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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX LAWS AMENDMENT BILL (No. 2) 1981

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer, the Hon. John Howard, M.P.)

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General outline

This Bill will introduce into the income tax law general anti-avoidance provisions to replace section 260 of the Income Tax Assessment Act 1936 (the "Principal Act"). Section 260 has appeared in the Principal Act in an unchanged form, as set out below, since 1936 and had appeared in Commonwealth income tax laws in virtually the same form prior to that time.

> "260. Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -
>
> (a) altering the incidence of any income tax;
>
> (b) relieving any person from liability to pay any income tax or make any return;
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> (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
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> (d) preventing the operation of this Act in any respect,
>
> be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

The literal terms of section 260 may suggest that it has a wide ambit. However, as early as 1921, in referring to the then equivalent of section 260, the Chief Justice of the High Court observed:

> "The section, if construed literally, would extend to every transaction whether voluntary or for value which had the effect of reducing the income of any taxpayer; but in my opinion its provisions are intended to and do extend to cover cases in which the transaction in question, if recognized as valid, would enable the taxpayer to avoid payment of income tax on what is really and in truth *his* income. It does not extend to the case of a bona fide disposition by virtue of which the right to receive income arising from a source which theretofore belonged to the taxpayer is transferred to and vested in some other person.".

In following a course of interpretation which starts from a position that the section is not to be read literally, the courts have reached a point where, as expressed by a Justice of the High Court in 1977, "... the very restricted operation conceded to section 260 by the course of judicial decision and the generality of the language in which the section is expressed stand in high contrast ...".

Four broad categories of limitation on the scope of section 260, as exposed by judicial decisions, can be identified:

(a) The "choice principle" is an interpretative rule according to which section 260 will not apply to deny to taxpayers a right of choice of the form of transaction to achieve a result if the Principal Act itself lays open to them that form of transaction. To do so does not alter the incidence of tax and this is so notwithstanding that the transaction in question is explicable only by reference to a desire to attract the operation of a particular provision of the Act and so achieve a reduction in liability to tax below what it would have been if that course had not been taken.

(b) The section is expressed in such a way that the purposes or motives of the persons entering into an arrangement are not to be enquired into in deciding whether the section applies to the arrangement. Rather, the "purpose" of an arrangement is to be tested only by examining the effect of the arrangement itself.

(c) It is unclear whether an arrangement to which the section is found to apply must be treated as wholly void or whether it can be treated as only partly void, i.e., to the extent necessary to eliminate the sought-after tax benefit.

(d) The section does not, once it has done its job of voiding an arrangement, provide a power to reconstruct what was done, so as to arrive at a taxable situation.

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 be in legal terms - are blatant, artificial or contrived. In other words, the new 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.

That test for application of the new provisions is intended to have the effect that arrangements of a normal business or family kind, including those of a tax planning nature, will be beyond the scope of Part IVA.

In this respect, Part IVA may be seen as effectuating in general anti-avoidance provisions of the income tax law a position akin to that which appears to emerge from the decision of the Privy Council in *Newton v. Federal Commissioner of Taxation* (1958) 98 CLR 1. The essence of the views expressed in that case was that a tax avoidance situation covered by section 260 exists only if it can be predicated from looking at an arrangement that it was implemented in that particular way so as to avoid tax.

In coming to a conclusion about the application of Part IVA in particular situations, it will be necessary to examine all relevant external evidence of the purposes for which a person entered into an arrangement and carried it out in the way it was carried out. The manner in which the scheme was entered into, its form and substance, timing aspects, its practical results, including changes in the financial positions of the taxpayer and connected persons and the nature of those connections (e.g., business, family) are all to be considered.

It will be necessary, if Part IVA is to apply, that a taxpayer has obtained a "tax benefit". A tax benefit will have been obtained by a taxpayer in connection with a scheme if, after applying the other provisions of the Principal Act to the taxpayer, either an amount is not included in assessable income of the taxpayer that might reasonably be expected to have been included if the scheme had not been entered into, or a deduction is allowable to the taxpayer the whole or a part of which might reasonably be expected not to have been allowable if the scheme had not been entered into.

The relevant purpose, already referred to, that is to be enquired into is a purpose of obtaining a tax benefit, in the sense just mentioned. Specification of what constitutes a tax benefit and that the relevant purpose is one of obtaining such a benefit is designed to eliminate the uncertainties associated with the use in section 260 of less precise expressions, e.g., "altering the incidence of any income tax" and "defeating, evading or avoiding any duty or liability imposed on any person by this Act" and which appear to be at the root of the development by the courts of the "choice principle" (limitation (a) referred to earlier).

So far as limitation (b) is concerned, the approach taken in proposed Part IVA aims to improve upon section 260, as interpreted, in two ways. Firstly, it will enable an enquiry into whether the new provisions are applicable to go beyond the effect of the arrangement itself. Secondly, it will require a wider enquiry directed to finding, on objective grounds, what was the purpose of a *person* who entered into the arrangement.

These various features are to be found in proposed sections 177A, 177B, 177C and 177D. Those provisions will, as a matter of law, determine whether Part IVA applies to a particular arrangement. Where it does, section 177F becomes relevant.

Part IVA will have within it, in section 177E, a supplementary code to deal with dividend-stripping schemes of tax avoidance and certain variations on such schemes, the effect of which is to place company profits in the hands of shareholders in a tax-free form, in substitution for taxable dividends. Section 177E is designed against the background that, while such schemes are of the general kind to which preceding provisions of Part IVA are to apply, it may not always be able to be concluded that, if the scheme had not been entered into, the relevant dividends would have been (or might reasonably be expected to have been) included in assessable income : the company may simply have retained the profits for the time being.

In schemes of this kind, arrangements are generally made to convert into cash the assets of the company to be stripped and, following the sale by shareholders of their shares in the company for a capital sum, subsequent transactions ensure either that the purchaser is reimbursed for the price of the shares in the form of a dividend or other payment from the company or that an entity which has a close association with the shareholder obtains the enjoyment of property of the company in one form or another. These transactions are structured so that profits thus effectively stripped from the company do not bear tax.

Section 177E will treat such schemes as schemes to which the Part applies so that, for example, a shareholder who disposes of his or her shares in the context of a dividend-stripping scheme will be treated as having obtained a "tax benefit" of the amount which the person would have derived as a dividend had the company paid as a dividend the amount of company profits that are represented in the property of the company that is stripped from it under the scheme.

Where on the application of either the general provisions of Part IVA or the more specific provisions of section 177E it is found that a tax benefit has been obtained, the Commissioner of Taxation will be authorised, under section 177F, to cancel the whole or (if the circumstances warrant it) a part of the tax benefit and, if it is fair and reasonable to do so, to effect corresponding tax adjustments in favour of the taxpayer or other persons concerned. In this way the particular "non-taxable" position sought for by the arrangement is annihilated and a "taxable" situation appropriate to the case is reconstructed. These procedures aim to overcome limitations (c) and (d), noted above, on the scope of the existing section 260.

Decisions by the Commissioner about the application of Part IVA will of course be subject to the usual rights of objection, review by an independent Taxation Board of Review and appeal to a court.

In ascertaining whether a tax benefit has arisen under a particular scheme, the other provisions of the Principal Act apart from Part IVA are first to be applied. This means, for example, that if a specific anti-avoidance provision has applied to take away a tax advantage sought to be achieved under a scheme there will be no room for Part IVA to apply to that scheme.

Another situation in which a tax benefit will not arise for examination under Part IVA is where a reduction in tax liability follows from the mere making of a declaration, election or selection, the giving of a notice or the exercising of an option expressly provided for by the Principal Act. Nor is the deduction available for investment in Income Equalisation Deposits to be within the purview of Part IVA.

Where an assessment which takes into account a determination under section 177F to cancel an amount of tax benefit is made, the taxpayer whose liability to tax is thereby increased will also be liable to pay an amount of additional tax. As is the case under the existing sub-section 226(2) of the Act when income is omitted or deductions are claimed in excess of expenditure incurred, the additional tax is to be expressed as an amount equal to double the amount of tax avoided. Any such statutory additional tax will be subject to a power of remission by the Commissioner and subject also to a power of review by a Taxation Board of Review, on a basis comparable with that applicable in relation to other amounts of additional tax imposed by existing sub-section 226(2).

An assessment may be amended within 6 years for the purposes of giving effect to a determination by the Commissioner to cancel a tax benefit, and may be amended without time limit for the purposes of making a complementary adjustment in favour of a taxpayer.

Part IVA is to apply only to schemes that are entered into after the date of introduction of the Bill into Parliament and section 260 is to be made inapplicable to arrangements entered into after that date.

Where, if Part IVA had applied to schemes entered into before that date, a tax benefit would have been cancelled, the amount of that benefit is not to be eligible for inclusion in a carry-forward loss deductible against income of the 1980-81 income year, or any later year, and there are also measures to counter any arrangements made, before the 1980-81 year ends, to side-step this limitation.

The provisions of the Bill are explained in more detail in the notes that follow.

The Bill is in three Parts. Part I, comprising clauses 1 and 2, gives the short title of the proposed Act and provides for it to come into operation on the date of Royal Assent. As noted below, substantive provisions of the Bill are to have effect mainly in relation to schemes entered into or carried out after the date of its introduction into Parliament.

Part II of the Bill contains the main provisions, which amend the Income Tax Assessment Act 1936 (the "Principal Act") and Part III will make amendments of a consequential nature to the Income Tax (International Agreements) Act 1953 (the "Agreements Act").

PART II - AMENDMENTS OF THE INCOME TAX ASSESSMENT ACT 1936

Clause 3 : Principal Act

This clause formally identifies the Assessment Act as the Act that is being amended by Part II.

Clause 4 : Losses of previous years

Clause 4, along with clause 5, is designed so that the deduction for losses carried forward from one year to another will not be available against income of the 1980-81 or any later income year where the loss concerned is one that would not have been available for deduction if Part IVA were not limited to schemes entered into or carried out after the date of introduction of the Bill into Parliament. The clause will, in relation to Part IVA, give effect to a policy that is already expressed in the law, in relation to other anti-avoidance measures, by sub-section 80(5).

Paragraph (a) of the clause will make purely formal amendments to section 80 of the Principal Act in consequence of the proposed addition of a further sub-section, sub-section (7). Paragraph (b) of the clause adds that further sub-section.

Section 80 applies where, in any one of the 7 preceding years of income, a taxpayer has suffered a loss (in the sense that allowable deductions exceed the assessable income of the year), to the extent that the loss has not, by section 80, been allowed as a deduction against income of any of those preceding years. The section authorises allowance of the loss as a deduction against income of the relevant year. The section applies in relation to losses other than losses incurred in a business of primary production.

By reason of proposed sub-section (7), this deduction will not be available to the extent that the carry-forward loss that would otherwise be available for deduction is one that would not be available if Part IVA (in particular, sections 177D and 177E) extended to schemes entered into or carried out on or before the date of introduction of the Bill. This rule is to have effect in calculating the deduction for carry-forward losses for the 1980-81 and subsequent years of income. (See also clause 11.)

Clause 5 : Losses of previous years incurred in engaging in primary production

This clause relates to section 80AA of the Principal Act under which losses of one year from a business of primary production are to be carried forward for deduction against income of a later year or years. The section operates on a basis comparable with that of section 80, except that under section 80AA losses may be carried forward without time limit.

The amendments proposed by clause 5 will have a corresponding effect in relation to the deduction for primary production losses as will clause 4 in relation to losses generally. (See also clause 11.)

Clause 6 : Re-insurance with non-residents

This clause relates to section 148 of the Principal Act which provides a special taxation code for the taxation of income derived by non-resident re-insurers, and sets out taxation consequences for a firm in Australia that re-insures risks with a non-resident re-insurer.

Section 148 is expressed to have application notwithstanding anything contained in the Principal Act and the object of the amendment proposed by clause 6 is to ensure that these words do not operate to prevent Part IVA from having, where necessary, paramount effect.

Clause 7 : Part IVA - Schemes to reduce income tax

Clause 7 proposes to insert in the Principal Act - as Part IVA - new general anti-avoidance provisions to replace section 260 of the Act. Provisions to terminate the operation of that section are contained in clause 10.

Part IVA has seven sections, sections 177A, 177B, 177C, 177D, 177E, 177F and 177G.

Section 177A : Interpretation

This section contains a number of provisions of a definitional nature.

By sub-section (1), "scheme" is to be defined in a way that covers the various forms in which tax avoidance arrangements may be found. It is to mean any agreement, arrangement, understanding, promise or undertaking whether it is express or implied and whether or not legally enforceable. Any scheme, plan, proposal, action, course of action or course of conduct is also to be treated as a "scheme". Under sub-section 177A(3) "scheme" in the sense just referred to is to include such arrangements when they are of a unilateral kind.

The definition of "taxpayer" in sub-section (1) as including a taxpayer in a trustee capacity is designed to refer to those situations where a trustee is - for example, under section 99 or 99A of the Principal Act - subject to tax in respect of some or all of the net income of a trust estate. The definition will make it clear that Part IVA can be applied in such a case.

Where a trust estate or partnership is involved and, in keeping with the basic provisions of Divisions 5 (Partnerships) and 6 (Trustees) of Part III of the Principal Act, the trustee's or partnership's activities have effect in calculating the taxable income of a beneficiary or partner, the application of Part IVA will be considered in relation to the trustee or partnership. If it does apply then, by reason of the operation of those Divisions, Part IVA will have an effect on the taxable income of the beneficiary or partner concerned.

The object of proposed sub-section 177A(2) is to indicate that the definition of "taxpayer" just referred to is not to carry implications for the interpretation of that expression when used elsewhere in the Act.

Proposed sub-section (4) is addressed to the fact that schemes of the kind to which Part IVA is directed usually involve a number of parties. Accordingly, references to the carrying out of a scheme by a person are to be taken as including references to the carrying out of a scheme by a person together with others.

Sub-section (5) is a provision of some consequence and is designed as part of the measures necessary to give effect to the intention that the relevant tax-motivated purpose that may bring Part IVA into operation is a sole or dominant purpose. Sub-section (5) relates principally to the words at the end of proposed section 177D which refer to a person having acted for "the purpose" of enabling a taxpayer to obtain a tax benefit. That language refers to a person's sole purpose but, by reason of sub-section 177A(5) the expression is in the case of a scheme with more than one purpose to include also a dominant purpose, i.e., a purpose that outweighs all other purposes put together.

Section 177B : Operation of Part

The basic purpose of proposed section 177B is to give to Part IVA a position of paramount force in the income tax law.

As explained elsewhere in this memorandum, Part IVA will be applicable where from an objective view of a scheme and its surrounding circumstances it would be concluded that it was entered into for the sole or dominant purpose of obtaining a tax benefit, (as defined). Against this background, sub-section (1) of section 177B will mean that the anti-avoidance operation of Part IVA is not to be limited by anything else in the general income tax law, whether in the Principal Act or in a double taxation agreement with another country that is given the force of law in Australia by the Income Tax (International Agreements) Act 1953. (See also clause 13.)

Sub-section (2) will, however, exclude from the scope of Part IVA the deduction that is available under Division 16C of Part III of the Principal Act for deposits made under the income equalization deposits (IED) scheme. Under that scheme a qualifying primary producer may be entitled to a deduction for deposits with the Commonwealth that bear interest of (at present) 7 per cent, and is liable to have a repayment of such a deposit included in assessable income.

A deposit made under the IED scheme will, except in rare instances, be made by a person so as to attract the deduction for which the scheme provides and of which it is an integral part and, in order that, in these circumstances, it be clear that the deduction will not be negated by Part IVA, sub-section 177B(2) is included.

Sub-section (3) reflects the "last resort" character of Part IVA. It is applicable where, as for example in sub-sections 65(1) and 75B(7) and section 82KJ, a provision of the Principal Act refers to a deduction being allowable but for or apart from that provision and/or other provisions of the Act. In such a case the provision is to be read as covering a deduction that is allowable but for or apart from Part IVA and, in particular, the "re-construction" provisions of sub-section 177F(1). The result is that the specific provision in question will have effect before Part IVA is applied.

To illustrate, sub-section 65(1) indicates that a payment by a taxpayer to an associated person (broadly, a relative) that would "but for this sub-section" be an allowable deduction is to be deductible only to the extent that the Commissioner of Taxation considers it to be reasonable in amount. If the facts of a case were such that sub-section 177F(1) could operate to reduce or deny a deduction for a payment that also fell within the scope of sub-section 65(1), sub-section (3) of section 177B would mean that the reference in sub-section 65(1) to the deduction that would "but for this sub-section" be deductible is to be read as though it said "but for this sub-section and sub-section 177F(1)". That is, the possible application of sub-section 177F(1) must be put aside. The result would be that the application of sub-section 65(1) would be considered before, and not after, the possible application of Part IVA is considered.

As explained below in the notes dealing with proposed section 177C, the concept of what is a "tax benefit" is framed so that a deduction item can give rise to such a benefit only when it has been found that, after the application of other provisions of the Principal Act, the deduction is otherwise allowable.

Sub-section (4) is a closely corresponding provision that is concerned with provisions, such as sub-section 75(2) of the Principal Act, that refer to a deduction being otherwise allowable. By reason of sub-section (4) such provisions are to be taken as referring to a deduction that is otherwise allowable, but for sub-section 177F(1). Again, the provision reflects the last resort character of sub-section 177F(1).

Section 177C : Tax benefits

The significance of the term "tax benefit", which this section defines, is that it represents the kind of tax consequence which a person must have the sole or dominant purpose to achieve, and which must have been achieved, if Part IVA is to apply by reason of section 177D. In brief, a "tax benefit" represents the non-inclusion in assessable income of an amount that, but for the scheme, might reasonably be expected to have been included and a deduction being allowable that, but for the scheme, might reasonably be expected not to have been allowable.

A tax consequence other than non-inclusion of an amount in assessable income or allowance of a deduction will not be a "tax benefit", and will thus be outside the scope of Part IVA. In other words, Part IVA applies only in relation to things that go to make up a person's taxable income, and not to rebates of or credits against the tax on a person's taxable income. Withholding taxes, being taxes that are not based on the difference between assessable income and allowable deductions will also be outside the scope of Part IVA.

The main part of section 177C is in sub-section (1). Taking assessable income and allowable deduction items separately, the sub-section is designed as follows.

First, a "scheme" (see sub-section 177A(1)) must be identified. Then, it has to be found that an amount would have been included, or might reasonably be expected to have been included, in assessable income of a taxpayer but for the scheme. For the purposes of answering the twin questions posed by section 177D, viz., whether a tax benefit has been obtained, and whether a person has a purpose of obtaining a tax benefit, that amount, to the extent that it is not, or is not to be, included in assessable income, is to represent a tax benefit in relation to the taxpayer concerned.

It follows that if there is a scheme designed so that an amount is not included in assessable income and another provision of the Principal Act operates to counter that scheme by requiring that it be so included, the amount cannot be a tax benefit obtained by the taxpayer concerned, and Part IVA will be inapplicable. In other words, Part IVA is a "last resort" measure.

A similar position will exist in relation to allowable deductions. Corresponding with the position just outlined in relation to income, a tax benefit represented by a deduction will not exist if a provision of the Principal Act outside Part IVA has operated to deny a deduction sought to be obtained. Sub-sections 177B(3) and (4), commented on earlier, reflect this position.

More generally, once a "scheme" is identified, a purpose of obtaining an otherwise allowable deduction will be a purpose of obtaining a tax benefit of an amount that is the amount that would not have been allowable, or might reasonably be expected not to have been allowable, if the scheme had not been entered into or carried out. Similarly, if a deduction is allowable, and the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, but for the scheme the latter amount will be a tax benefit obtained in connection with the scheme.

Sub-section (2) is designed so that a mere making of a declaration, election or selection, giving of a notice or exercising of an option will not be affected by Part IVA.

The Principal Act expressly provides in various provisions for taxpayers to exercise in one of these ways, a choice as to the taxation consequences of designated transactions or states of affairs. For example, the amount to be included in assessable income in respect of the difference between opening and closing values of trading stock on hand will vary according to whether the taxpayer has opted to have the stock valued at its cost price, market selling value or the price at which it can be replaced (sub-section 31(1)). A taxpayer's deduction in respect of the cost of certain mining plant depends on whether the taxpayer elects for depreciation allowances instead of deductions under the mining provisions (section 124AG).

By sub-section 177C(2) there will not, for purposes of section 177D, be a "tax benefit" when the situation is one where (in the sense explained earlier) an amount is left out of assessable income by a scheme and its non-inclusion is attributable to a declaration, election, etc., expressly provided for by the Principal Act. That will be so, however, only if the scheme was not one for the purpose of creating the conditions necessary for the declaration, election, etc., to be made.

The sub-section will, on a corresponding basis, treat a deduction as not giving rise to a tax benefit for purposes of section 177D.

By sub-section (3), the non-inclusion of an amount in assessable income or the allowance of a deduction is expressly attributed to a declaration, election, etc., if, but for it, the amount would have been included in assessable income or the deduction not allowed.

Section 177D : Schemes to which Part applies

This section will identify schemes to which Part IVA is to apply. Supplemented by section 177E in the particular area of the stripping of company profits it will provide the basis on which action is to be taken under section 177F to cancel the relevant tax benefit.

In brief, section 177D makes Part IVA applicable as a matter of law to a scheme if a taxpayer has obtained a tax benefit under it and, on the basis of an objective view of features of the scheme and its surrounding circumstances, it would be concluded that the scheme was, in tax terms, a "blatant" one, that is, it was entered into by a person for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit.

In more detail, for a scheme to be one to which Part IVA applies by reason of section 177D it must be a scheme entered into after the date of introduction of the Bill or a scheme that technically is not "entered into" (e.g., one constituted by a unilateral course of action) but is carried out or commenced to be carried out after that date. (By reason of clauses 4 and 5 "carry-forward" losses arising from prior schemes will not be eligible for deduction in the 1980-81 or subsequent years.)

Part IVA will apply whether a scheme is carried out in Australia or abroad.

Under paragraph (a) it is a condition for the application of Part IVA that a taxpayer has obtained, or would otherwise obtain, a "tax benefit" (section 177C) in connection with the scheme concerned.

Paragraph (b) sets out the range of matters to which regard is to be had in coming to a conclusion whether a relevant person had the degree of taxation purpose that must exist if section 177D is to make Part IVA apply.

These are -

- the manner in which the scheme was entered into or carried out;
- its form and substance;
- the particular time at which the scheme was entered into and the period during which it was carried out;

- the tax result that, but for Part IVA, would be achieved by the scheme;
- any change resulting from the scheme in the financial position of the taxpayer;
- any such change in the financial position of a person with whom the taxpayer has business, family or other connections;
- any other consequence of the scheme for the taxpayer or a connected person;
- the nature of any connections between the taxpayer and a connected person whose financial position changes as a result of the scheme.

Against this background, the remaining provisions of sub-paragraph (b) of section 177D operate so that Part IVA will effectively strike down a scheme that on its face, and considered in the light of the designated surrounding circumstances just outlined, is one of which it is appropriate to say that it must have been engaged in for tax purposes.

In more detail, if on the basis of the matters to which regard is to be had it would be concluded that the person or one of the persons who entered into or carried out the scheme, or any part of it, did so for the sole or (by reason of sub-section 177A(5)) dominant purpose of enabling the taxpayer or any taxpayer concerned to obtain a tax benefit then (the other tests of section 177D having been satisfied), Part IVA will apply.

There are some additional points of note. It will be irrelevant whether or not the person who entered into or carried out the scheme with the relevant purpose is the taxpayer or one of the taxpayers enjoying the particular tax benefit. Nor will there need to be an exact correspondence between the tax benefit that has been obtained (paragraph (a)) and the tax benefit sought to be obtained.

Further, the relevant purpose is, having regard to the scheme as a whole, to be tested in relation to the involvement of a person in either a part of the scheme or the whole of it. It has been a feature of tax avoidance schemes of the kind that Part IVA is directed against that a considerable number of parties and of connected transactions are involved, and provisions against such schemes would fail in their purpose if limited to purposes of persons who were involved in the schemes in their entirety.

Section 177E : Stripping of company profits

In brief, this section is a self contained code, within the framework of Part IVA, designed to apply to schemes of a dividend stripping kind which would otherwise effectively place company profits in the hands of shareholders in a tax-free form.

Schemes of the kind to which section 177E is directed could on occasions come within the general ambit of section 177D, but section 177E is needed for situations where, for example, although profits are in fact stripped from a company, it may not be a reasonable hypothesis that, but for the scheme, the profits would have been paid as dividends. But for the scheme they would formally have remained in the company, at least for the time being. If that were so in a particular case, the situation would not fall within section 177D because there would not, under section 177C, be a "tax benefit" - i.e., an amount not included in assessable income that but for the scheme would have been, or might reasonably be expected to have been, included.

Also, without section 177E Part IVA may not operate to counter a dividend strip carried out in relation to current-year profits of a company, where tax purposes other than those of avoiding tax on dividends may also be present.

Sub-section (1) is the operative sub-section. It lists the conditions which must exist for section 177E to apply and the results which flow from the application of the section.

Paragraph (a) sets out the initial and key test that there be a scheme that in fact is either one by way of or in the nature of dividend stripping or one having substantially the effect of such a scheme. Schemes within the category of being, or being in the nature of, dividend stripping schemes would be ones where a company (the "stripper") purchases the shares in a target company that has accumulated profits that are represented by cash or other readily-realisable assets, pays the former shareholders a capital sum that reflects those profits and then draws off the profits by having paid to it a dividend (or a liquidation distribution) from the target company.

In the category of schemes having substantially the same effect would fall schemes in which the profits of the target company are not stripped from it by a formal dividend payment but by way of such transactions as the making of irrecoverable loans to entities that are associates of the stripper, or the use of the profits to purchase near-worthless assets from such associates.

It is of note that sections 46A and 46B of the Principal Act, which deal with dividend stripping from the angle of the stripping company, apply to schemes that the Commissioner of Taxation is satisfied were of a dividend stripping kind.

Where the initial test is met, paragraph (a) lays down the further qualification on the application of section 177E, that property of the company must be disposed of under the scheme. As to that, see sub-section (2).

The next prerequisite for the application of section 177E is provided by paragraph (b). It is that, in the opinion of the Commissioner, the disposal of company property represents a distribution of the company's profits of the current accounting period or of an earlier or later one. In other words, the actions representing a distribution of company profits are, in the context of schemes of a dividend stripping kind, taken as a substitute for the hypothesis - referred to above - that may not be able to be made. Paragraph (c) calls for a consideration of what would have been the position if the profits concerned - the profits effectively distributed - had been paid as a dividend immediately before the scheme was entered into. It requires a conclusion that in that event an amount would or might reasonably be expected to have been included in a taxpayer's assessable income. The paragraph is framed so as to cover not only the position of a shareholder who would have received, or might reasonably be expected to have received, a dividend on his or her own account, but also, for example, a person whose entitlement is as a beneficial owner of a share held by a trustee.

The need for the reference to later accounting periods is brought about by the existence of "forward stripping" practices under which shares in companies are disposed of for a consideration that includes an element calculated in anticipation of profits in train at the time, but which are formally derived by the company afterwards. A further point of note is that paragraph (c) is structured so as to be capable of application in relation to schemes, such as those involving the selling of "current year" profit companies, where the accounts of the company have not been formally drawn up (so that technically it might be said that there were no profits in a book-keeping sense), or the profits have been derived after the disposal of property took place under the scheme (as in a "forward stripping" operation).

A conclusion reached by the Commissioner of Taxation under either paragraph (b) or (c) will, by reason of sections 192 and 193 of the Principal Act, be capable of review by an independent Taxation Board of Review, which may substitute its opinion for that of the Commissioner.

Consistent with the general application of Part IVA, paragraph (d) makes it a final condition for the application of section 177E that the scheme be one entered into after the date of introduction of the Bill. The section will apply whether the scheme is carried out in Australia or abroad.

The remaining paragraphs of the sub-section then provide the basis on which, if conditions (a) to (d) are met, action is to be taken under section 177F to cancel the tax benefit sought to be achieved. First, the taxpayer is to be taken to have obtained a tax benefit in connection with the scheme (paragraph (f)), and the scheme is to be taken to be a scheme to which the Part applies (paragraph (e)). The amount of the tax benefit obtained is to be taken to be the amount that would have been included, or might reasonably be expected to have been included, in the taxpayer's assessable income if the profits had been paid as a dividend (paragraph (g)).

Sub-section (2) relates to the requirement under sub-section (1) that property of the company is disposed of as a result of the scheme. Paragraphs (a), (b) and (c) make it clear that the payment of a dividend, the making of a loan and the bailment of property by a company are transactions that are to be classified as disposals of property. And, in order to ensure that the proposed legislation is not defeated by transactions which, while stripping a company of its profits, would not on a technical view amount to "disposals" of company property but which have the equivalent effect of diminishing the value of the property, a "disposal of property" will, by paragraph (d) be declared to include any transaction having such an effect, whether directly or indirectly. Even where sub-section (2) declares a transaction to be one involving the disposal of company property the other tests of sub-section (1) must, of course, be satisfied before section 177E applies.

By sub-section (3) "property" is defined to cover the various legal forms of interests in property.

Section 177F : Cancellation of tax benefits, etc.

Section 177F is the "reconstruction" provision of Part IVA and will come into play once section 177D, together with section 177C (for the general run of cases), or section 177E (for dividend stripping and similar schemes) has done its work of both exposing for annihilation a sought-for "non-taxable" position and quantifying the amount of the "tax benefit" that stands to be cancelled. The essential function of section 177F is to enable the Commissioner of Taxation, against the background of the other sections mentioned, to determine precisely what tax adjustments should be made in the assessments of the taxpayer concerned and of other taxpayers affected by the scheme.

Sub-section (1) effectively calls on the Commissioner to make a formal determination as to how much of the amount of the identified tax benefit is to be cancelled and directs him, where he has made such a determination, to take such assessing and other action as he considers necessary to give effect to it. There are two kinds of determination possible - under paragraph (a), that the whole or a part of an amount that is not otherwise included in assessable income be so included and, under paragraph (b), that the whole or a part of a deduction or of a part of a deduction that is otherwise allowable be not allowable.

By sub-section (2), the Commissioner is required, where a determination has been made under paragraph (1)(a), to further determine the appropriate provision of the Principal Act under which the amount in question is to be included in assessable income. A corresponding provision is not called for in relation to a determination that is made under paragraph (1)(b) because the process of cancelling a tax benefit (by disallowing a deduction) under the latter paragraph does not involve the same degree of positive reconstruction to a taxable position as will be necessary where, under a scheme, an amount has not been included in assessable income.

An example of where a determination of the provision under which an amount is to be included in assessable income would be relevant is where there is a question of whether or not an amount to be included in the assessable income of a company has the character of a dividend on which the rebate of tax on intercorporate dividends (section 46) is allowable.

Where the Commissioner has made a determination under sub-section (1), he is also authorised, by sub-section (3), to make a compensating adjustment in favour of either the taxpayer against whom the determination has been made, or any other taxpayer, if he is of the opinion that the person concerned has suffered a taxation disadvantage as a result of the scheme and that it is fair and reasonable that the adjustment be made. The Commissioner again is empowered to take whatever action is necessary to give full and proper reconstructive effect to the determination.

Paragraph (a) deals with a disadvantage in the form of an amount having been included in a person's assessable income that would not have been included if the scheme had not been entered into. The Commissioner is empowered, if it is fair and reasonable to do so, to determine that the amount or part of the amount should not be included in the taxpayer's assessable income. Correspondingly, under paragraph (b) the Commissioner is empowered, if it is fair and reasonable to do so, to make a determination to reverse either wholly or partially a disadvantage in the form of a deduction not having been allowed to a taxpayer that would have been allowable if the scheme had not been entered into.

Where the Commissioner is to make an adjustment in favour of a person under paragraph (3)(b) by allowing a deduction not otherwise allowable, sub-section (4) will have the effect that the reconstruction of the taxpayer's taxation position is to be effected by allowing a deduction under such provision of the Principal Act as the Commissioner determines.

This serves a purpose corresponding with that served by sub-section (2) in the reconstruction process accompanying the cancellation of a tax benefit attributable to the exclusion of an amount of assessable income.

The next four sub-sections (5) to (8), are designed to extend the benefit of the ordinary objection and appeal provisions to a taxpayer who is dissatisfied with any decision of the Commissioner to not make a determination under sub-section (3) in favour of the taxpayer.

As background, any assessment action by the Commissioner in reliance on section 177F - whether adverse to or in favour of the taxpayer - will be subject to the usual rights of objection, review by an independent Taxation Board of Review and appeal to a Court. These procedures include the power of a Board of Review to substitute its determinations and decisions for those of the Commissioner. However, these procedures may not be available to a taxpayer in a situation where Part IVA has been applied against another taxpayer and the Commissioner considers that the case is not one calling for him to make a compensating adjustment under sub-section (3) in favour of the first taxpayer, i.e., an adjustment which that taxpayer considers should be made.

Under proposed sub-section (5) such a taxpayer may ask the Commissioner to make a determination under sub-section (3). By sub-section (6) the Commissioner is to consider the request and give written notice of his decision. If the tax-payer is dissatisfied with the decision he may, under sub-section (7), and within 60 days, lodge a formal objection with the Commissioner. By sub-section (8) the objection, review and appeal provisions of the Principal Act are to apply in relation to such an objection.

Section 177G : Amendment of assessments

Under the general powers of amendment contained in section 170 of the Principal Act, if a full and true disclosure by a taxpayer of material facts is made, an amendment increasing an assessment liability may be made within 3 years, but only to correct an error in calculation or a mistake of fact. If there is no such full and true disclosure an amendment may be made within 6 years (or at any time if there has been fraud or evasion).

The tendency in the promotion of recent tax avoidance schemes has been for an individual taxpayer to be given as little information as possible of the usually complicated series of transactions (often involving many legal entities) entered into to effectuate the scheme as a whole. In such a situation, although the taxpayer may have made the "full and true disclosure" of which he or she personally is capable (and which is critical under the provisions referred to), there may well still be much more to be disclosed to the Commissioner before it could be said in a full sense that a disclosure of all material facts had occurred. The task of gathering all the material facts could well be a time-consuming one.

In recognition of these practical aspects, sub-section 177G(1) will enable the amendment of an assessment within 6 years of tax becoming due and payable under the assessment, if the amendment is for the purpose of giving effect to a determination under sub-section 177F(1) to cancel a tax benefit.

An amendment to reduce the liability of a taxpayer can be made under section 170 within 3 years, but only to correct an error in calculation or a mistake of fact. For the reasons just given as to the special nature of the information gathering process in the case of tax avoidance schemes and to enable full justice to be done, sub-section (2) will permit an amendment to be made at any time to give effect to a determination under sub-section 177F(3) to reduce the liability of a taxpayer by making corresponding adjustments in his or her favour.

Clause 8 : Powers of Board

This clause proposes an amendment to sub-section 193(2) of the Principal Act that is complementary to the amendment of section 226 proposed by clause 9. The latter amendment will insert in that section a new sub-section (2A) that will statutorily impose additional tax by way of penalty on a taxpayer in relation to whom a determination has been made under sub-section 177F(1) that results in an increase in the tax assessable to the taxpayer.

In broad terms, section 193 provides for a Taxation Board of Review to have, for the purpose of reviewing a decision of the Commissioner, powers and functions of the Commissioner in making assessments, determinations and decisions under the Principal Act. Under that Act the Commissioner has power to remit statutory additional tax imposed under section 226 and, under the existing law contained in sub-section 193(2), a Board has the power to review decisions relating to the remission of additional tax imposed under sub-sections 226(1) and (2) where the additional tax payable, after remission, exceeds an amount calculated at 10 per cent per annum of the tax avoided by the relevant failure to furnish a return, omission of income or over-claiming of a deduction.

Against the background of the Commissioner's power to remit the additional tax being proposed by clause 9, the amendment proposed by clause 8 will extend the operation of section 193 to make similar provision for review in those cases in which additional tax is imposed under the new sub-section 226(2A) proposed by clause 9.

Clause 8, as a matter of drafting convenience and to incorporate the new "forward referencing" style, omits existing sub-section 193(2) and inserts a new sub-section (2), expanded by the insertion of a paragraph (c). Paragraph (c) means that, in any case to which sub-section 226(2A) applies, a Board of Review will, consistently with the other paragraphs of sub-section 193(2), have power to review a decision relating to the remission of the additional tax imposed under sub-section 226(2A) where that additional tax, after remission, exceeds an amount equal to 10 per cent per annum of the tax avoided (the increase in tax arising from sub-section 177F(1)). As a matter of drafting convenience, that threshold amount of additional tax (after remission) is expressed as 5 per cent per annum of the amount of additional tax that would be payable but for the remission (i.e., double the tax sought to be avoided), which is 10 per cent of the tax in question.

Clause 9 : Additional tax in certain cases

This clause proposes the insertion in the Principal Act of a new sub-section, sub-section (2A), under which statutory additional tax will be imposed where, in calculating the tax assessable to a taxpayer, a determination under sub-section 177F(1) to cancel a tax benefit has been taken into account and the application of the section has resulted in an increase in the amount of tax assessable to the taxpayer. The amount of additional tax being imposed is, where no tax would have been assessable without the determination, double the amount of tax attributable to the application of section 177F or, where the case is one in which a lesser amount of tax would have been assessable without the application of section 177F, double the difference between that lesser tax and the tax payable following the application of section 177F.

The additional tax under sub-section 226(2A) will be payable only where a determination under section 177F(1) is directly taken into account in the making of an assessment. Accordingly, it will not be payable in a case where an assessment is affected by the "no carry-forward" provisions proposed by clauses 4 and 5.

The power of the Commissioner of Taxation under sub-section 226(3) to remit all or a part of the additional tax imposed by section 226 will, by virtue of that sub-section, apply in relation to the additional tax that results from the proposed amendment, in the same way that it applies, for example, in relation to additional tax (of double the amount avoided) under sub-section 226(2) in cases of omission of income or claiming of deductions in excess of expenditure incurred. See also clause 8.

Clause 10 : Contracts to evade tax void

By this clause, the commencement of application of Part IVA - the Part will apply to schemes entered into or carried out after the date of introduction of the Bill into

Parliament - is to be accompanied by an amendment to section 260 of the Principal Act which makes that section inapplicable to any contract, agreement or arrangement made or entered into after that date.

Clause 11 : Arrangements to avoid the operation of clauses 4 and 5

Clause 11, which will not amend the Principal Act, contains safeguarding provisions designed to ensure that the amendments proposed by clauses 4 and 5 are not frustrated by arrangements designed to convert proscribed tax avoidance losses into other losses or outgoings that, formally, have a different character.

One example of the arrangements that might be employed in the 1980-81 year of income to frustrate the ban on the carry-forward of losses resulting from participation in "Part IVA schemes" prior to the date of effect of the remedial measures proposed by clauses 4 and 5 would involve an amount of income, equal to the tax avoidance loss, being diverted by an associate, before the end of the 1980-81 income year, to the individual or partnership that had created the tax avoidance loss. At that point the individual or partnership would, in 1980-81, have matched the tax avoidance loss against the diverted income, the object also having been to give the income payment the character of a deductible expense in the hands of the associated entity. That expense, not being formally a loss of the proscribed kind, could then be sought to be applied against income of the associate. In other words, the arrangement would be designed so as to formally transfer to the associated entity the tax benefit that would otherwise have been denied by the operation of the "no carry-forward loss" provisions being inserted by clauses 4 and 5.

Sub-clause (1) of clause 11 is directed against the possible use of this kind of method of circumventing the amendments proposed by clauses 4 and 5 and will ensure that amounts incurred under arrangements of this type do not qualify for deduction under any provision of the income tax law.

For sub-clause (1) to apply, an amount must be included in the assessable income of a recipient taxpayer of the 1980-81 income year (paragraph (a)), and must in whole or in part represent an otherwise allowable deduction to another taxpayer - referred to as an "associated taxpayer" (paragraphs (b) and (c)). A key test (contained in paragraph (f)) is that the amount, or a part of it, was incurred by the associated taxpayer to the recipient taxpayer for a purpose of wholly or partly preventing the operation of clause 4 or 5 of the Bill in relation to the taxpayer or, where the recipient taxpayer is a partnership, a partner in the partnership, i.e., of frustrating the intention to deny deductions for the carry-forward of the particular tax avoidance losses to which clauses 4 and 5 are applicable.

Paragraphs (d) and (e) of sub-clause (1) contain tests that further define the scope of the sub-clause. Under paragraph (d), it must be the case that, if the amount had not been included in assessable income of the recipient taxpayer, that taxpayer would be deemed to have incurred a loss or a greater loss for the year. Paragraph (e) imposes the contrasting test that if Part IVA had been in effect prior to its operative date, a tax benefit which the Part would have cancelled would have existed. In other words, the paragraphs together make it necessary that the case be one where, but for the arrangement, clause 4 or 5 would have been applicable.

By reason of sub-clause (4) the loss referred to in paragraph (d) or (f) is, if the recipient taxpayer is a partnership, a partnership loss for the year, and in other cases, a carry-forward loss under section 80 or section 80AA.

Where all the tests of paragraphs (a) to (f) of sub-clause (1) are satisfied, the sub-clause will operate so that a deduction is not allowable to the associated taxpayer for so much of the relevant expenditure, paid under the arrangement designed to prevent the operation of clause 4 or 5, as is paid with that purpose in mind.

Sub-clause (2) is directed at a related method of circumventing the operation of clauses 4 and 5 that is made possible by the ability of a taxpayer to value his or her trading stock at either cost, replacement cost or market value.

But for sub-clause (2), a taxpayer who would otherwise have a loss that would be subject to the operation of clause 4 or 5 could value trading stock at the highest value possible under the income tax law with the object of increasing his or her trading profit in 1980-81 by an amount sufficient to absorb the carry-forward loss. The effect of this arrangement would be to substitute the corresponding reduction in the taxpayer's 1981-82 trading profit for the 1980-81 loss that would otherwise have been subject to the operation of clause 4 or 5.

By virtue of sub-clause (2), the tests for which match those of sub-clause (1), where a taxpayer values his or her trading stock under arrangements of this type with a purpose of preventing the operation of clause 4 or 5, the value of that trading stock will at base be taken to be the lowest value at which the trading stock could be taken into account for income tax purposes (paragraph (e)). A higher value will, however, be adopted where the taxpayer satisfies the Commissioner of Taxation that that higher value might reasonably be expected to have been adopted if the trading stock had not been valued with a purpose of preventing the operation of clause 4 or 5.

Sub-clause (3) is a drafting measure under which a reference in sub-clause (2) to the valuation of trading stock by a taxpayer is a reference to the making of an election under section 31 of the Principal Act as to which of the previously-mentioned bases of valuation is to be applied in relation to that trading stock. An election as to the basis of valuation of trading stock on hand at the end of a year of income is available under section 31 in respect of trading stock other than livestock. In the case of livestock, section 33 of the Act contains controls on variations in the basis of valuation of such stock.

Sub-clause (4) is a measure that will ensure that the safeguarding provisions operate in circumstances where arrangements of the kind described in sub-clauses (1) and (2) are entered into by a partnership.

By virtue of section 90 of the Principal Act a partnership loss is calculated as if the partnership were a taxpayer. A partnership loss is not itself treated as a loss for the purposes of section 80 or 80AA of the Principal Act. Rather, each partner in the partnership is entitled to a deduction under section 92 of the Act in respect of his or her share of the loss incurred by the partnership. That deduction may form the basis for a carry-forward loss for the partner.

Against this background, sub-clause (4) enables the object of sub-clauses (1) and (2) to be achieved by specifying that a reference in sub-clauses (1) or (2) to a loss incurred is both a reference to a loss for the purposes of section 80 or 80AA of the Principal Act and to a partnership loss for the purposes of section 92.

Sub-clause (5) will make clear the power of the Commissioner to amend assessments for the purpose of giving effect to the safeguarding provisions of sub-clauses (1) and (2). By virtue of sub-clause (5) the Commissioner will be authorised to amend an assessment to give effect to those provisions within 3 years after the date on which the tax became due and payable under that assessment, should facts emerge to justify such a course.