

5-11-2017

Comparing the New Zealand and Australian GAAR

John Tretola
Adelaide University

Follow this and additional works at: <http://epublications.bond.edu.au/rlj>

Recommended Citation

Tretola, John (2017) "Comparing the New Zealand and Australian GAAR," *Revenue Law Journal*: Vol. 25 : Iss. 1 , Article 3.
Available at: <http://epublications.bond.edu.au/rlj/vol25/iss1/3>

This Journal Article is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Revenue Law Journal by an authorized administrator of ePublications@bond. For more information, please contact [Bond University's Repository Coordinator](#).

Comparing the New Zealand and Australian GAAR

Abstract

This paper seeks to compare and contrast the Australian and New Zealand general anti-avoidance rules (GAAR) and to highlight what parts of each respective GAAR work well and which parts could be improved.

Keywords

tax, avoidance, revenue, rules

COMPARING THE NEW ZEALAND AND AUSTRALIAN GAAR

JOHN TRETOLA*

This paper seeks to compare and contrast the Australian and New Zealand general anti-avoidance rules (GAAR). The paper will first discuss what is meant by the term tax avoidance and then outline the current general anti-avoidance rules in New Zealand and Australia that are designed to counter tax avoidance. In the Australian context this means not only reviewing the income tax GAAR rules but also the GST GAAR rules which are similar but different in some key respects. The paper will then compare the New Zealand GAAR as against both the Australian income tax and GST GAARs to highlight similarities and differences across these different sets of GAAR rules. Since the GAAR provisions in each jurisdiction are broad in their potential application it has largely been left to the courts to determine, by their interpretations of the GAAR rules, where the line is to be drawn between acceptable and unacceptable tax minimisation strategies.

INTRODUCTION - WHAT IS TAX AVOIDANCE?

Many jurisdictions have introduced a statutory general anti-avoidance rule (GAAR) as a primary method to tackle tax avoidance.¹ Australia and New Zealand both have had a GAAR in one form or another for many years. A statutory GAAR is in essence an admission of legislative defeat by parliament that it is unable to foresee all possible future structures or transactions with sufficient clarity and so the GAAR acts to try and render ineffective these arrangements that parliament cannot foresee nor delineate.²

Tax avoidance activities reduce government revenue and attack the integrity and equity of the tax system.³ However, 'tax avoidance' is not a statutory defined concept and therefore defining the concept of 'tax avoidance' has been to date elusive. In 1997 Lord Templeman, writing extra-

* Lecturer, Adelaide University, Business School.

¹ Apart from Australia and New Zealand, Canada has a GAAR found in its *Income Tax Act* 1985 (Canada) c1 (5th Supp.) in s 245; Hong Kong has a GAAR found in its *Inland Revenue Ordinance* (Hong Kong), ch 112, s 61A; South Africa in the *Income Tax Act* 1962 (South Africa) in s 80A; the United Kingdom in the *Finance Act* 2013 (UK) in s 206; China in the *Corporate Income Tax Law of the People's Republic of China* 2008 article 47; Ireland in the *Taxes Consolidation Act* 1997 (Ireland), Pt 33; Malaysia in the *Income Tax Act* 1967 (Malaysia) in s 140 and Singapore in the *Income Tax Act* (Singapore) ch 134 in s 33. The United States has an economic substance test as an equivalent to a GAAR in s 7701(o) of the *Internal Revenue Code* 1986 and many other countries also have a GAAR such as, among others, Germany in the *Fiscal Code of Germany*, article 42 and South Korea in the *Basic Act for National Taxes*, article 14.

² Graeme Cooper, 'The Role and Meaning of "Purpose" in statutory GAARs', *Sydney Law School, Legal Studies Research paper*, No 16/22 (March 2016) 4.

³ Chris Atkinson, 'General anti-avoidance rules: exploring the balance between the taxpayer's need for certainty and the government's need to prevent tax avoidance' 14 *Journal of Australian Taxation*, Issue 1, 1 referring to the Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) 7.

judicially, stated that ‘tax avoidance reduces the incidence of tax borne by an individual taxpayer contrary to the intentions of Parliament’.⁴ Tax avoidance encompasses all actions that are not illegal but that have the effect of reducing, eliminating or deferring tax liability (in contrast to tax evasion). While these actions give the illusion that the transaction complies with the letter of the law, the tax advantage is not intended by the law and is clearly against the intention of Parliament.⁵ Tax avoidance is likely to involve artificial or contrived arrangements with little or no real underlying business activity or purpose and a substantial removal of any risk to the taxpayer.

Despite the difficulty in defining tax avoidance it is certainly possible to explain the characteristics of tax avoidance arrangements as they exhibit such qualities as ‘artificiality’, ‘undue complexity’ and ‘circularity’ or ‘lack of business reality’.⁶ It seems therefore, as the Privy Council pointed out in *Newton’s* case in 1958 that it is possible to know tax avoidance when it occurs but it has to be seen first before it can be properly identified.⁷ The issue that then confronts taxpayers is, what is acceptable tax behaviour ‘according to the intention of Parliament’, which is more correctly referred to as tax planning or tax mitigation, and what is unacceptable tax behaviour, which is regarded as tax avoidance?⁸ Working out where to draw this line between arrangements which are acceptable and those which are not and the principles relevant to enable this line to be drawn is still very much a valid question and for which there is still uncertainty in the context of both the Australian and the New Zealand GAARs.⁹

President Woodhouse of the NZ Court of Appeal noted that tax is an important factor in business decision making and so what should be attacked are ‘artifices and other arrangements which have tax induced features outside the range of acceptable practice’.¹⁰ This was a point picked up in the recently introduced UK GAAR¹¹ as foreshadowed by the Aaronson Report which stated that ‘the starting point should be to see whether the arrangement is abnormal, in the sense of having abnormal features specifically designed to achieve a tax advantageous result. If an arrangement has such an abnormal feature or features it becomes in effect ‘short listed’ for consideration as a potential target for the GAAR’.¹²

Arguably, to be effective a GAAR should target unacceptable tax avoidance and contain explicit or implicit tests to determine whether a particular arrangement is impermissible.¹³

⁴ Lord Templeman in ‘Tax Avoidance and the Law’, (Adrian Shipwright (ed), Key Haven, London, 1997) at 1.

⁵ Judith Freeman, ‘Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle’ [2004] *British Tax Review* 332.

⁶ *Barclays Mercantile Business Finance Limited v Mawson (Inspector of Taxes)* [2005] STC 1, para 24, citing Park J in the High Court.

⁷ *Newton v Commissioner of Taxation* [1958] AC 450, 466.

⁸ Lord Templeman first used terms such as acceptable tax mitigation and unacceptable tax avoidance in *CIR (NZ) v Challenge Corporation* [1987] AC 155.

⁹ M Cashmere, ‘Part IVA after Hart’ (2005) 24 *Aust Tax Rev* 131, 145.

¹⁰ *Elmiger v Commissioner of Inland Revenue* [1966] NZLR 683, 688.

¹¹ As set out in the *Finance Act* (UK) 2013 in s 206.

¹² GAAR Study - A Study to consider whether a general anti-avoidance rule should be introduced into the UK tax system, Report by Graham Aaronson QC, 11 November 2011 (*Aaronson Report* 2011), para. 5.15.

¹³ Chris Atkinson, ‘General anti-avoidance rules: exploring the balance between the taxpayer’s need for certainty and the government’s need to prevent tax avoidance’ 14 *Journal of Australian Taxation*, Issue 1 at 6.

THE NEW ZEALAND GAAR

New Zealand can lay claim to developing and introducing the first GAAR anywhere in the world when it introduced a GAAR in s 29 of the *New Zealand Property Assessment Act* 1879 which then carried forward into s 40 of the *Land and Income Assessment Act* 1891 and later s 108 of the *Land and Income Tax Act* 1954.

The current New Zealand GAAR is found in ss BG 1, GA 1 and YA 1 of the *Income Tax Act* 2007 (NZ) (ITA 2007). ‘Tax avoidance’ is defined in s YA 1 as including any arrangement that:

- (a) directly or indirectly alters the incidence of any income tax;
- (b) directly or indirectly relieves a person from a liability to pay income tax or from the potential or prospective liability to pay any future income tax;
- (c) directly or indirectly avoids, postpones or reduces any liability to income tax or any potential or prospective liability to future income tax.

The term ‘arrangement’ is also defined in s YA 1 as ‘any contract, agreement, plan or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect.’

The term ‘tax avoidance arrangement’ is defined in s YA 1 of the *Income Tax Act* 2007 as follows:

Tax avoidance arrangement means an arrangement, whether entered into by the person affected by the arrangement or any other person, that directly or indirectly

- (a) has tax avoidance as its purpose or effect; or
- (b) has tax avoidance as its purpose or effect or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.

This wording of the term ‘tax avoidance arrangement’ under the New Zealand GAAR is different in one significant respect from that of Australia’s GAAR. Tax avoidance does not have to be the sole or dominant purpose and only has to be one of the purposes and effects, although not one that is merely incidental.

Section BG 1(2) provides that a tax avoidance arrangement is void against the Commissioner for income tax purposes and so the Commissioner may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement.

Section GB 1 sets out the consequences that follow from an avoidance arrangement being declared void under s BG 1. Section GB 1 provides that the Commissioner may adjust the amounts of gross income, allowable deductions and net losses associated with the arrangement ‘as he thinks appropriate so as to counteract any tax advantage obtained’ under the arrangement’. The New Zealand approach effectively means that the New Zealand Tax Commissioner may have regard to the business reality of the transactions that would have eventuated but for the arrangement. However, the New Zealand general anti-avoidance provisions, in theory at least, could be construed so broadly so as to treat as tax avoidance the simple decisions to lease equipment rather than to purchase it, or make a donation to charity, as the tax benefits of such decisions would not be incidental to the arrangement.

Due to this potentially broad application that follows from having such a wide definition of 'tax avoidance' in s YA 1, it has been left to New Zealand courts to refine and restrict the application of the provision. Indeed, President McCarthy stated:

[The GAAR] cannot be given a literal application, for that would, the Commissioner has always agreed, result in the avoidance of transactions which were obviously not aimed at by the section. So the Courts have had to place glosses on the statutory language so that the bounds might be held reasonably fairly between the Inland Revenue authorities and taxpayers.¹⁴

The New Zealand approach sees the role of a GAAR to ensure the effectiveness of the primary taxing provisions when they somehow have failed to achieve their presumed purpose. The application of the GAAR provisions in New Zealand has involved the application of three successive steps with this three-step approach explicitly endorsed by the Court of Appeal in *C of IR v BNZ Investments Ltd*¹⁵ and by the Privy Council in *Peterson v C of IR*.¹⁶ The three-step approach involves the following steps:

- First, identifying the arrangement;
- Second, ascertaining if there is more than a merely incidental purpose or effect of tax avoidance; and
- Third, if there is a non-incidental purpose or effect of tax avoidance, then considering what adjustments ought to be made to counteract any tax advantages obtained.

However, more recently in *Ben Nevis* the Supreme Court of New Zealand¹⁷ has further clarified the application of s BG 1 by applying a two-step tandem process to its application. This requires the first step to be to determine whether the provision has been used within its intended scope and then the second step is to consider the taxpayer's use of the specific provision in light of the arrangement as a whole. In taking this approach, the *Ben Nevis* decision rejected previous tests used and instead adopted a 'parliamentary contemplation test'. In adopting this different approach, the Supreme Court of New Zealand also highlighted the importance of considering the badges of avoidance, such as the degree of artificiality and contrivance and also as to how bad the scheme smelt (applying in this way a kind of smell test).¹⁸

An arrangement can be both oral and written¹⁹ and this first step of identifying the arrangement assumes a temporal connection as it assumes that a plan will be thought out and implemented in contrast to random events not planned or co-ordinated.²⁰ However, this concept of requiring planning from the outset does not prevent a plan conceived at the outset with further key decisions made on a year by year basis from being an arrangement.²¹

¹⁴ *Commissioner of Inland Revenue v Gerard* [1974] 2 NZLR 279, 280.

¹⁵ *C of IR v BNZ Investments Ltd* (2001) 20 NZTC 17,103.

¹⁶ *Peterson v C of IR* (2005) 22 NZTC 19,098.

¹⁷ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289.

¹⁸ Michael Carmody, the Australian Federal Commissioner of Taxation at the time famously first referred to this 'smell test' in a conference speech, 'Part IVA- Where to Draw the Line' (Address presented at the 13th National Convention of the Taxation Institute of Australia, Melbourne, 19 March 1997).

¹⁹ *Ashton v C of IR* (1975) 2 NZTC 61,030 (Privy Council) at 61,030, 61,033.

²⁰ *AMP Life Ltd v C of IR* (2000) 19 NZTC 15,940 (New Zealand High Court).

²¹ *C of IR v Penny and Hooper* (2010) 24 NZTC 24,287 (Court of Appeal) at [73] to [78].

The second step involves determining if there is a purpose or effect of tax avoidance, as s YA 1 provides that if tax avoidance or effect is the sole purpose, or one which is not merely incidental, of the arrangement then the GAAR can apply to void the tax benefits obtained from the arrangement.

Purpose or effect in this context requires looking at the end in view²² but that the two words do not have any independent meanings.²³ The test for purpose is objective and so subjective motivations are not relevant.²⁴ If the arrangement in question has a tax avoidance purpose then the next question to be considered is whether the arrangement is referable to ordinary business or family dealings. This is necessary to determine whether or not the tax avoidance purpose is more than merely incidental to the arrangement. In *Hadlee and Sydney Bridge Nominees* the size of the tax benefit obtained was the key factor used to determine whether the tax avoidance purpose was merely incidental to the arrangement.²⁵

President Woodhouse in *Challenge Corporation*²⁶ stated that 'I am satisfied as well that the issue as to whether or not a tax savings purpose or effect is 'merely incidental' to another purpose is something to be decided not subjectively but objectively by reference to the arrangement itself.' President Woodhouse noted that a number of factors are relevant and these included the degree of economic reality associated with the arrangement and therefore the degree of artificiality or contrivance. His Honour also considered the extent to which the arrangement seeks to exploit the statute in pursuit of tax advantages as a relevant factor to determine whether avoidance had occurred.

The term 'tax advantage' is not defined in the legislation but following on from the *Ben Nevis* case there is strong authority that there is a link between the concept of a 'tax advantage' and the manner in which the tax benefit is obtained outside the contemplation of Parliament. Tax advantages may occur at multiple points in an arrangement and the Commissioner is free to select which ones he will counteract.

Once tax avoidance is determined then s GA 1 provides the power to the Commissioner to adjust the taxable income of a person affected by the arrangement in a way the Commissioner thinks is appropriate in order to counteract a 'tax advantage' obtained by the arrangement.

If an arrangement is found to be tax avoidance then this potentially exposes the taxpayer to 100% shortfall penalties under s 141D of the *Tax Administration Act* (NZ) 1994. The Commissioner's power of adjustment can be exercised against anyone benefiting from the tax avoidance arrangement and the Commissioner is not obliged to conjure up counterfactuals.²⁷ However, any evidence tendered by the taxpayer as to what would have happened, or would in all likelihood have happened or might have been expected to have happened may be used to determine whether or not the adjustment under GA 1 is wrong by being too excessive.²⁸

The *Ben Nevis* case did reject the view that the New Zealand GAAR was of paramount importance, but at the same time held that effect must be given to both the general anti-avoidance provision

²² *Newton v FC of T* (1958) 11 ATD 442, 465.

²³ *Ashton v C of IR* (1975) 2 NZTC 61,030 (Privy Council) at 61,030, 61,034.

²⁴ *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 (Supreme Court) at [38].

²⁵ *Hadlee and Sydney Bridge Nominees Ltd v C of IR* (1989) 11 NZTC 6,155 (High Court) per Eichelbaum CJ at 6,175.

²⁶ *C of IR v Challenge Corporation Ltd* (1986) 8 NZTC 5,001, 5,006.

²⁷ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 [170] and *Access Management Ltd v C of IR* (2007) 23 NZTC 21,323 (CA) at [155].

²⁸ *Ibid* at [171].

and any specific provisions applicable in the circumstances. This is a similar approach to the operation of the GAAR as takes place in Australia as discussed later.

In the *Ben Nevis* case, a number of factors were considered relevant in trying to work out whether the arrangements were ‘artificial’ or ‘contrived’. These factors were similar factors to those contained in the Australian equivalent when determining the purpose of the arrangement.²⁹ Hence, factors such as the manner in which the arrangement was carried out; the role of the relevant parties; economic and commercial effect of documents and transactions (such as looking at whether any inflated prices were paid); and, amongst other things, the nature and extent of the financial consequences for the taxpayer were all considered relevant and were all applied in the *Ben Nevis* case.³⁰

This approach by the Supreme Court in *Ben Nevis* does suggest that the level of ‘artificiality’ or ‘degree to which the arrangements are contrived’ are important considerations in determining whether the arrangement that came within the specific tax law provisions came in a manner outside of Parliament’s intended contemplation.

In explaining the application of the two-step process, the NZ Supreme Court stated:

If, when viewed in that light [of the arrangement as a whole], it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement ... A classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament’s purpose for the specific provisions to be used in that manner.³¹

The *Ben Nevis* decision indicates that the particular arrangement in question must be examined by reference to the particular legislative provisions with which it engages³² and when an arrangement uses a specific provision in a manner outside of Parliament’s contemplation it is likely to fall foul of the GAAR.³³ Atkinson argues that what the NZ Supreme Court is really saying is that the court has to consider whether the arrangement was structured and carried out in a commercially and economically realistic way to determine whether the use of the taxing provision by the taxpayer would be ‘consistent with Parliament’s purpose’.³⁴ Arrangements that are likely to be ‘contrived’ or ‘artificial’ would be arrangements with no business purpose, those with circular flows of money and self-cancelling obligations, where the investor has no risk or arrangements between tax asymmetrical parties at uncommercial prices or terms. Another example of an artificial arrangement is the issue of an optional convertible note to a 100% owned subsidiary.³⁵ Artificial could therefore be described as where there is a divergence from the legal and economic effects of the transaction.

²⁹ As set out in s 177D of the *Income Tax Assessment Act 1936*.

³⁰ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 [108-109].

³¹ *Ibid* 331-332 [107-108].

³² *Ibid* [102].

³³ *Ibid* [104].

³⁴ *Ibid* 332 [109] as quoted by Chris Atkinson, ‘General anti-avoidance rules: exploring the balance between the taxpayer’s need for certainty and the government’s need to prevent tax avoidance’, *Journal of Australian Taxation* Volume 14, Issue 1, 39.

³⁵ As was seen and ruled artificial and hence avoidance in *Alesco New Zealand Ltd v C of IR* (2011) 25 NZTC 20-042.

This follows from the view that Parliament seeks to impose tax by reference to the economic reality of transactions and not merely their form. It is then this degree of artificiality that is the key to distinguish avoidance from mitigation.

Another case that involved an artificial arrangement that was cancelled due to s BG 1 was *Dandelion Investments Ltd v CIR*.³⁶ In this case there was a circular self-cancelling transaction which was designed to take advantage of a statutory mismatch which enabled the taxpayer to claim an interest deduction without having to show that the borrowed money was used to generate assessable income. The arrangement involved no commercial or business objectives which could have justified the arrangement if the tax mismatch was not available. Where arrangements are entered into such as those in the *Dandelion Investments Ltd v CIR* case, where the taxpayer enters into round-robin transactions, deductions are created without any corresponding change in the true economic position of the parties or where legal ownership changes without the usual risks of ownership being also at risk then the nature of the transactions at issue would suggest that they are artificial or contrived and so would fall on the wrong side of the line and be avoidance transactions.

Even apart from the artificiality issue it is not always possible to work out with precision what the overriding 'parliamentary purpose' should be in order to guide taxpayer conduct. This is sometimes a factor of the complexity of tax legislation, as was noted by Justice Learned Hand in the United States where he stated that 'as the articulation of a statute increases, the room for interpretation must contract'.³⁷ In this Justice Learned Hand was suggesting there is a direct relationship between the complexity of tax legislation and the difficulty in interpreting its purpose. It is interesting to note that the terms 'parliament's intention' and 'parliament's contemplation' and 'parliament's purpose' were all used interchangeably in *Ben Nevis*.³⁸

The more recent New Zealand Supreme Court case of *Penny and Hooper*³⁹ demonstrated a further application of the principles adopted in the *Ben Nevis* case, allowing the court to determine what parliament would think of the particular transaction and consequently whether this was a transaction carried out according to the intention that parliament would have applied to the taxing provision in question.

The *Penny and Hooper* case involved a change in business structure by two orthopaedic surgeons (Penny and Hooper) who transferred their respective practices as sole traders to a new related company owned by various family trusts. This change of structure allowed the profits of the business to be split amongst other family members instead of being fully taxable to the respective surgeon in their own name. One of the features of the new structure provided for dramatically below market salary payments made by the respective company employing the respective orthopaedic surgeon.

The taxpayers in *Penny and Hooper* had claimed that the main purpose for the restructure was to limit liability for medical negligence claims and so was not a tax driven arrangement even though some obvious tax benefits flowed from the arrangement. The Supreme Court rejected the taxpayer's arguments and held that s BG 1 applied to the arrangement as the use of this new structure went beyond parliamentary contemplation as the tax purpose was considered to be the overriding purpose driving the whole restructure. Consequently the Commissioner was entitled to

³⁶ (2003) 21 NZTC 17,293.

³⁷ *Gregory v Commissioner of Internal Revenue* 69 F 2d 809 (2nd Cir, 1934), 810.

³⁸ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 [102, 104-109].

³⁹ *Penny and Hooper v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

tax the taxpayers by reference to a 'commercially realistic salary' effectively negating the tax advantage achieved by the restructure.⁴⁰

These two recent New Zealand cases of *Ben Nevis* and *Penny and Hooper*⁴¹ seem to suggest that the term 'parliament's contemplation' means that if the arrangement is looked at in a commercially and economically realistic manner can it then be predicated that parliament intended the specific provision to be used in the way it was used in the arrangement? In other words, if the arrangement produces a tax benefit in a manner contrary to how the specific provision was intended to operate then tax avoidance will be found.⁴² Broadly, what is within parliament's contemplation can be determined from the text of the provision, the context of the legislation in which it operates, any explicit purpose provisions in the Act, commentary from officials when the relevant Bill was introduced, academic articles and case law summaries.⁴³

However, as Dunbar writes, 'many cases on tax avoidance involve arrangements which seek to take advantage of the absence of any such evident intention in the words used in the statute which is why the alleged tax avoidance arrangement was entered into in the first place'.⁴⁴ Further,

the problem is that often Parliament only enacts a general rule and does not consider or anticipate all of the possible variations in commercial transactions which are sometimes deliberately designed to take advantage of the general rule in an unintended manner... Accordingly often the courts are being asked to second-guess what Parliament would have enacted if it had considered the particular transaction that is now before the courts. The judiciary are often being asked to determine the unknowable.⁴⁵

John Prebble suggests that, although the New Zealand Supreme Court embarked on a 'principled' approach in *Ben Nevis*, it did not in its approach identify any new principle and instead has simply given effect to the 'proper effect' of the statutory language.⁴⁶ The current approach taken by the Supreme Court in *Ben Nevis* contrasts sharply with the earlier approach taken by Richardson J in *C of IR v Challenge Corporation*, where His Honour indicated that if an arrangement met the terms of the specific provision as purposively interpreted then there was no room for the GAAR to apply.⁴⁷ Justice Richardson stated that the GAAR will not apply to activities that Parliament seeks to encourage⁴⁸ and the GAAR may not apply if the legislation itself is not clear or coherent:

Tax legislation reflects historical compromises and it bears the hands of many draftsmen in the numerous amendments made over the years. It is obviously fallacious to assume that revenue legislation has a totally coherent scheme, that it

⁴⁰ Ibid 435 [33].

⁴¹ *Penny and Hooper v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

⁴² *BNZ Investments Ltd v C of IR* (2009) 24 NZTC 23,582 (High Court) at [117-138].

⁴³ *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 (Supreme Court) at [40-47].

⁴⁴ David Dunbar, 'A Comparative Study of the Australian and New Zealand Judicial Approaches to Anti-Avoidance Legislation', paper presented to 2007 Australasian Tax Teachers' Association conference in Brisbane in January 2007 at 8.

⁴⁵ Ibid 8-9.

⁴⁶ John Prebble, 'Kelsen's Pure Theory of Law Sheds Light on, but fails to Account for, General Anti-Avoidance Rules of Income Tax Law', paper presented at the 27th Australasian Tax Teachers' Association conference in Adelaide in January 2015 (unpublished) at 14.

⁴⁷ (1986) 8 NZTC 5,001 (Court of Appeal).

⁴⁸ Lord Templeman (Privy Council) in *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513, 516.

follows a completely consistent pattern, and that all its objectives are readily discernible.⁴⁹

Nevertheless where the purpose of the taxing provision can be clearly ascertained it does provide a useful bright-line test to distinguish between avoidance and mitigation. Accordingly where the provision is not being used in a manner intended by Parliament there is avoidance but where the provision is being used in a manner intended by Parliament there is only mitigation and not avoidance.

Interpreting a statute according to its purpose requires a court to look at the words of the statute and appropriate secondary materials, and this purposive approach and reference to appropriate secondary materials is in fact required when interpreting Australian statutes.⁵⁰ Arguably the approach of the majority of the New Zealand Supreme Court in *Ben Nevis* suggests that the court should read Parliamentary purpose into the legislation by going beyond the purpose of the specific provision and by applying this purpose in its wider context. This approach requires the court to ask itself ‘what would Parliament do’ and then assess the transaction against the GAAR by reference to the answer to this question.⁵¹

THE AUSTRALIAN GAAR (PART IVA)

On 27 May 1981 Part IVA was introduced into the *Income Tax Assessment Act* 1936 (ITAA36) and in his Second Reading Speech to the Bill, the then Treasurer, the Hon. John Howard stated what he saw as the purpose of this new part of the legislation:

The proposed provisions embodied in a new Part IVA 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.⁵² In order to confine the scope of the proposed provisions to schemes of the ‘blatant’ or ‘paper’ variety, the measures in this Bill are expressed so as to render ineffective a scheme whereby a tax benefit is obtained and an objective examination, having regard to the scheme itself and to its surrounding circumstances and practical results, leads to the conclusion that the scheme was entered into for the sole or dominant purpose of obtaining a tax benefit.⁵³

The views of the Treasurer were also supported by the Explanatory Memorandum (EM) which accompanied the Bill. The explanation in the EM stated that the aim of the Bill ‘was to restore the anti-avoidance rule to the position as it was understood immediately after the decision of the Privy Council in *Newton*’.⁵⁴ By the wording of its provisions, Part IVA is intended to operate on the basis

⁴⁹ *Challenge Corporation* [1986] 2 NZLR 513, 549. This case did involve tax avoidance as the company reduced its liability to tax without any real economic loss.

⁵⁰ *Acts Interpretation Act* 1901 (Cth) ss 15AA and 15AB.

⁵¹ Chris Atkinson, ‘General anti-avoidance rules: exploring the balance between the taxpayer’s need for certainty and the government’s need to prevent tax avoidance’ 14 *Journal of Australian Taxation*, Issue 1, 43.

⁵² Second Reading Speech, *Income-tax laws Amendment Bill (No. 2) 1981*, *Hansard*, House of Representatives, 27th May 1981.

⁵³ *Ibid.*

⁵⁴ The Treasurer, *Income Tax Laws Amendment Bill (No. 2) 1981: Explanatory Memorandum* (Canberra AGPS, 1981).

that the primary taxing provisions have failed to achieve their intended purpose. Keith Kendall has noted that Part IVA is a provision of last resort and, based on the wording in s 177B of ITAA36, operates subject to the specific anti-avoidance provisions. Given that a tax benefit as defined in s 177C of ITAA36 can only be obtained if the arrangement in question is effective against the various specific anti-avoidance rules in the tax legislation Kendall has therefore noted that if no tax benefit is found Part IVA has no application.⁵⁵ Accordingly, Kendall notes that Part IVA can only apply after it has been determined that the transaction in question has given rise to a tax benefit and that there is no specific anti-avoidance rule that would deny or limit that tax benefit.⁵⁶

Kendall writes that the structure of the Australian legislation itself, as reinforced by decisions of the Australian courts, requires that the tax authorities take a linear or progressive approach to the legal effectiveness of a tax planning transaction and this requires that a particular order must be followed. First, it needs to be determined whether the arrangement is in fact a ‘sham’ and if so then that arrangement is to be ignored in favour of the true underlying transaction.

If the purported tax planning arrangement is not a sham then it is necessary to determine whether the transaction is effective on the face of the primary tax legislation and then as to whether there is a specific anti-avoidance provision which would apply to the transaction. If there is no specific anti-avoidance provision then, and only then, pursuant to s177B(3) of the *Income Tax Assessment Act 1936* can the application of Part IVA be considered.⁵⁷

Justice Pagone, writing extra-judicially, notes that a conceptual difficulty arises in that since the general anti-avoidance provision is not intended to be the primary taxing provision, a conceptual tension arises between the anti-avoidance provisions and a purposive construction to tax legislation.⁵⁸ However, his Honour suggests that by Part IVA only applying when the taxing provisions have not had effect indicates that its provisions do in fact impose taxation.⁵⁹ Justice Pagone therefore suggests that the drafters of Part IVA did in essence decide to go back to *Newton’s* case⁶⁰ as the source of a possible solution to this conceptual tension (as previously explained in the EM). In this way tax avoidance was found when, by looking at the overt acts by which it was implemented, you were able to predicate that it was done in that particular way so as to avoid tax. This was to be contrasted to a transaction that was capable of explanation by reference to ordinary business or family dealings and in his view, to a substantial extent, Part IVA was an attempt to return and develop those ideas.⁶¹

Pre-conditions for operation of Part IVA

Section 177F of ITTA36 makes it clear that Part IVA is not a self-operating provision, as it requires the Commissioner to exercise his discretion to cancel a tax benefit that has been obtained, or would, but for s 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.

⁵⁵ K Kendall, ‘The structural approach to tax avoidance in Australia’, *The Tax Specialist*, Volume 9 No 5 June 2006 at 292.

⁵⁶ *Ibid* 290-91.

⁵⁷ K Kendall, ‘The structural approach to tax avoidance in Australia’, *The Tax Specialist*, Volume 9 No 5 June 2006 at 290, referring to s 177B (3) and (4).

⁵⁸ GT Pagone, *Tax Avoidance in Australia* (Federation Press 2010) 16.

⁵⁹ GT Pagone, speech to the Tax Institute of Australia on 1 March 2011 at 1-3.

⁶⁰ *Newton v FCT* (1958) 98 CLR 1 (Privy Council).

⁶¹ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) at vi.

For Part IVA to apply three elements must be satisfied. Each is to be considered individually, though the Part IVA provision must be interpreted as a whole.⁶²

The three elements that are required to be established are that:

- there must be a 'scheme';
- a taxpayer must obtain a 'tax benefit' in connection with that scheme; and
- it would be concluded that the scheme was carried out for the dominant purpose of enabling the taxpayer to obtain a tax benefit in connection with that scheme.

Scheme

Section 177A of ITAA36 defines the term 'scheme' in very broad language as:

- (a) 'any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct'.

Due to this broad definition of 'scheme' in s177A (1), almost any activity, even if taken out unilaterally, would appear to amount to a scheme. However, the Full Federal Court in *FCT v Peabody*⁶³ held that where a scheme consists of a series of steps, or a course of action, the Commissioner cannot just isolate one step out of the course of action and classify that one step as a scheme. Indeed, Hill J stated that: '[I]n a case where a series of steps constitutes a scheme, that whole series of steps is to be considered, the individual steps being seen as parts of the scheme rather than each step being capable of being seen as a scheme in itself.'⁶⁴ Although the High Court accepted on appeal that it is possible to have a narrower scheme within a broader scheme the court made it clear that the scheme must still be capable of standing on its own without being robbed of all practical meaning.⁶⁵ Justice Cooper in *Spotless Services Ltd* noted that the definition of scheme 'requires that the parties to the scheme, insofar as they are known, must be identified and the terms or content of any agreement, arrangement, understanding, promise or undertaking and the steps or stages of any course of action or proposal insofar as they are relevant, be identified'.⁶⁶ This therefore means that the relevant facts must be included in the relevant formulation of the scheme as identified.

Tax Benefit

Section 177C of ITAA36 defines the kind of tax outcomes that a participant in the scheme must have had in connection with the scheme. Accordingly it provides that a tax benefit can be any one of the following:

- An amount not included in assessable income;
- A deduction being allowed;

⁶² *FCT v Peabody* 94 ATC 4,663.

⁶³ (1994) 28 ATR 344.

⁶⁴ (1993) 93 ATC 4104, 4111.

⁶⁵ *Peabody v Commissioner of Taxation* (1994) 94 ATC 4663, 4670.

⁶⁶ (1995) 95 ATC 4775, 4805.

- A capital loss being incurred; and
- A foreign income tax offset being allowed.

Finding a tax benefit was a necessary but not sufficient condition for the application of s 260 (the former provision of the Australian GAAR), and similarly is not by itself a sufficient condition for the operation of Part IVA: the critical additional condition being the presence of a sole or dominant purpose or objective of tax avoidance. What the GAAR seeks to render ineffective is particular conduct entered into or carried out for the purpose of obtaining the tax advantage. The Commissioner can put his case in relation to the scheme and tax benefit in alternative ways. However, the existence of a scheme and a tax benefit must be established as matters of objective fact and are not affected by the Commissioner exercising his opinion or satisfaction that there is a tax benefit that was obtained in connection with a scheme.⁶⁷

Determining whether a tax benefit exists may at first glance be an easy thing to identify. However, as Domenic Carbone has pointed out determining whether a tax benefit exists also requires considering the taxpayer's actual state of mind and all the known circumstances in determining what the taxpayer's subjective intention is likely to have been. Carbone notes that 'subjective intention can therefore be drawn from direct evidence given by a person, as well as by inference from the known circumstances' but that a taxpayer's testimony must always 'be examined against and judged in light of the known circumstances of a case'. To put it another way, subjective intention is determined objectively.⁶⁸

A Part IVA inquiry in determining what the tax benefit actually is requires a comparison between the scheme in question and an alternative postulate or so called 'counter-factual'.⁶⁹ A counterfactual scenario can be described as an alternative hypothesis or what would have happened or might reasonably be expected to have happened if the particular scheme had not been entered into or carried out. The reasonable expectation test requires more than a possibility and involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.⁷⁰ Such a comparison can be undertaken in two ways:

- First, comparisons between the tax consequences of the scheme and the tax consequences of the alternative postulates provide a basis for identifying (and quantifying) any tax advantages obtained from the scheme;
- Second, a consideration of alternative postulates may assist in reaching a conclusion about the purposes of the participants in the scheme to help reach a conclusion about the eight matters as set out in s177D (b) of ITAA36.

In order to reach a conclusion that one of the specified outcomes has been secured, and in order to quantify it, 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.

⁶⁷ *Peabody v Commissioner of Taxation* (1994) 181 CLR 359, 382-384

⁶⁸ Domenic Carbone, 'Part IVA & the Relevance of Subjective Intention- the Second Instalment', paper presented at the 20th annual Australasian Tax Teachers' Association conference in Hobart in January 2008 at 1-2.

⁶⁹ *FCT v Hart* (2004) 217 CLR 216, [66].

⁷⁰ *FCT v Peabody* 94 ATC 4,663, 4,671.

An alternative postulate could merely be that the scheme did not happen or that it did not happen but that something else did happen. Applying these so-called ‘counter-factual’ or ‘alternative postulate’ tests to determine the tax benefit has sometimes created disagreement among the judiciary as Hill J noted in *Macquarie Finance Ltd v FCT*⁷¹ where his Honour acknowledged that differences of application of these counterfactuals were likely due to their interpretative uncertainties. Dabner also notes that on this point ‘reasonable people will often reasonably disagree’.⁷²

One of the main cases that irritated the Commissioner on the application of this ‘do nothing’ alternative postulate was *RCI Pty Ltd v FCT*.⁷³ The *RCI* case ultimately was decided upon the issue of whether the taxpayer had obtained a tax benefit when it sold its shareholding in a foreign subsidiary to another company within the corporate group as part of a corporate restructuring exercise. Prior to this sale, RCI had arranged the subsidiary to pay a large dividend which was non-taxable and which also had the effect of reducing the value of the shares that were to be sold and thereby reducing the assessable capital gain. In rejecting that there was a tax benefit involved the Full Federal Court determined that the taxpayer would reasonably have been expected to have done nothing rather than trigger a very large tax liability.

Indeed, this issue, particularly of a taxpayer being able to argue that, had they not entered into the scheme, they would have done nothing and so would not have obtained a tax benefit was the main reason that led to the 2012 amendments to the definition of ‘tax benefit’.

The 2012 amendments⁷⁴

Due to problems perceived by the ATO in determining whether a tax benefit exists⁷⁵ the ATO proposed amendments to Part IVA to protect the integrity of Australia’s tax system to allow for the identification of possible alternative courses of action.⁷⁶

These 2012 amendments provide that it is no longer possible for a taxpayer to argue that ‘but for’ the scheme they would have done nothing, deferred the arrangement indefinitely or undertaken another scheme that also avoided tax. The issue of the choice principle is now specifically addressed by the recently amended subsection 177C(2). It provides that an amount is not a tax benefit and is excluded from the operation of Part IVA if the benefit is expressly provided for in the Act and:

- (i) ...is attributable to the making of a declaration, agreement, election, selection or choice, the giving of a notice or the exercise of an option by any person, being a declaration, agreement, election, selection, choice, notice expressly provided for by this Act...; and

⁷¹ 2004 ATC 4866.

⁷² T Calvert and J Dabner, ‘GAARs in Australia and South Africa: Mutual Lessons’ (2012) 7 *Journal of the Australasian Tax Teachers’ Association* 53, 70.

⁷³ [2011] FCAFC 104.

⁷⁴ There have also been other more recent amendments to Australia’s GAAR rules such as the inclusion of specific multi-national anti-avoidance rules and in the 2016 Budget it was announced that further measures would apply to diverted profits (diverted profits tax or DPT) to multinational companies.

⁷⁵ As outlined in the Corrs publication on the corrs.com.au website accessed 29 April 2016 at corrs.com.au/publications/corrs-in-brief-announced-changes-to-australian-general-anti-avoidance-rule-gaar/.

⁷⁶ The changes resulted from an announcement by the Assistant Treasurer, Mark Arbib, on 1 March 2012 and then a further announcement by the new Assistant Treasurer, David Bradbury in May 2012.

(ii) ...the scheme was not entered into or carried out by any person for the purpose of creating any circumstance or state of affairs the existence of which is necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised.

On 29 June 2013 Part IVA was amended⁷⁷ with effect from 16 November 2012 with the insertion of new ss 177CB and 177D which repealed the old sections 177CA and 177D of the *Income Tax Assessment Act 1936*. Whilst s 177C has still been preserved to retain the alternative postulate of assessing ‘what would have’ or ‘might reasonably be expected to have’ been included in income or allowed as a deduction, the new provision of s177CB(4)(a) requires having regard to:

1. The substance of the scheme; and
2. Any result or consequences for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act).

In effect the new provision limits the range of alternative postulates to be considered as to only those with the same objective as the scheme identified and which provide the same commercial result. Notwithstanding this, s 177CB notes that these factors are not an exhaustive list and so other factors which may impact on a taxpayer’s facts and circumstances in deciding upon a particular transaction may still be relevant in terms of the alternative postulate enquiry.

Section 177CB of ITAA36 now provides that any alternative postulate result that takes into account federal income taxation is to be disregarded. This does, it seems, still allow a consideration of foreign and/or state taxes in determining whether a tax benefit exists apart from the scheme.⁷⁸ Section 177CB now also expressly provides for two bases for the identification of a tax benefit with the first basis being as to what ‘would’ have resulted if the scheme had not been entered into. This approach is referred to as the ‘annihilation’ approach and is stated in 177CB (2).

The second basis, meanwhile, involves comparing the tax consequences of the scheme with the tax consequences that ‘might reasonably be expected to have’ resulted if the scheme was not entered into. This approach is known as the reconstruction approach and is stated in subsections 177CB (3) and (4).

Purpose of entering into the scheme

The mere fact that the taxpayer has obtained a tax benefit in connection with a scheme does not of itself mean that Part IVA will apply. Part IVA will only apply to a tax benefit if a person or persons who participated in the scheme did so for the sole or dominant purpose of enabling the taxpayer to obtain the tax benefit.

This purpose of the taxpayer must be established objectively based on applying paragraph 177D (b) of ITAA36, which lists eight factors which must be taken into account in determining the purpose of the taxpayer entering into the scheme. This requires an analysis of how the scheme was implemented, what the scheme actually achieved as a matter of substance or reality (as distinct from legal form) and the nature of any connection between the taxpayer and other parties. These eight factors, which were included in ITAA36 at subparagraphs 177D (b) (i) to (viii), were amended in 2013 and are now included in subsection 177D (2).⁷⁹

⁷⁷ These amendments were contained in the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013*.

⁷⁸ *PwC Tax Talk Monthly* 1 August 2013 at page 1.

⁷⁹ *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013*.

In considering whether Part IVA applies, these eight criteria need to be applied separately but they are not mutually exclusive and so must also be considered together.

The eight factors listed in sub-section 177D (2) are:

- The manner in which the scheme was entered into or carried out;
- The form and substance of the scheme;
- The time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- The result in relation to the operation of the Tax Act, but for Part IVA, would be achieved by the scheme;
- Any change in the financial position of any person, who has any connection (whether of a business, family or other nature) with the relevant taxpayer, which will result from the scheme;
- Any consequences for the relevant taxpayer or other connected person of the scheme having been entered into or carried out;
- The nature of the connection (whether of a business, family or other nature) between the relevant taxpayer and that other connected person; and
- Any changes in the financial position of the taxpayer.

A former Commissioner of Taxation (Michael Carmody) in a speech in 1997 referred to the application of these eight criteria as the application of a kind of ‘smell test’ suggesting that if the taxpayer’s arrangements ‘smell’ like tax avoidance then they probably do amount to tax avoidance.⁸⁰ In practical terms the Commissioner was suggesting that the degree of artificiality or contrivance present is a key factor in assessing which side of the tax planning/avoidance line the taxpayers is on.

A sole purpose is clear enough to establish, as ‘sole’ denotes the only purpose, but a dominant purpose is more problematic. The meaning of the term ‘dominant’ purpose was clarified by the High Court in *Peabody* where all seven judges stated unanimously that:

Much turns upon the identification, among various purposes, of that which is ‘dominant’. In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose.⁸¹

Since the *Spotless* decision one commentator has suggested that there appear to have been two main approaches to the application of purpose in Part IVA.⁸² One approach, more certain in its application of Part IVA, has been applied to artificial schemes that made no commercial sense.⁸³

⁸⁰ M Carmody, (Federal Commissioner of Taxation), ‘Part IVA- Where to Draw the Line’ (Address presented at the 13th National Convention of the Taxation Institute of Australia, Melbourne, 19 March 1997).

⁸¹ *FCT v Peabody* 94 ATC 4,663, 5,206.

⁸² T Calvert and J Dabner, ‘GAARs in Australia and South Africa: Mutual Lessons’ (2012) 7 *Journal of the Australasian Tax Teachers’ Association* 53, 69.

⁸³ For example, Part IVA was applied to disallow the tax benefits obtained in the so-called mass-marketed tax scheme cases such as *FCT v Sleight* 2004 ATC 4477 (a case involving an investment in a tee-tree

The other approach for which it is less likely that Part IVA will apply has been applied to arrangements that are more commercial in nature.⁸⁴ Indeed, Hill J in the Full Federal Court in *Peabody v FCT* had much earlier stated that Part IVA would ‘seldom if ever [apply] where the overall transaction is in every way commercial, although containing some element which has been selected to reduce the tax payable’.⁸⁵

In its application of Part IVA, Australian courts, as the cases noted have indicated, have largely applied a predication test requiring the objective purpose of the taxpayer to be determined by reference to the eight criteria in s 177D (b).⁸⁶

This purpose is to be attributed to the taxpayer involved in a scheme based on what a reasonable person would have done in the same situation as the taxpayer based on the objective analysis of the eight objective criteria in s 177D (b) without regard to the actual purpose of the relevant scheme participants.⁸⁷

Gleeson CJ and McHugh J in the High Court in *Hart* stated ‘a transaction may take such a form that there is a particular scheme in respect of which a conclusion of the kind described in s 177D is required, even though the particular scheme also advances a wider commercial objective’.⁸⁸ In reaching this conclusion their Honours gave special emphasis to the former s 177D (b) (i) which requires consideration of the manner in which the scheme was entered into and that this allowed reference to be made to how the transaction was structured and as such placed emphasis on the ‘wealth optimiser’ aspect of the borrowing at issue rather than the mere borrowing itself.⁸⁹

plantation and oil production scheme); *Vincent v FCT* [2002] ATC 4742 (a case involving deductions claimed in relation to a cattle breeding scheme); *Puzey v FCT* [2003] FCAFC 197 and *FCT v Lenz* [2007] FCA 1402 (both cases involving investments in a sandalwood plantation). This approach of readily applying Part IVA to artificial schemes which made no commercial sense has also been applied to a flood of post-2009 cases such as, among many others, *Citiigroup Pty Ltd v FCT* [2011] FCAFC 61 (a case involving an artificial arrangement to acquire bonds and then sell the right to receive coupon interest on the bonds arranged in a way which made no commercial sense and was only arranged to allow access to foreign tax credits) and *British American Tobacco Australia Services Ltd v FCT* [2010] FCAFC 130 (a case involving a scheme to avoid capital gains tax on the disposal of a business by establishing circumstances to artificially avail the company of rollover relief).

⁸⁴ For example cases involving the establishment of business structures for asset protection purposes (such as *Mochkin v FCT* 2003 ATC 4272); sale and leaseback arrangements (for example *Eastern Nitrogen v FCT* 2001 ATC 4164; stapled security capital raising arrangements (such as in *Macquarie Finance Ltd v FCT* 2005 ATC 4829; group finance company structures (such as in *FCT v Ashwick (Qld) No. 127 Pty Ltd* [2011] FCAFC 49 and pre-disposal reconstructions (such as in *Futuris Corporation v FCT* [2010] FCA 935 and also with respect to cases involving elements of a global reconstruction (as in *Nozga Holdings Pty Ltd v FCT* [2011] FCA 46. In each one of this group of cases, Part IVA was held not to apply to the arrangements as they were seen to be commercial in nature and not tax driven.

⁸⁵ *FCT v Peabody* 93 ATC 4104, 4110 and 4118.

⁸⁶ In *FCT v Consolidated Press Holdings Ltd (No 1)* 99 ATC 4945, 4971, it was noted by the High Court that all eight factors must be determined in a holistic way without the need to prioritise or weight the relevant factors. Since 2013, section 177D (b) is now included in section 177D (2).

⁸⁷ *Orica Limited v Commissioner of Taxation* [2015] FCA 1399, para 19.

⁸⁸ *FCT v Hart* (2004) 2004 ATC 4599, 4604.

⁸⁹ *Ibid* 4605.

Part IVA amendment introduced in 2015

The *Tax and Superannuation Laws Amendment (2015 Measures No. 1) Act 2015* introduced a new s 177DA into the *Income Tax Assessment Act 1936* to give effect to the so called ‘Google tax’. Section 177DA extends the definition of a scheme that gives rise to a tax avoidance determination broadly to those schemes whereby a foreign entity makes a supply to an Australian customer and activities are undertaken in Australia directly in connection with that supply giving rise to the derivation of either ordinary or statutory income from the supply whereby some or all of that income is not attributable to an Australian permanent establishment of the foreign entity where it can be concluded that persons who entered into the scheme, or any part of the scheme, did so for a principal purpose of enabling the taxpayer or another taxpayer to obtain a tax benefit in relation to the scheme.

The 2015 amendment is part of the Australian Government’s *Tax Integrity Multinational Anti-Tax Avoidance Law* (MAAL) and was designed to ‘prevent foreign corporations from using complex, contrived and artificial schemes that enable them to have substantial sales activities in Australia, but pay little or no tax anywhere’.⁹⁰ This new amendment became effective January 1, 2016 for enterprises with annual group turnover over \$1 billion.

The new rule is specifically designed to address abusive structures like the ‘Double Irish Dutch Sandwich’ and the Explanatory Memorandum contains an example that deals specifically with this type of arrangement.⁹¹ The Explanatory Memorandum includes an example where Company B provides supplies in Australia and owns SubCo in Australia, which provides support, but where all contracts are made with Company B. Company B then pays a large royalty to Company C, located in a non-tax jurisdiction and no withholding tax applies. In these circumstances, Company B is treated as having a PE (permanent establishment) in Australia and the royalty paid by Company B to Company C is treated as an expense incurred by the PE, but is then subject to withholding tax.

Essentially the new rules aim to tax the foreign resident as if it had a deemed PE in Australia and so subject the foreign resident to income tax and also withholding taxes. The Commissioner is currently communicating with 26 companies and has also issued a ‘MAAL client experience roadmap’ and signalled that the ATO will contact a further 60 potentially affected companies⁹² with the Assistant Treasurer advising that the ATO is focussing on almost 400 companies potentially affected by the MAAL.⁹³

Reconstruction

Where the three elements are found and it is concluded that the sole or dominant purpose of entering into the scheme was to obtain a tax benefit, s177F of ITAA36 allows the Commissioner the power to reconstruct the taxpayer’s affairs. With this reconstruction the tax benefit is removed (so either an amount is included in assessable income or a deduction or capital loss or foreign tax credit is disallowed) and this then gives rise to a tax shortfall amount. Penalties can then also be

⁹⁰ *Explanatory Memorandum to Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015* Para. 1.10.

⁹¹ For example, in Examples 1.14 and 1.15 in the *Explanatory Memorandum to Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015*.

⁹² Toby Knight & Igor Golshtein, ‘Commissioner threatens to issue higher tax bills’, *Governance Directions* April 2016 at 172.

⁹³ The Hon Kelly O’Dwyer MP, Address at the Heads of Tax Roundtable Lunch, Melbourne (16 February 2016).

applied to this tax shortfall amount based on the degree of culpability involved and these penalties can range from 25% (for lack of reasonable care) to 75% (for intentional disregard) of the tax shortfall amount.

ATO Position set out in Practice Statement PS LA 2005/24

The ATO has set out guidelines or warning signs in PS LA 2005/24 to assist in identifying when Part IVA may apply. These warning signs, the ATO suggest, would occur when:

- The arrangement (or any part of it) is out of step with ordinary family dealings or the sort of arrangements ordinarily used to achieve the relevant commercial objective.
- The arrangement seems more complex than necessary and/or includes a step or a series of steps that appear to serve no real purpose other than to gain a tax advantage (such as where an entity is interposed to access a tax benefit);
- Intra-group or related party dealings that merely produce a tax result;
- Arrangements involving a circularity of funds or no real money;
- The tax result of the arrangement appears at odds with its commercial or economic result (such as where a loss is claimed for what was a profitable commercial venture or transaction);
- The arrangement results in little or no risk in circumstances where significant risks would normally be expected such as where non-recourse loans are used; or
- Where there is a gap between the substance of what is being achieved under the arrangement and the legal form it takes.

Australian GST- Anti-avoidance rules

Division 165 of the *A New Tax System (Goods & Services Tax) Act 1999* (GST Act) contains anti-avoidance rules for the operation of the GST system in Australia. These rules are similar to those contained in Part IVA of ITAA36, requiring there to be a GST benefit obtained from a scheme, entered into or carried out for the sole or dominant purpose of obtaining a GST benefit, or where the principal purpose and effect of the scheme was to obtain a GST benefit, determined by reference to the objective matters outlined in s 165-15 of the GST Act.

The GST benefit is worked out in much the same way under Division 165 as it is under Part IVA in that regard is to be had to the 'counter-factual' or what would have happened if the actual choice made did not happen.⁹⁴

If a GST benefit is found then the Commissioner has the power to make a declaration which operates to negate the tax benefit and may impose additional penalty on the avoider.⁹⁵ This power of reconstruction is the same as the power contained in s 177F of ITAA36.

⁹⁴ *Case 3/2010* (2010) ATC 1-022 at 149-152.

⁹⁵ Sub-division 165-C of the GST Act.

Another similarity between the GST and income tax general anti-avoidance rules is that both require the time for testing the dominant purpose be at the time at which the scheme was entered into or carried out and by reference to the law as it then stood.⁹⁶

One way in which Division 165 and Part IVA differ is that s 165-1 of the *A New Tax System (Goods & Services Tax) Act 1999* (GST Act) enshrines the policy objective that the provision 'is aimed at artificial or contrived schemes' whereas of course in Part IVA, although this was an expressed intention of the rules in the *Explanatory Memorandum*, this purpose was never explicitly addressed in the legislation.

Another way in which Division 165 and Part IVA differ is that Division 165 includes a reference to twelve factors and not eight as are found in Part IVA. Division 165 includes additional factors such as the 'dominant purpose or object of this Act'⁹⁷ or 'principal effect that this Act'⁹⁸ would have in relation to the scheme.

These 'purpose and effect' considerations are not factors or criteria found in the income tax GAAR in Part IVA and have similarities with the 'abuse and misuse' test from the Canadian GAAR⁹⁹ and also the parliamentary contemplation test used to apply the New Zealand GAAR. Division 165 requires the principal effect test must be determined by reference to the reasonable conclusion drawn from a consideration of the twelve factors contained in s165-15(1) of the GST Act. The *Explanatory Memorandum* explained that the test for principal effect was the dominant effect and not merely an incidental effect but no comment was made on any difference between the dominant purpose and principal effect.¹⁰⁰

The AAT has explained in *Case 3/2010* that in determining the principal effect test the only relevant factors that were to be considered,¹⁰¹ amongst those listed in s 165-15 of the GST Act, were the 'form and substance of the scheme', 'whether there was a GST benefit from the scheme', 'any change in the taxpayer's position', 'and any 'change in the financial position of connected entities'.¹⁰² The AAT also stated that other factors listed in s 165-15 such as 'the manner in which the scheme was entered into', 'the purpose of the GST Act', 'the timing and period of the scheme', 'the nature of the connection between the taxpayer and other parties to the scheme', 'the circumstances surrounding the scheme' and 'any other relevant circumstances'¹⁰³ were not relevant factors to determine the principal effect of the scheme but were relevant factors in determining the purpose of the scheme.¹⁰⁴ These last group of factors all went towards determining the dominant purpose of the scheme and the conclusions as to dominant purpose of the scheme and the principal effect of the scheme were all relevant towards the conclusion as to whether Division 165 should apply to that particular taxpayer.

⁹⁶ *CPH Property Pty Ltd v Commissioner of Taxation* (1998) 88 FCR 21, 42.

⁹⁷ Section 165-15 (1) (c) of the GST Act.

⁹⁸ Section 165-15 (1) (f) of the GST Act.

⁹⁹ Section 245 of the *Income Tax Act* 1985 (Canada).

¹⁰⁰ *Explanatory Memorandum, A New Tax System (Tax Administration) Bill (No. 2) 2000* (Cth), [1.95].

¹⁰¹ *Case 3/2010* (2010) ATC ¶1-022 at 159.

¹⁰² The factors are those listed in paragraphs 165-15 (1) (b), (f), (g) and (h).

¹⁰³ These factors are those listed in paragraphs 165-15 (a), (d), (e), (j), (k) and (l).

¹⁰⁴ *Case 3/2010* (2010) ATC ¶1-022 at 159.

In *Case 3/2010* the AAT adopted the same test from Part IVA, so that where an arrangement produces a number of purposes or effects, then the assessment will focus primarily on the most principal and significant purpose or effect.¹⁰⁵

In 2005 the Commissioner issued a Practice Statement which clarified that the principal effect test is based on the result of the scheme and the consequence of the transaction.¹⁰⁶ Accordingly, since 2005, the principal effect test is seen to be different from the conclusion about objective purpose determined under s177D of ITAA36 and is in effect more similar to the predication test from the *Newton* case¹⁰⁷ where the Privy Council described the purpose of an arrangement as ‘the effect which the arrangement itself is intended to achieve’.¹⁰⁸

Another difference between the income tax GAAR found in Part IVA of ITAA36 and Division 165 of the GST Act is the inclusion of two other factors in Division 165 not found in Part IVA. These additional factors are the factors of ‘the circumstances surrounding the scheme’ and ‘any other relevant circumstances’.¹⁰⁹ The Commissioner has noted in PSLA 2005/24 that these two factors may allow regard to be had to the prevailing economic conditions or industry practices relevant to the scheme.¹¹⁰ Justice Pagone has noted, however, that these two factors are expressed in such broad terms that it is difficult to determine the extent of what other relevant circumstances will be relevant.¹¹¹ It is considered that the inclusion of this purpose and effect test as a second limb of the test to determine GST avoidance in addition to the first limb of determining the purpose of the scheme, adds to certainty and predictability in the application of Division 165 and provides more certainty than is presently available under Part IVA.¹¹²

Unquestionably, the objective determination of taxpayer purpose is ‘the pivot upon which Part IVA turns’¹¹³ and so the inclusion of a second limb in determining whether the GST GAAR is to apply to a particular scheme or arrangement, as Huang states, ‘provides greater certainty to this fundamental inquiry’.¹¹⁴

It is clear that the GST anti-avoidance rules have been cast in much wider terms than in the Part IVA GAAR.¹¹⁵ This also suggests that the GST rules should be interpreted in their own context and should lead to the result that the GST rules will have greater efficacy and predictability.¹¹⁶

¹⁰⁵ Ibid 160.

¹⁰⁶ Australian Tax Office, Practice Statement Law Administration, PS LA 2005/24, ‘Tax Avoidance Conclusion, paragraph 165-5 (1) (c) and s 165-15 of the GST Act.’

¹⁰⁷ *Newton v Commissioner of Taxation* (1958) 98 CLR 1.

¹⁰⁸ Ibid 8.

¹⁰⁹ Section 165-15 (1) (k) and (l) of the GST Act.

¹¹⁰ PSLA 2005/24 at [177].

¹¹¹ GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 156.

¹¹² Louisa Huang, ‘Comparing the GAARs under the Income Tax and GST systems’ 11 *Canberra L Rev* 2012 117, 145.

¹¹³ *FCT v Spotless Services Limited* (1996) 186 CLR 404, 413.

¹¹⁴ Louisa Huang, ‘Comparing the GAARs under the Income Tax and GST systems’ 11 *Canberra L Rev* 2012 117, 146.

¹¹⁵ S Barkoczy, ‘The GST General Anti-Avoidance Provisions- Part IVA with a GST Twist?’ (2000) 3 *Journal of Australian Taxation* 35, 50.

¹¹⁶ Louisa Huang, ‘Comparing the GAARs under the Income Tax and GST systems’ (2012) 11 *Canberra L Rev* 117, 144.

COMPARING THE NEW ZEALAND AND AUSTRALIAN GAARS

The jurisprudential analysis concerning the New Zealand and Australian GAARs as discussed in the passages above indicates that there has been a continuous incremental development in the interpretation of both the income tax and GST GAARs in both countries and that to date both sets of rules have been considered by the courts and tribunals in a very similar manner.¹¹⁷

The Australian income tax and GST GAARs are the more detailed as the income tax GAAR contains eight factors and the GST GAAR contains twelve factors to determine purpose under s 177D of the ITAA36 and Division 165 of the GST Act respectively. The New Zealand GAAR uses fewer words and has no equivalent to s177D. In this sense the NZ GAAR is the simpler GAAR version and so is preferable in that respect. Having fewer words does also leave more room for the courts to determine whether an arrangement is a tax avoidance arrangement. There is a strong and compelling argument that judges, with their greater jurisprudential skills, are perhaps better suited than Parliament to resolve the issue of where the line is to be drawn between tax planning and tax avoidance.

President Woodhouse echoed these sentiments when he stated that ‘the courts must now ensure that the anti-avoidance provision as it stands is given that purposive construction which will enable it to do its work in the balanced but effective way intended for it’.¹¹⁸

However, a review of the definitional elements of tax avoidance across New Zealand and Australia reveals that the elements in themselves as they are written into the legislation cannot definitively distinguish between tax avoidance and tax planning.

SIMILARITIES BETWEEN THE NEW ZEALAND AND AUSTRALIAN GAARS

Australian courts have sought to distinguish between tax planning and tax avoidance by focusing on the level of artificiality in a scheme and as to whether it has any commercial purpose and if so to what extent. The mass-marked cases and other cases such as *British American Tobacco* indicate that Australian courts are willing to apply Part IVA to artificial contrived arrangements that have no real commercial purpose other than obtaining a tax advantage. However, cases such as *Eastern Nitrogen*¹¹⁹ and *Macquarie Finance*¹²⁰ and the *Ashwick*¹²¹ case indicate that Australian courts are unlikely to apply Part IVA to an arrangement, even if it includes some complex artificial arrangements when these are more commercially driven.

New Zealand courts have also taken a similar approach as was seen in the *Ben Nevis*¹²² *Dandelion Investments*¹²³ and *Glenbarrow*¹²⁴ cases and in these cases New Zealand courts have also identified this dividing line between acceptable and unacceptable arrangements in applying the parliamentary contemplation test to decide whether the tax benefit obtained is in accordance with parliament’s

¹¹⁷ Ibid. This was also the conclusion reached by Domenic Carbone and John Tretola, ‘*FCT v Hart: An analysis of the impact of the High Court decision on the application of Part IVA*’ (2005) 34 Aust Tax Rev 196, 215.

¹¹⁸ *CIR (NZ) v Challenge Corporation* [1986] 2 NZLR 513, 534.

¹¹⁹ 2001 ATC 4164.

¹²⁰ 2005 ATC 4829.

¹²¹ [2011] FCAFC 49.

¹²² *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289.

¹²³ *Dandelion Investments Ltd v CIR* (2003) 21 NZTC 17,293.

¹²⁴ *Glenbarrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236.

intention in relation to the way in which the taxpayer went about obtaining this tax benefit and in this determination the level of artificiality and contrivance is used as an important indicator.

The analysis throughout this paper shows that there are many similarities in the wording and operation of both the Australian and New Zealand GAAR provisions. Both GAARs require the identification of a course of action that gives rise to the tax advantage obtained.

The Australian GAAR uses the concept of ‘scheme’¹²⁵ whereas the New Zealand GAAR that of ‘arrangement’.¹²⁶ How broadly or narrowly the arrangement is defined is critical to the operation of both GAARs. The broader a scheme or arrangement is defined, the more likely that it will be found to have an overall non-tax purpose. Conversely, the narrower a scheme or arrangement is defined, the more likely a GAAR will be found to apply to the scheme or arrangement. In recognition of this issue of the identification of a scheme or arrangement, courts have sought to limit the way in which a scheme or arrangement can be defined. For example, the majority of the Supreme Court of New Zealand took a somewhat narrow view of an arrangement in *Ben Nevis* by restricting the arrangement to be only all those elements that led to the tax benefit.¹²⁷ Similarly the High Court of Australia in *Hart* took a narrow view of the scheme in question (although it did accept that a broad approach was also possible).¹²⁸

Both sets of GAAR rules also recognise the importance of identifying the tax benefit, however they go about doing this in different ways.

Both the Australian and New Zealand GAARs also contain a similar reconstructive element which imposes taxation by reference to a hypothetical state of affairs that it is reasonably considered that the taxpayer would have entered into in the absence of the arrangement.¹²⁹ They also are similar in that they impose penalties on taxpayers who have been found to have entered into tax avoidance schemes.

DIFFERENCES BETWEEN THE NEW ZEALAND AND AUSTRALIAN GAARS

There is a subtle difference between the Australian and New Zealand GAARs with respect to the second element, identifying the relevant tax benefit which has been obtained in connection with the scheme or arrangement. The Australian GAAR refers to a ‘tax benefit’ in s 177C of ITAA36 whereas the New Zealand GAAR refers to ‘tax avoidance’ in s YA 1 of the *Income Tax Act* 2007 (NZ).¹³⁰

Under the Australian GAAR, the tax benefit in question is identified by comparing the actual amount of tax payable under the arrangement as defined to a hypothetical determination of the amount of tax that would have been payable in the absence of the arrangement. The difference between these two amounts is the tax benefit. In *Peabody* the High Court stated that to identify the tax benefit it must be ‘reasonably expected’ to have been obtained without the scheme and that this requires a certain state of affairs be determined as likely to apply if the tax benefit was not obtained. This state of affairs must amount to more than a mere possibility and so must be sufficiently likely

¹²⁵ As defined in s 177A of the *Income Tax Assessment Act* 1936.

¹²⁶ *Income Tax Act* (NZ) 2007 ss BG 1(1) and YA 1.

¹²⁷ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 at 333.

¹²⁸ *FCT v Hart* (2004) 217 CLR 216 per Gummow and Hayne JJ at paras. [48]-[55].

¹²⁹ Australia: s 177F *Income Tax Assessment Act* 1936 and New Zealand: s GA 1 of the *Income Tax Act* 2007 (NZ).

¹³⁰ Section 177C of the *Income Tax Assessment Act* 1936 and s YA 1 of the *Income Tax Act* 2007 (NZ).

to have happened.¹³¹ Justice Pagone, writing extra-judicially, has noted that the purpose of this comparison between what occurred and a hypothetical alternative scenario (the so called ‘counterfactual’ or ‘alternative postulate’) is to ensure that it was the scheme itself which caused the tax benefit.¹³²

In New Zealand, s YA 1 of the *Income Tax Act* 2007 (NZ) defines ‘tax avoidance’ in very broad terms to include directly or indirectly altering the incidence of income tax, or avoiding, reducing or postponing any liability to income tax. This very broad definition of tax avoidance in s YA 1, much like as in s 177C and s177CB of the ITAA36 in Australia could of course include every tax deduction, credit or other reduction in tax provided for in the tax legislation,¹³³ but nevertheless New Zealand courts do not generally require any comparison to be drawn between two or more possible courses of action (as is currently the case in Australia).

Instead, the New Zealand rules simply accept the tax benefit as identified by the revenue authorities. Indeed in *Ben Nevis* the Supreme Court held that once an arrangement is identified then the burden is on the taxpayer to show that the arrangement was not a tax avoidance transaction.¹³⁴ Despite this, the court cited with approval *BNZ Investments Ltd* where it stated that ‘something more than the existence of a tax benefit in one hypothetical situation compared with another is required to justify [the application of the GAAR]’.¹³⁵

This therefore suggests that the identification of a tax benefit when compared to a hypothetical state of affairs is a necessary pre-condition to the application of a GAAR in New Zealand. However, it is submitted that there is no real practical difference between these terms as both relevant terms are defined broadly enough to ensure that any arrangement that reduces tax payable or provides a timing advantage through deferring the derivation of income or bringing forward a deduction can potentially be caught by either GAAR. As such the aim of both GAARs is to ensure that all forms of tax benefit, whether acceptable or not, are potentially caught. As part of identifying the tax benefit it is also necessary to show that the ‘scheme’ or ‘arrangement’ as identified actually produced the ‘tax benefit’.

In respect to the third and final element of both the Australian and New Zealand GAARs – the requisite purpose element – there is a very significant difference between the Australian and New Zealand GAARs. In Australia, to find tax avoidance requires the scheme to be the sole or dominant purpose of the transaction¹³⁶ whereas in New Zealand tax avoidance is found if the arrangement produces a tax benefit and the tax advantage is just one of the purposes of the arrangement as long as it is more than incidental.¹³⁷

The Australian GAAR considers the intention of the taxpayer as determined objectively by reference to the eight factors in subsection 177D (2) of ITAA36 in determining whether the taxpayer had the sole or dominant purpose of engaging in tax avoidance. A sole purpose implies there is no other purpose present whereas a ‘dominant purpose’ has been interpreted by Australian

¹³¹ *Peabody v Federal Commissioner of Taxation* (1993) 181 CLR 359, 385.

¹³² GT Pagone, *Tax Avoidance in Australia* (Federation Press, 2010) 49.

¹³³ An issue noted by New Zealand courts almost half a century ago in *Elmiger v Commissioner of Inland Revenue* [1966] NZLR 683, 686 (Woodhouse J).

¹³⁴ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289, 333.

¹³⁵ *Ibid* at 328 citing *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450, 463.

¹³⁶ As set out in s 177D of ITAA36.

¹³⁷ Section YA 1 ITA 2007 (NZ).

courts as the ‘ruling, prevailing or most influential’ purpose.¹³⁸ The New Zealand GAAR, on the other hand, looks at the intention found in the scheme itself and does not specifically refer to any set of factors.

The New Zealand GAAR sets out the purpose requirement in s BG 1(1) of the *Income Tax Act* 2007 (NZ) which applies to all arrangements that directly or indirectly have tax avoidance as their purpose or effect or one of their purposes or effects or where that purpose or effect is not merely incidental. The New Zealand GAAR applies whether or not any other purpose or effect is referable to ordinary business or family dealings.¹³⁹

The Australian GAAR therefore arguably requires a stronger tax avoidance purpose as it refers to a sole or dominant purpose whereas the New Zealand GAAR requires tax avoidance to be just one of the purposes of the arrangement as long as the tax avoidance purpose is more than merely incidental. As an example of this difference in application it is interesting to compare and contrast the different results that were obtained in somewhat comparable cases that both involved the use of a different operating structure to obtain some tax and other benefits, such as asset protection. Comparing, in this regard, the New Zealand case of *Penny and Hooper*¹⁴⁰ where the surgeon taxpayers transferred their respective practices as sole traders to a newly related company owned by various family trusts, where the New Zealand court found by applying the New Zealand GAAR that there was tax avoidance in the use of this interposed professional practice with the Australian case of *Mochkin*¹⁴¹ which did not find the use of the family trust in place of the sole trader share-broking business amounting to tax avoidance due to the other identified purpose that drove the arrangement of obtaining asset protection. This difference in outcomes can be linked to different threshold requirements for establishing tax avoidance across both jurisdictions.

Despite the apparent differences in how ‘purpose’ is to be determined, the New Zealand Supreme Court in *Ben Nevis* effectively applied a range of factors very similar to those contained in s 177D of the Australian GAAR in determining whether the arrangements amounted to tax avoidance. Hence, factors such as the manner in which the arrangement was carried out; the role of the relevant parties and the commercial and economic effect of the documents and transactions and the nature and extent of the financial consequences for the taxpayer and related parties were all relevant in assessing the level of artificiality and hence in determining purpose.¹⁴²

Even though the Australian income tax GAAR does not presently include a policy objective, unlike the Australian GST GAAR, the High Court in the *Hart* decision has already clearly stated that a dominant purpose could be drawn if the transaction appeared to be artificial or contrived and that therefore such a transaction is likely to be caught by Part IVA.¹⁴³ By taking this approach and thereby giving much weight to this issue of artificiality or whether a transaction is contrived, suggests that the High Court has already acknowledged in its application of Part IVA that the concepts of degree of contrivance or artificiality are already effectively embraced within the policy objectives of Part IVA.

¹³⁸ *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 416.

¹³⁹ Section YA 1 of the *Income Tax Act* 2007 (NZ).

¹⁴⁰ *Penny and Hooper v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

¹⁴¹ *Mochkin v FCT* 2003 ATC 4272.

¹⁴² *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 [108-109].

¹⁴³ *Commissioner of Taxation v Hart* (2004) 217 CLR 216, 254 [86].

Huang has recognised that to improve certainty and predictability in the application of Part IVA that this factor of acknowledging the degree of artificiality or contrivance could be expressly recognised as another factor to be included in s 177D (b) of ITAA36.¹⁴⁴

WHICH MODEL IS BETTER: THE AUSTRALIAN OR NEW ZEALAND GAAR?

Both GAAR models use very broad wording which helps to achieve the aim of having the GAAR be as useful and flexible as possible. The use of such broad language could be criticised for promoting uncertainty which was after all the nemesis of the demise of the forerunner to Part IVA, s 260 of the ITAA36 with the result that Australian courts took a restrictive approach to its interpretation.¹⁴⁵ However, as Prebble has noted in respect to the New Zealand GAAR, that whilst the use of broad wording in the GAAR does leave some uncertainty this uncertainty is not necessarily a bad thing. Prebble has stated that ‘a degree of uncertainty is necessary for a general anti-avoidance rule to operate as intended. If such a rule tried to define tax avoidance with absolute certainty, tax avoiders would soon find new strategies that fell outside the definition. Concrete rules are the most open to avoidance; thus a general anti-avoidance rule must indeed be general if it is to catch tax avoidance arrangements and have deterrent value’.¹⁴⁶

As the NZ GAAR does not specifically refer to a list of criteria to apply the GAAR, the NZ GAAR does leave more room for the courts to determine whether an arrangement is a tax avoidance arrangement. However, it is posted that judges, with their greater jurisprudential skills, are perhaps better suited than Parliament to resolve the issue of where the line is to be drawn between tax planning and tax avoidance.

Having fewer words does therefore leave more room for the courts to develop judicial interpretative techniques to determine if arrangements amount to tax avoidance. The New Zealand judge, President Woodhouse echoed these sentiments when he stated that ‘the courts must now ensure that the anti-avoidance provision as it stands is given that purposive construction which will enable it to do its work in the balanced but effective way intended for it’.¹⁴⁷

Whilst the New Zealand and Australian GAARs do have some subtle differences in some respects in, for example, the way the tax benefit is determined and appear to quite different in other respects, such as how purpose is determined, given that the eight criteria found in s 177D (b) of the ITAA36 are not replicated anywhere in the New Zealand ITA 2007, in essence in terms of how the respective GAARs are applied, which is in both cases with an objective analysis, they appear to operate in an almost identical fashion. It was no surprise then when the New Zealand Supreme Court in *Ben Nevis* applied criteria very similar to the eight criteria in s 177D (b) of ITAA36 in its assessment of the purpose of the arrangement in question and in so doing reached its result that the taxpayer had obtained a tax benefit not within the contemplation of parliament.

One way to better improve the delineation between acceptable and unacceptable tax planning is, as suggested by Atkinson, that the Australian GAAR provision include an additional positive

¹⁴⁴ Louisa Huang, ‘Comparing the GAARs under the Income Tax and GST systems’ 11 *Canberra L Rev* 2012 117, 146.

¹⁴⁵ Discussed in J Dabner, ‘Tax Planning for Professional People - What remains after the unholy trinity’, (1987) 21 (8) *Taxation in Australia* 568.

¹⁴⁶ John Prebble and M Zoe, ‘Comparing the general anti-avoidance rule of income tax law with the civil law doctrine of abuse of law’, *Victoria University of Wellington Legal Research Papers*, Paper No. 34/2013, *Bulletin for International Taxation* April 2008 at 156.

¹⁴⁷ *CJR (NZ) v Challenge Corporation* [1986] 2 NZLR 513, 534.

requirement of a 'misuse or abuse' provision supported by clear and coherent standards placed in the legislation which are capable of being applied consistently would provide the best guide to taxpayer conduct.¹⁴⁸

The abuse and misuse test echoes the test applied in Canada¹⁴⁹ but which is also similar to the way in which the parliamentary contemplation test is currently used in New Zealand. The abuse and misuse test asks the same critical question as to whether the taxpayer has obtained the tax benefit in a way that parliament intended or has their intended claim amounted to an abuse or misuse of the tax law.

CONCLUSION

A review of the definitional elements of tax avoidance across New Zealand and Australia reveals that there are many similarities in the wording and operation of both the Australian and New Zealand GAAR provisions. The New Zealand GAAR is simpler in its wording than the Australian GAAR and this therefore leaves more work for the courts to do to interpret its provisions. This results, as recent New Zealand jurisprudence has shown, in an effective and efficient and relatively consistent application of the GAAR provisions using purposive techniques of statutory interpretation which look at Parliamentary contemplation and intention. This method determines whether or not the particular arrangement has been carried out and the specific tax rules applied in accordance with the intention of Parliament, or if tax avoidance has occurred. This is, the author concludes, a welcome and desirable outcome where the New Zealand courts have enabled the GAAR provisions, by techniques of purposive interpretation, to do their work in a balanced and effective way. This is also the approach to be taken in the application of the Australian GST GAAR given the inclusion of the purpose and effect test among the criteria found in the application of Division 165 of the GST Act.

Australian jurisprudential history of the application of the eight criteria set out in s 177D (b) of ITAA36 has shown that Australian courts are willing to strike out artificial and contrived arrangements.¹⁵⁰ New Zealand jurisprudential history reveals the same approach as New Zealand courts have also been willing and very capable of striking out artificial arrangements.¹⁵¹

Courts in both jurisdictions have by the application of their respective GAAR rules, which in essence work in much the same ways, sought to focus on the level of artificiality and contrivance and to use that as a large determinant of whether the scheme was for a dominant tax purpose in Australia or was against the contemplation of parliament in New Zealand.

¹⁴⁸ Chris Atkinson, 'General anti-avoidance rules: exploring the balance between the taxpayer's need for certainty and the government's need to prevent tax avoidance' 14 *Journal of Australian Taxation* Issue 1, 32.

¹⁴⁹ This is set out in sub-section 245(4) of the *Income Tax Act* 1985 (Canada).

¹⁵⁰ As the results in cases, among others, such as *FCT v Spotless Services Ltd* (1996) 186 CLR 4040 and *FCT v Hart* (2004) 217 CLR 216 and *FCT v Sleight* 2004 ATC 4477 and *Vincent v FCT* [2002] ATC 4742 and *Puzey v FCT* [2003] FCAFC 197 and *FCT v Lenz* [2007] FCA 1402 and *Citigroup Pty Ltd v FCT* [2011] FCAFC 61 and *British American Tobacco Australia Services Ltd v FCT* [2010] FCAFC 1 all show.

¹⁵¹ As the results in cases such as, among others, *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289 and *Glenharrow Holdings Ltd v C of IR* (2009) 24 NZTC 23,236 and *Hadlee and Sydney Bridge Nominees Ltd v C of IR* (1989) 11 NZTC 6,155 and *Penny and Hooper v Commissioner of Inland Revenue* [2012] 1 NZLR 433 and *Dandelion Investments Ltd v CIR* (2003) 21 NZTC 17,293 also all show.

The Australian income tax GAAR in Part IVA has undergone recent changes since 2012 and it is still too early to assess in the absence of any relevant cases on their application whether or not they have improved the operation of the GAAR provision.

Australian courts since the 1980s have been even handed, in the author's opinion, not favouring either the revenue authority or taxpayers as such, in the application of the Australian GAAR and the eight criteria set out in s 177D (b) of the *Income Tax Assessment Act 1936* and have been willing to apply the GAAR to strike out artificial and contrived arrangements.

It is a conclusion of this article that the Australian income tax GAAR be improved further to allow courts to look specifically at the purpose and effect of the rules, such as by including similar wording as is found in the Australian GST GAAR, in order to determine, in the harder cases, whether the spirit of the GAAR has been breached.

It is also a conclusion that a policy objective be added to the Australian income tax GAAR indicating that it is aimed to apply at artificial and contrived arrangements without any genuine commercial or business purpose. The inclusion on this policy objective should enable the Australian income tax GAAR to work more efficiently and more predictably as has been the experience as noted in the application of the New Zealand GAAR.¹⁵²

¹⁵² By including a commercial purpose test or economic substance style test the Australian income tax GAAR would also more closely approximate the United States GAAR which includes an economic substance test in its GAAR in s 7701(o) of the *Internal Revenue Code 1986*.