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Mr Tim Bryant
Committee Secretary
Senate Economics Legislation Committee
Parliament House
CANBERRA ACT 2600

BY EMAIL ONLY: economics.sen@aph.gov.au

Dear Mr Bryant

PROPOSED CHANGES TO THE GENERAL ANTI-AVOIDANCE RULE

Cleary Hoare Solicitors welcomes the invitation to provide further comment in relation to the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* ("the Bill"), referred to the Senate Economics Legislation Committee on 14 March 2013. Schedule 1 of the Bill seeks to amend Part IVA of the *Income Tax Assessment Act 1936,* whilst Schedule 2 of the Bill is focused on modernising Australia's transfer pricing regime.

Our comments are limited to the Part IVA proposed amendments. We previously made comment to the proposed changes to the House of Representatives Standing Committee on Economics, and having viewed their report entitled *Advisory Report on the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*, our opinion on the proposed changes remains unchanged.

The draft legislation introduced to Parliament in the Bill aims to achieve the same objectives as those articulated in the Exposure Draft that was released for public comment on 16 November 2012, specifically restrictions on the "tax benefit" test in particular excluding any tax considerations from the analysis.

It is our view that whilst the Bill has better clarity of language than the ambiguous and uncertain exposure draft, the proposed changes continue to be too broad and unnecessary. The proposed amendments are significantly more wide-reaching than the original intentions of the regime. This change to the Part IVA regime should not be implemented in its current form. In making that submission, the following comments are relevant:

1. The Explanatory Memorandum to the *Income Tax Laws Amendment Bill (No. 2) 1981* said of the proposed anti-avoidance provisions:

   "The proposed new Part IVA, which this Bill will insert into the principal Act, is designed to overcome these difficulties and provide – with paramount force in the income tax law – an effective general measure against those tax-avoidance arrangements that – inexact though the words may be in legal terms – are blatant,

artificial or contrived. In other words, the provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered into for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income."

2. In the exposure draft Explanatory Memorandum, it is evident that the Government saw the "prediction test" in *Newton's Case* as its model for capturing the essence of what was to be caught by the anti-avoidance provisions. The provisions were to be inapplicable to schemes entered into in the course of ordinary business or family dealings and the criterion for determining whether something fell within the operation of the anti-avoidance rules was whether the identified scheme was blatant, contrived or artificial.

3. The 1983-84 Annual Report of the Australian Tax Office said:

"At the time the boom in the promotion of tax-avoidance and evasion schemes of the kind experienced in the late '70s and early '80s was a thing of the past. That elimination of "paper schemes" is one of the success stories of the last decade. They have been beaten by a combination of legislation, administration, changes in attitude and sheer hard work."

The blatant and contrived "Curran schemes", "trading stock schemes" and "bottom of the harbour schemes" that proliferated in the '70s and early '80s were effectively stopped by the General Anti-Avoidance regime. Part IVA as it was initially drafted has been successful.

4. The proposed changes seek to create two separate and distinct limbs under Part IVA which may give rise to a tax benefit. Where the taxpayer obtains a favourable tax outcome and such an effect either would not ("first limb") or might reasonably be expected ("second limb") not to have occurred if the scheme had not been entered into or carried out. The Explanatory Memorandum ("EM") of the proposed changes illustrates that this is designed to bring focus away from the importance of alternative postulates in Subsection 177C as developed in recent case law.

5. Based on the language of the EM, it is evident that the first limb is set to only apply to blatant and contrived tax avoidance schemes; ie the actual original intention of Part IVA. However, this is not reflected in the draft legislation, and amendments should be clarified as to in which circumstance either limb will be relied upon.

6. The changes to the second limb will require alternative postulates in which the taxpayer could reasonably be expected to achieve the same non-tax effects as achieved from the scheme. The Explanatory Memorandum provides that "alternative postulates should not be rejected as unreasonable postulates on the grounds that the tax costs involved in undertaking those postulates… would have caused the parties to either abandon or indefinitely defer the schemes and/or the wider transactions of which they were a part". When hypothesising these alternative postulates to a scheme, limited consideration is to be given to the potential tax costs of these alternatives.

7. The language used in the EM when detailing the process for having regard to the alternative postulates is uncertain. Specifically, paragraph 1.110 details that the non-tax results should simply be "comparable" which seems to conflict with paragraph 1.102 that outlines that in order to provide a meaningful comparison the

alternative postulate should achieve "substantially the same non-tax results" as those achieved through the arrangement. Treasury has stated that this uncertain wording has "broadly the same meaning", however we submit that language should be as specific as possible in order to provide clarity for taxpayers.

8. These proposed changes continue to demonstrate a complete disregard for the commercial reality of decision making that relates to the profitability of an enterprise and the employment of Australians in those enterprises. By seeking to close the door on the "do nothing" and the "unreasonable tax burden" alternatives, the legislation will be stepping away from the realities of commercial decision-making. Australian businesses routinely decide to not enter transactions on the basis that an excessive tax burden will make a transaction uncommercial. Preventing this reality from being examined when hypothesising alternative postulates would create an incongruency between regular business decision making and the General Anti-Avoidance Rules.

9. Treasury has responded that leaving the "unreasonable tax burden" alternative as an option would accept that there are situations in "which it is reasonable for a taxpayer to avoid the ordinary operation of the taxation law on the substance or reality of what they have actually done." Taxpayers avoid the operation of taxation law whenever they decide not to proceed with a transaction; to disallow an alternative postulate that does the same is to accept that the new General Anti-Avoidance Rules are contrived and do not reflect commercial reality.

10. On this basis, we are inclined to agree with the dissenting report of the House Standing Committee on Economics:

"If the ATO's reconstructed alternative is not what a taxpayer focused after tax return would ever have undertaken or even contemplated – as it lacks common sense or commercial reality/judgment – then the tax difference which arises is arguably excessive and unfair."

11. In his speech introducing the proposed changes, the Assistant Treasurer, David Bradbury, highlighted that the reason for the Part IVA changes was to attempt to prevent large technology companies such as Amazon, Apple and Google from routing their profits through overseas entities and jurisdictions. Whilst we applaud the decision to modernise the transfer pricing regime as attempted in Schedule 2 of the Bill, we believe that the legislature has decided to broaden Part IVA in such a way that will negatively affect commercial decision making for *all* ordinary Australian SME businesses.

12. In 1975, the Asprey Committee acknowledged that:

"In framing legislation sufficiently all-embracing to deter tax-avoidance, there is always the danger of penalising those who have genuine reason for entering into a bona fide transaction which, if carried out by others, has the objective that ought to be prevented. There is frequently such a very fine line to be drawn between the transaction which offends and the one which merits no condemnation."

13. By preventing consideration of potential tax costs to alternative postulates, the legislation is removing a tool for the judiciary to identify which transactions are tax-avoidant in nature, and which are bona fide transactions meriting no condemnation. We urge you to reconsider making these changes, as they will have

negative consequences for ordinary Australian SMEs completing bona fide commercial transactions.

14. The balance in "getting it right" is not easy but the proposed amendments are nowhere near close to that balancing point. As the Honourable Murray Gleese AC said in the foreword of Justice Pagone's book "*Tax Avoidance in Australia*":

> *"The difficulties of legislating on the problem of tax avoidance can never be resolved to complete satisfaction. The difference between a 'blatant, contrived, and artificial' scheme and prudent fiscal planning may be easy to recognise at the extremes, but not at the margin. Yet the same applies to the difference between night and day. Furthermore, what is explicable by reference to ordinary business or family dealings changes over time. How many Australians nowadays receive a medical bill that is not issued in the name of a corporate entity? Fifty years ago, a doctor's bill that identified the creditor as a corporation would have borne the stamp of tax avoidance. Now it bears the stamp of wise superannuation planning. Parliament itself deliberately creates fiscal benefits to promote certain forms of business activity. The Act contains provisions designed to encourage taxpayers to act in a particular way; responding to such encouragement, if that is all there is to it, is normal business planning."*

Thank you for the opportunity to provide these comments and we are happy to be involved in any further consultation. If you require any further clarification on the issues raised and our views on them, please do not hesitate to contact the writer.

Yours faithfully

Brett Hart
Cleary Hoare Solicitors