

Application of Part IVA of the Income Tax Assessment Act (1936) (Cth) to the consolidation of entities (Consolidations)

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E ancora dare a molti e' impossibile senza dare a uno; conciossiache' uno in molti sia inchiuso. Ma dare a uno si puo' bene senza dare a molti: pero' chi giova a molti fa l'uno bene e l'altro, chi giova a uno fa pur l'un bene; onde vedemo li ponitori delle leggi massimamente pure alli piu' comuni beni tenere fissi gli occhi, quelle componendo²

Dante 1265- 1321

1. Introduction

The juxtaposition of the welfare of the many as against that of the few is central to considerations in taxation law. Dante's view of the 'imposers' of the law in mediaeval Italian law is that their eyes should be fixed on the welfare of the many when drafting laws. Little has changed in contemporary law where protection of national revenue is critical to juridical interpretation of tax legislation. This is so in particular where a tax planning strategy has as its dominant purpose the gaining of a tax benefit.

The difficulty from both a social and legal perspective begins in the drafting of tax legislation which has competing interests at hand. Business lobby groups may argue in favour of strategies to minimise tax. The government of the day must legislate somewhere between the opposing needs of the lobby group and the population it is there to serve. This article seeks to examine some of the aspects of this dilemma by looking at the conflict between Part IVA of the Income Tax Assessment Act (ITAA) 1936 (Cth) (Part IVA) and the law pertaining to consolidation of entities in ITAA 1997 Part 3-90 (Part 3-90) that allows a tax beneficial strategy to be applied to a group of companies.

To understand the different character of these aspects of taxation law it is important to examine the diverse nature and purpose of ITAA 1936 Part IVA and its counterpoint ITAA 1997 Part 3-90. The implications of consolidations on

² Dante Alighieri *Il Convito Treatise 1, Chapter VIII*:

And again, to give to many is impossible without giving to one, forasmuch as one is included in many. But to give to one may be good without giving to many, because he who assists many does good to one and to the other; he who assists one does good to one only: hence, we see the imposers of the laws, especially if they are for the common good, hold the eyes fixed whilst compiling these laws.

For the original text in the Tuscan see:

<http://books.google.com/books?id=E840AAAAIAAJ&pg=PA30&dq=Il+Convito+Trattato+Primo#PPA82,M1>

For the translation into English see: <http://www.online-literature.com/dante/banquet/1/>

revenue will be discussed in the context of concessions that provide consolidated groups with significant tax benefits. This will be followed by a review of the major cases in order to see the importance the High Court places on protecting revenue. Against this are some judgments of the Federal Court which continue to have a view that encompasses the commercial circumstances of a transaction to determine the application of Part IVA. Overall, the tension highlighted in this article is that between the tax incentives provided to business and the sometimes legalistic interpretation given in favour of revenue.

The significance of this topic is seen in the Commissioner of Taxation's article entitled: *The application of Part IVA to elections to consolidate*.³ This article analyses the Commissioner's opinion as to when Part IVA will or may apply to consolidation of entities. Of significance in the article is the comment in relation to s177C(2) subparagraph (ii)⁴:

In the Commissioner's view, if a scheme is found to have a dominant purpose of enabling an election to be made, then for the purposes of subparagraph (ii), it is still necessary to undertake the analysis required by s177D to see if the scheme entered into or carried out for the dominant purpose of obtaining a tax benefit, (There is no contradiction in saying that a scheme may be solely or dominantly entered into to enable an election to be made, and solely or dominantly entered into or carried out to obtain a tax benefit, provided the election itself is made solely or dominantly to obtain a tax benefit: as, indeed, one would generally expect to be the case.)

The comment in parenthesis is central to the issue: that there is no contradiction in saying:

1. an election *may* have a dominant purpose to obtain a tax benefit; and
2. entering a scheme *may not* have a dominant purpose to obtain a tax benefit.

The comment, while allowing a tax benefit in relation to an election, still requires the substance of the scheme itself to be scrutinised to determine what the dominant purpose is and whether there is an intrinsic tax benefit.

The contraposition of Part 3-90 with Part IVA highlights the deliberate focus on allowing an exception to Part IVA in a particular circumstance. This contrast has clear policy and commercial objectives and will be discussed in detail below. Suffice to say that there are significant benefits to large corporates with the ability to transfer, among other benefits, losses and profits within the group.

³ ATO website. <http://www.ato.gov.au/content/downloads/PartIVAandconsolidation09oct03.pdf>

⁴ Ibid. Page 3

Another dimension this article explores is the structural aspects of consolidations and the difficulties associated with the application of the anti-avoidance legislation. It discusses the imbalance of the asset valuation methodologies used; the conflict between the anti-avoidance legislation and the legislation which encourages tax minimisation via the mechanism of consolidation; and the view of the High Court (which has had in part a reductive view of commercial strategies but which has also allowed latitude in certain circumstances). Finally, it will consider the potential influence of the *Peabody* doctrine in relation to commercial circumstances.

2. Definition

An important aspect of today's tax planning is the examination of the tax implications on groups of companies when there is a decision to consolidate entities within the group for tax purposes. Combining different entities can blur tax responsibilities due to the shift in tax liability from the subsidiary to the head entity. The question to be answered is where does the tax liability fall when it has its origin in the subsidiary but is then subsumed into the consolidated group? To answer that question we must first investigate the legal aspects of the term 'consolidations.'

'Consolidations' has its conceptual origin in the amendment to the *Income Tax Assessment Act 1997*. The amendment allows for certain companies, trusts and partnerships to be taxed as if they are one taxpaying entity. The option to consolidate is offered to the head entity of a group of entities. In many cases this results in less tax being paid overall than if each of the individual entities were assessed on their own.

From 1 July 2002 eligible wholly owned groups were allowed to consolidate.⁵ This means that the head entity pays PAYG installments and lodges a single income tax return on behalf of the whole group. In addition, the entity advises the Tax Office of its decision to consolidate by the time it lodges its first consolidated income tax return. Note that the decision to consolidate does not apply to tax liabilities in GST, FBT and PAYG withholding.

AH Slater⁶ clarifies the scope of consolidation by stating that the deeming of the subsidiary entities being part of the parent company only applies when there is a need to address the core purposes of the legislation. Those core purposes are the working out of the income tax liability and the tax losses of the members of the consolidated group. It does not extend for example to enquiring whether an inter-company asset exists.⁷

⁵ *Consolidation Reference Manual BO-1, Consolidation – key points and pathway, page 1*

⁶ See AH Slater QC and Peter Murray, *Tax Consolidation and the Single Entity Rule*. The Tax Specialist, Vol. 7 no. 4. April 2004, p 206

⁷ *Ibid* at p. 207

The process of forming a consolidated group has a series of defined steps.⁸ They are:

- ∞ Determine asset values for joining subsidiaries
- ∞ Transfer losses and calculate a utilisation rate
- ∞ Transfer franking credits and foreign tax credits, and
- ∞ Deal with the other tax attributes of the joining subsidiaries

3. Implications

The first step in the process is important. The valuation methods used for subsidiaries to comply with this requirement are known as 'stick' and 'spread' valuations.⁹ The choice as to which method to use is left up to the consolidating entity. Stick valuations involve using a pre-existing valuation of an asset. Spread valuations involve an updated valuation. In choosing one of these the head entity will have regard to the one that is most advantageous from a financial point of view. That will often mean selecting one that most contributes to the minimisation of capital gains. Therefore, it is most advantageous to the group to be able to consolidate as many capital losses as possible to offset capital gains generated in other parts of the group.

A consequence of this may be a loss of tax revenue where directors value assets at the point of consolidation and upon discovering an increase in capital value decide to use the previous valuation. Alternatively, where the valuation generates a capital loss the new valuation becomes the declared value for the consolidation. This option allows the group to have benefits that are not otherwise available to entities on a commercial basis. The purpose of a valuation is to establish at a point in time the true market value of an asset so as to base a future transaction on that value. To allow submission of a prior value is to create a fiction in favour of the taxpayer and at cost to the community.

Another aspect of the process of consolidation is the transfer of trading losses and profits. Clearly, where a loss can be offset against a profit the tax otherwise payable in the financial year is, depending on the economic climate and the industry under scrutiny, decreased. This is so independently of how profitable the group is. Where the majority of the member entities run at a loss on their Profit and Loss account, the losses will absorb some or all of the profits of the other members. Where the majority generates a profit, the group income tax paid will still be decreased by the amount of losses absorbed from the remaining members. The transfer of benefits also extends to foreign tax credits where a new member's credits will be absorbed into the group financial position subject to

⁸ *Consolidation Reference Manual*, page 2

⁹ Note that these optional valuations are not available to the head entity. It enters consolidation always using existing asset values. See *Consolidation Reference Manual, Introduction to Consolidation BO-2*, page 3. Also, the consolidated group inherits the tax history of its joining subsidiaries. This is referred to as the entry history rule.

certain criteria being met. The upshot of this is that there is a net decrease in revenue under both scenarios.

This effect can be further amplified during a climate of merger and acquisition where the trading profits of a new acquisition are absorbed into the trading losses of the purchaser. The reverse can also take place where a takeover target can be a loss-making company whose accumulated losses are attractive in tax minimisation terms. Those losses can be used to minimise the purchaser's tax liability. There is of course a dual benefit to the purchaser in circumstances where the share price of the takeover target will in all probability be lower due to its poor trading performance. The price then paid will be lower and there will in addition be an immediate benefit to the purchaser in its corporate tax liability. Such strategies can even have a flow on effect of increasing the share value of the purchaser where the market interprets the takeover as adding value to its portfolio.

Another benefit can be viewed in terms of transferring the benefits of deductibility which may not otherwise have been entered into as an expense. If a member board is conscious of the availability of consolidation of its tax liability, it may actually inflate its purchases in order to further increase its losses. Such a strategy may, subject to evidentiary constraints and the internal funding structure of the group, actually contravene the insolvent trading provisions covering directors' duties. This may occur, unexpectedly, as a consequence of the consolidations rules.

When, as is argued here, we are considering the impact of consolidation rules on the welfare of the community at large, it is useful to ask what would happen in the above scenarios but for the consolidation rules. The answer would need to consider the effect on each member entity. The tax liability status would be dependent not on the benefits of membership of a consolidated group but on its own responsibility for its trading performance. Where the performance is positive the tax liability increases and the market value of the entity may rise. Where the reverse occurs, the tax liability decreases and the market value reflects the poor performance. These can be considered commercial and appropriate responses to performance. To allow transfer of responsibility for corporate performance to a complex group may be to encourage less responsibility on the part of directors and less transparency on the part of boards.

The net effect, apart from the loss of revenue to the community, may be to create less accountability and perhaps a culture of cynicism. The tax legislation becomes a means whereby rather than face the need to improve a company's trading results, boards may employ evasive restructures to mask the underlying problem. In fact, the legislation may be rewarding them for doing so. To what extent these matters have been the subject of evaluation prior to the enactment of Part 3-90 is unclear. However, at the very least the substantive effect of the transfer of losses and profits as discussed above would tend towards the view

that the benefit of consolidation is in favour of commercial activity. Whether these benefits are for the common good is questionable.

A possible argument exists in favour of consolidation. That is, that commercial benefit is ultimately being passed onto the community. The argument is that the tax revenue is forgone in the current year in favour of further business re-investment. This deferral results in stronger companies and a stronger economy in the future. Such a self-sacrificing approach for the community may assist in a developing economic environment. However, given the global commercial influences at play in Australia, there is a contrary argument that while the tax benefit would be taken today there is no guarantee that those same groups of international companies would not simply maximise their profits offshore and never contribute to the local community.

4. Tax Driven vs Anti-Avoidance

While consolidation is a forward step from a commercial perspective it also poses some legal difficulties when it becomes necessary to assess one of the members of the group which has not fulfilled its tax obligations.¹⁰ This conflict is in part due to the different character of the relevant legislation. As GT Pagone states 'There may, more broadly, be tension between the policy objectives of the consolidations regime which encourages tax driven arrangements and the anti-avoidance objectives of Part IVA which may have those very arrangements in their sights'.¹¹ Whether in fact such arrangements will come within the scope of Part IVA is to be seen. However, it is argued that the two are opposites in purpose and character. Further, they may co-exist each in their own context. The question is not so much whether they are in conflict but whether the existence of the consolidations rules themselves are in conflict with the provision of revenue for the community.

The judicial pronouncement of this tension has its clearest articulation in the High Court's rejection of the argument put forward in *FCT v Spotless Services Limited and Anor* (1996) 186 CLR 404 that every taxpayer is entitled to order his affairs so that the applicable tax was less than it otherwise would be.¹² Indeed, the rejection was stated as follows: 'Part IVA is to be construed and applied according to its terms, not under the influence of "muffled echoes of old arguments" concerning other legislation'. The claim put forward by the taxpayer was as follows:

... the respondents claimed that the interest was exempt from income tax by virtue of s. 23(q) of the Income Tax Assessment Act 1936 ("the Act") which was

¹⁰ From article on ATO website entitled: *The application of Part IVA to elections to consolidate.*

¹¹ See GT Pagone, *The Divine Comedy: Consolidations and Part IVA of the Income Tax Assessment Act 1936 (Cth)* (2004) 32 ABLR 35.

¹² See *IRC v Duke of Westminster* (1936) AC 1 at 19; see Maurice Cashmere, *Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA*, (2006) 35 AT Rev 231 at 234.

*then in force. (By s. 23(q), as it then stood, it was provided, relevantly, that income derived by a resident from sources out of Australia was exempt income where it was not exempt from income tax in the country where the income was derived provided that there was a liability for tax in the country where that income was derived and the Commissioner was satisfied that the tax had been, or would be, paid.)*¹³

There is also an argument that s23 (q) was not meant to operate in a situation where such a benefit accrued due to an offshore investment with significant tax implications. The arguable aim is one of preventing a tax liability in Australia when tax had already been paid offshore. In fact, taking this line of thought can lead to supporting the contention that there was a dominant purpose of obtaining a tax benefit.

The complexity arises where one considers s23 (q) alongside Part 3-90. In this case and in accordance with the aim of s23 (q) in the previous paragraph, a consolidated group which included a transaction mirroring *Spotless* would both contradict the assumed rationale behind s23 (q) and avoid the impact of Part IVA. This would in turn raise the notion of extending the tax benefit to a group within an international context. Again the revenue would decrease by that amount of tax that would be paid but for the benefit conferred by the consolidation.

Prior to *Spotlight*, in *FCT v Peabody* (1994) 181 CLR 359 the court held that it was open to the Commissioner to argue that if there were a narrower scheme within a wider scheme context and the narrower view satisfied the requirements of Part IVA, then it was open to the Commissioner to rely on that narrower view. Cooper¹⁴ states the impact of *Peabody* on *FCT v Hart* (2004) 217 CLR 216 in these terms: ‘By the time of the judgment in *Hart*, it appears this invitation (to the Commissioner)¹⁵ has been well and truly accepted – the Court notes the Commissioner’s practice to “identify, as he did in these cases, both a wider scheme and a narrower scheme.”’

The result could then lead to the approach seen in *FCT v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 where the focus on defining the tax scheme operated to the exclusion of the broader commercial and tax contexts. In *FCT v Zoffanies Pty Ltd* 2003 ATC 4942, the Full Federal Court held ‘it follows, generally at least, evidence of what may be referred to as the actual or subjective purpose of the taxpayer is irrelevant.’ The Court supports this by citing itself in *Eastern Nitrogen, Hart and Consolidated Press Holdings*. The rejection of matters such as subjective purpose and surrounding commercial contexts makes the scope of tax planning vulnerable.

13 FC of T v SPOTLESS SERVICES LIMITED & ANOR95 ATC 4775 per Beaumont J

14 G. Cooper, The Emerging High Court Jurisprudence on Part IVA. Legal Studies Research Paper No. 06/09, p10

15 My addition

Does this mean that overall there is no scope for finding in favour of the taxpayer at all? In *Peabody* the Court found:

*...it cannot be said that the amount which the Commissioner included in Mrs Peabody's assessable income for the year ended 30 June 1986 was an amount which would have been included or might reasonably be expected to have been included in her assessable income for that year had the devaluation of the Kleinschmidt shares not taken place.*¹⁶

In *Macquarie Finance Ltd v FC of T* [2005] FCAFC 205 (16 September 2005) the Federal Court held in favour of the applicant and said:

There is force in MFL's submission that ultimately the Commissioner's case is that MFL borrowed money, thereby incurring deductible interest, and that if another party (MBL) had done something different (issued shares) MFL would not have incurred the deductible outgoing. The fallacy in this case is that – contrary to the direction in s 177D(b) – it confines attention to the tax consequences of the actual and 'counterfactual' transactions and leaves out of account the commercial advantages and consequences obtained and flowing from what was done.

This reinforces the broader commercial context of applying Part IVA as opposed to a tax purist approach.

In *Eastern Nitrogen v FC of T* 2001 ATC 4164, Lee J agreeing with Carr J held:

The dominant purpose of the appellant was to obtain funds on the best available terms for use in the conduct of the appellant's business. The fact that the arrangements entered into to provide those funds included outgoings deductible under the Act was incidental to the purpose, but not the dominant purpose, of the transaction.

The commercial aspects of the transactions once again are seen as relevant to determining the question of dominant purpose.

There are therefore elements within judgments that still maintain the view that surrounding commercial circumstances assist in determining the application of Part IVA. It is also possible that such a broader view will find its way into examining the application of the consolidation rules. The commercial circumstances behind the activities of large corporations can be extremely complex. To address such transactions without commercial considerations could render the analysis of such arrangements clinical and unrealistic.

16 FC of T v PEABODY 94 ATC 4663

5. Applying Part IVA to Consolidated Groups

Looking at the breadth the High Court has afforded the application of Part IVA will indeed lead to the embracing of consolidations that have as part of their commercial arrangements investments in schemes. The outcome of this is that the High Court interpretations to date may lead the anti-avoidance legislation on a collision course with legislation allowing consolidated groups. In doing so, the courts will need to address the identification of the entity to whom Part IVA applies and potentially the validity of Tax Sharing Agreement granting immunity from Part IVA to that entity.

The difficulty begins with the application of Part IVA to any schemes within the re-organisation. The complexity is in identifying which member entity is liable under Part IVA. The second issue is whether any entity is liable. GT Pagone questions how Part IVA can apply to companies that have ceased to exist¹⁷ (within the scope defined by Slater's comments above). He also poses the question of against which company can the Commissioner can make determinations? Moreover, he makes the point that the subsidiary that derives the tax benefit by the force of law may not have been the entity for which the scheme was entered into in the first place. All this he suggests is fertile ground for disputes.

One possible view here is that just as the benefit has passed on to the head entity in a consolidation so too should the liability for a member pass. It may be that targeting a member that has ceased to exist is not possible from a procedural point of view. In that case there may need to be a legislative adjustment to cater for this. It may be that it is necessary to create a legal fiction which attributes the tax liability to the head entity on a form over substance basis. In philosophical terms it is logical that the risk as well as the benefit should pass to the head entity under the consolidation rules.

The choice to consolidate is an extraordinary election.¹⁸ It is to be distinguished from the choice made when considering whether to declare income or claim a deduction. In the case of a consolidation, the choice directly results in a tax benefit i.e. it is directly attributable to it. In the case of a consolidation the choice made has specific features:

- ∞ It is only made by the head entity
- ∞ It applies to current and future members of the group
- ∞ It has the effect of applying certain statutory fictions to the members

The practical result of the election to consolidate is to allow the head entity to claim the allowable deductions that previously belonged to the member entity, to

¹⁷ See GT Pagone, *Part IVA – The voyage continues*. The Tax Specialist. Vol. 10 No. 1 August 2006 at p45

¹⁸ See ATO website article p.2

incur the capital losses of the members and to claim the income of the member as its own (the result of course is that the member ceases to have assessable income). In addition, the assets of the subsidiary are treated as if they are assets of the head entity. All this comes about as a result of the choice to consolidate.¹⁹

Section 177C(2)

Subsection s177C(2) provides that a tax payer participating in a scheme has not obtained a tax benefit linked to that scheme if it is:

'...attributable to the making of an agreement, choice, declaration, election or selection, the giving of a notice or the exercise of an option (expressly provided by for by this Act or the Income Tax Assessment Act 1997 [with certain exceptions] by any person...'

The consequence of the choice is that by not declaring income or by claiming a deduction the head entity has created a tax benefit. Ordinarily, subsection s177C(1) would apply. However, because this type of election is within subsection s177C (2) the effect of s177C (1) is negated. The benefit created by the consolidation is not one that will attract a penalty derived from Part IVA as applied to schemes.

The choice to consolidate is within the ambit of this subsection and does therefore not give rise to a tax benefit within the meaning of Part IVA. However, the choice to consolidate may not be the only cause of the creation of a tax benefit. It may only be incidental to its creation. It is therefore critical to consider whether the tax benefit arises from the application of the scheme itself rather than the choice to consolidate.

The subsidiary in consolidations has entered into an arrangement whereby it has claimed a deduction or reduced its assessable income. In isolation these events may attract an adverse finding under Part IVA. The fact that a choice to consolidate then occurs does not have the effect of negating the application of s177C (1) in favour of s177C (2). It merely has the effect of transferring liability under an assessment to the head entity. In this case, the choice to consolidate and the exclusion of the tax benefit by s177C (2) become an incidental consideration. The tax benefit in this case is brought within the ambit of Part s177C (1).

It is relevant to consider the question of timing between the subsidiary's strategy to enter into an arrangement and the head entity's election to consolidate. Where the subsidiary's actions occur well ahead of the decision to consolidate there is a clear distinction in time between the two actions. They are easier to distinguish. Where the two occur closely or contemporaneously, there may be the attempt to

¹⁹ On the history of the choice principle see GT Pagone, *Part IVA: The General Anti-Avoidance Provisions in Australian Taxation Law*. [2003] MULR 30 at p 4

characterise the subsidiary's actions as those of the head entity's election to consolidate. This may inappropriately allow the benefit of s177C (2) to apply. Ultimately, the matter rests on the facts and the detail provided by internal group documentation.

Peter Donovan and Jason Georgallis write interestingly that the distinction between the primary scheme and election scheme is highlighted in s177(2) by its reference to the primary scheme in the past tense. The effect is to distinguish between the two and therefore the applicability of Part IVA. The writers argue that in fact Part IVA cannot apply to the primary scheme as it does not provide the tax benefit – this is done by the election scheme.²⁰ They point to this deficiency in the drafting of the legislation and state that Part IVA is ineffective for this reason. The tax benefit arises in the election scheme while Part IVA purports to apply to the primary scheme.

They state that ordinarily the 'scheme' and 'tax benefit' necessary for Part IVA to operate co-exist. However, this is not the case where the scheme predates the election to consolidate and is subject to s177C (2). This is because such schemes will often not exhibit a tax benefit.

This is arguable as Part 3-90 is structured to convey a tax advantage by virtue of the tax benefit that immediately succeeds the election. This is an easily identifiable event. Part 3-90 has a prospective element to it which is different to the historical view a court takes when looking at a potential tax benefit under Part IVA. Part IVA is applied retrospectively to a potential benefit that already exists; Part 3-90 creates the tax benefit attaching to it a character that cannot be subject to the same assessment of dominant purpose.

There are other aspects to the choice to consolidate.²¹ That is, the election to use 'available fraction' (losses) and the calculation of cost of assets (relevant to capital allowance deductions and CGT). These may have an impact on both deductions claimed and income declared in the future through the calculation of capital gains. Because the election to consolidate is the primary consideration, s177C (2) applies so as to negate the tax benefit unless it falls within the ambit of s177C (2) (b) (ii).

Subparagraph (ii)

The application of subsection s117C (2) is conditional upon satisfying s117C (2) (b) (ii). This subparagraph has the effect of being an exception to s117C (2) in that it can negate s117C (2) by considering the purpose behind the entering into the scheme. This raises the issue of the dominant purpose behind the scheme. It applies where the scheme is entered into or carried out to enable the election to

²⁰ Peter Donovan and Jason Georgallis, *Dissecting the Commissioner's Part IVA Analysis on the election to consolidate*. Taxation in Australia. Issue 38, No.9 April 2004 at 478.

²¹ ATO doc. Page 3

consolidate to be made. If the Commissioner finds that the scheme was entered into to enable the election to be made then to address subparagraph (ii) it is still necessary to examine s117D and its criteria to determine whether the scheme was entered into for the dominant purpose of obtaining a tax benefit.

6. Likely Outcomes

A critical aspect of reconciling the incentives to consolidate as against the anti-avoidance legislation is to examine the success that arrangements have had in the courts. Cooper states that Part IVA focuses on three main concepts: the existence of a scheme, the subset of schemes 'to which this part applies' and the identification and measurement of a 'tax benefit'.²² Once these conditions are satisfied, s177F permits the Commissioner to issue a determination that reverses the tax benefit. It is helpful to look at the court decisions to begin to outline the scope of Part IVA.

In *FCT v Consolidated Press Holdings Ltd* the High Court confirmed the Commissioner could select a small part of a larger transaction as the scheme relevant to the application of Part IVA. The possibility that a wider and narrower scheme could conflict was not seen as an impediment.²³ Maurice Cashmere goes as far as stating that the High Court has given Part IVA an interpretation of...omnipotence.²⁴ He refers to *FCT v Hart* (2004) 217 CLR 216 as demonstrating that Part IVA can be interpreted so widely that it can be used to deny any transaction that manifests a tax advantage.²⁵

Whether the implication of the decision goes as far as this requires a review of the individual judgments. In reading the conclusions for their judgments it is clear that Gummow and Hayne JJ analyse the financing structure within the scheme strategy to arrive at the conclusion that the dominant purpose was to derive a tax benefit. Gleeson CJ and McHugh J also come to the same conclusion. However, they base their decision on an examination of the banking product used which had at its centre a tax advantageous structure. Is it to draw a long bow to say that Part IVA is omnipotent when it can still be subject to subtle, cogent judicial analysis?

The High Court in *Peabody* held:

But Pt IVA does not provide that a scheme includes part of a scheme and it is possible, despite the very wide definition of a scheme, to conceive of a set of circumstances which constitutes only part of a scheme and not a scheme in

²² G. Cooper, *The Emerging High Court Jurisprudence on Part IVA*. Legal Studies Research Paper No. 06/09, p3.

²³ *Ibid* at p8.

²⁴ Maurice Cashmere, *Towards an appropriate interpretative approach to Australia's general tax avoidance rule – Part IVA*, (2006) 35 *AT Rev* 231 at 235.

²⁵ *Ibid* at p235.

itself. That will occur where the circumstances are incapable of standing on their own without being ``robbed of all practical meaning''.

This view went against the Commissioner's argument that the definition of a scheme includes a part of a scheme. There is some strength in this decision in that where the part of a scheme takes the transaction out of practical context, it cannot stand. However, for the present it appears that this approach may be less favourable than that proposed by Cashmere. Nevertheless, the position in terms of tax planning lies somewhere between the two. At present, the pendulum certainly seems to have swung in favour of supporting an expansive view of tax strategy over commercial circumstances. However, perhaps *Macquarie Finance* signals a counterbalance to this view. In that case had the interest been deductible the court stated that Part IVA would not have applied to the facts (see Hely J with whom French J agreed on the Part IVA issue – though considering the issue a hypothetical one).

Cashmere goes on to criticise the concept of the counterfactual citing *Macquarie Finance Ltd v FCT (2005) 146 FCR 77*.²⁶ In that case, Hely J says that considering the tax consequences of the actual and counterfactual transactions ignores the commercial background and outcomes. Cashmere then states that this does nothing to support the identification of the dominant purpose. The counterfactual is a hypothetical and does not form part of an alternative to a dominant purpose.

Moreover, Cashmere highlights the 'schism' between the Full Federal Court and the High Court on the matter of how to establish what a dominant purpose is.²⁷ He says that the consideration as to what it is necessarily asks the question as to what alternatives there are. He answers the question by suggesting things like commercial, business or family purposes.

There is indeed a noticeable divergence between the two courts. However, this disagreement may be a reflection of the complexity at hand rather than a fundamental divergence of interpretation.

The difficulty in the High Court's current view is that it has taken a strong position on what is a complex interdependence between poles on the same axis. Commercially speaking, tax benefits are but one financial benefit amongst many. So too tax liabilities are seen as a cost of doing business. In a competitive world of goods and services, tax also has its share of competition. In the final analysis it may be that the view in *Peabody* may persist.

Finally, Nabil Orow²⁸ argues in favour of repealing Part IVA in order to deal with anomalies that exist in its application. His definition of tax avoidance²⁹ looks to

²⁶ Ibid at p237

²⁷ Ibid at p240

²⁸ N. Orow *General Anti-avoidance Rules: A Comparative International Analysis (2000)*

the 'purposes and policy' of tax legislation. Tax avoidance has less to do with the transactional analysis than it does with legislative intention. Orow says that the conflict between the objectives of the GAAR and those of the ordinary or charging provisions of the legislation cannot be reconciled.³⁰ It would be better to restructure the legislation to overcome the anomalies. He says:

*However, it is submitted that the problem of tax avoidance can be effectively dealt with by the common law process of statutory interpretation which looks to the purpose and policy of the statute as a guide to its meaning and application.*³¹

To remove Part IVA altogether and to revert to examining the purpose and policy of the statute is to allow judicial interpretation a broader scope to evaluate tax avoidance. To allow this is to provide a less circumscribed method of judging tax avoidance. The question then becomes whether too much latitude is given to statutory interpretation and not enough to focus on the methodology of evaluating tax avoidance through transactional analysis. It may be that a specific methodology as that required by Part IVA acts as a more focused benchmark for judicial analysis. There may not be one view in its application but it affords a narrower starting point for addressing complex commercial matters.

7. Conclusion

This paper has investigated the effects of two aspects of tax legislation. When contrasted, these demonstrate two differing impacts on Australian national revenue. In general terms, Part IVA exists as a means of countering the effects of tax avoidance schemes. Its application by the High Court has to a significant extent been to find that the dominant purpose of a taxpayer is to gain a tax benefit. On the other hand, Part 3-90 favours tax minimisation where it is achieved through the process of consolidation. The two are at opposite ends of the tax spectrum and it has been argued that the consolidations process favours business. Any consequential gain to the community is limited to an indirect, deferred benefit. It may also be impossible to quantify the loss to revenue of the myriad of transactions now geared to absorbing income and capital losses.

In looking at the tax benefits that arise from a corporate group consolidation, various issues were considered. Firstly, there are anomalies in valuation methods which were structured in favour of business. Such anomalies could allow potential manipulation of gains and losses to minimise taxation in a way that deviates from established commercial principle. Secondly, a similar rationale was applied to the use of offsetting trading losses and profits. Examples considered were the application of these concepts to foreign tax credits, application during a climate of merger and acquisition and the manipulation of deductibility of expenses. The conclusion reached was that the net benefit was in

²⁹ Ibid at 45

³⁰ Ibid at 196

³¹ Ibid at 231

favour of business. This then led to juxtaposition with Part IVA whose role is less supportive of business strategies.

In considering the application of Part IVA to the consolidations legislation it was also considered that there was a need to identify which member entity was liable. This may pose difficulty especially where the entity has ceased to exist. It was argued that with appropriate changes to legislation a solution could be the passing on of the tax liability to the head entity. This would be in line with the rationale of passing on of the tax benefit when the choice to consolidate is made.

In considering the case law on Part IVA the argument is made that there is some divergence between the view of the High Court and the Federal Court in High Court cases such as *Consolidated Press, Spotless and Hart*. In other cases for example *Peabody* and *Macquarie Finance*, the courts demonstrate a capacity to distinguish the facts sufficiently to allow flexibility of interpretation of Part IVA. This is particularly relevant from a tax planning point of view.

There remains a somewhat grey area in tax planning and it is suggested that continued interaction between the Tax Office and tax practitioners will assist in overcoming this. In particular, the Commissioner's guidance through commentary such as *The application of Part IVA to elections to consolidate* is of significant value to the community.

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