme ignored – in finding tax benefit) (Lenzo vs Trail Brothers (alternative postulate includes integers of scheme – reconstructed the scheme).

4. Implications of the Exposure Draft

- Significance of Tax Benefit diminished and puts focus on 177D – purpose:
  - Way in which the scheme was implemented (177D(2) (a-c)).
  - The effects of the scheme (177D(2)(d-g)).
  - The nature of any connection between the taxpayer and other parts (177D (2)(h)).
- Reignites intensive focus on definition of scheme – more likely application to narrower scheme particularly if no non-tax effect evidenced – alternative postulate not involve reconstruction of broader commercial transaction.
- Increasing importance of contemporaneous evidence of non-tax effects and eight factors in 177D(2) (a-h) in Part IVA.
- Focus on the non-tax ends to which scheme is directed as now contemplated under 177D(2) – overcomes Axa and Futuris – alternative postulates preferred by Courts were not pursued by taxpayers.