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The UK general anti abuse rule: Lessons for Australia?

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Abstract

Australia and the UK have general anti-avoidance rules (GAAR) in their respective income tax legislation. The UK GAAR is relatively new, while the Australian GAAR, bar a number of amendments over the years, was introduced in 1981. This article comparatively analyses these two GAARs with a view to determining whether certain aspects of the UK GAAR provide lessons for certain perennially controversial aspects of the Australian GAAR. In this regard, this article particularly focuses on the way these two GAARs define an arrangement or a scheme, identify a tax benefit and target impermissible or abusive tax avoidance, before concluding with the lessons that can be learned from the UK GAAR.

Keywords: Tax avoidance, general anti-avoidance rule, general anti-abuse rule, Part IVA, tax benefit, tax avoidance scheme/arrangement, judicial anti-avoidance doctrines, substance over form, double reasonableness test, predication test

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1. INTRODUCTION

General anti-avoidance rules (GAARs) are used as broad mechanisms to curb impermissible tax avoidance in many jurisdictions. Australia and the UK are two of these jurisdictions. Due to the dynamic and complex nature of the target of GAARs, GAARs isolate or define impermissible tax avoidance in different ways, even though there are certain broad similarities. When it comes to GAARs, Australia has a significantly longer history than the UK. This implies that the UK had the advantage of drawing lessons from this history in drafting its own GAAR. It also means that Australia might derive lessons from the UK GAAR in return. This article will discuss the UK and Australian GAARs in detail for the purposes of determining whether there are any lessons for Australia in the UK GAAR. The GAARs will be discussed separately followed by a comparative analysis of the concepts in the GAARs.

The UK GAAR will be discussed in Section 2. The discussion will start with the background to the GAAR in the UK. Aspects of this background that have influenced the nature and scope of the UK GAAR will be highlighted. The provisions of the UK GAAR will be referenced and discussed. The discussion will be limited to the core provisions of this GAAR and supporting provisions will only be discussed to the extent that they help to clarify the core provisions. The UK GAAR requirements that must be established before the GAAR can apply will also be covered in Section 2. The definition of tax arrangements, the purpose requirement, the tax advantage requirement and, most significantly, the provision that sifts impermissible tax avoidance from the sea of avoidance transactions will be considered.

Section 3 of this article will review the Australian GAAR. This part will start with a background analysis and how this background has affected the current Australian GAAR. The analysis of the GAAR will also focus on the core provisions. Possible upcoming amendments to the Australian GAAR, which add provisions on diverted profits and a new multinational anti-avoidance law, are beyond the scope of this article and will therefore not be considered. The emphasis will be on the provisions on purpose, tax benefit, and the establishment of the scheme, and how these provisions have been interpreted by the courts.

Section 4 will establish and analyse three main points of comparison between the Australian and the UK GAARs. The aim of this comparative analysis will be to determine whether certain approaches taken in the UK GAAR should be considered in Australia.

2. THE UK GENERAL ANTI ABUSE RULE

2.1 Background

To understand the tenets of the UK GAAR, it is important to analyse its unique background. Unlike the Australian and other GAARs, the UK GAAR was introduced after a period of extensive consultation on whether the UK needed a GAAR and, if so, the type of GAAR that would best suit the UK. This background can be divided into two distinct periods, namely the judicial period, where the need for a GAAR was not considered until 1998, and the period which followed when there was acceptance that the GAAR was needed in the modern world.

The judicial period was arguably largely based on the *Ramsay* approach to tax avoidance schemes.[2] This *Ramsay* approach was a reaction to the unintended effect of Lord Tomlin's submission in the famous *IRC v Duke of Westminster*[3] case where he stated that:

> It is said that in revenue cases there is a doctrine that the court may ignore the legal position and regard what is called "the substance of the matter", and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioner apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting "the uncertain and crooked cord of discretion" for the golden and straight metwand of the law. Every man is entitled if he can to order his affairs … 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.[4]

The reaction to this submission was the widespread use of tax avoidance schemes purchased from promoters. These schemes contained composite transactions that contained a series of transactions that appeared to be independent but were, in reality, connected and aimed at avoiding tax by cancelling out one another. The taxpayers argued that the *Duke of Westminster* case was authority for the proposition that the courts were obliged to recognise the independence of each transaction in the composite transaction, meaning that the fiscal reality of the whole transaction was to be ignored. In other words, the legal position was that the transactions were separate, but the substance was that the transactions were connected and self-cancelling. Lord Tomlin's statement above appears to have done away with the substance and promoted the legal separation of transactions in a series.

The *Ramsay* approach basically countered this trend and stated that self-cancelling transactions could be disregarded for tax purposes if there was evidence of the fact that the transactions were preordained to take place in a particular order.[5] As time went on, the *Ramsay* approach evolved to include the application of purposive statutory interpretation to composite transactions, and not to individual transactions in the composite transaction.[6] It was therefore a judicial anti-avoidance rule that negated

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[2] Derived from *WT Ramsay Ltd v IRC; Eilbeck v Rawling* [1981] 1 All ER 865 HL.

[3] [1936] AC 1 (HL).

[4] Ibid 22.

[5] While the *Ramsay* case is widely credited with the introduction of the judicial anti avoidance approach in the UK, it must be stated that the seeds for viewing composite transactions with self-cancelling individual transactions as a whole were sown in *Floor v Davis* (1979) 52 TC 609. The majority in this case stated that the Crown's argument that the self-cancelling transactions had to be viewed as whole was contrary to the principles in *IRC v Duke of Westminster*. In a dissenting judgment, Everleigh J stated at 609 that 'I see this case as one in which the court is not required to consider each step taken in isolation'.

[6] The purposive approach under *Ramsay* is encapsulated in *Collector of Stamp Revenue v Arrowton Assets Ltd* (2004) 6 ITLC 454. In *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51 [53] it was stated that 'the driving principle in the *Ramsay* line of cases continues to involve a

the need for a GAAR in the UK. The *Ramsay* approach, being more of a general anti-avoidance mechanism, was not the only anti-avoidance mechanism in the UK. Reliance was also placed on a network of specific anti-avoidance rules (SAARs).

A part of the judicial period was also characterised by consultations on introducing a statutory GAAR in the UK. In 1997, the Tax Law Review Committee (TLRC) document, *Tax Avoidance*, stated that the plethora of SAARs should continue but the question whether these SAARs needed the support of the deterrent effect of a GAAR required consideration.[7] In answering this question, the TLRC stated that it preferred a 'sensibly targeted statutory general anti-avoidance provision with a considered framework and appropriate safeguards for taxpayers'.[8] The safeguarding of the rights of taxpayers was of particular importance to the TLRC. To reinforce this position, the TLRC stated:

> [a] statutory provision that fails to address satisfactorily the issues to which we draw attention or to meet the criteria we identify (in particular for safeguarding taxpayer's rights) will inhibit the conduct of ordinary commercial and personal affairs and prove an administrative nightmare for the Revenue authorities. The Committee will vehemently oppose such a provision.[9]

The Inland Revenue submissions on the potential introduction of a GAAR, *A General Anti-Avoidance Rule for Direct Taxes: Consultative Document*, stated that the *Ramsay* approach created by the courts and legislation had put some limits on tax avoidance but 'new devices for avoiding tax' continued to be created.[10] The Inland Revenue acknowledged that the UK was 'unusual among developed countries in having neither a statute nor an established legal principle to counter tax avoidance in general'.[11] Like the TLRC, Inland Revenue accepted that the UK needed a GAAR that would 'put a stop' to costly corporate tax avoidance.[12] Another key similarity between the submissions of the TLRC and the Inland Revenue is that the Inland Revenue stated that while 'the aim of a GAAR would be to reduce tax avoidance, it should not unduly harm the level of certainty of tax treatment enjoyed by businesses that are not engaged in avoidance'. The Inland Revenue went further and stated that '[a]n important criterion of the success of a GAAR would be that it should not unduly harm the levels of certainty which companies currently have about the tax treatment of a transaction'. In this regard, it can be said that the Inland Revenue strongly believed in a balanced GAAR whose success would not only be measured by the extent to which it deterred taxpayers from engaging in avoidance, but also by the extent to which it created certainty for taxpayers. However, the GAAR that Inland Revenue proposed was

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general rule of statutory construction and an unblinkered approach to the analysing of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically'.

[7] Available at <http://www.ifs.org.uk/publications/1908>.

[8] Ibid vii–viii.

[9] Ibid.

[10] Available <http://www.ifs.org.uk/comms/comm77.pdf> [4.1].

[11] Ibid [4.3].

[12] Ibid [4.5].

rejected by the TLRC, which opined that the proposed GAAR was not 'sensibly targeted' and did 'not offer appropriate safeguards for the taxpayers'.[13]

The 1998 discussions for the introduction of a GAAR in the UK ended with the TLRC's response to the Inland Revenue's proposed GAAR. While the TLRC unequivocally rejected the Inland Revenue's proposed GAAR, a move that can be interpreted as showing a divided opinion on the scope and characteristic of a GAAR for the UK, the two parties were united in their view that the GAAR needed to be balanced, certain and protective of the rights of the taxpayer. This was a consistent theme from the main protagonists in the 1998 discussions on a GAAR for the UK.

More than a decade later in 2011, it was acknowledged that the UK needed a GAAR. Another round of consultations on a GAAR in the UK was initiated when the UK government agreed to establish a study group chaired by Graham Aaronson QC. The group published its report, *GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system* (the Report).[14] The Report concluded that the UK needed a GAAR and provided reasons in support. On the *Ramsay* approach that had served as a general anti-avoidance mechanism, the Report opined that the approach was 'a very positive development' when it was created.[15] The Report however indicated that the purposive construction of statutes that the *Ramsay* approach gradually embraced was exposed unfavourably since the courts had, in some cases, shown a tendency to use it to 'stretch the interpretation of tax legislation in order to thwart tax avoidance schemes which they regard as abusive'.[16] As a result, the Report stated that a new general anti-avoidance mechanism was required.

On the other forms of legislative anti-avoidance, the targeted anti-avoidance rules (TAARs) and the provisions requiring the disclosure of tax avoidance schemes (known as DOTAS), the Report stated that there were more than 300 TAARs. The Report also noted that the DOTAS were a useful source of information for HMRC on trends in tax avoidance schemes.[17] However, the Report concluded that TAARs, DOTAS and purposive interpretation under the *Ramsay* approach combined were incapable of dealing with some abusive tax avoidance schemes.[18] An example was given of the so-called SHIPS 2 scheme, which had seven steps that led to the creation of a tax loss that could be used to neutralise or reduce a taxpayer's taxable income. This scheme was challenged in *Mayes v HMRC*,[19] but due to the detailed and prescriptive nature of the statutory provisions relied on in the scheme, the court could not establish the purpose that had been violated and had to allow the tax advantages obtained.

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[13] TLRC, *A General Anti-Avoidance Rule for Direct Taxes: A response to the Inland Revenue's Consultative Document*, vii <http://www.ifs.org.uk/comms/comm77.pdf>.

[14] Available at <http://webarchive.nationalarchives.gov.uk/20130605083650/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf>.

[15] Ibid [3.13].

[16] The particular case that gave rise to these concerns is *HMRC v DCC Holdings* [2010] UKSC 58. See [25], where it appears that the court would stretch the statutory provision in question in order to avoid what it saw as an absurd result.

[17] Above n 13, [3.17], [3.18].

[18] Ibid [3.20].

[19] [2011] EWCA civ 407.

In keeping with the conclusions of the TLRC and the Inland Revenue in 1998, the Report found that the question whether the UK needs a GAAR must be answered in the affirmative and comprehensively, namely that the UK needs a GAAR but one that adheres to certain principles.[20] This was consistent with the conclusions of the TLRC and the Inland Revenue in the sense that the Report concluded that a suitable GAAR for the UK needed to be targeted and not too wide as to affect permissible transactions. The Report noted that the GAAR needed to be guided by an overarching principle which required the GAAR to target 'highly abusive, contrived and artificial schemes which are widely regarded as intolerable, but not affect the large centre ground of responsible tax planning'.[21] Other principles proposed to guide the GAAR were, inter alia, the reduction of uncertainty, the counteraction of abusive schemes, distinguishing between responsible tax planning and abusive schemes.[22]

In expanding on one of the principles mentioned above, namely distinguishing between responsible tax planning and abusive tax avoidance, the Report came up with an unusual way of drawing the line between what is permissible and what is not. It concluded that the preferable principle to distinguish between permissible and impermissible tax avoidance is one that focuses on what makes responsible tax planning permissible, and basing the analysis of abnormal transactions that have been set aside for further analysis on whether they contain elements of responsible tax planning.[23] This view is opposed to the approach followed in many GAARs of drawing this line by attempting to define impermissible tax avoidance. In this regard, the Report noted that the approach of the Hong Kong Court of Final Appeal in *Ngai Lik Electronics Co Ltd v Commissioner of Inland Revenue*,[24] that 'the statutory purpose of s°61A is not to attack arrangements made to secure benefits which are legislatively intended to be available to the taxpayer', was the right one for the UK. The principle that was proposed to distinguish between permissible and impermissible tax avoidance was thus whether a transaction can be said to be a reasonable response to the choices offered by tax legislation to obtain tax benefits.[25]

On 12 June 2012, the UK government accepted the recommendation of the Report that a GAAR targeted at artificial and abusive tax avoidance was needed.[26] It then published *A General Anti-Abuse Rule Consultation Document*[27] (the Document) for consultation on the draft GAAR contained therein. This Document stated that the government accepted the conclusion in the Report that a broad GAAR would not be beneficial for the UK as a place to do business. The government also reaffirmed its desire that the GAAR must establish enough certainty for business and individual taxpayers to know the tax implications of transactions without incurring undue costs.[28]

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[20] Above n 13, [3.24].

[21] Ibid [5.1].

[22] Ibid section 5 of the Report.

[23] Ibid [5.19].

[24] FACV No 29 of 2008 [101].

[25] The Report, above n 13 [5.21]. The Report also contained an illustrative GAAR embodying the principles identified. For a discussion of this illustrative GAAR, see generally Helen Lethaby, 'Aaronson's GAAR' (2012) 1 *British Tax Review* 27.

[26] See generally <http://www.hm-treasury.gov.uk/tax_avoidance_gaar.htm>.

[27] Ibid.

[28] Ibid [1.5] and [1.6].

In this regard, the Document stated that the proposed GAAR would have a narrower ambit than the GAARs in other countries.[29]

2.2 The provisions

The UK GAAR was introduced in 2013 following the aforementioned consultation process. The scheme is detailed in Part 5 of the *Finance Act 2013* (UK). To reinforce that the GAAR is targeted at abusive tax avoidance, as opposed to tax avoidance, s°206(1) states that '[t]his Part has effect for the purpose of counteracting tax arrangements that are abusive'. Section°206(2) continues in the same vein, providing that '[t]he rules of this Part are collectively to be known as the general anti-abuse rule'.

Section°207(1) defines tax arrangements as those that can reasonably be said to have a sole or main purpose of obtaining a tax advantage. An objective sole or one of the main purposes to obtain a tax advantage is not the sole focus of the UK GAAR, which requires more. This is in line with its intended exclusive focus on abusive tax avoidance. Section°207(2) defines abusive tax arrangements as follows:

> Tax arrangements are abusive if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including:
>
> (a) Whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions
>
> (b) Whether the means of achieving those results involves one or more contrived or abnormal steps, and
>
> (c) Whether the arrangements are intended to exploit any shortcomings in those provisions.

This section contains the so-called 'double reasonableness' test. Its reference to 'a reasonable course of action in relation to the relevant tax provisions' shows that it is partly based on the principles in the Report by Aaronson QC, that the focus of the GAAR must be on what makes responsible tax planning permissible. The indicators listed under s°2017(2)(a)-(c) direct the enquiry into the abusive nature of an arrangement to focus on whether there are any policy objectives that have not been complied with, any contrived or abnormal steps or any exploitation of weaknesses in the provisions. These indicators of abuse are more akin with characteristics of abusive tax avoidance, which shows that the GAAR is not solely based on what makes responsible tax planning permissible, as suggested in the Report.

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[29] Ibid [2.3]. The draft GAAR contained in Annex D of the Document incorporates some of the conclusions of the advisory committee. It targets abusive tax arrangements, and defines what the terms 'abusive' and 'tax arrangement' mean in ss°2(2) and 2(1), respectively. This draft GAAR was accepted by Aaronson, who noted in the *GAAR Study: A Study to Consider Whether a General Anti-Avoidance Rule Should be Introduced into the UK Tax System: Supplementary Report* (2012) at [2.1] that '[w]e are agreed that the consultation draft GAAR embodies all of the main principles which we consider need to be incorporated in, and to form the framework of, a GAAR that would be appropriate for the United Kingdom'. Available at <http://www.hm-treasury.gov.uk/tax_avoidance_gaar.htm>.

Section°207(4) refers to the provisions quoted below as indicating the abusive nature of an arrangement:

> (a) The arrangements result in an amount of income, profits or gain for tax purposes that is significantly less than the amount for economic purposes
>
> (b) The arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes
>
> (c) The arrangements result in a claim for the payment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid
>
> but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

Given the UK experience with complex composite arrangements, the UK GAAR recognises that an arrangement can be part of a composite, multi-step arrangement, or be the wider arrangement itself. Section°207(3) provides that if a targeted arrangement is part of a wider multi-step arrangement, then 'regard must be had to those other arrangements' before the arrangement can be targeted for GAAR purposes.

In line with other GAARs, the GAAR in s°207(1) requires the existence of a tax advantage. Under s°208, a tax advantage includes:

> (a) Relief or increased relief from tax
>
> (b) Repayment or increased repayment of tax
>
> (c) Avoidance or reduction of a charge to tax or an assessment to tax
>
> (d) Avoidance of a possible assessment to tax
>
> (e) Deferral of a payment of tax or advancement of a repayment of tax
>
> (f) Avoidance of an obligation to deduct or account for tax.

Sections°209–215 contains supporting provisions such as provisions for the counteraction of the tax advantages, interpretation of terms in the GAAR and other provisions that are beyond the scope of this article.[30]

[30] For more discussion of the UK GAAR, see generally Malcolm Gammie, 'Moral Taxation, Immoral Avoidance —What Role for the Law' (2013) 4 *British Tax Review* 577; Judith Freedman, 'GAAR as a Process and the Process of Discussing the GAAR' (2012) 1 *British Tax Review* 22; Judith Freedman, 'Designing a General Anti-Abuse Rule: Striking a Balance' (2014) 20 *Asia-Pacific Tax Bulletin* 167; D Roxburgh, 'United Kingdom: General Anti Abuse Rule' (2014) 55 *European Taxation* 113.

3. THE AUSTRALIAN GENERAL ANTI-AVOIDANCE RULE

3.1 Background

Unlike the UK, Australia is not a newcomer to a statutory GAAR system and has had possibly the longest experiences with a GAAR of all the countries in the world.[31] The first Australian GAARs are said to have been contained in the *Income Tax Act 1895* (Vic) and the *Land and Income Tax Act 1895* (NSW), and were succeeded by s°53 of the *Commonwealth and Land Tax Assessment Act 1910* (Cth). Section°53 was itself succeeded by s°260 of the *Income Tax Assessment Act 1936* (Cth). After a series of restrictive judicial interpretations of the literally wide s°260, Part IVA of the *Income Tax Assessment Act* took over from s°260 in 1981.[32]

As a jurisdiction that never relied on judicial anti-avoidance doctrines in the manner that the UK did, there was no alternative to a GAAR in Australia. Consequently, there was no question of discussing the need for a GAAR in Australia throughout its GAAR history. The judicial restriction of s°260 has been alluded to. However the same judiciary that annihilated s°260 as a potent GAAR laid the foundations of the one of the central concepts of Part IVA. Regarding s°260, the Privy Council in *Newton v FCT* stated:

> 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 dealings, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section.[33]

This is the so called 'predication test' that was created as a way of limiting the literally wide s°260. From this test it is clear that the GAAR would apply to a transaction where it could objectively be said that it was structured in a particular way to enable it to result in tax benefits. As will be seen, the predication test is encapsulated in an integral section of Part IVA. Part IVA and the UK GAAR are partially based on judicial principles advanced in GAAR cases.

Another similarity is the fact that both were introduced amidst assurances that they would target abusive transactions only. While it would be untrue to say that the focus on abusive transactions was identical in both jurisdictions, (because the focus on abusive transactions in the UK was much stronger and sustained over a longer time transcending two periods of consultations on the need for a GAAR and into the legislated introductory comments of the GAAR itself), Part IVA was introduced in 1981 with John Howard, then Treasurer stating in his Second Reading Speech in the House of Representatives that:

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[31] See GT Pagone *Tax Avoidance in Australia* (The Federation Press, 2010) 24.

[32] These cases are *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66, *Mullens v Federal Commissioner of Taxation* (1976) 135 CLR 290, *Slutzkin v Federal Commissioner of Taxation* (1977) 140 CLR 314, and *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330. These cases involved the creation of the choice doctrine that stated that taxpayers have a right to exercise choices available in tax legislation when seeking to minimise tax.

[33] (1958) 98 CLR 1 8–9.

> [t]he proposed provisions … 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 taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs. Some writers on the subject suggest that tax avoidance involves conduct entered into for the sole or dominant purpose of obtaining a particular tax advantage. That description could be expected to cover the types of tax avoidance that, again using the language of social and political debate, are blatant, artificial or contributed, and which are indeed intended to be covered by this Bill. But it is also apt to describe other arrangements, including some family arrangements, which are beyond the appropriate scope of general anti avoidance measures …[34]

Part IVA was also designed to overcome the difficulties encountered with the application of s°260. The commitment to creating a GAAR that targeted so called 'blatant, artificial or contrived' arrangements was aimed at correcting the anomaly of s°260, which, when literally interpreted, could be used to target all schemes where tax was avoided.[35]

3.2 The provisions

Section°177D of Part IVA provides as follows:

> 1. this Part applies to a scheme if it would be concluded (having regard to the matters in ss2) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of
>
>   (a) enabling a taxpayer (a relevant taxpayer) to obtain a tax benefit in connection with the scheme; or
>
>   (b) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit in connection with the scheme;
>
> whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers.

[34] Quoted in Michael Kobetsky et al *Income Tax; Text, Materials and Essential Cases* (The Federation Press, 2006) 642.

[35] While words such as 'blatant, artificial and contrived' were used to describe the schemes targeted by Part IVA, they were not inserted into the GAAR itself. This would have been a difficult exercise. As Justice Richard Edmonds notes, 'whether a particular arrangement or scheme can be so described will be much a function of perception on the part of the beholder, it is unlikely that anyone would suggest that the Commissioner of Taxation in his administration of the ITAA, has confined his application of Part IVA to schemes which are "blatant, artificial or contrived". The reason, according to Justice Edmonds, is that 'nowhere will you find these words in the text of the relevant provisions of the statute'. (See, Richard Edmonds, 'Judicial Construction of Part IVA: What to Expect from the Application of Existing Principles Going Forward' (2013) 42 *Australian Tax Review* 213.) This can be partly contrasted with the UK GAAR where the word 'abusive' was incorporated in the provisions introducing the GAAR, and where the word 'contrived' forms part of the provisions under s°207(2), which provide indicators of abusive arrangements.

Have regard to certain matters:

2. For the purpose of subsection (1), have regard to the following matters:

   (a) the manner in which the scheme was entered into or carried out;

   (b) the form and substance of the scheme;

   (c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;

   (d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;

   (e) 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;

   (f) 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;

   (g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;

   (h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

This part can be said to be the core of the GAAR itself. Concepts mentioned in this part are defined in-depth in supporting sections of Part IVA.

3.2.1 Scheme

Section°177A(1)(a) and (b) define a scheme respectively as '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 'any scheme, plan, proposal, action, course of action or course of conduct'. A scheme is defined widely because it provides a basis for the application of the GAAR.[36] A tax benefit and a purpose cannot be ascribed to anything other than a scheme.

The width of the definition of a scheme poses a critical question; whether a single scheme that is part of a broader course of action can be isolated for the purposes of applying the other provisions of the GAAR to it or whether the whole course of action, not part thereof, must be targeted. If the former question is answered in the affirmative, it gives the Commissioner of Taxation (Commissioner), much more flexibility when targeting schemes. If the latter question is answered in the affirmative, the Commissioner's advantage from the wide definition of a scheme will be limited. Moreover, taxpayers will be able to place schemes that could be the target of the GAAR into broader multi-step commercial schemes or courses of action for the

[36] See *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2004) 57 ATR 115 137.

purposes of using the commercial nature of these broader schemes to effectively launder the potentially abusive single schemes. Most, if not every, broad commercial schemes or courses of action have a part that is decisive in obtaining a tax benefit. Isolating this part could render the scheme liable to the GAAR and lead to the denial of tax benefits obtained in terms of the broader scheme.

As Krever notes:

> Perhaps the most important question to be determined is what constitutes the scheme. Taxpayers rarely act solely for tax reasons. Most often, taxpayers act to realize a profit through investment, business or some other arrangement. Naturally they seek to realize that profit in the most tax-advantaged way possible, but almost always, if the transaction or scheme is taken to be the overall arrangement entered into by a taxpayer, it will have a bona fide commercial objective, namely, to derive a profit. Identification of the correct transaction is thus the first threshold that must be crossed before the general anti avoidance provision can be applied. Is it the entire transaction or just the tax effective element in the larger transaction? [37]

The courts have dealt with the isolation of a scheme within a broader scheme, albeit in two contrasting ways. In *FCT v Peabody*,[38] the court stated that a scheme within a scheme will not qualify as a scheme for Part IVA purposes if it cannot stand independently without losing its practical meaning.[39] The court, in rejecting the so-called 'sub-scheme' approach relied on *IRC v Brebner* where Lord Pierce stated that:

> [i]t would be unrealistic and not in accordance with the subsection to suppose that [the taxpayer's] object has to be ascertained at each step in the arrangements … The subsection would be robbed of all practical meaning if one had to isolate one part of the carrying out of the arrangement, namely, the actual resolutions which resulted in the tax advantage, and divorce it from the object of the whole arrangement.[40]

The court accepted that the Commissioner may identify alternative schemes, including steps in a broader scheme. However, it stressed that such scheme must be capable of being taken from the main scheme and standing on its own without being rendered meaningless.

In another decision, *Hart v FCT*,[41] the court stated that the Commissioner could not isolate a part of the broad scheme that had been entered into. The court followed the approach taken in *Peabody* and held that since the sub-scheme targeted by the Commissioner could not stand alone without being absurd, it could not be isolated for GAAR purposes. However, on appeal, this approach was unanimously rejected. Gummow JJ and Hayne JJ stated:

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[37] R Krever, 'The Ghost of the Duke of Westminster Laid to Rest in Australia?' (1997) 45 *Canadian Tax Journal* 122, 123.

[38] (1994) 181 CLR 359.

[39] For an analysis of how this approach can limit the application of Part IVA, see Julie Cassidy, '*Peabody v FCT* and Part IVA' (1995) *Revenue Law Journal* 197, 200.

[40] [1967] 2 AC 18 27.

[41] (2002) 50 ATR 369.

> The reference to circumstances being "robbed of all practical meaning" appears to have been understood in the Full Court in the present matters as a criterion which must be applied in deciding whether there is a scheme to which Part IVA applies. That is not right. First, it is far from clear what legal test is intended by saying that a scheme must "stand on its own feet". It is not clear how the metaphor is to be translated into legal principle. Secondly, as the Full Court pointed out in the present matters, the words "robbed of all practical meaning", which were adopted in *Peabody*, were taken from *IRC v Brebner*. There they were used in a very different context and with a clearly intended meaning … thirdly, and most importantly, there is no basis to be found in the words used in Part IVA for the introduction of some criterion additional to those identified in the Act itself. There is no reference to a scheme having some commercial or other coherence.[42]

The approach taken by the appeal court in *Hart* is the correct one according to the provisions of Part IVA. Nevertheless, *Peabody* should not be taken as the antithesis of *Hart*. This is because the court in *Peabody* did not state that a sub-scheme should never be isolated, but that such isolation should only take place where the sub-scheme does not lose its practical meaning in the process.

3.2.2 Tax benefit

Part IVA requires a tax benefit to exist before it can apply.[43] Section°177C defines a tax benefit. The determination of whether a tax benefit has been obtained is quite detailed under Part IVA. The starting point is that a comparison between two schemes is required before it can be said that a tax benefit has been obtained. In this regard, the two schemes are the scheme that has been entered into and the so-called alternative postulate. As is noted in the Explanatory Memorandum, 'it is necessary to compare the tax consequences of the scheme in question with the tax consequences that either would have arisen, or might reasonably be expected to have arisen, if the scheme had not been entered into or carried out'.[44]

This approach to identifying tax benefits led to taxpayers in some cases arguing that they had not obtained tax benefits for Part IVA purposes because they would either have entered into schemes with similar tax results, with higher tax benefits or would not have entered into any scheme at all. In one of these cases, *AXA Asia Pacific Holdings Ltd*,[45] the identified tax benefit arose from the capital gain that the taxpayer did not make because of claimed rollover relief. The court heard that the alternative postulate, a disposal yielding the tax benefit assessed by the Commissioner, would have taken place if the scheme in question had not been entered into. However, evidence showed that the participants in the scheme would not have entered into the alternative postulate because it was not commercially viable to do so. Consequently, a tax benefit could not be established.

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[42] (2004) 55 ATR 712 725–726.

[43] In line with the more targeted nature of Part IVA when compared with the old s°260, the mere fact that a tax benefit has been obtained, hence the avoidance of tax, does not lead to the application of this GAAR. The tax benefit must have been avoided in a scheme to which Part IVA applies, and that involves another step, namely the establishment of the sole or dominant purpose of the scheme.

[44] Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 [1.29].

[45] (2010) 189 FCR 204.

In another case, *FCT v Futuris,*[46] the taxpayer decided to sell one of its divisions. Through a series of transactions involving the transfer of shares between subsidiaries and the declaration of rebatable dividends from the profits obtained from the transfers, the end result was a rise in the cost base of the shares in the division sold. This meant that the capital gain obtained was lesser and the Commissioner included the capital gain that would have been obtained if the division had been disposed of without any cost base increase. The taxpayer contended that the alternative postulate advanced by the Commissioner was not reasonable, as it would have resulted in two disposals (one internal between the subsidiaries and the other external), hence, two instances where capital gains tax could have been levied for the same economic result. The taxpayer argued that it was not a reasonable alternative that its directors would have committed to, as it would have meant facing double capital gains taxation. The court accepted this argument, and a tax benefit could not be established.[47] In these cases, the court accepted the taxpayer's proposition that there was no reasonable basis for entering into an alternative scheme that would have led to higher taxation and, but for the scheme entered into, the tax payer would have adopted a different course or have done nothing at all.[48]

In order to remove the possibility of the taxpayer arguing as above, Part IVA was amended in 2013. Section°177CB was added, which provides the bases for identifying tax benefits. Section°177CB(2) states that:

> [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).

Section°177CB(3) and (4) state that:

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

[46] (2012) 205 FCR 274.

[47] See also *RCI Pty Ltd v FCT* (2011) 84 ATR 785.

[48] AH Slater QC, 'The 2013 Part IVA "Reforms"' (2013) 42 *Australian Tax Review* 221–224.

Section°177CB(2)(a) empowers the Commissioner to annihilate all the steps in the scheme before focusing on the surrounding events or circumstances that actually occurred or existed. This excludes any speculation on what could or may have happened but for the scheme. Section°177CB(3) and (4) are a direct response to the cases discussed above namely *RCI*, *Futuris* and *AXA Asia Pacific Holdings*. These provisions make it clear that an alternative postulate need not be one that the taxpayer considered. It must only be reasonable taking into consideration the substance of the scheme and any result that the taxpayer would have achieved. This determination of a tax benefit allows some speculation regarding what could have taken place but for the scheme.[49]

According to the Explanatory Memorandum, s°177CB offers two alternative ways of determining the existence of a tax benefit.[50] The above extracts from this section present two ways of determining the tax benefit. However, there is nothing in this section that indicates that the two tests are alternative. As it stands, the Commissioner can determine the existence of a tax benefit by referring to both tests. Moreover, as Justice Edmonds notes:

> there is nothing in the legislation, as distinct from the EM, to indicate the type of scheme to which subs(2) is to apply, the type of scheme to which subs (3) is to apply and, most importantly, to prevent the Commissioner from applying both, potentially giving rise to two distinct tax benefits, one quantified by reference to the statutory postulate coming out of subs(2) following the annihilation of the scheme, and the other quantified by reference to the reconstructed postulate, that is, the reasonable alternative, coming out of subs (3). The Commissioner could defend either or both under one assessment by making an adjustment by reference to the larger but the taxpayer would have to fight the assessment on two distinct fronts.[51]

It remains to be seen whether the amendments to the determination of a tax benefit will solve the issues raised in the cases discussed above.[52] Some commentators argue that the amendments were unnecessary because 'Part IVA was not broken, and did not need fixing'.[53] Section°177CB(3) and (4) function on the premise that the alternative postulate must be reasonable and in determining whether it is so, one must look at the substance of the scheme and any result that is or would be achieved by the scheme. A potential problem can be identified in this amendment. On one hand, it allows the

[49] Justice Edmonds, above n 35, 218 and Frank Gilders et al., *Understanding Taxation Law* (LexisNexis, 2014) 1135.

[50] Explanatory Memorandum, above n 44, [1.33]–[1.35].

[51] Justice Edmonds, above n 35, 219.

[52] Gilders et al., above n 49, 1135.

[53] Slater, above n 48, 221. Slater further states that the cases lost by the Commissioner were lost as a result of the factual findings of the court, not as a result of any weakness in Part IVA. This view has merit. If one is to analyse the cases lost one can see a commercial objective in each of the cases and the commercial objective was achieved in a tax effective manner. These cases prompted the Treasury to issue Media Release No 10/2012 (5 March 2012), 'Maintaining the Effectiveness of the GAAR'. In this statement, Treasury stated that '[s]uch an outcome can potentially undermine the overall effectiveness of Part IVA and so the government will act to ensure such arguments will no longer be successful. The government amendments will confirm that Part IVA was always intended to apply to commercial arrangements which have been implemented in a particular way to avoid tax. This also includes steps within broader commercial arrangements'. The accuracy of Treasury's implied view that these cases would be decided differently under the amendments will be seen with time.

Commissioner to speculate that if the substance of the scheme is considered, the taxpayer could have achieved the same economic objective(s) in an alternative scheme that would have resulted in less tax benefits. On the other hand, taxpayers can argue that the provisions of s°177CB(3) and (4) primarily require reasonableness, so if an alternative postulate is advanced on the basis of these provisions, it must be reasonable, and it is unreasonable to expect a taxpayer company, for instance, to subject itself to achieving commercial objectives through a scheme that leads to higher taxation. Arguably most commercial schemes with tax benefits have alternative postulates that lead to higher taxation. Will the courts find these alternative postulates reasonable under these provisions all the time, considering that taxpayers are entitled to enter into commercial schemes with the most tax benefits?[54] It remains to be seen, and this is a potential source of more litigation on the determination of a tax benefit.

3.2.3 Sole or dominant purpose

The existence per se of a scheme and a tax benefit is insufficient for Part IVA purposes. The scheme and the tax benefit must be entered into with the sole or dominant purpose of obtaining a tax benefit. Section°177D(2) contains an inexhaustive list of eight factors that can be used to determine the sole or dominant purpose of a scheme. This means that this determination is objective, and that the subjective views of the taxpayer in question will only be accepted if they are in line with the objective evidence. A review of the list shows that the enquiry is, inter alia, focused on the nature of the scheme and the facts and circumstances associated with the scheme. In this regard, the manner in which a scheme was entered into, its timing, its appearance and reality, and the changes that it makes in the financial position of the taxpayer or any related party are some of the factors considered when determining the sole or dominant purpose of the scheme.

As mentioned before, the determination of the sole or dominant purpose of a scheme is partly derived from the predication test created in the *Newton* case. In summary, the predication test states that for a scheme to be struck down, one must be able to predicate, by looking at what was done, that the scheme was entered into in a particular way in order to obtain a tax benefit. The s 177D(2) enquiry requires a look at, for example, the manner in which the scheme was entered into. If this points to the pursuit of a tax benefit then a conclusion that the sole or dominant purpose of the scheme was to avoid tax will follow. The alternative postulate that is used to determine the existence of a tax benefit is also used to determine the sole or dominant purpose of the scheme.[55] The sole or dominant purpose test is the provision in Part IVA that draws the line between impermissible tax avoidance and responsible tax planning.[56]

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[54] Section°177C(2) provides exclusions from the definition of a tax benefit, and one of these exclusions is where taxpayers avail themselves of an expressly allowed declaration, election, selection or choice available under legislation. This means that all tax benefits obtained through choices exercised in terms of legislation must be expressly provided for.

[55] See generally, *British American Tobacco Australian Services Ltd v FCT* [2010] FCAFC 130. In this case the court referred to the manner in which the scheme had been entered into and found that a comparison between the scheme entered into and the alternative postulate showed that the only plausible explanation for the scheme was tax avoidance.

[56] Explanatory Memorandum, above n 44, [1.22] describes this test as 'indeed the fulcrum upon which Part IVA turns'. Pagone, above n 30, 72 reiterates this view, and states that the purpose test is the 'lynchpin' of Part IVA.

In practice, the application of the sole or dominant purpose test has shown one significant characteristic of Part IVA. In *FCT v Spotless Services Ltd* it was stated that the dominant purpose is the 'ruling, prevailing or most influential purpose'.[57] This case showed that Part IVA could apply to schemes with both commercial objectives and tax benefits. The court unanimously applied Part IVA to strike down an investment that offered good after-tax returns in the Cook Islands. The taxpayer's argument that the purpose behind the scheme was to secure the investment of a large sum was rejected by the court, which stated that the required purpose lay in the particular means the taxpayer adopted to obtain the commercial advantage. The court held that the presence of a rational commercial decision was irrelevant to the question whether a taxpayer had operated a scheme with a dominant purpose to obtain a tax benefit.[58] In stating this, the court made it clear that s°177D required a close inspection of the particular method(s) utilised to obtain the tax benefit.[59] An examination of the scheme in this case reveals that it had a commercial basis. The taxpayer invested a huge sum and got a considerable return. This means that it was not the lack of a commercial purpose that led to an adverse conclusion for the taxpayer. The inquiry turned on the particular method the taxpayer relied on to obtain the tax benefit. Since the particular method was complex and involved a series of planned steps the court opined that the method could largely be explained by reference to the tax benefits obtained.

This decision demonstrates that Part IVA can be used to strike down an ordinary commercial scheme if the scheme is 'elaborate' and has 'attendant circumstances' that 'lead inevitably to the conclusion that the scheme was not merely tax-driven but that its purpose was to enable the taxpayer to obtain a tax benefit by participating in the scheme'.[60] The reasoning behind the decision was that the most influential, prevailing, or ruling purpose of the transaction was to obtain a tax benefit.[61] In another case, *FCT v Consolidated Press Holdings Ltd*, it was stated that:

> [t]he fact that the overall transaction was aimed at a profit making does not make it artificial and inappropriate to observe that part of the structure of the transaction is to be explained by reference to a s°177D purpose. Nor is there any inconsistency involved, as was submitted, in looking to the wider

[57] (1996) 34 ATR 183 192. For more discussion of this case, see generally John Passant, '*Spotless*: Removing the Stain of Tax Avoidance in Australia' (1997) 2 *British Tax Review* 131, who describes the case as an 'outstanding victory for the Revenue'. See also Michael D'Ascenzo, 'Part IVA Post Spotless' (1998) *Journal of Australian Taxation* 3 <http://www.austlii.edu.au/au/journals/JlATax/1998/3.html>.

[58] *FCT v Spotless Services Ltd*, above n 57, 184.

[59] Ibid.

[60] Ibid 194.

[61] Ibid 192. The court stated that by operating a scheme with investments in tax havens such as the Cook Islands, the taxpayers possessed, 'as their most influential and prevailing or ruling purpose, and thus their dominant purpose, the obtaining thereby of a tax benefit, in the statutory sense'. Krever, above n 37, 127 notes that this reasoning appears to suggest that the term 'dominant' in the ITAA does not require a purpose accounting for more than half of the taxpayer's purpose, as long as it is the single most significant purpose driving the scheme.

transaction in order to understand and explain the scheme, and the eight matters listed in s°177D.[62]

The Explanatory Memorandum states that the mere fact that Part IVA is targeted at schemes with a sole or dominant purpose to avoid tax does not mean that it 'is incapable of applying to arrangements that also have wider commercial objectives'.[63] If such commercial objectives are pursued in a way that progresses over to a tax avoidance purpose, Part IVA will apply. This has been praised by some commentators as a reflection of the efficacy of Part IVA as a GAAR.[64]

However, the tendency of Part IVA to apply to schemes that have commercial elements has drawn some criticism from others. One of the criticisms is that it is uncertain when actions to secure a favourable tax result in a commercial scheme trump the commercial objectives of the scheme, and turns the sole or dominant purpose of the scheme to tax avoidance. In *Spotless*, the court noted that the elaborate nature of the scheme was decisive towards the decision against the taxpayer. According to Dabner, this is not necessarily a sound guide because 'what is elaborate for one person may not be for another'.[65] The fact that Part IVA has shown in the past that it can be used to strike down commercial schemes with tax benefits means that it is not exclusively targeted at 'blatant, artificial or contrived schemes', as indicated when it was introduced. Due to this, Orow states that '[i]f Pt IVA is considered to be directed at transactions which can truly be described as tax avoidance, being transactions which result in a tax benefit contrary to the purpose and policy of the Act, then its presence in the Act cannot be justified'.[66]

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[62] (2001) 207 CLR 235, 264. See also *Cummins v FCT* (2007) 66 ATR 57, where the timing of the scheme was held to have been decisive in showing that the sole or dominant purpose of the scheme was to avoid tax.

[63] Explanatory Memorandum, above n 44, [1.15]. It is stated in the Explanatory Memorandum at [1.16] that the High Court has repeatedly confirmed that if an arrangement is structured in way that shows a tax avoidance purpose, Part IVA will apply. This is an apparent reference to cases discussed above such as *Spotless Services Ltd*, *Consolidated Press Holdings Ltd* and *British and American Tobacco Services Australia Ltd.*

[64] See Chris Evans, 'The Battle Continues: Recent Australian Experience with Statutory Avoidance and Disclosure Rules' (Paper presented at the Oxford University Centre for Business Taxation Conference: Corporation Tax Battling with the Boundaries, 28–29 June 2007) <http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/summer_conference/2007/evans.pdf>. Evans states that '[a]fter *Peabody*, the High Court has subsequently heard three cases (*Spotless*, *Consolidated Press Holdings* and *Hart*) relating to the application of Part IVA. In addition there have been many cases on Part IVA heard in the lower Federal and Full Federal Courts. The Commissioner has enjoyed success in most of these Part IVA cases. In particular, outright High Court victory in *Spotless* and in *Hart*, and partial success in *Consolidated Press Holdings*, has provided the Commissioner with a weapon of mass destruction that is not only perceived to be a potential threat, but which actually is a powerful threat'.

[65] Dr Justin Dabner, 'The Spin of a Coin–In Search of a Workable GAAR' (2000) 3 *Journal of Australian Taxation* 232 <http://www.austlii.edu.au/au/journals/JlATax/2000/12.html>. See also Nabil F Orow, 'Part IVA: Seriously Flawed in Principle' (1998) 1 *Journal of Australian Taxation* 57 <http://www.austlii.edu.au/au/journals/JlATax/1998/5.html>. Describing sole or dominant purpose in terms of s°177D, Orow notes that it 'create[s] a major difficulty in determining the stage at which the relevant tax purpose passes the requisite threshold of dominance because that threshold is a matter of impression and degree and hence there will be significant differences in opinion as to what constitutes a dominant purpose. Further, there is greater difficulty in determining the relevant purpose to be considered so as to ascertain whether it passes the threshold of dominance'. Thus, 'dominant purpose conclusions can arguably be made in many ordinary tax planning arrangements'.

[66] Orow, above n 65.

The criticism of Part IVA can be tempered by reference to cases such as *Eastern Nitrogen Ltd v Commissioner of Taxation.*[67] This case involved a sale and leaseback scheme. The finance proposal presented to the taxpayer had a lower after-tax cost than other borrowing methods. The Commissioner sought to apply Part IVA to this scheme and to disallow the deduction sought for rentals paid by the taxpayer. The court rejected the Commissioner's contentions and stated that:

> [d]ue 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 other 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 the outgoings incurred in connection with the obtaining of that finance.[68]

This shows that the Commissioner has not been able to successfully apply Part IVA to all commercial schemes with tax benefits.[69] Nevertheless, the concerns that Part IVA sets a low threshold, and that it can apply to many inoffensive commercial schemes that contain tax benefits are valid.

4. COMPARATIVE ANALYSIS BETWEEN THE UK AND AUSTRALIAN GAARS

There are similarities and differences between the UK and Australian GAARs. The GAARs have similar foundations in the sense that they all require the existence of at least three of the following:

1. An arrangement, scheme, transaction
2. A tax benefit or advantage
3. A sole or main or dominant purpose to obtain a tax benefit, objectively determined
4. An indicator of impermissible tax avoidance, which differs from GAAR to GAAR.

In the case of Part IVA, the indicator of impermissible tax avoidance would be (c) above. The enquiry ends at (c) and a decision on whether or not Part IVA will be applied will be made at that point. The UK GAAR goes beyond that and requires the double reasonableness test under (d) above to be applied before an arrangement can be struck down.

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[67] (2001) 46 ATR 474.

[68] Ibid 478.

[69] For instance, in *FCT v Metal Manufacturers Ltd* [2001] FCA 365, a case with similar facts to *Eastern Nitrogen*, the court held that even though one of the purposes of the scheme was to obtain a tax benefit, the dominant purpose was to obtain a huge amount of finance in the most tax-effective way. See also *Commissioner of Taxation v BHP Billiton Finance Ltd* [2010] FCAFC 25.

The differences between the GAARs lie in this broad similarity. Apart from the minor differences in the terms used, there are differences on how an arrangement or a scheme is defined, how a tax benefit is determined and on how impermissible tax avoidance transactions are targeted.[70] These differences, and possible lessons for Part IVA, will now be addressed.

4.1 Scheme/sub-scheme and arrangement

As noted above, the definition of a scheme in Australia is broad. It is broad enough to cover a scheme within a wider scheme. In other words, many tax benefits are obtained from wide schemes that can be broken down into smaller parts or sub-schemes. One of these smaller parts is usually decisive in obtaining the tax benefit. The definition of a scheme under Part IVA is such that even the smaller parts or sub-schemes can constitute schemes. This narrow view of a scheme has two advantages from the Commissioner's perspective. Firstly, it allows the Commissioner to focus on the action, or part of the wider scheme, that is most closely linked to the tax benefit. This makes the duty to link the tax benefit and the scheme easier to discharge. The second advantage is connected to the first; and allows the Commissioner to apply Part IVA to sub-schemes of a wider commercial scheme. This is so because the commercial purpose of the wider scheme will be irrelevant when the purpose of the isolated sub-scheme is determined. The narrow view of a scheme can be useful where taxpayers try to launder impermissible schemes by placing them within wide commercial schemes, and basically using the commercial purpose or nature of the wider scheme to effectively neutralise or launder the tax avoidance purpose of the inserted scheme.

In the UK GAAR, the discussion above shows that an arrangement that is part of a series of arrangements can only be targeted after a consideration of the other arrangements in the series. This is a different approach to the one that can be followed under Part IVA, where there is no requirement to consider the wider scheme before isolating the sub-scheme. The UK GAAR approach denies Her Majesty's Revenue and Customs (HMRC) automatic access to the advantages available to the Commissioner in Australia. However, it is submitted that the UK GAAR approach is more neutral as it favours neither the taxpayer nor HMRC. This is especially the case where isolating an arrangement that was meant, from the beginning, to work in tandem with other arrangements would change the nature of the arrangement and render it subject to the GAAR. HMRC will not be able to automatically isolate such an arrangement where it is clear that the series of arrangements have commercial purpose and that the isolated arrangement would lose its commercial character if it was to be isolated. The UK approach will also not allow taxpayers to launder an abusive arrangement with commercial arrangements as described above because it will be clear, after all arrangements have been considered, that the abusive arrangement has a different nature and was placed with commercial arrangements for the purposes of laundering it.

There is no judicial interpretation of the definition of an arrangement in the UK GAAR as yet. However, in Australia, the discussion above shows that there have been conflicting judicial opinions on the isolation of a sub-scheme. In *Peabody* the

[70] The differences in terminology are minor in the sense that what is known as 'scheme terms' of Part IVA is an 'arrangement' in the UK GAAR. What is referred to as a 'tax benefit' in Australia is referred to as a 'tax advantage' in the UK.

court stated that the sub-scheme must be capable of standing alone, which is related to the UK GAAR approach because a consideration of the other schemes would determine whether the sub-scheme makes sense when isolated. This approach was rejected in *Hart*. It is submitted that the UK GAAR approach to arrangements would not weaken Part IVA if it was to be adopted in Australia. This is because sub-schemes would still be isolated and sole or dominant purpose ascribed to them where, after considering the wider scheme, it is seen that the scheme has a different sole or dominant purpose. It would deny the Commissioner certain advantages currently enjoyed but it would ensure more parity with the taxpayer, especially in cases where the isolation of a sub-scheme would change the nature of the sub-scheme.

4.2 The determination of a tax benefit

One of the things that is immediately obvious after a comparative analysis of the two GAARs is the differences in the determination of a tax benefit. In the UK GAAR, a tax advantage is defined in s°208 by reference to different instances where tax is either reduced, deferred or not paid at all. There is no reference to an alternative postulate or an alternative transaction that results in more tax and consequently shows that what the taxpayer did resulted in a tax benefit. In contrast, the discussion in Section 3.2.2 shows that Part IVA dedicates detailed sections such as ss°177C and 177CB to the determination of a tax benefit.

The approach to a tax advantage in the UK is that the taxpayer would not have obtained a tax advantage but for the arrangement. In other words, the focus is on the arrangement and its tax effect. HMRC will look at a taxpayer's acts or omissions in an arrangement and conclude that due to these, a tax advantage was obtained. This, it is submitted, involves a reference to some form of an alternative postulate in the sense that an act or omission that resulted in a tax advantage is removed and the tax consequences of that removal are considered. If a tax advantage as defined under s°208 has been obtained, then a tax advantage can be linked to the arrangement. There is no possibility of a taxpayer arguing that a tax advantage has not been obtained because an alternative arrangement would not have been entered into, or an arrangement with even more tax advantages would have been entered into.

Section°177CB(2)(a) of Part IVA has a similar approach. It essentially states that a tax benefit exists if it is clear that it would not have been obtained but for the scheme entered into. This subsection requires an analysis of what actually happened or existed and establishes a tax benefit by annihilating the action or omission that led to a tax benefit. If it is clear that as a result of the annihilation, more tax would be payable a tax benefit will be established.

Sections°177CB(3) and (4) present a very different method of identifying a tax benefit. In short, these subsections state that an alternative postulate is reasonably expected to have happened (therefore applicable to the taxpayer whether or not the taxpayer would have entered into that postulate) if it is reasonable considering the substance of the scheme entered into and any result or consequence for the taxpayer that is achieved through the scheme. As noted above, these subsections were added to stop a taxpayer company, for instance, from arguing that it would not have entered into any alternative scheme with higher tax consequences. It remains to be seen whether these subsections will counter such submissions from taxpayers. However, it is submitted that taxpayers might still be able to argue that the alternative postulate advanced is unreasonable since taxpayers are not expected to enter into commercial

schemes with the least tax benefits. If problems are encountered with these subsections, the UK approach to establishing a tax advantage, which focuses only on the actual arrangement, must be considered. This will not necessarily require much change since s°177CB(2) already encapsulates the UK approach and can be used as the sole test for a tax benefit in Australia.[71]

4.3 The identification of impermissible tax avoidance and the threshold

GAARs ideally should not affect all schemes or arrangements where tax is avoided, so the identification of impermissible tax avoidance is critical to the efficacy of a GAAR. Part IVA basically defines impermissible tax avoidance as a scheme that has a sole or dominant purpose, objectively determined, to obtain a tax benefit. In case law on Part IVA, discussed in Section 3.2.1, it is clear that taxpayers have lost Part IVA cases on the basis of the facts surrounding the implementation of their schemes. The courts have held that if a scheme is implemented in a particular way in order to obtain tax benefits, Part IVA will apply. Some commentators state that this standard has enhanced the efficacy of Part IVA. Slater states that:

> Part IVA has achieved the objectives for which it was introduced in 1981: it has been a strikingly "effective general measure against those tax avoidance arrangements that … are blatant, artificial or contrived … 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 advantage.[72]

Slater states further that 'the Commissioner has, generally speaking, won cases that he should have won, but more importantly (from the viewpoint of the Revenue) the presence and potential of Pt IVA has acted as a deterrent to the implementation of tax avoidance arrangements'.[73] Comparing Part IVA to other GAARs, Slater states that Part IVA can be set apart for its effectiveness when invoked and its greater certainty on what it will apply to or not.[74]

While Part IVA has been successfully invoked in many cases, some of those cases have raised serious questions about its potential to affect commercial schemes with tax benefits. For tax benefits to be obtained in a commercial scheme, something has to be done. If the action taken to secure the tax benefits passes a certain threshold, Part IVA will apply. This threshold is unknown, which has created uncertainty.[75] If one is to

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[71] Section°177CB as a whole is not only different from the approach taken in the UK GAAR. GAARs in countries such as South Africa, Canada, New Zealand, Ireland do not refer to the alternative postulate. See Graeme S Cooper, 'Taxation by Analogy' (2013) 42 *Australian Tax Review* 255, 267.

[72] AH Slater, 'Part IVA: An International Perspective' (2013) 42 *Australian Tax Review* 149, 149.

[73] Ibid.

[74] Ibid. At 159, Slater states that '[m]easured against its international counterparts, Part IVA is at least their equal, and in many cases preferable, if the measures of quality are taken to be balance and clarity; protection of the Revenue without undue inhibition of commercial activity or personal choices, and (subject to the inevitable differences of perspective as to the characterisation of given facts) sufficient certainty that both revenue officers and the community understand when the rule comes into operation and what is its effect'.

[75] Cooper and Russell state that the primary aim of any GAAR is to deter impermissible tax avoidance, and that this purpose is served best when the scope and application of the GAAR is uncertain or unknown. They state further that '[o]nce the unknown becomes the familiar, then fear will diminish'. (Gordon Cooper and Tim Russell, 'The New Improved Part IVA-With Extra Tax Benefit!' (2013) 42 *Australian Tax Review* 234, 236.) Nevertheless, while uncertainty can serve as a deterrent, it affects

pair the success of Part IVA with its propensity to apply to some commercial schemes, one may come up with this question: since it has proven to be impossible, to date, to create a perfect GAAR, is an approach that targets impermissible tax avoidance by setting a low threshold and affecting some commercial transactions that have tax benefits the best way to curb impermissible tax avoidance? This question will be answered below.

In the UK, part of the background to the introduction of a GAAR was characterised by one consistent theme; that the UK needs a GAAR that is targeted and narrow, rather than broad and uncertain. This led directly to the introduction of the UK general anti-abuse (as opposed to avoidance) rule that targets abusive tax avoidance.[76] The emphasis on abuse is patent. Abusive tax avoidance is basically singled out as an arrangement with a sole, or one of the main purposes, to obtain a tax advantage in a manner that cannot reasonably be said to be a reasonable exercise of choices offered by legislation. The double reasonableness test is the one that draws the line between permissible tax avoidance and abusive tax avoidance. This test gives effect to the long held views on the ideal GAAR for the UK, that it must be narrow and targeted. The test does this through the following:

1. Instead of attempting to draw one thin, clear line between permissible and abusive tax avoidance, the test creates three scenarios. One is permissible tax avoidance which is acceptable to everyone. The second is tax avoidance that can be described as permissible by one person, and as abusive by the next person. The third is abusive tax avoidance that is unanimously accepted as such.

2. Focusing on clearly abusive arrangements. As stated by Gammie in relation to these arrangements, '[i]t does not matter whether a person considers the particular arrangement an unreasonable course of action: no reasonable person should be able to regard the course of action as reasonable'.[77]

This shows that the UK GAAR approach to impermissible tax avoidance is narrow and targeted at abusive arrangements that leave no doubt about their abusiveness. The UK GAAR was introduced after a period of consultation that involved consideration of the experience with a GAAR in various countries, Australia included. The test for impermissible tax avoidance preferred after this consultation shows that the UK authorities did not want to hazard a GAAR that can affect commercial arrangements that confer tax benefits.

The UK GAAR clearly sets a high threshold. Its approach is substantially different from the approach taken in Part IVA. It is essentially that in targeting abusive tax avoidance, commercial arrangements should not be affected at all and some arrangements that may be considered abusive will not be struck down unless no

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everyone. It might cause the Commissioner to challenge schemes that should not be challenged, leading to losses. It might also provoke the courts into restrictively interpreting the GAAR in order to protect taxpayers, as happened in relation to s°260 before the introduction of Part IVA.

[76] Malcolm Gammie states that all tax avoidance is abusive and using the word abusive instead of avoidance does not change anything, (M Gammie, 'When is Avoiding Tax Not Abusive? Comparative Approaches to a GAAR in Australia and the United Kingdom' (2013) 42 *Australian Tax Review* 279, 279).

[77] Ibid.

reasonable person would find them reasonable. There is no case law on the UK GAAR yet but the application of this test could result in some arrangements that could be found impermissible in, for instance, Australia under Part IVA being accepted under the UK GAAR because the degree of abusiveness does not cross the high threshold. This leads to another fundamental question: considering that there is no knowledge of where the line between permissible and abusive tax avoidance is, is it better to curb abusive or impermissible tax avoidance by focusing exclusively on arrangements or schemes that are unanimously abusive and allowing borderline arrangements to thrive? To answer these two questions, it is submitted that no GAAR is perfect and it is distinctly possible that perfection in this area of tax law will never be found. However, it is submitted that the better approach to the design of a GAAR, from the approaches discussed here, is one where the GAAR sets a lower threshold that could affect some commercial arrangement with tax benefits, solely because the tax benefits in these commercial arrangements were pursued in a way that changes the commercial character of the arrangements. Setting a high threshold as in the UK GAAR has its advantages such as the attraction of foreign business, but this could backfire as the very same businesses start entering into abusive arrangements that raise the ire of the public and HMRC but do not cross the high threshold. As stated by the Trades Union Congress (TUC):

> What this means is that the vast majority of the tax abuse by large and multinational companies is completely outside the scope of the Rule. That is because while there is no doubt that many companies do abuse the principles and provisions of such [double taxation] agreements (which form part of UK law) the very fact that many do so means that such abuse is not exceptional and as a result it is reasonable to think it is accepted practice, and for that reasonable, the GAAR does not apply. We think this is an extraordinary definition of abusive. In effect, it says that if abuse has become habitual it is by definition acceptable.[78]

Therefore, regarding the targeting of impermissible tax avoidance, there is no need for Part IVA to raise its threshold to the levels set in the UK GAAR.

5. CONCLUSION

This article has substantially analysed the GAARs of the UK and Australia. It has been established that the UK has created a GAAR with a unique approach to curbing abusive tax avoidance that is in line with the long held views in the UK that a GAAR should have a narrow and targeted scope and that targets undoubtedly abusive arrangements. This GAAR, created after consultation on the experience with GAARs in many countries, has certain points that Australia can learn from and these are summarised below:

1. The UK GAAR has steered clear of the controversy associated with isolating arrangements within a series of arrangements before considering the other arrangements in the series. In Australia, where

[78] TUC, *The Deficiencies in the General Anti-abuse Rule*, 5 <https://www.tuc.org.uk/sites/default/files/GAAR.pdf>. At 1, the TUC states that the UK GAAR only targets abusive tax avoidance which 'is so narrowly defined that the number of occasions on which the rule will be used will be few and far between'.

the word scheme is used, the Commissioner can target a part of a composite scheme when establishing a scheme to apply Part IVA to, without reference to the composite scheme as a whole. After analysing both GAARs, it is submitted that when considering the existence of a scheme and isolating a scheme within a scheme, Part IVA should follow the approach taken in the UK GAAR of considering the wider scheme before isolating a scheme within the composite scheme. This approach is balanced as it protects individual parts of a composite commercial or non-tax scheme from being isolated and losing their commercial or non-tax character as a result of the isolation, and also allows the Commissioner to target an abusive part of a composite scheme where a taxpayer has tried to launder that part by placing it into a composite commercial or non-tax scheme.

2. The UK GAAR does not extensively define a tax advantage, instead focusing on the actions or omissions that actually occurred and that result in a tax benefit being obtained. In Australia, Part IVA extensively defines tax benefit and establishes a tax benefit by referring to an alternative postulate that the taxpayer could have derived less tax benefits from. The current provisions defining tax benefit in Part IVA are motivated by the fact that taxpayers have in some cases survived a Part IVA attack by arguing that they would not have entered into alternative postulates with higher tax costs, or would have entered into alternative postulates with similar or even higher tax benefits. The recent amendments to Part IVA were aimed at eliminating these arguments, but it remains to be seen whether these amendments have actually done away with the possibility of taxpayers making the same arguments. It also submitted that the definition of tax benefit in Part IVA after the amendments might cause even more litigation from taxpayers arguing that it is unreasonable for them to enter into or to be expected to enter into schemes with higher taxes than the one entered into. If problems with the new legislation are encountered, the approach taken in the UK GAAR of focusing on what was done and determining the tax advantages that flow from it could be adopted in Australia.

3. Regarding the Australian GAAR, it has been seen that this GAAR targets schemes that result in tax benefits and that have a sole or dominant purpose to obtain the tax benefits, objectively determined by reference to an inexhaustive list of factors in Part IVA. Objective sole or dominant purpose is the indicator that draws the line between what is permissible and what is impermissible. When establishing the sole or dominant purpose of a scheme, the Commissioner can attack commercial schemes if they are entered into in such a way that it can be said that obtaining the tax benefits is at least the dominant purpose of the scheme. This means that Part IVA can affect commercial schemes that have substantial tax benefits. The UK GAAR can be said to be the opposite. Its double reasonableness test is designed to ensure that it targets only the most abusive arrangements, while allowing arrangements that are not abusive enough or that could be

found to be abusive in terms of a GAAR with a lower threshold. An ideal GAAR should not target commercial arrangements. It should also not target only the most abusive arrangements. Due to the fact that the ideal GAAR is elusive, is a GAAR that targets abusive arrangements and, in the process, affects commercial arrangements better than a GAAR that targets only the most abusive arrangements while allowing less abusive ones? It is submitted that the approach in Part IVA, which has been successfully applied in a number of cases, is a greater deterrent than the approach taken in the UK GAAR. It is also submitted that considering the fact that a perfect GAAR has not been drafted yet, a GAAR whose indicator affects some commercial arrangements in targeting abusive tax avoidance is better than one that allows some abusive arrangements in targeting only the most abusive arrangements.

Overall, the UK GAAR, being one of the newest GAARs in the world, has been drafted to avoid the controversy and problems associated with isolating a part of a composite tax avoidance arrangement and with having an extended definition of a tax benefit. Australia can draw lessons from the UK approach on these two concepts. GAARs typically have one element that is meant to indicate impermissible tax avoidance. This element is arguably the most important part of the GAAR, and it is in respect of this element that the UK GAAR, it is respectfully submitted, is lacking when compared to Part IVA. In a world where taxpayers are becoming more and more aggressive in avoiding tax, it is better to have a GAAR that is founded on a provision that could possibly affect some commercial transactions in targeting abuse, than one that is founded on a provision that targets only the most abusive transactions. In this regard, while some provisions in Part IVA are problematic and lessons on eradicating these problems should be drawn from the UK, Part IVA retains strength on the element that is ultimately relied on to attack impermissible tax avoidance.