Law Council
OF AUSTRALIA
Business Law Section

22 February 2013

Committee Secretary
Standing Committee on Economics
House of Representatives
PO Box 6021
Parliament House
CANBERRA ACT 2600
Via email: economics.reps@aph.gov.au

Dear Sir,

Tax Laws Amendment (Countering Tax Avoidance and Multi-National Profit Shifting) Bill 2013 – Schedule 1 – Amendments to Part IVA Income Tax Assessment Act 1936

1. This submission of the Tax Committee of the Business Law Section of the Law Council of Australia (**Committee**) concerns the provisions of the Bill relating to the "General Anti-Avoidance Rules" (see Schedule 1 to the Bill). The Committee has lodged a separate submission in relation to other aspects of the Bill.

2. The Committee welcomes the opportunity to make submissions in relation to the Bill.

Executive Summary

3. The Explanatory Memorandum to the Bill states at paragraphs 1.4, 1.31 and 1.133 that losses in recent cases have shed light on weaknesses in Part IVA. The Committee does not accept that this is necessarily so. The results in those cases may be due either to poor case selection or case management by the ATO,[1] or attempts in litigation to try to make Part IVA extend to situations to which it was not intended to apply.

[1]Logan J ' Mission Accomplished? – A Perspective on Part IVA of the Income Tax Assessment Act 1936' (Paper presented at The Tax Institute 2012 Queensland Corporate Tax Retreat, Hyatt Regency Gold Coast, 6 September 2012). Ibid page 12 (referring also to a report by the Inspector-General of Taxation, 'Review of the

4. Be that as it may be, the government's policy has been to address the perceived weaknesses thought to be exposed by those cases. However, the concern of the Committee is that Parliament recognise that in doing so the Bill is not changing the application of Part IVA, within the original policy setting. The Bill would fundamentally change the operation of Part IVA as it would tax people by reference to things they did not do, and, importantly, would never have done.

5. The consequences of the Bill will be to create great uncertainty, additional compliance costs, conflict with other legal responsibilities of taxpayers and further, adversely differentiate our tax regime from those of other countries.

Recommendation

6. While the government's policy is to exclude a consideration of tax costs from the identification of the reasonable alternative possibilities, the Committee submits that the Bill should be amended to require that, while excluding a consideration of tax costs, the reasonable alternatives must be otherwise economically or commercially feasible.

The Bill changes the legislative policy underlying Part IVA

7. The Bill will change fundamentally the policy approach to tax anti-avoidance law followed in this country for the last 30 years. the comments made at paragraphs 1.71 and 1.134 of the Explanatory Memorandum to the Bill to the effect that the proposed amendments do not change any legislative policy do not reconcile with two significant changes in policy which result from the Bill which are discussed below.

8. The policy evident from the current words of Part IVA is to determine if a transaction produces an avoidance of tax by an objective test of comparing what the taxpayer did, which resulted in less or no tax, with the one reasonable alternative they may prove, by a forensic analysis of evidence, that they would have done (importantly, not might or could have done) in the alternative.

9. This is not an easy burden for a taxpayer to discharge. Indeed, the ATO has won cases on Part IVA because the taxpayer could not pass this test. Currently, the field is heavily slanted to the ATO by the applicable burden of proof rules. This requirement to compare what was done with the proven alternative course of action reflects a policy that if you did not have a tax liability from what you did do, and you would not have had a tax liability if you had instead done the one reasonable alternative (proven by the taxpayer), then there is no tax mischief – that is, there is no tax avoided.

Australian Taxation Office's Use of Early and Alternative Dispute Resolution', especially the section, "ATO Management of Tax Litigation", paras 6.17 to 6.32: http://www.igt.gov.au/content/reports/ATO_alternative_dispute_resolution/ADR_Report_Consolidated.pdf).

10. The first policy change reflected in the Bill is that no longer will the comparison be with the one alternative which the taxpayer proves would have happened, but with any reasonable alternative possibility which could have occurred. The Bill does not require these alternative possibilities (in relation to the 'reconstruction approach') to be economically or commercially feasible.

11. Because of that, and because the Bill proposes that those hypothetical possibilities are to be based on an assumption which excludes the tax costs of alternatives, the possibilities included in the ambit of the new law will include possibilities which would never have occurred.

12. The second policy change reflected in the Bill is explained in paragraphs 1.56 to 1.59 of the Explanatory Memorandum. That is, the present requirement that a tax benefit be obtained in connection with a scheme before a determination is made of dominant purpose, will be replaced with a single unified enquiry into whether or not the taxpayer's dominant purpose in entering the scheme was obtaining a tax benefit.

13. This also reveals a logical difficulty in the operation of the proposed amendments. That is, it is difficult to conceptualise the 'single inquiry' explained at paragraph 1.58 of the Explanatory Memorandum as to whether or not someone has a dominant purpose of obtaining a tax benefit, without articulating first what that tax benefit is.

Consequences of the Change in Approach

14. The change in approach to the application of Part IVA will have a number of detrimental consequences, as outlined below:

(a) *Increased uncertainty*

The consequence of legislating this Bill will be to create significant difficulties, for ordinary taxpayers, small businesses and large corporations (both Australian and foreign) in understanding their tax obligations. They will be required to assess their tax obligations by reference to the tax which would have been paid if they had done something that in reality they would never have done. Further, the significant body of case law which has developed over the last 20 years - where courts have developed the interpretation of Part IVA in response to a variety of commercial circumstances would, if the Bill is enacted in its current form, be largely otiose. The lack of applicable precedent means courts will need to "start from scratch". Again this leads to an environment of increased uncertainty.
Because it would create this uncertainty, this Bill breaches a basic principle of the rule of law – that every citizen should be able to know what the tax law is and how it applies to them.

(b) *Increased compliance costs*

Legislating the Bill, with its inherent uncertainty of operation discussed above, will increase compliance costs for taxpayers.

(c) *Creating conflicting legal responsibilities for directors and trustees*

This Bill will require taxpayers (such as company directors and trustees) who have a duty (under the *Corporations Act 2001* (Cth) or trust principles), to consider tax costs in deciding how to act for the benefit of others, assess the acceptability of transactions by reference to one or more hypothetical alternative transactions while ignoring tax costs. In other words they need to hypothesise alternative transactions as viable which, if they were pursued, would cause or give rise to breaches of duty.

(d) *Australia will be out of step with other developed countries' tax regimes*

This Bill will move Australia's tax law even further out of step with the tax laws of our major trading partners and capital providers. Part IVA is already far stronger than tax general anti-avoidance rules in other developed countries - USA, Canada, UK - let alone the dynamic economies of China, India, Singapore, Japan and the Asia Pacific. For example, in Canada, a society and economy similar to ours, its anti-avoidance rules ('GAAR') have a business purpose exception, and a requirement that they only apply in cases where the transaction involves a use or mis-use of the tax laws.

(e) *Increased sovereign risk*

The uncertainty and difficulty of the application of this Bill, and its retrospective effect, will add to the sovereign risk for foreign investors of dealing with Australia.

Retrospective Operation

15. The Bill is substantially different in its terms from the draft Bill released for consultation on 16 November 2012 (for example, there is a substantive change in approach to the operation of the amended law; and new drafting around the annihilation approach and the reconstruction approach are not contained in the consultation draft of 16 November 2012). It is inappropriate for the amendments contained in this Bill to have retrospective effect from 16 November 2012, as the legislative amendments now introduced are significantly different, so that taxpayers could not have known the proposed legislative landscape at that time.

Conclusion

The ATO is concerned that it has lost some recent cases on Part IVA. This does not signal a design flaw in Part IVA. In the 1990's the ATO lost the first case on Part IVA to reach the High Court of Australia[2]. The ATO overcame that loss and over 30 years has found Part IVA to be effective. Part IVA has achieved its purpose[3]. An administrator of a statute losing cases occasionally is a healthy sign that the administrator is identifying where the boundaries of the statute lie.

Further contact

[2] *Commissioner of Taxation v Peabody* (1994) 181 CLR 359.
[3] Ibid, note 1.

The Chair of the Committee (Mark Friezer at Partner at Clayton Utz in Sydney) would be happy to speak to the foregoing should it be thought to be helpful. Mark can be contacted on 02-9353 400 or via email: mfriezer@claytonutz.com

Yours faithfully

Frank O'Loughlin
Section Chairman

SUBMISSION 4

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OF AUSTRALIA
Business Law Section

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22 February 2013

Dear Sir / Madam,

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS INQUIRY INTO THE TAX LAWS AMENDMENT (COUNTERING TAX AVOIDANCE AND MULTINATIONAL PROFIT SHIFTING) BILL 2013

1. This submission on behalf of the Tax Committee of the Business Law Section of the Law Council of Australia (**Committee**) is concerned with the provisions of the Bill relating to the "modernization of transfer pricing rules" (see Schedule 2 to the Bill). The Committee has lodged a separate submission in relation to other aspects of the Bill.

2. The Committee welcomes the opportunity to make submissions in relation to the Bill.

3. The Committee has made a number of submissions to Treasury and the Senate Economics Legislation Committee in relation to transfer pricing reforms.

4. Enclosed with this submission is a copy of the Committee's submission to Treasury dated 17 December 2012 in relation to the Exposure Draft of the proposed transfer pricing amendments, to which reference is made below.

Principal points

5. The Committee endorses the move to adopt the arm's length principle as the basis for establishing prices for international related party transactions.

6. The Committee however has a number of concerns in relation to the Bill.

Reconstruction Power

7. First, the Committee does not support conferral of a reconstruction power on the Commissioner. Reconstruction of transactions is an arbitrary exercise liable to

result in double taxation. The Committee considers that in certain cases it may be necessary to go beyond the contractual terms and examine the functions, assets and risks to identify the real transaction. However, that should be no warrant for substituting some allegedly more commercially realistic arrangement for that agreed by the parties. See further paragraph 6-9 of the enclosed submission.

Arm's length principle and the OECD Guidelines

8. Second, both the legislation and the explanatory memorandum ought reflect that the OECD Guidelines emphasize that the focus when considering the arm's length conditions is the pricing of the transactions. Note 1 to s815-115(1) suggests that price is but one of the many potentially relevant "conditions".

9. Third, the requirement in s815-135 that "arm's length conditions" be identified "so as to best achieve consistency with the documents covered by the section" highlights two problems: (1) what is the status of the Guidelines – are they an interpretative guide or effectively incorporated into domestic legislation, and (2) if the latter, it is undesirable that unelected tax administrators of foreign jurisdictions effectively dictate the operation of Australian domestic tax law.

10. Fourth, it is an abrogation of the legislative function to permit critical interpretative text to be prescribed by regulation. It may expose (rightly or wrongly) the Executive to accusations of unfair discrimination. It is an undesirable development.

11. See generally paragraph 5 of the enclosed submission.

Onus of Proof in Reviews and Appeals

12. Fifth, the information imbalance in the Commissioner's favour distinguishes transfer pricing matters from other tax matters and warrants a reversal (or at least a re-balancing) of the onus of proof (see paragraphs 10-13 of the enclosed submission). For example, once the Commissioner determines (rightly or wrongly) that independent entities "would" have entered into other commercial arrangements (see s815-130(3)-(b)), the onus will fall on the taxpayer to prove otherwise. Information about the arrangements of comparable taxpayers will be readily available to the Commissioner – but not the taxpayer. It follows that the policy grounds for taxpayers generally bearing the burden of proof in taxation matters are not applicable in the transfer pricing context. The suggestion that "would" in s815-130(3) imposes a higher standard of proof on the Commissioner in forming the relevant view is not to the point (c.f. EM, para 3.102).

Documentation obligations

13. Sixth, the Committee agrees with the approach of tying base document obligations to the level of penalties. However, the Committee strongly disagrees that base document obligations should be a pre-condition to demonstrating a reasonably arguable position. The assessment of whether a taxpayer has a "RAP" is an objective inquiry that ought not be pre-judged by reference to the level of documentation: see paragraphs 18-19 of the enclosed submission.

14. Seventh, a more sensible *de minimis* exclusion for penalties than $10,000 or 1% of tax payable ought be included. Contrary to the suggestions otherwise in the Explanatory Memorandum (e.g. EM, para 6.26), such a low threshold effectively makes the documentary obligations mandatory in all cases: see paragraphs 15-16 of the enclosed submission. Moreover, the *intention* that an entity only need maintain documentary records of "material" matters (EM, paras 6.25-6.26) is not reflected in the text of s284-255.

15. Eighth, the documentation obligations effectively require taxpayers to waive legal professional privilege and other potential protections in order to avoid penalties. This may have adverse public policy consequences, such as a practice developing of less comprehensive written advice being provided to taxpayers. See paragraphs 20-22 of the enclosed submission.

If you require any further information on this submission, please contact either the Committee Chair, Mark Friezer, on 02-9353 4000 or via email: mfriezer@claytonutz.com or Reynah Tang on 03-9672 3534 or via email: reynah.tang@corrs.com.au

Yours faithfully,

Frank O'Loughlin
Section Chairman