AUSTRALIAN TAX AVOIDANCE CASES – A COMPARATIVE APPROACH

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The Australian general anti-avoidance rules are found mainly in Part IVA of the *Income Tax Assessment Act 1936* (Cth). The provisions are complicated, long and are attached as an annexure to this paper. They operate by giving to the Commissioner of Taxation the power to cancel a tax benefit where Part IVA applies to a scheme in connection with which a tax benefit has been obtained or would be obtained but for the cancellation of the tax benefit by the Commissioner. The word "scheme" is not used in the legislation with any pejorative connotation but to describe the broad range of arrangements and circumstances which may fall within the general anti-avoidance rule.[1] The Commissioner's power to cancel a tax benefit is given by s 177F(1) of the 1936 Act which, in its most essential elements, permits the Commissioner to cancel a tax benefit obtained by a taxpayer in connection with a scheme to which Part IVA applies. The intended effect of the Commissioner's determination to cancel a tax benefit is to undo the tax effect of the tax benefit which the taxpayer had obtained. The Commissioner is permitted to give effect to a determination to cancel a tax benefit[2] which will usually involve the Commissioner making an assessment on the basis of the taxpayer's taxable income after the tax benefit has been cancelled.[3]

A preliminary point that might be useful to note about the Australian general anti-avoidance rule is that to operate it requires a specific determination by the Commissioner to cancel a tax benefit that would otherwise have been obtained. The general anti-avoidance rule is not, in other words, a general rule of law that

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[1] *Income Tax Assessment Act 1936* (Cth), s 177A(1) "scheme", (3).

[2] *Income Tax Assessment Act 1936* (Cth), s 177F(1).

[3] *Income Tax Assessment Act 1936* (Cth), s 177F(1); *Federal Commissioner of Taxation v Jackson* (1990) 27 FCR 1, 17-18.

applies without administrative intervention. That was not always the case in Australia and it is not the case in some other jurisdictions. The predecessor to Part IVA operated without the Commissioner's intervention as a general rule of tax law.[4] Similarly, the doctrine known in the United States as the economic substance doctrine,[5] found in *Gregory v Helvering*,[6] is a law of general application that is not dependent upon administrative action. The New Zealand general anti-avoidance rule also applies by force of law without the need for specific application by administrative determination[7] although the New Zealand Commissioner has consequential powers to counteract a tax advantage obtained from a tax avoidance arrangement.[8] The Australian general anti-avoidance rule, in contrast, has no direct application unless and until the Commissioner first makes a determination to cancel a tax benefit obtained by a taxpayer and then takes action necessary to give effect to the determination.

A consequence of the Australian general anti-avoidance rule requiring administrative action is of some jurisprudential, and not only practical, significance because the anti-avoidance provisions work upon the assumption that the other provisions of tax law have correctly applied to enable a taxpayer to obtain an "impermissible" tax benefit. To put that proposition in different terms, Part IVA can only apply if a taxpayer has otherwise been legally successful in obtaining a tax benefit. The general anti-avoidance rule permits the Commissioner to change the tax consequences for a taxpayer where the general tax laws would otherwise have allowed the taxpayer to obtain the tax benefit. The ability of a government official to alter the operation of general taxing provisions raises important historical, constitutional and legal issues about executive discretions and the rule of law which are beyond the scope of

[4] *Income Tax Assessment Act 1936* (Cth), s 260 (repealed).
[5] See *Internal Revenue Code of 1986*; 26 USC § 7701(o); introduced by the *Health Care Act of 2010*.
[6] 293 US 465 (1935).
[7] *Income Tax Act (New Zealand) 2007*, s BG1(1)).
[8] Ibid, ss BG1(2) and GA1.

this paper.[9] It might, however, be worth noting in passing that there is some tension between the application of the general anti-avoidance provisions and the application of the general taxing provisions. The anti-avoidance rule might be thought to be based upon the logical conundrum that a tax benefit will not be allowed to a taxpayer in some cases where the general provisions when correctly interpreted and correctly applied would have allowed the tax benefit to be obtained. An important aspect of the provisions which make up the general anti-avoidance provisions is to resolve that conundrum; that is, to provide how, when and why something which is lawful and otherwise effective will not be allowed.

A second general point to make about the Australian general anti-avoidance rule is that the cancellation of any tax benefit depends upon the specific application of the anti-avoidance provisions in Part IVA rather than depending upon the general anti-avoidance provisions altering how the other taxing provisions work or by altering how those other provisions are to be interpreted or are to be applied. The Australian general anti-avoidance rule does not require the other provisions to be read, interpreted or applied as if they had a rule to prevent their misuse or abuse.[10] The existence in Australian law of a statutory anti-avoidance rule was said by the High Court to exclude the possibility of interpreting the taxing provisions as containing an implication of a further limitation upon what a taxpayer may do. In *John v Federal Commissioner of Taxation*[11] it was said:

> The Act, in s 260 and now in Pt IVA, makes specific provision on the topic of what may be called tax minimisation arrangements and thereby excludes any implication of a further limitation upon that which a

[9] See, for example: G.T. Pagone "Tax Uncertainty" (2009) 33 *Melbourne University Law Review* 886; G.T. Pagone "Taxation by Discretion" (2011) 22 *Public Law Review 283*.
[10] c.f. *Gregory v Helvering* 293 U.S. 65 (1935); *W.T. Ramsay Ltd v Inland Revenue Commissioner* [1982] AC 300; *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 2 NZLR 289,305.
[11] (1989) 166 CLR 417.

> taxpayer may or may not do for the purpose of obtaining a tax advantage.[12]

This dicta, however, has not meant that tax avoidance consideration will never defeat a taxpayer's claims outside of the specific general anti-avoidance rule. The High Court subsequently decided in *Fletcher v Federal Commission of Taxation*[13] that a tax deduction would not be allowable to a taxpayer to the extent that the explanation for a loss or outgoing lay in "the very substantial personal income tax advantages" obtained from entering into a transaction rather than in deriving income.[14] The tax objective of the taxpayer in *Fletcher* deprived the loss or outgoing claimed as a deduction from having the income producing character which was needed for the loss or outgoing to be allowed as a tax deduction. In *Raftland Pty Ltd v Federal Commissioner of Taxation*[15] the High Court also upheld a finding that a trust resolution was a sham intended to achieve only tax effects where the appearance of legal entitlement, which had been created by the trust deed and by the resolution for distribution, did not reflect the intentions of the parties by reference to the actual benefits of the parties in question. The outcomes in *Fletcher* and *Raftland* denied the tax benefits of tax avoidance arrangements but that was not because the relevant statutory provisions had been interpreted to have a meaning to prevent avoidance. In each case the tax avoidance objectives by the transactions meant, rather, that the transactions lacked the legal character needed to come within the ordinary meaning of the taxing provision.

Dominant Purpose of Tax Avoidance

The fundamental element necessary to the application of the general anti-avoidance rule is that the scheme is one to which Part IVA applies. The

[12] Ibid, 434.
[13] (1991) 173 CLR 1.
[14] Ibid, 23.
[15] (2008) 238 CLR 516.

Commissioner's power to make a determination to cancel a tax benefit depends upon Part IVA applying to a scheme.[16] The basis for the application of the general anti-avoidance rule in Part IVA is the drawing of an objective conclusion having regard to the matters specified in s 177D(2) which do not include the subjective purpose or intention of the participants to the scheme. Section 177D(1) provides that Part IVA applies to a scheme if "it would be concluded" that a person who entered into or carried out a scheme, or part of a scheme, did so for the purpose of enabling one or more taxpayers to obtain a tax benefit in connection with the scheme.

Those drafting the provisions that came to be in Part IVA sought to give statutory expression to a principle from the decision of the Privy Council in *Newton v Federal Commissioner of Taxation*[17] known as the predication test. That case had been concerned with the precursor to Part IVA in s 260 of the 1936 Act and the Privy Council had said:

> In order to bring the arrangement within the section you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax. If you cannot say predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealings, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section. Thus, no-one, by looking at a transfer of shares *cum* dividend can predicate that the transfer was made to avoid tax. Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Div 7 tax…Nor could anyone, on seeing a declaration of trust made by a father in favour of his wife and daughter, predicate that it was done to avoid tax (footnotes omitted).[18]

The application of the predication test as enunciated by the Privy Council in *Newton* required a consideration of the particular agreement impugned by the Commissioner to determine whether its objectively ascertainable purpose was to

[16] *Income Tax Assessment Act 1936* (Cth), s 177F(1).
[17] (1958) 98 CLR 1.
[18] Ibid, 8-9.

avoid taxation. The inquiry was not into the actual motive or purpose of the participants but, rather, into whether the objectively ascertained explanation of the arrangement undertaken in the particular way it had been undertaken was to avoid tax. In its most essential element the test might be thought to depend upon an inquiry into whether what produced the tax advantage had some purpose other than the tax advantage. In that inquiry the actual purpose or motive of the participants was irrelevant to whether the general anti-avoidance rule applied.

Many cases before and since *Newton* had accepted that a tax avoidance motive or purpose was permissible and was insufficient to strike down an arrangement as a tax avoidance arrangement. That was also said about the economic substance doctrine enunciated by the United States Supreme Court.[19] The distinction between subjective motive and objective intention is sometimes difficult[20] but it is important. It has frequently been said as part of Anglo-Australian law that a motive of avoiding tax is not impermissible or relevant to determine whether the general anti-avoidance rule was applicable.[21] It is a fundamental feature of many general anti-avoidance rules that they do not depend upon a taxpayer's motive or subjective intention of avoiding tax. It is generally accepted that it is permissible to have the motive or subjective intention of avoiding tax as long as what is done is otherwise defensible. In other words, that the target of general avoidance provisions is obtaining tax benefits which lack non-tax purpose rather than whether, for example, a non-tax driven transaction is chosen for tax driven motives. One reason why the general anti-avoidance rule depends upon objective matters rather than the subjective motive or subjective purpose of the taxpayer is because a general anti-avoidance

[19] *Gregory v Helvering* 293 U.S. 65 (1935), 470.
[20] *Magna Alloys and Research Pty Ltd v Federal Commissioner of Taxation* (1980) 33 ALR 213; *Ure v Federal Commissioner of Taxation* (1981) 34 ALR 237.
[21] *The Commissioner of Inland Revenue Appellants v the Duke of Westminster* [1936] AC 1,8; *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66, 92-3.

rule should be predictable and of general application to similar transactions and not be made to depend upon the fiscal awareness of the taxpayer.[22] General anti-avoidance rules should operate uniformly across transactions independently of the individual awareness of the tax consequences of individual taxpayers. A tax avoidance transaction should be disallowed if it is objectively found to be an avoidance arrangement irrespective of whether the particular taxpayer gives evidence of not having a tax avoidance motive. Similarly, a motive of tax avoidance should not deny a tax benefit if it was available to be obtained.

The inquiry required by s 177D, therefore, requires careful consideration of what produced the tax benefit to determine whether a scheme was entered into in the particular way it was entered into or carried out for the dominant purpose[23] of obtaining the tax benefit. Part IVA tries to achieve this through the analysis required in concluding whether the dominant purpose was for the taxpayer to obtain the tax benefit in connection with the scheme. Section 177D(2) identifies eight matters from which the conclusion is to be drawn. The consideration of the eight matters is likely to reflect upon whether the scheme which was entered into or carried out had some purpose or outcome other than the dominant purpose for the taxpayer to obtain the tax benefit. The eight matters in the section do not include motive or subjective purpose and in *Federal Commissioner of Taxation v Hart*[24] it was said:

> That provision requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any inquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.[25]

The section is designed to look to what occurred to see from what occurred whether an objective conclusion is to be stamped upon the taxpayer that the

[22] *Federal Commissioner of Taxation v Consolidated Press Holdings Limited* (2001) 207 CLR 235, 264, [95].
[23] *Income Tax Assessment Act 1936* (Cth), s 177A(5).
[24] (2004) 217 CLR 216.
[25] Ibid p 243, [65].

dominant purpose was to obtain the tax benefit whatever might have been the actual purpose or motives of those concerned.

A consequence of this approach, however, is that the anti-avoidance rule can apply to commercial transactions where a tax benefit might have been obtained if the transaction had been undertaken differently in circumstances which would not have attracted the general anti-avoidance rule. The taxpayer in *Federal Commissioner of Taxation v Spotless Services Limited*[26] had put money on deposit with a wholly owned subsidiary of a European financial institution in the Cook Islands. The deposit was at a rate of interest of about 4% below applicable bank bill rates available in Australia. The taxpayer claimed that the interest income from the deposit was exempt from income tax in Australia because a provision at the time exempted from tax income derived from a foreign source.[27] The after tax return to the taxpayer of the interest on deposit in the Cook Islands financial institution, however, was greater than if it had received a higher pre-tax interest rate from a deposit of the funds with an Australian bank because of the tax that would have been payable on the higher interest if it had been earned in Australia.

There seems little doubt that the taxpayer would have been entitled to claim the Cook Island interest as exempt from tax if the taxpayer had done no more than to make a deposit of money with a financial institution in the Cook Islands. In *Spotless*, however, more had occurred than a simple deposit by the taxpayer of money with an offshore financial institution to derive foreign source income. The steps taken by the taxpayer in *Spotless* included steps that would not normally have been taken in making a deposit offshore. The taxpayer's activities included transactions to protect itself from the commercial and sovereign risks of the foreign source deposit. The Commissioner argued in

[26] (1996) 186 CLR 404.
[27] *Income Tax Assessment Act 1936* (Cth), s 23q (repealed).

Spotless that a transaction may be "so attended with elements of artificiality or contrivance primarily directed to the obtaining of the tax benefit that any commerciality in the scheme is overshadowed."[28] The Court held on the facts in *Spotless* that a reasonable person would conclude that in entering into and carrying out "the particular scheme" in that case the taxpayers had "as their most influential and prevailing or ruling purpose, and thus as their dominant purpose, the obtaining thereby of a tax benefit".[29] The taxpayer had invested $40 million in the Cook Islands at an interest rate of some 4% below the applicable bank rates available in Australia but the circumstances in that case included also that the taxpayer had letters of credit giving them assurance of not being exposed to the risks of not recovering their deposit or interest. The transactions entered into included the International Division in London of the Midland Bank PLC giving the taxpayer an irrevocable non-transferrable standby letter of credit for an amount of $40 million plus interest, less any withholding tax legally payable, and made available at a branch of an Australian bank in Melbourne.[30] It is important to emphasise, however, that the transaction caught by the general anti-avoidance rule in *Spotless* was, on any view, a commercial transaction. There was no doubt that the taxpayer placed on deposit $40 million in return for the payment of interest.

The same can be said about the subsequent case of *Federal Commissioner of Taxation v Hart*[31] which was concerned with claims for interest deductions on borrowings made by taxpayers in a way which was explicable only by the tax deductions available from the transaction. In *Hart's* case the taxpayers had borrowed money under an arrangement with a bank that gave them a split loan facility which permitted them to treat part of the borrowing as an investment

[28] *Federal Commissioner of Taxation v Spotless Services Limited* (1996) 186 CLR 404, 408.
[29] Ibid, 423.
[30] Ibid, 419 -20.
[31] (2004) 217 CLR 216.

borrowing (in respect of which they could claim income tax deductions for the interest) and to treat the other part as a domestic borrowing for their private residence (in respect of which interest payments were not tax deductible to them under Australian tax law).

The arrangement they had with the bank permitted the taxpayers to repay the private loan before repayment of the investment loan with the consequence that their after-tax position was better than it would have been if they had paid both loans proportionately over time. It was the presence of the provisions in the arrangements between the taxpayers and the bank that enabled two otherwise uncommercial loans to be treated as one commercially feasible package not putting the bank in a net negative position but giving to the taxpayers a net economic benefit that was explicable only from the tax deductions that the arrangement allowed. In the joint judgment of Gleeson CJ and McHugh J their Honours said:

> The "wealth optimiser structure" depended entirely for its efficacy upon tax benefits generated by arrangements between the respondents and the lender that had no explanation other than their fiscal consequences. What "optimised" the respondents' "wealth" was the tax benefit earlier described: not the deductibility of interest as such; but the deductibility of additional interest on loan 2 contrived by the particular form of the borrowing transaction.[32]

A similar view was expressed in the joint judgment of Gummow and Hayne JJ where their Honours said:

> There could be no doubt in these matters that the terms on which the loan was made available were explicable *only* by the taxation consequences for the respondents.[33]

It should again be emphasised that there was no doubt that the transaction entered into by the taxpayers in *Hart's* case was a commercial transaction.

[32] Ibid, 228, [18].
[33] Ibid, 244, [68] (emphasis in original).

It was entered into between the taxpayers as borrowers and an arm's length bank as part of its ordinary banking operations. The bank made a net return on the loans and Mr and Mrs Hart obtained money which they applied to purchase real estate. What made the general anti-avoidance rule apply in *Hart* was an objective consideration of the way in which the transaction was entered into from which it was possible to conclude that the tax benefit was the dominant purpose of the transaction being entered into in that way. A more recent example of the same conclusion might be seen in the decision in *Orica Limited v Commissioner of Taxation.*[34] In that case the taxpayer had entered into an arrangement that gave rise to a domestic Australian tax deduction for the purpose of deriving income in America to take advantage of carried forward losses which the group had incurred in America and which it did not expect to be able to utilise from its ordinary trading operations.

The conclusion must be one about obtaining a tax benefit

The conclusion to be drawn for the purposes of s 177D(1) is about a tax benefit being obtained by the taxpayer in connection with the above. Section 177C provides the meaning to be given to the expression "the obtaining by the taxpayer of a tax benefit in connection with a scheme". In general terms its meaning covers each of the expected tax advantages that might arise from a scheme intended to minimise tax. It includes, therefore, the non-inclusion of amounts as assessable income and the obtaining of deductions, as well as incurring capital losses, obtaining foreign income tax offsets, innovation tax offsets, exploration credits and withholding tax.

The identification of a tax benefit being obtained operates through s 177C(1) by reference to a hypothesis of alternative circumstances where the scheme had not been entered into or carried out. Section 177C(1) requires, in other words, an

[34] (2015) 332 ALR 621.

inquiry into what would have occurred or might reasonably be expected to have occurred if the scheme had not been entered into or carried out. The application of this hypothesis has proven difficult and led to some substantial amendments to Part IVA in 2013. Complex factual arguments arose about how the alternative hypothesis was to be constructed and about what evidence was relevant to the hypothetical alternative.[35]

The 2013 amendments to Part IVA are yet to be tested in court but they were designed to focus upon the tax effects arising from events and circumstances that actually happened or existed. Section 177CB(2) requires that a decision that a tax effect would have occurred (had the scheme not been entered into or carried out) must be based upon a postulate that comprises only the events or circumstances that actually happened or existed. Section 177CB(3) deals with a decision that a tax effect might reasonably be expected to have occurred and provides that the postulate in that case must be "a reasonable alternative". A reasonable alternative must be hypothesised by having regard to the substance of the scheme and the results or consequences for the taxpayer achieved by the scheme but disregarding any result in relation to the operation of tax law that would be achieved by the postulate for any person.

Choice Principle

The reasoning behind the enactment of s 177C was probably to be found in the jurisprudence known as the "choice principle" which had developed around the application of s 260 before the enactment of Part IVA. One of the conceptual difficulties with any general anti-avoidance rule is how to distinguish between tax benefits which are encouraged through the tax law and those which are not to be permitted. Taxpayers are frequently given tax incentives to encourage

[35] See *Lenzo v Federal Commissioner of Taxation* (2008) 167 FCR 255; *AXA Asia Pacific Holdings Ltd v Federal Commissioner of Taxation* (2009) 77 ATR 829; *Federal Commissioner of Taxation v Macquarie Bank Ltd* [2013] FCAFC 13.

particular behaviour or transactions which the general anti-avoidance rule might, but should not, strike down. It had long been said of the simpler provision preceding Part IVA that it was too broad and that it was apt to apply to situations which could not have been intended. In 1921 Knox CJ in *Deputy Commissioner of Taxation v Purcell*[36] said of the previous provision:

> This 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 …[37]

In 1956 another judge of the High Court said in *Federal Commissioner of Taxation v Newton:*[38]

> [T]he "purposes" or "effects" which will attract its operation are stated vaguely. If we interpret it very literally, it will seem to apply to cases which it is hardly conceivable that the legislature should have had in mind.[39]

It was clear that the anti-avoidance rule was not intended to apply, for example, to those cases where the taxing legislation expressly gave the taxpayer a choice or provided an incentive, but it was not clear which advantages might not permissibly be obtained. Our legislation, for example, encourages tax deductible gifts to be made to various charities and it could hardly be expected that a general anti-avoidance rule was intended to apply to deny a tax deduction which the provision expressly intended to give to a donor who had made a donation to a charity with tax deductible gift status. On the other hand there are tax consequences provided to taxpayers which may not be intended to be available to taxpayers who construct their affairs to come within terms that might not otherwise apply to them.

[36] (1921) 29 CLR 464.
[37] Ibid, 466.
[38] (1956) 96 CLR 577.
[39] Ibid, 646.

There developed a series of cases under the former general anti-avoidance provision before the enactment of Part IVA in which the Courts determined that the general anti-avoidance rule could not apply where the legislation was seen to have given a taxpayer a choice that the taxpayer had adopted. The decision in *WP Keighery Pty Ltd v Federal Commissioner of Taxation*[40] provided one example. That case was decided at a time when Australian tax law applied differently as between public companies and private companies. A private company was obliged to make distributions to shareholders and would be subject to tax on certain amounts which had not been distributed to the shareholders. Public companies, however, were not subjected to the same tax liability. WP Keighery Pty Ltd was a private company which altered its corporate arrangements to fall within the public company provisions and thus would not be subject to the tax it might have been obliged to pay as a private company on undistributed profits. The taxpayer conceded that the reason it had altered its corporate arrangements was to avoid the tax to which it would otherwise have been exposed as a private company, but argued that the general anti-avoidance rule did not apply to prevent a taxpayer from organising its affairs to come within a more favourable taxing regime provided by the legislation. The High Court accepted the taxpayer's contention and held that the general anti-avoidance provision did not apply because the purpose or policy of the legislation was said by the Court "to present the choice to a company between incurring the liability" provided by one division of the legislation or "taking measures to enlarge the number capable of controlling its affairs".[41] Choosing to become a public company was said not to defeat, evade or avoid a liability imposed, or to prevent the operation of the Act, because it was a choice expressly contemplated by the legislation.

[40] (1957) 100 CLR 66.
[41] Ibid, 93-4.

Subsequent cases extended what was thought to come within the ambit of choice provided by the legislation. In *Mullens v Federal Commissioner of Taxation*[42] it was said that a taxpayer was "entitled to create a situation to which the Act attaches taxation advantages for the taxpayer".[43] In that case the taxpayer entered into arrangements to take advantage of a provision which gave a tax deduction for certain expenditure in carrying on prospecting or mining operations for the purpose of discovering or obtaining petroleum, or on plant necessary for carrying on such operations. In *Slutzkin v Federal Commissioner of Taxation*[44] the taxpayer relied on legal form to avoid the imposition of tax. In that case the shareholders of a company sold shares in a company which had accumulated profits that would have been taxable if distributed to its shareholders as dividends. The liability of the existing shareholders for tax upon the dividends was removed by the shareholders selling the shares for cash at a price equivalent to the value of the company's accumulated assets. The buyer stipulated that the company's assets were to be converted to cash by the date of settlement of the transaction and that the company was to have no liabilities. The buyer, a dividend stripping company, subsequently caused dividends to be declared on the shares but no tax was paid on the dividends although the vendors would have paid tax on them if they had received the dividends rather than the sale price. In that case the taxpayer's choice lay in creating circumstances which changed the form in which the taxpayers (that is, the shareholders) received the economic equivalent of dividends as capital. In *Cridland v Federal Commissioner of Taxation*[45] the choice principle was applied to the creation of a situation which attracted tax consequences for which the Act made specific provision for primary producers. In that case university students were invited to apply for units in trusts which carried on a business of

[42] (1976) 135 CLR 290.
[43] Ibid, 298.
[44] (1977) 140 CLR 314.
[45] (1977) 140 CLR 330.

primary production. This enabled the students to obtain the benefit of the averaging provisions which were then available to primary producers, and to defer the full fiscal burden of taxation when commencing to derive greater assessable income than they have been deriving during their time as students.

Choice Principle and Misuse and Abuse

The people who drafted Part IVA intended to limit the operation of the choice principle.[46] Section 177C does that by excluding certain tax benefits from what is to be understood as falling within what is meant by the obtaining by a taxpayer of a tax benefit in connection with a scheme. Section 177C(2) excludes from the meaning to be given to that phrase those tax benefits which are attributable to the making of an agreement, choice, declaration, election, selection choice, notice or option which is expressly provided for. The exclusion, however, does not apply if the scheme was entered into for the purpose of creating any circumstances or state of affairs, the existence of which was necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised. The intention of these provisions is to narrow the choices excluded from the operation of the general anti-avoidance rules to those which are attributable to specific choices identifiable as express choices clearly given by statutory words.[47] For something to be "attributable" to a provision it must be a cause.[48]

It is possible to see in the choice principle something like the misuse or abuse concept found in United States jurisprudence and in equivalent statutory provisions found in Canada and New Zealand. The decision of the United States Supreme Court in *Gregory v Helvering*[49] was about the meaning of a

[46] Explanatory Memorandum, Income Tax Laws Amendment Bill (No 2) 1981 (Cth), 9552.
[47] See, for example, *AAT Case 529* (1989) 20 ATR 3777, 3790-91; *Ryan and Federal Commissioner of Taxation* (2004) 56 ATR 1122, [32]-[33].
[48] *Commissioner of Taxation v Sun Alliance Investments Pty Ltd (in liq)* (2005) CLR 488, [77]-[83].
[49] 293 US 465 (1935).

statutory provision concerned with corporate reorganisation. What the taxpayer had done in that case was said not to be within the meaning of a corporate reorganisation because it had no business or corporate purpose but had been used as a device for concealing the real character of the transaction rather than to reorganise a business or any part of the business. The Court interpreted the words in the legislation to exclude a meaning or operation which would result in a misuse of the provision, that is, to exclude a transaction found to lie "outside the plain intent of the statute".[50]

The Canadian legislation expressly adopted a requirement of abuse in its statutory general anti-avoidance rule in addition to the requirement for there to be a finding of avoidance. Section 245(1) of the *Income Tax Act RSC 1985* applies to deny tax benefits to avoidance transactions as defined by s 245(3) but excludes avoidance transactions from the operation of the general anti-avoidance rule unless they fail the abuse or misuse test. A transaction to be caught by the Canadian general anti-avoidance rule must, therefore, be both an "avoidance" transaction and found also to involve an "abuse or misuse" of the provision relied upon.

In *Canada Trust Co Mortgage Co v Canada*[51] the Canadian Supreme Court explained that in determining whether the general anti-avoidance rule applied to a transaction there needed to be considered (a) whether there was a tax benefit arising from the transaction, (b) whether the transaction was an avoidance transaction because it was not arranged primarily for *bona fide* purposes other than to obtain the tax benefit, and (c) whether the avoidance transaction was abusive. Each of these requirements needed to be satisfied for the Canadian general anti-avoidance rule to operate. The second of these requirements depends upon a consideration of the purpose for which the transaction was

[50] Ibid, 470.
[51] (2005) 2 SCR 601.

entered into and, in particular, upon whether the transaction had been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. The focus of the inquiry needed for this requirement is the transaction itself. The requirement that the transaction was abusive, however, depends upon an inquiry into whether the transaction, although an avoidance transaction, is also to be regarded as abusive in the sense that the taxpayer was relying upon a specific provision "in order to achieve an outcome that those provisions seek to prevent".[52] The focus of inquiry in that context is the contextual and purposive interpretation of the relevant provision "and the application of the properly interpreted provision to the facts of a given case".[53] The Court explained in *Canada Trust Co* that the application of the abuse and misuse test in s 245(4) imposed a two part inquiry:

> The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied upon for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.[54]

In that case the Court concluded that deductions which had been claimed by the taxpayer from a sale and leaseback transaction were consistent with the object and spirit of the taxing provisions relied upon by the taxpayer notwithstanding that it was an avoidance transaction and that there may not have been real financial risk or economic cost.

The general anti-avoidance rule in New Zealand does not expressly include a concept of abuse or misuse such as that found in the Canadian legislation, but the New Zealand Supreme Court has construed its provisions by reference to similar concepts. In *Ben Nevis Forestry Ventures Limited v Commissioner of*

[52] Ibid, [45].
[53] Ibid, [44].
[54] Ibid, [55].

Inland Revenue[55] the New Zealand Supreme Court adopted a test for the application of its general anti-avoidance rules to a transaction which required consideration of the purpose contemplated by Parliament when enacting the provision which the transaction was said to have avoided. In the joint judgment of Tipping, McGrath and Gault JJ their Honours said:

> When, as here, a case involves reliance by the taxpayer on specific provisions, the first enquiry concerns the application of those provisions. The taxpayer must satisfy the court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used a specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement.[56]

The inquiry called for in that context is similar to the Canadian abuse test and to the economic substance doctrine of the United States. The New Zealand Parliamentary contemplation test also calls for an inquiry into whether the specific transaction entered into by the taxpayer was the kind of transaction which the Parliament could have been expected to contemplate by the provision relied upon by the taxpayer.

The New Zealand test may be seen to assume that a transaction is otherwise an avoidance transaction but provides principles by which to decide which choices made by taxpayers (otherwise within the scope of tax avoidance) might nonetheless be permissible within the context of the provision. In that task the Supreme Court of New Zealand indicated that the enquiry into whether a tax avoidance arrangement exists is broad and not confined. In *Ben Nevis* it was said:

[55] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 2 NZLR 289.
[56] Ibid, [107].

> The general anti-avoidance provision does not confine the Court as to the matters which may be taken into account when considering whether a tax avoidance arrangement exists. Hence the Commissioner and the courts may address a number of relevant factors, the significance of which will depend on the particular facts. The manner in which the arrangement is carried out will often be an important consideration. So will the role of all relevant parties and any relationship they may have with the taxpayer. The economic and commercial effect of documents and transactions may also be significant. Other features that may be relevant include the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer. As indicated, it will often be the combination of various elements in the arrangement which is significant. A classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.
>
> In considering these matters, the courts are not limited to purely legal consideration. They should also consider the use made of the specific provision in the light of the commercial reality and the economic effect of that use. The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond Parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.[57]

The Parliamentary contemplation test is not without its difficulty,[58] but its underlying purpose, like the choice principle and the abuse doctrines, is to provide a predictable and objective foundation for determining when a taxpayer may rely upon a provision to secure its benefit without falling foul of the general anti-avoidance rules.[59]

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[57] Ibid, [108]-[109].
[58] GT Pagone, 'Appeals of Tax Avoidance: Trans-Tasman observations' (2011) 40 *Australian Tax Review* 145.
[59] See Interpretation Statement IS 13/01, Tax Avoidance and the Interpretation of sections BG1 and GA1 of the *Income Tax Act 2007*, New Zealand Inland Review (13 June 2013). Accessible at http://www.ird.govt.nz/technical-tax/interpretations/2013/interpretations-2013-index.html.

The general anti-avoidance rule adopted in England also depends upon a taxpayer's misuse or abuse of a statutory provision. The United Kingdom adopted a general anti-avoidance rule in Part 4 of the *Finance Act 2013* after an independent report headed by Mr Graham Aaronson QC[60] and the release of a government consultation document published on 12 June 2012.[61] The target of the general anti-avoidance rule was expressed to be "artificial and abusive tax-avoidance schemes which, because they [were] often complex and/or novel, could not have been contemplated directly when formulating the tax legislation".[62]

The provisions to achieve the aims, substantially in line with those proposed in the Aaronson Report, authorise the revenue to counteract abusive arrangements on a just and reasonable basis[63] subject to a number of safeguards. The statutory targets (before consideration of any of the safeguards) are arrangements "which cannot reasonably be regarded as a reasonable course of conduct" as judged by reference to the relevant provisions, the substantive results and any other arrangements forming part of the arrangements.[64] The UK model is targeted at arrangements having consequences that Parliament would not have countenanced had it foreseen the arrangement, and the tax consequence claimed.[65] The UK model is, therefore, directed to abuse and looks to the presumed intentions of Parliament rather than to a "constructive" purpose imputed to the participants by analysing the transaction.[66]

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[60] G Aaronson QC, *GAAR Study* (London) 11 November 2011. Accessible at: http://webarchive.nationalarchives.gov.uk/20130605083650/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf
[61] HM Revenue and Customs, A General Anti-Abuse Rule: Consultation Document (12 June 2012). Accessible at: https://www.taxation.co.uk/files/General+Anti-Abuse+Rule+%2528GAAR%2529+Consultation+document.pdf
[62] Ibid, 7 [2.2].
[63] Ibid 17; *Finance Act 2013* (UK) s 209(2).
[64] Ibid 14; *Finance Act 2013* (UK) s 207(1).
[65] Ibid 15 [3.15].
[66] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 2 NZLR 289.

The primary safeguard for taxpayers in the UK provisions is the "double reasonableness test". The UK general anti-avoidance rule applies only where conduct "cannot reasonably be regarded as a reasonable course of action".[67] The double reasonableness test is designed to ensure that the general anti-avoidance rule will be limited to counteract "only artificial and abusive schemes".[68] One of the reasonableness requirements in the test looks to the course of action and asks whether it is reasonable, the other looks to the observer and asks whether the otherwise "unreasonable" course of action would nonetheless be regarded as reasonable.

An essential aspect of the UK general anti-avoidance rule is the existence of a "tax advantage". A broad definition of tax advantage was adopted,[69] but implicit in the definition is that the tax position obtained by a transaction is to be contrasted with something else. In *Inland Revenue Commissioners v Parker*[70] Lord Wilberforce said in respect of a different definition of "tax advantage":

> The paragraph, as I understand it, presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that *the way in which he received what it is sought to tax* prevents him from being taxed on it; and that the Revenue is in a position to reply that if he had received what it is sought to tax *in another way* he would have had to bear tax. In other words, there must be a contrast as regards the "receipts" between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists, the existence of the tax advantage is not established.[71]

[67] *Finance Act 2013* (UK) s 207(2).
[68] HM Revenue and Customs, 'A General Anti-Abuse Rule: Consultation document' (12 June 2012), 15. Accessible at: https://www.taxation.co.uk/files/General+Anti-Abuse+Rule+%2528GAAR%2529+Consultation+document.pdf
[69] *Finance Act 2013* (UK) s 208.
[70] [1966] AC 141.
[71] Ibid 178-9.

The existence of a tax advantage will therefore need to be determined by identifying something against which to compare what was done. The appropriate comparator was contemplated in the Aaronson Report to derive from the "arrangements that *would have occurred* absent the relevant tax purpose" (emphasis added).[72] In other words, it will require the identification of a hypothetical fact based upon a prediction about what would otherwise have happened. It is not clear from the Aaronson Report whether the hypothetical will require an inquiry into how else the commercial aspect of a transaction might have been achieved without the perceived tax mischief (in other words, by asking "how else could what was done have been done") or whether the inquiry called for is about what else a taxpayer would have done if the taxpayer had not done the particular transaction with the perceived tax mischief (in other words an inquiry into "what else would have been done" assuming that what was done was not an option).

The concept of abuse, however, is central to the operation of the UK general anti-avoidance rule. "Abusive" is defined in s 207(2) as follows:

> Tax arrangements are "abusive" if they are arrangements entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including –
>
> (a) whether the substantiating result of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions;
>
> (b) whether the means of achieving those results involve one or more contrived or abnormal steps; and

[72] HM Revenue and Customs, 'A General Anti-Abuse Rule: Consultation document' (12 June 2012),16 [3.20]. Accessible at: https://www.taxation.co.uk/files/General+Anti-Abuse+Rule+%2528GAAR%2529+Consultation+document.pdf

(c) whether the arrangements are intended to exploit any shortcomings in those provisions.

Although different from the jurisprudence concerning abuse in the US, Canada and New Zealand, and different from the concept of specifically permitted choices in s 177C(2) in the Australian general anti-avoidance rule, the underlying concept is similar and calls for an inquiry into whether the way a taxpayer sought to use a provision is the way the provision was intended to be used.

International tax avoidance arrangements

Substantial additions were made to the general anti-avoidance rules in 2015 (with effect from 1 January 2016) and 2017 (with effect from 1 July 2017) to apply to different aspects of what was described as tax avoidance by large multinational groups. The 2015 amendments were said to have been designed to counter base erosion by international entities "using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia".[73] The 2017 amendments were enacted together with the creation of a new tax by the *Diverted Profits Tax Act 2017* (Cth) to impose tax on "diverted profits" at a rate of 40% to deal with what was described as "taxpayers who transfer profits to offshore associated entities using arrangements entered into or carried out for a principal purpose of avoiding Australian tax".[74] The assumption in these amendments appears to be that the domestic tax avoided is to be seen as part of a broader corporate activity in which multinationals organise their global affairs to achieve an unacceptable domestic Australian tax effect.

[73] Explanatory Memorandum, Tax Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2015 (Cth), 7.
[74] Explanatory Memorandum, Treasury Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2017 (Cth); Diverted Profits Tax Bill 2017 (Cth), 7.

The 2015 amendments are directed at schemes entered into by "significant global entities" which are defined, broadly, as members of multinational corporate groups with annual global income exceeding A$1 billion. The 2015 amendments were described in an Australian Tax Office document as being "designed to counter the erosion of the Australian tax base by multinational entities using artificial and contrived arrangements to avoid the attribution of profits to a permanent establishment in Australia".[75] New provisions were introduced into Part IVA to extend the general anti-avoidance provisions to schemes described as those "that limit a taxable presence in Australia"[76] by s 177DA extending the application of Part IVA to a scheme having as its features: (a) a foreign entity making a supply to an Australian customer of the foreign entity, (b) activities being undertaken in Australia directly in connection with the supply, (c) some or all of the activities being undertaken by an Australian entity which is an associate of or which is commercially dependent on the foreign entity where the activities are undertaken at or through an Australian permanent establishing of the Australian entity, (d) the foreign entity deriving ordinary income or statutory income from the supplier, and (e) some or all of that income not being attributable to the Australian permanent establishment of the foreign entity.

The extension to the general anti-avoidance rule by s 177DA is made to depend upon it being concluded that a person who entered into or carried out the scheme having those features did so for a "principal purpose" that included a purpose of enabling a taxpayer to obtain a tax benefit in Australia or both to obtain a tax benefit and to reduce one or more of their foreign tax liabilities, or enabling a taxpayer and another taxpayer each to obtain tax benefits in Australia

[75] Australian Taxation Office Law Companion Guideline LCG 2015/2 [6]; Accessible at https://www.ato.gov.au/law/view/view.htm?docid=%22COG%2FLCG20152A2%2FNAT%2FATO%2F00001%22.
[76] *Income Tax Assessment Act 1936* (Cth), s 177DA, Heading.

or both to obtain a tax benefit and to reduce one or more of their foreign tax liabilities. The conclusion to be reached is expressed in s 177DA by language suggesting an objective determination rather than an inquiry into subjective motives or reasons. The matters to which regard must be had in reaching that conclusion include those ordinarily provided for in Part IVA, but include also the extent to which the activities that contribute to bringing about the contract for the supply are performed and are able to be performed by the foreign entity, another entity, or other entities as well as the result, in relation to the operation of any foreign law relating to taxation, that would be achieved by the scheme but for the operation of Part IVA.[77]

The application of this provision was intended to have, however, a lower threshold test than the sole or dominant purpose test in s 177D and, therefore, to apply more easily. The general anti-avoidance rule had been made to depend upon it being concluded that a tax benefit was the "dominant purpose"[78] of one of the participants but in the case of the extension made by s 177DA it is sufficient that the purpose be "a principal purpose of, or more than one principal purpose that includes a purpose of" one of the relevant participants enabling the relevant taxpayer to obtain the tax benefit or the other tax effect.[79] An aspect of this provision that distinguishes it from the more general provision is that it can apply where the purpose of what was done, objectively ascertained, may be to obtain both a domestic Australian tax benefit and also a reduction in a foreign tax liability for the taxpayer[80] or another taxpayer.[81] The words "or more than one principal purpose" suggest that more than one principal purpose may exist for entering into a scheme and that "principal" in this context may not mean strictly "first or highest in rank" but, rather, "among the most important,

[77] *Income Tax Assessment Act 1936* (Cth), s 177DA(2).
[78] *Income Tax Assessment Act 1936* (Cth), s 177A(5).
[79] Ibid, s 177DA(1)(b).
[80] Ibid, s 177DA(1)(b)(i).
[81] Ibid, s 177DA(1)(b)(ii).

prominent, leading, main".[82] The fact that the purpose is described also by the word "a" principal purpose rather than as "the" principal purpose also suggests a lower threshold than dominant purpose.

The "diverted profits tax" provisions introduced in 2017 have some resemblance to transfer pricing provisions and included a new tax and additional changes to the general anti-avoidance rule in Part IVA. The provisions are directed to "significant global entities" and permit the Commissioner to impose a new tax at a penalty rate of 40%[83] where the new provision of s 177J in Part IVA applies to a scheme rather than to make a determination to cancel the tax benefit.[84] The *Diverted Profits Tax Act 2017* gives the Commissioner a new statutory power to make a diverted profits tax assessment which the taxpayer must pay within 21 days. The taxpayer then has a 12-month period of review during which it can provide the Commissioner with information disclosing reasons why the assessment should be reduced.[85] The taxpayer may shorten the period by written notice. If, at the end of the period, the taxpayer is dissatisfied with the assessment, it may challenge it by making an appeal to the Federal Court of Australia.[86] However, the taxpayer will generally be restricted in any appeal to adducing evidence that was provided to the Commissioner during the period of review.[87]

The Commissioner's ability to impose the new tax depends upon the general anti-avoidance rule in Part IVA applying because of s 177J.[88] That section identifies the schemes to which Part IVA is made to apply by the extended provisions and does so in language consistent with the earlier provisions as well

[82] Explanatory Memorandum, Tax Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2015 (Cth), [13].
[83] *Income Tax Assessment Act 1936* (Cth), s 177P; *Diverted Profits Tax Act 2017*, s 4.
[84] *Income Tax Assessment Act 1936* (Cth), s 177N(b).
[85] *Taxation Administration Act 1953* (Cth), Schedule 1, ss 145-15(1)(a).
[86] *Administrative Decisions (Judicial Review) Act 1977* (Cth), Schedule 1, (e) *Taxation Administration Act 1953* (Cth) Schedule 1, s 145-20.
[87] *Taxation Administration Act 1953* (Cth), s 145-25 of Schedule 1.
[88] *Income Tax Assessment Act 1936* (Cth), s 177J.

as with those which had been introduced in 2015. The section depends, like s 177DA, upon a taxpayer obtaining a tax benefit where the conclusion would be drawn that a principal purpose of one of the relevant participants entering into or carrying out the scheme was to enable a taxpayer to obtain a tax benefit, or to enable the taxpayer to obtain both a tax benefit and a reduction of foreign tax liability or of enabling the taxpayer and another taxpayer to do so. The provisions can only apply to a taxpayer which is a "significant global entity"[89] which is defined to mean an entity having an annual global income of AUD$1 billion or more in an income year.[90] The taxpayer obtaining the diverted profits tax benefit must have an associate which is a foreign entity[91] and which participates in, or is connected with, the scheme by which the taxpayer obtains the tax benefit.[92]

The extended operation of the general anti-avoidance rule to diverted profits tax, however, is restricted in various ways. A number of entities are specifically excluded,[93] such as managed investment trusts, complying superannuation entities and foreign pension funds. The provisions also contain a negative test based upon a standard of reasonableness which is designed to limit its operation. Section 177J will not apply where it is reasonable to conclude that any one of three tests is satisfied,[94] namely, the $25 million income test,[95] the sufficient foreign tax test,[96] and the sufficient economic substance test.[97] The $25 million income test is designed to ensure that the general anti-avoidance rule will not apply in relation to a diverted profits tax benefit if the aggregate of

[89] Ibid, s 177J(1)(a).
[90] *Taxation Administration Act 1953* (Cth), s 960-555(1) definition "significant global entity".
[91] Ibid, s 177J(1)(d).
[92] Ibid, s 177J(1)(e).
[93] Ibid, s 1775(1)(f).
[94] Ibid, s 177J(1)(g).
[95] Ibid, s 177K.
[96] Ibid, s 177L.
[97] Ibid, s 177M.

certain amounts does not exceed $25 million.[98] The sufficient foreign tax test is designed to exclude s 177J from applying if it is reasonable to conclude that the increase in the liability for foreign income tax was equal to or exceeded 80% of the corresponding reduction of the Australian tax liability.[99] The sufficient economic substance test[100] was designed to ensure that the diverted profits tax will not apply in relation to a relevant taxpayer if it is reasonable to conclude that the profit made as a result of a scheme reasonably reflected the economic substance of the entity's activities in connection with the scheme. For this purpose, regard may be had to the taxpayer's transfer pricing documents[101] including OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators as approved by the Council of the OECD.[102]

Dividend Stripping

A separate provision in Part IVA deals with dividend stripping. Dividend stripping has been known as a form of tax avoidance for some time and was thought to require a separate provision in Part IVA because it was thought that the mechanics of dividend stripping might not readily be dealt with through the application of the dominant purpose test in s 177D. Section 177E was, therefore, designed to negate the tax effect of dividend stripping operations by taking them to be a scheme to which Part IVA applies and to provide that a taxpayer was deemed to have obtained a tax benefit in relation to such a scheme.

[98] Ibid, s 177K.
[99] Ibid, s 177L.
[100] Ibid, s 177M.
[101] Ibid, s 177M(4).
[102] *Income Tax Assessment Act 1997* (Cth), s 815-135.

The concept of "dividend stripping" is not defined in the legislation but had been said by 1970 to have "become well known in English revenue law".[103] In that year Windeyer J said:

> I quote from *Halsbury's Laws of England*, 3rd ed., vol. 20, p. 201:
>
> > 'Dividend stripping is a term applied to a device by which a financial concern obtained control of a company having accumulated profits by purchase of the company's shares, arranged for these profits to be distributed to the concern by way of dividend, showed a loss on the subsequent sale of shares of the company, and obtained repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividend.'
>
> So well known has the term become that the second edition of *Fowler's Modern English Usage* (1965) has a brief explanation, under the heading "Bond washing and dividend stripping ", introduced by-
>
> > 'Most of us are familiar with these terms, but few know much more about them than that they are devices for the legal avoidance of taxation. In the course of the duel provoked by them between the tax avoider and the legislature they have developed a protean variety of detail, but their essence remains the same.'[104]

The essence of dividend stripping may be said to be an operation by which the economic value of an otherwise taxable dividend is received or enjoyed free from tax by the person who would have had to pay tax if the dividend had been paid. However, such a description fails to exclude many transactions with like effect but which do not have any tax avoidance purpose or effect, such as, for example, the sale of shares *cum* dividend which occurs regularly in ordinary share trading.

The formal preconditions for the operation of s 177E are (a) that a company disposed of property as a result either of a scheme by way of, in the nature of, dividend stripping or a scheme having substantially the effect of such a scheme,

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[103] *Investment & Merchant Finance Corporation Ltd v Federal Commissioner of Taxation* (1970) 120 CLR 177, 179.
[104] Ibid, 179.

(b) that the Commissioner be of the opinion that the disposal of the property represented, wholly or in part, a distribution of profits of the company, and (c) that an amount would have been included, or might reasonably be expected to have been included, in the assessable income of a taxpayer by reason of the payment of a dividend if immediately before the scheme was entered into the company had paid a dividend out of profits of an amount equal to the amount determined by the Commissioner to be the amount of profits represented by the disposal of the property.

The complexity and variety of structures capable of being dividend stripping operations make difficult a search for definitive features that all dividend stripping operations must have. In its simplest form dividend stripping was described in the explanatory memorandum accompanying one amendment as involving:

> the purchase by a share-trading company of shares in another company which has accumulated profits. A payment of a dividend is then made to the share-trading company which, in effect, wholly or substantially recoups its outlay on purchase of the shares that are then resold for a reduced price or are retained at a reduced value for income tax purposes.[105]

In *Federal Commissioner of Taxation v Consolidated Press Holdings Limited*[106] the operations in previous dividend stripping operations considered by the courts were said to have had the following common characteristics:

> [A] target company, with substantial undistributed profits creating a potential tax liability; the sale or allotment of shares to another party; the payment of a dividend to the purchaser or allottee; the purchaser escaping Australian tax on the dividends so declared; and the vendor shareholders receiving a capital sum for their shares in an amount the same as or very close to the dividends paid to the purchasers. A further common characteristic of each case was that the scheme was carefully planned for

[105] Explanatory Memorandum, Income Tax Assessment Bill (No 3) 1972 (Cth).
[106] (2001) 207 CLR 235.

> the predominant if not sole purpose of the vendor shareholders avoiding tax on a distribution of dividends.[107]

Section 177E was also expressed to extend to schemes having substantially the "effect" of a scheme by way of, or in the nature of, dividend stripping. A literal extension of the provision to schemes having the "effect" of dividend stripping might apply more broadly than to tax avoidance arrangements but the High Court considered in *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd*[108] that the extension of the provisions to schemes having the "effect" of dividend stripping required that the operations undertaken have the character of tax avoidance as a dominant purpose. It can be seen from the essence of dividend stripping that operations having the effect of stripping profits from a company may be undertaken both prospectively and retrospectively; that is, there may be both forward and backward dividend stripping operations. An example of a "forward" strip was considered by Lord Denning in *Finsbury Securities Ltd v Bishop (Inspector of Taxes)*[109] where his Lordship said:

> This is yet another case about dividend stripping, but of a new kind. It is forward-stripping as distinct from backward-stripping. We had to consider backward stripping in *Griffiths* v. *J. P. Harrison (Watford) Ltd.*, and in *Argosam Finance Co. Ltd.* v. *Oxby.* The essence of backward-stripping is that a dealer in shares buys shares in a company which has accumulated large profits and has paid tax on those profits. It is in a position to declare a dividend, after deduction of tax. The price is high because of the dividend soon to be distributed. The dealer pays the price and receives the dividend. In consequence the value of the shares falls at once by a large amount. He re-sells (or holds till the end of the year). The dealer then makes out his accounts for income tax purposes. These accounts omit all reference to the dividend received. (This practice is sanctioned by law: see *F.S. Securities Ltd.* v. *Inland Revenue Commissioners.*) The accounts show simply the shares bought at a high price, and re-sold (or re-valued) at a low price. So they show a large loss

[107] Ibid, 273, [126].
[108] (2001) 207 CLR 235.
[109] [1965] 1 WLR 1206.

> on the purchase and sale of the shares. The dealer claims tax-repayment on this loss; and succeeds. He gets back into his own hands all the tax which the company paid. It is all sheer gain to him. No tax on it. No surtax. The only loser is the revenue, or rather the other taxpayers.
>
> Now in forward-stripping the dealer buys shares in a company which hopes to make in the future large profits out of which it will be asked to declare a dividend, after deduction of tax. The dealer agrees to pay a lump sum price to cover the anticipated amount of dividends in the next few years. It may be five years, three years, or only one year. He keeps the shares and receives the dividends each year as they are declared. The value of the shares drops each year as and when the dividends are received. Then each year he makes out his accounts for income tax purposes. These omit all reference to the dividends received. So the accounts show a loss each year as the shares are revalued. The dealer claims tax-repayment on this loss. Can he succeed? I should add that if the dividend's should not reach the anticipated figure, the original price is reduced to meet the deficiency. So the dealer in the long run only pays the amount of the dividends. The price equals the amount of the dividends received. But he gets the whole of the tax-repayment (if permitted) free of any tax at all.[110]

(Footnotes omitted).

In *Lawrence v Federal Commissioner of Taxation*[111] it was held that a transaction diminishing the value of a company represented a distribution of its profits. In that case two companies had each entered into transactions which had as their objective and effect a diminution of the company's property.

Other general anti-avoidance provisions

It may seem a contradiction of terms to talk about "other general anti-avoidance provisions" but some provisions in Part IVA are directed specifically to particular types of avoidance. Significant additions were made to Part IVA in 1999 to have the general anti-avoidance rule specifically apply to what was described as abuses of the imputation system for tax paid by companies.

[110] Ibid, 1216.
[111] (2009) 175 FCR 277.

Australia had adopted a system of tax imputation to enable the tax paid by companies to be imputed to their shareholders in receipt of franked dividends. Not all shareholders in receipt of a franked dividend, however, were able to use the franking credit because not all shareholders were liable to pay Australian tax against which to credit their franked amounts. A consequence was that the economic value of franked dividends differed as between those shareholders who could utilise franked credits and those shareholders who could not. There developed, therefore, an economic incentive on the part of shareholders who could not utilise their franking credits to sell the credits to those who could use them. Some trading in franking credits emerged as did differential streaming of dividends as between shareholders with credits attached to one stream of dividends but not to another.

It was subsequently announced that the government had designed the imputation system upon the assumption that there would be a certain amount of "wastage" of franking credits resulting from the distribution of franking credits to persons who could not use them.[112] Part IVA was therefore amended to prevent trading in franking credits and schemes in which dividends were streamed as between different classes of shareholders. Section 177EA was introduced to target schemes involving a disposition of shares or similar equity instrument entered into with a purpose of enabling a taxpayer to obtain an imputation benefit including franking credits. A general company consolidation regime was subsequently enacted and s 177EB was introduced to limit the capacity of taxpayers to shift franking credits to a group holding company to those cases where the holder of the franking credits joined a corporate group under a legitimate commercial dealing.

[112] Supplementary Explanatory Memorandum, Taxation Laws Amendment Bill (No 3) 1998 (Cth); Para [2.3].

Provisions similar to Part IVA can also be found in provisions imposing taxes which are different from the tax upon income and capital gains. Australia introduced a general tax upon goods and services with effect from 2000 which included, in Division 165, a provision modelled upon Part IVA. Although a tax upon income and a tax upon goods and services are conceptually different the general anti-avoidance provision in Division 165 follows broadly the structure of Part IVA. Division 165 is expressly stated to be aimed at "artificial or contrived schemes" with the object being to deter schemes giving GST benefits "by reducing GST, increasing refunds or altering the timing of payments" of GST or refunds.[113] The model of Part IVA is also found in other taxing legislation or measures in which liabilities are imposed including that for compulsory insurance by employers for workplace injuries.[114]

G.T Pagone

Melbourne, June 2017

[113] *A New Tax System (Goods and Services Tax) Act 1999* (Cth), s 165-1.
[114] See for example *Workplace Injury Rehabilitation and Compensation Act 2013* (Vic), s 457; *Duties Act 2000* (Vic), s 69B.

ANNEXURE

Part IVA—Schemes to reduce income tax

177A Interpretation

(1) In this Part, unless the contrary intention appears:

associate has the same meaning as in Part X.

Australian customer, of a foreign entity, means another entity who:

(a) is in Australia, or is an Australian entity; and

(b) if the foreign entity is a member of a global group—is not a member of that global group.

Australian entity has the same meaning as in Part X.

Australian permanent establishment of an entity means:

(a) if:

(i) the entity is a resident in a country that has entered into an international tax agreement (within the meaning of subsection 995-1(1) of the *Income Tax Assessment Act 1997*) with Australia; and

(ii) that agreement contains a permanent establishment article (within the meaning of that subsection);

a permanent establishment (within the meaning of that agreement) in Australia; or

(b) otherwise—a permanent establishment of the person in Australia.

capital loss has the meaning given by subsection 995-1(1) of the *Income Tax Assessment Act 1997*.

DPT base amount has the meaning given by subsection 177P(2).

DPT provisions means sections 177H, 177J, 177K, 177L, 177M, 177N, 177P, 177Q and 177R.

DPT tax benefit has the meaning given by subsection 177J(1).

entity has the meaning given by section 960-100 of the *Income Tax Assessment Act 1997*.

foreign entity has the meaning given by subsection 995-1(1) of the *Income Tax Assessment Act 1997*.

foreign income tax offset means a tax offset allowed under Division 770 of the *Income Tax Assessment Act 1997*.

foreign law has the meaning given by subsection 995-1(1) of the *Income Tax Assessment Act 1997*.

global group means a group of entities, at least one of which is a foreign entity, that are consolidated for accounting purposes as a single group.

innovation tax offset means a tax offset allowed under:

(a) Subdivision 61-P (about early stage venture capital limited partnerships) of the *Income Tax Assessment Act 1997*; or

(b) Subdivision 360-A (about early stage investors in innovation companies) of that Act.

scheme means:

(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and

(b) any scheme, plan, proposal, action, course of action or course of conduct.

significant global entity has the meaning given by section 960-555 of the *Income Tax Assessment Act 1997*.

standard corporate tax rate means the rate of tax in respect of the taxable income of a company covered by paragraph 23(2)(b) of the *Income Tax Rates Act 1986*.

supply has the meaning given by section 9-10 of the GST Act, but does not include any of the following, or of any combination of 2 or more of the following:
(a) a supply of an equity interest in an entity;
(b) a supply of a debt interest in an entity;
(c) a supply of an option for:
(i) a supply of a kind referred to in paragraph (a) or (b); or
(ii) any combination of 2 or more such supplies.

taxpayer includes a taxpayer in the capacity of a trustee.

(2) The definition of ***taxpayer*** in subsection (1) shall not be taken to affect in any way the interpretation of that expression where it is used in this Act other than this Part.

(3) The reference in the definition of ***scheme*** in subsection (1) to a scheme, plan, proposal, action, course of action or course of conduct shall be read as including a reference to a unilateral scheme, plan, proposal, action, course of action or course of conduct, as the case may be.

(4) A reference in this Part to the carrying out of a scheme by a person shall be read as including a reference to the carrying out of a scheme by a person together with another person or other persons.

(5) A reference in this Part (other than sections 177DA and 177J) to a scheme or a part of a scheme being entered into or carried out by a person for a particular purpose shall be read as including a reference to the scheme or the part of the scheme being entered into or carried out by the person for 2 or more purposes of which that particular purpose is the dominant purpose.

177B Operation of Part

(1) Nothing in the following limit the operation of this Part:
(a) the provisions of this Act (other than this Part);
(b) the *International Tax Agreements Act 1953*;
(c) the *Petroleum (Timor Sea Treaty) Act 2003*.

(2) This Part does not affect the operation of Division 393 of the *Income Tax Assessment Act 1997* (Farm management deposits).

(3) Where a provision of this Act other than this Part is expressed to have effect where a deduction would be allowable to a taxpayer but for or apart from a provision or provisions of this Act, the reference to that provision or to those provisions, as the case may be, shall be read as including a reference to subsection 177F(1).

(4) Where a provision of this Act other than this Part is expressed to have effect where a deduction would otherwise be allowable to a taxpayer, that provision shall be deemed to be expressed to have effect where a deduction would, but for subsection 177F(1), be otherwise allowable to the taxpayer.

177C Tax benefits

(1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

(a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out; or

(b) a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out; or (ba) a capital loss being incurred by the taxpayer during a year of income where the whole or a part of that capital loss would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out; or

(bb) a foreign income tax offset being allowable to the taxpayer where the whole or a part of that foreign income tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or

(bbaa) an innovation tax offset being allowable to the taxpayer where the whole or a part of that innovation tax offset would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer if the scheme had not been entered into or carried out; or

(bba) an exploration credit being issued to the taxpayer where the whole or a part of that exploration credit would not have been issued, or might reasonably be expected not to have been issued, to the taxpayer if the scheme had not been entered into or carried out; or

(bc) the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out;

and, for the purposes of this Part, the amount of the tax benefit shall be taken to be:

(c) in a case to which paragraph (a) applies—the amount referred to in that paragraph; and

(d) in a case to which paragraph (b) applies—the amount of the whole of the deduction or of the part of the deduction, as the case may be, referred to in that paragraph; and

(e) in a case to which paragraph (ba) applies—the amount of the whole of the capital loss or of the part of the capital loss, as the case may be, referred to in that paragraph; and

(f) in a case where paragraph (bb) applies—the amount of the whole of the foreign income tax offset or of the part of the foreign income tax offset, as the case may be, referred to in that paragraph; and

(faa) in a case where paragraph (bbaa) applies—the amount of the whole of the innovation tax offset or of the part of the innovation tax offset, as the case may be, referred to in that paragraph; and

(fa) in a case where paragraph (bba) applies—the amount of the whole of the exploration credit or of the part of the exploration credit, as the case may be, referred to in that paragraph; and

(g) in a case to which paragraph (bc) applies—the amount referred to in that paragraph.

(2) A reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as not including a reference to:

(a) the assessable income of the taxpayer of a year of income not including an amount that would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out where:

(i) the non-inclusion of the amount in the assessable income of the taxpayer is attributable to the making of an agreement, choice, declaration, agreement, election, selection or choice, the giving of a notice or the exercise of an option (expressly provided for by this Act or the *Income Tax Assessment Act 1997*) by any person, except one under Subdivision 126-B, 170-B or 960-D of the *Income Tax Assessment Act 1997*; and

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

(b) a deduction being allowable to the taxpayer in relation to a year of income the whole or a part of which would not have been, or might reasonably be expected not to have been, allowable to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out where:

(i) the allowance of the deduction to the taxpayer is attributable to the making of a declaration, agreement, election, selection or choice, the giving of a notice or the exercise of an option by any person, being a declaration, agreement, election, selection, choice, notice or option expressly provided for by this Act or the *Income Tax Assessment Act 1997*, except one under Subdivision 960-D of the *Income Tax Assessment Act 1997*; and

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

(c) a capital loss being incurred by the taxpayer during a year of income the whole or part of which would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out where:

(i) the incurring of the capital loss by the taxpayer is attributable to the making of a declaration, agreement, choice, election or selection, the giving of a notice or the exercise of an option (expressly provided for by this Act or the *Income Tax Assessment Act 1997*) by any person, except one under Subdivision 126-B, 170-B or 960-D of the *Income Tax Assessment Act 1997*; and

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

(d) a foreign income tax offset being allowable to the taxpayer the whole or a part of which would not have been, or might reasonably be expected not to have been, allowable to the taxpayer if the scheme had not been entered into or carried out, where:

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

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

(e) an innovation tax offset being allowable to the taxpayer the whole or a part of which would not have been, or might reasonably be expected not to have been, allowable to the taxpayer if the scheme had not been entered into or carried out, where:

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

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

(2A) A reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme is to be read as not including a reference to:

(a) the assessable income of the taxpayer of a year of income not including an amount that would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out where:

(i) the non-inclusion of the amount in the assessable income of the taxpayer is attributable to the making of a choice under Subdivision 126-B of the *Income Tax Assessment Act 1997* or an agreement under Subdivision 170-B of that Act; and

(ii) the scheme consisted solely of the making of the agreement or election; or

(b) a capital loss being incurred by the taxpayer during a year of income the whole or part of which would not have been, or might reasonably be expected not to have been, incurred by the taxpayer during the year of income if the scheme had not been entered into or carried out where:

(i) the incurring of the capital loss by the taxpayer is attributable to the making of a choice under Subdivision 126-B of the *Income Tax Assessment Act 1997* or an agreement under Subdivision 170-B of that Act; and

(ii) the scheme consisted solely of the making of the agreement or election; or

(c) an exploration credit being issued to the taxpayer the whole or a part of which would not have been, or might reasonably be expected not to have been, issued to the taxpayer if the scheme had not been entered into or carried out, where:

(i) the issuing of the exploration credit to the taxpayer is attributable to the making of a choice under Division 418 of the *Income Tax Assessment Act 1997*; and

(ii) the scheme consisted solely of the making of the choice.

(3) For the purposes of subparagraph (2)(a)(i), (b)(i), (c)(i), (d)(i) or (e)(i) or (2A)(a)(i), (b)(i) or (c)(i):

(a) the non-inclusion of an amount in the assessable income of a taxpayer; or

(b) the allowance of a deduction to a taxpayer; or

(c) the incurring of a capital loss by a taxpayer; or

(ca) the allowance of a foreign income tax offset to a taxpayer; or

(caa) the allowance of an innovation tax offset to a taxpayer; or

(cb) the issuing of an exploration credit to a taxpayer;

is taken to be attributable to the making of a declaration, election, agreement or selection, the giving of a notice or the exercise of an option where, if the declaration, election, agreement, selection, notice or option had not been made, given or exercised, as the case may be:

(d) the amount would have been included in that assessable income; or

(e) the deduction would not have been allowable; or

(f) the capital loss would not have been incurred; or

(g) the foreign income tax offset would not have been allowable; or

(ga) the innovation tax offset would not have been allowable; or

(h) the exploration credit would not have been issued.

(4) To avoid doubt, paragraph (1)(a) applies to a scheme if:

(a) an amount of income is not included in the assessable income of the taxpayer of a year of income; and

(b) an amount would have been included, or might reasonably be expected to have been included, in the assessable income if the scheme had not been entered into or carried out; and

(c) instead, the taxpayer or any other taxpayer makes a discount capital gain (within the meaning of the *Income Tax Assessment Act 1997*) for that or any other year of income.

(5) Subsection (4) does not limit the generality of any other provision of this Part.

177CB The bases for identifying tax benefits

(1) This section applies to deciding, under section 177C, whether any of the following (***tax effects***) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

(a) an amount being included in the assessable income of the taxpayer;

(b) the whole or a part of a deduction not being allowable to the taxpayer;

(c) the whole or a part of a capital loss not being incurred by the taxpayer;

(d) the whole or a part of a foreign income tax offset not being allowable to the taxpayer;

(daa) the whole or a part of an innovation tax offset not being allowable to the taxpayer;

(da) the whole or a part of an exploration credit not being issued to the taxpayer;

(e) the taxpayer being liable to pay withholding tax on an amount.

(2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

(4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:

(a) have particular regard to:

(i) the substance of the scheme; and

(ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but

(b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).

(5) Subsection (4) applies in relation to the scheme as if references in that subsection to the operation of this Act included references to the operation of any foreign law relating to taxation:

(a) if this Part applies to the scheme because of sections 177DA or 177J; or

(b) for the purposes of determining whether this Part applies to the scheme because of sections 177DA or 177J.

177D Schemes to which this Part applies

Scheme for purpose of obtaining a tax benefit

(1) This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of:

(a) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit in connection with the scheme; or

(b) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit in connection with the scheme;

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers.

Have regard to certain matters

(2) For the purpose of subsection (1), have regard to the following matters:

(a) the manner in which the scheme was entered into or carried out;

(b) the form and substance of the scheme;
(c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
(d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
(e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
(f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
(h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

Note: Section 960-255 of the *Income Tax Assessment Act 1997* may be relevant to determining family relationships for the purposes of paragraphs (f) and (h).

Tax benefit

(3) Despite subsection (1), this Part applies to the scheme only if the relevant taxpayer has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme.

When schemes entered into etc.

(4) Despite subsection (1), this Part applies to the scheme only if:
(a) the scheme has been or is entered into after 27 May 1981; or
(b) the scheme has been or is carried out or commenced to be carried out after that day (and is not a scheme that was entered into on or before that day).

Schemes outside Australia

(5) This section applies whether or not the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

177DA Schemes that limit a taxable presence in Australia

Scheme for a purpose including obtaining a tax benefit etc.

(1) Without limiting section 177D, this Part also applies to a scheme if:

(a) under, or in connection with, the scheme:

(i) a foreign entity makes a supply to an Australian customer of the foreign entity; and

(ii) activities are undertaken in Australia directly in connection with the supply; and

(iii) some or all of those activities are undertaken by an Australian entity who, or are undertaken at or through an Australian permanent establishment of an entity who, is an associate of or is commercially dependent on the foreign entity; and

(iv) the foreign entity derives ordinary income, or statutory income, from the supply; and

(v) some or all of that income is not attributable to an Australian permanent establishment of the foreign entity; and

(b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:

(i) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme;

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers; and

(c) the foreign entity is a significant global entity for a year of income in which the relevant taxpayer, or one or more other taxpayers, would (but for this Part):

(i) obtain a tax benefit; or

(ii) reduce one or more of their liabilities to tax under a foreign law;

in connection with the scheme.

Have regard to certain matters

(2) For the purposes of paragraph (1)(b), have regard to the following matters:

(a) the matters in subsection 177D(2);

(b) the extent to which the activities that contribute to bringing about the contract for the supply are performed, and are able to be performed, by:

(i) the foreign entity; or

(ii) another entity referred to in subparagraph (1)(a)(iii); or

(iii) any other entities;

(c) the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme.

Deferral of foreign tax liabilities

(3) For the purposes of paragraph (1)(b), a deferral of a taxpayer's liabilities to tax under a foreign law is taken to be a reduction of those liabilities, unless there are reasonable commercial grounds for the deferral.

Tax benefit

(4) Despite subsection (1), this Part applies to the scheme because of this section only if the relevant taxpayer has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme.

Commissioner not required to enquire into foreign tax matters

(5) The Commissioner is required to have regard to a matter referred to in paragraph (2)(c) only so far as information relevant to that matter is available to the Commissioner, and is not required to acquire further information in order to have regard to that matter.

Schemes outside Australia

(6) This section applies whether or not the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

177E Stripping of company profits

(1) Where:

(a) as a result of a scheme that is, in relation to a company:

(i) a scheme by way of or in the nature of dividend stripping; or

(ii) a scheme having substantially the effect of a scheme by way of or in the nature of a dividend stripping;

any property of the company is disposed of;

(b) in the opinion of the Commissioner, the disposal of that property represents, in whole or in part, a distribution (whether to a shareholder or another person) of profits of the company (whether of the accounting period in which the disposal occurred or of any earlier or later accounting period);

(c) if, immediately before the scheme was entered into, the company had paid a dividend out of profits of an amount equal to the amount determined by the Commissioner to be the amount of profits the distribution of which is, in his or her opinion, represented by the disposal of the property referred to in paragraph (a), an amount (in this subsection referred to as the ***notional amount***) would have been included, or might reasonably be expected to have been included, by reason of the payment of that dividend, in the assessable income of a taxpayer of a year of income; and

(d) the scheme has been or is entered into after 27 May 1981, whether in Australia or outside Australia;

the following provisions have effect:

(e) the scheme shall be taken to be a scheme to which this Part applies;

(f) for the purposes of section 177F, the taxpayer shall be taken to have obtained a tax benefit in connection with the scheme that is referable to the notional amount not being included in the assessable income of the taxpayer of the year of income; and

(g) the amount of that tax benefit shall be taken to be the notional amount.

(2) Without limiting the generality of subsection (1), a reference in that subsection to the disposal of property of a company shall be read as including a reference to:

(a) the payment of a dividend by the company;

(b) the making of a loan by the company (whether or not it is intended or likely that the loan will be repaid);

(c) a bailment of property by the company; and

(d) any transaction having the effect, directly or indirectly, of diminishing the value of any property of the company.

(2A) This section:

(a) applies to a non-share equity interest in the same way as it applies to a share; and

(b) applies to an equity holder in the same way as it applies to a shareholder; and

(c) applies to a non-share dividend in the same way as it applies to a dividend.

(3) In this section, ***property*** includes a chose in action and also includes any estate, interest, right or power, whether at law or in equity, in or over property.

177EA Creation of franking debit or cancellation of franking credits

(1) In this section, unless the contrary intention appears:

relevant circumstances has a meaning affected by subsection (17).

relevant taxpayer has the meaning given by subsection (3).

scheme for a disposition, in relation to membership interests or an interest in membership interests, has a meaning affected by subsection (14).

(2) An expression used in this section that is defined in the *Income Tax Assessment Act 1997* has the same meaning as in that Act, except to the extent that its meaning is extended by subsection (16), (18) or (19), or affected by subsection (15).

Application of section

(3) This section applies if:

(a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and

(b) either:

(i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

(ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and

(c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and

(d) except for this section, the person (the ***relevant taxpayer***) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and

(e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

Bare acquisition of membership interests or interest in membership interests

(4) It is not to be concluded for the purposes of paragraph (3)(e) that a person entered into or carried out a scheme for a purpose mentioned in that paragraph merely because the person acquired membership interests, or an interest in membership interests, in the entity.

Commissioner to determine franking debit or deny franking credit

(5) The Commissioner may make, in writing, either of the following determinations:

(a) if the corporate tax entity is a party to the scheme, a determination that a franking debit or exempting debit of the entity arises in respect of each distribution made to the relevant taxpayer or that flows indirectly to the relevant taxpayer;

(b) a determination that no imputation benefit is to arise in respect of a distribution or a specified part of a distribution that is made, or that flows indirectly, to the relevant taxpayer.

A determination does not form part of an assessment.

Notice of determination

(6) If the Commissioner makes a determination under subsection (5), the Commissioner must:

(a) in respect of a determination made under paragraph (5)(a)—serve notice in writing of the determination on the corporate tax entity; or

(b) in respect of a determination made under paragraph (5)(b)—serve notice in writing of the determination on the relevant taxpayer.

Publication in national newspaper of determination in relation to listed public company denying imputation benefit

(7) If the Commissioner makes a determination under paragraph (5)(b), in respect of a distribution made by a listed public company, the Commissioner is taken to have served notice in writing of the determination on the relevant taxpayer if the Commissioner causes the notice to be published in a daily newspaper that circulates generally in each State, the Australian Capital Territory and the Northern Territory. The notice is taken to have been served on the day on which the publication takes place.

Objections

(9) If a taxpayer to whom a determination relates is dissatisfied with the determination, the taxpayer may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

Effect of determination of franking debit or exempting debit

(10) If the Commissioner makes a determination under paragraph (5)(a):

(a) on the day on which notice in writing of the determination is served on the entity, a franking debit or exempting debit of the corporate tax entity arises in respect of the distribution; and

(b) the amount of the franking debit or exempting debit is such amount as is stated in the Commissioner's determination, being an amount that:

(i) the Commissioner considers reasonable in the circumstances; and

(ii) does not exceed the amount of the franking debit or exempting debit of the entity arising under item 1 of the table in section 205-30 of the *Income Tax Assessment 1997* or item 2 of the table in section 208-120 of that Act in respect of the distribution.

Effect of determination that no imputation benefit is to arise

(11) If the Commissioner makes a determination under paragraph (5)(b), the determination has effect according to its terms.

Application of section to non-share dividends

(12) This section:

(a) applies to a non-share equity interest in the same way as it applies to a membership interest; and

(b) applies to an equity holder in the same way as it applies to a member; and

(c) applies to a non-share dividend in the same way as it applies to a distribution.

Meaning of ***interest in membership interests***

(13) A person has an interest in membership interests if:

(a) the person has any legal or equitable interest in the membership interests; or

(b) the person is a partner in a partnership and:

(i) the assets of the partnership include, or will include, the membership interests; or

(ii) the partnership derives, or will derive, income indirectly through interposed companies, trusts or partnerships, from distributions made on the membership interests; or

(c) the person is a beneficiary of a trust (including a potential beneficiary of a discretionary trust) and:

(i) the membership interests form, or will form, part of the trust estate; or

(ii) the trust derives, or will derive, income indirectly through interposed companies, trusts or partnerships, from distributions made on the membership interests.

Meaning of ***scheme for a disposition***

(14) A scheme for a disposition of membership interests or an interest in membership interests includes, but is not limited to, a scheme that involves any of the following:

(a) issuing the membership interests or creating the interest in membership interests;

(b) entering into any contract, arrangement, transaction or dealing that changes or otherwise affects the legal or equitable ownership of the membership interests or interest in membership interests;

(c) creating, varying or revoking a trust in relation to the membership interests or interest in membership interests;

(d) creating, altering or extinguishing a right, power or liability attaching to, or otherwise relating to, the membership interests or interest in membership interests;

(e) substantially altering any of the risks of loss, or opportunities for profit or gain, involved in holding or owning the membership interests or having the interest in membership interests;

(f) the membership interests or interest in membership interests beginning to be included, or ceasing to be included, in any of the insurance funds of a life assurance company.

(15) In determining whether a distribution flows indirectly to a person, assume that the following provisions of the *Income Tax Assessment Act 1997* had not been enacted:

(a) section 295-385 (about income from assets set aside to meet current pension liabilities), section 295-390 (about income from other assets used to meet current pension liabilities) and 295-400 (about income of a PST attributable to current pension liabilities); or

(b) paragraph 320-37(1)(a) (about segregated exempt assets) or paragraph 320-37(1)(d) (about income bonds, funeral policies and scholarship plans).

When imputation benefit is received

(16) A taxpayer to whom a distribution flows indirectly receives an ***imputation benefit*** as a result of the distribution if:

(a) the taxpayer is entitled to a tax offset under Division 207 of the *Income Tax Assessment Act 1997* as a result of the distribution; or

(b) where the taxpayer is a corporate tax entity—a franking credit would arise in the franking account of the taxpayer as a result of the distribution.

Note: Where the distribution is made directly to the taxpayer, see subsection 204-30(6) of the *Income Tax Assessment Act 1997* for a definition of ***imputation benefit***.

Meaning of ***relevant circumstances*** *of scheme*

(17) The ***relevant circumstances*** of a scheme include the following:

(a) the extent and duration of the risks of loss, and the opportunities for profit or gain, from holding membership interests, or having interests in membership interests, in the corporate tax entity that are respectively borne by or accrue to the parties to the scheme, and whether there has been any change in those risks and opportunities for the relevant taxpayer or any other party to the scheme (for example, a change resulting from the making of any contract, the granting of any option or the entering into of any arrangement with respect to any membership interests, or interests in membership interests, in the corporate tax entity);

(b) whether the relevant taxpayer would, in the year of income in which the distribution is made, or if the distribution flows indirectly to the relevant taxpayer, in the year in which the distribution flows indirectly to the relevant taxpayer, derive a greater benefit from franking credits than other entities who hold membership interests, or have interests in membership interests, in the corporate tax entity;

(c) whether, apart from the scheme, the corporate tax entity would have retained the franking credits or exempting credits or would have used the franking credits or exempting credits to pay a franked distribution to another entity referred to in paragraph (b);

(d) whether, apart from the scheme, a franked distribution would have flowed indirectly to another entity referred to in paragraph (b);

(e) if the scheme involves the issue of a non-share equity interest to which section 215-10 of the *Income Tax Assessment Act 1997* applies—whether the corporate tax entity has issued, or is likely to issue, equity interests in the corporate tax entity:

(i) that are similar, from a commercial point of view, to the non-share equity interest; and

(ii) distributions in respect of which are frankable;

(f) whether any consideration paid or given by or on behalf of, or received by or on behalf of, the relevant taxpayer in connection with the scheme (for example, the amount of any interest on a loan) was calculated by reference to the imputation benefits to be received by the relevant taxpayer;

(g) whether a deduction is allowable or a capital loss is incurred in connection with a distribution that is made or that flows indirectly under the scheme;

(ga) whether a distribution that is made or that flows indirectly under the scheme to the relevant taxpayer is sourced, directly or indirectly, from unrealised or untaxed profits;

(h) whether a distribution that is made or that flows indirectly under the scheme to the relevant taxpayer is equivalent to the receipt by the relevant taxpayer of interest or of an amount in the nature of, or similar to, interest;

(i) the period for which the relevant taxpayer held membership interests, or had an interest in membership interests, in the corporate tax entity;

(j) any of the matters referred to in subsection 177D(2).

Meaning of ***greater benefit from franking credits***

(18) The following subsection lists some of the cases in which a taxpayer to whom a distribution flows indirectly receives a ***greater benefit from franking credits*** than an entity referred to in paragraph (17)(b). It is not an exhaustive list.

(19) A taxpayer to whom a distribution flows indirectly receives a ***greater benefit from franking credits*** than an entity referred to in paragraph (17)(b) if any of the following circumstances exist in relation to that entity in the year of income in which the distribution giving rise to the benefit is made, and not in relation to the taxpayer if:

(a) the entity is not an Australian resident; or

(b) the entity would not be entitled to any tax offset under Division 207 of the *Income Tax Assessment Act 1997* because of the distribution; or

(c) the amount of income tax that would be payable by the entity because of the distribution is less than the tax offset to which the entity would be entitled; or

(d) the entity is a corporate tax entity at the time the distribution is made, but no franking credit arises for the entity as a result of the distribution; or

(e) the entity is a corporate tax entity at the time the distribution is made, but cannot use franking credits received on the distribution to frank distributions to its own members because:

(i) it is not a franking entity; or

(ii) it is unable to make frankable distributions.

Note: Where the distribution is made directly to the taxpayer, see subsections 204-30(7), (8), (9) and (10) of the *Income Tax Assessment Act 1997* for a list of circumstances in which the taxpayer will be treated as deriving a greater benefit from franking credits than another entity.

177EB Cancellation of franking credits—consolidated groups

Expressions to have same meanings as in section 177EA and Income Tax Assessment Act 1997

(1) Unless the contrary intention appears, expressions used in this section:

(a) if those expressions are defined in section 177EA—have the same meanings as in that section (subject to subsection (10) of this section); and

(b) otherwise—have the same meanings as in the *Income Tax Assessment Act 1997*.

This section and section 177EA do not limit each other

(2) This section does not limit the operation of section 177EA, and section 177EA does not limit the operation of this section.

Application of section

(3) This section applies if:

(a) there is a scheme for a disposition of membership interests in an entity (the ***joining entity***); and

(b) as a result of the disposition, the joining entity becomes a subsidiary member of a consolidated group; and

(c) a credit arises in the franking account of the head company of the group because of the joining entity becoming a subsidiary member of the group; and

(d) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the credit referred to in paragraph (c) to arise in the head company's franking account.

Bare acquisition of membership interests

(4) It is not to be concluded for the purposes of paragraph (3)(d) that a person entered into or carried out a scheme for a purpose mentioned in that paragraph merely because the person acquired membership interests in the joining entity.

Commissioner to determine no franking credit

(5) The Commissioner may make, in writing, a determination that no credit is to arise in the head company's franking account because of the joining entity becoming a subsidiary member of the consolidated group. A determination does not form part of an assessment.

Effect of determination

(6) A determination under subsection (5) has effect according to its terms.

Notice of determination

(7) If the Commissioner makes a determination under subsection (5), the Commissioner must serve notice in writing of the determination on the head company.

Objections

(9) If a taxpayer to whom a determination relates is dissatisfied with the determination, the taxpayer may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

Relevant circumstances

(10) The ***relevant circumstances*** of a scheme include the following:

(a) the extent and duration of the risks of loss, and the opportunities for profit or gain, from holding membership interests in the joining entity that are respectively borne by or accrue to the parties to the scheme, and whether there has been any change in those risks and opportunities for the head company or any other party to the scheme (for example, a change resulting from the making of any contract, the granting of any option or the entering into of any arrangement with respect to any membership interests in the joining entity);

(b) whether the head company, or a person holding membership interests in the head company, would, in the year of income in which the joining entity became a subsidiary member of the group or any later year of income, derive a greater benefit from franking credits than other persons who held membership interests in the joining entity immediately before it became a subsidiary member of the group;

(c) the extent (if any) to which the joining entity was able to pay a franked dividend or distribution immediately before it became a subsidiary member of the group;

(d) whether any consideration paid or given by or on behalf of, or received by or on behalf of, the head company in connection with the scheme (for example, the amount of any interest on a loan) was calculated by reference to the franking credit benefits to be received by the head company;

(e) the period for which the head company held membership interests in the joining entity;

(f) any of the matters referred to in subsection 177D(2).

Section to apply to exempting credits

(11) This section applies to exempting credits arising in the exempting account of the head company of a consolidated group in the same way that it applies to credits arising in the head company's franking account.

177F Cancellation of tax benefits etc.

(1) Where this Part applies to a scheme in connection with which a tax benefit has been obtained, or would but for this section be obtained, the Commissioner may:

(a) in the case of a tax benefit that is referable to an amount not being included in the assessable income of the taxpayer of a year of income—determine that the whole or a part of that amount shall be included in the assessable income of the taxpayer of that year of income; or

(b) in the case of a tax benefit that is referable to a deduction or a part of a deduction being allowable to the taxpayer in relation to a year of income—determine that the whole or a part of the deduction or of the part of the deduction, as the case may be, shall not be allowable to the taxpayer in relation to that year of income; or

(c) in the case of a tax benefit that is referable to a capital loss or a part of a capital loss being incurred by the taxpayer during a year of income—determine that the whole or a part of the capital loss or of the part of the capital loss, as the case may be, was not incurred by the taxpayer during that year of income; or

(d) in the case of a tax benefit that is referable to a foreign income tax offset, or a part of a foreign income tax offset, being allowable to the taxpayer—determine that the whole or a part of the foreign income tax offset, or the part of the foreign income tax offset, as the case may be, is not to be allowable to the taxpayer; or

(da) in the case of a tax benefit that is referable to an innovation tax offset, or a part of an innovation tax offset, being allowable to the taxpayer—determine that the whole or a part of the innovation tax offset, or the part of the innovation tax offset, as the case may be, is not to be allowable to the taxpayer; or

(e) in the case of a tax benefit that is referable to an exploration credit, or a part of an exploration credit, being issued to the taxpayer—determine that:

(i) the whole or a part of an exploration development incentive tax offset that would otherwise be allowable to the taxpayer in relation to the exploration credit, or the part of the exploration credit, as the case may be, is not to be allowable to the taxpayer; or

(ii) the whole or a part of a franking credit that would otherwise arise in the franking account of the taxpayer in relation to the exploration credit, or the part of the exploration credit, as the case may be, is not to arise in the franking account of the taxpayer;

and, where the Commissioner makes such a determination, he or she shall take such action as he or she considers necessary to give effect to that determination.

(2) Where the Commissioner determines under paragraph (1)(a) that an amount is to be included in the assessable income of a taxpayer of a year of income, that amount shall be deemed to be included in that assessable income by virtue of such provision of this Act as the Commissioner determines.

(2A) Where a tax benefit that is covered by paragraph 177C(1)(bc) has been obtained, or would but for this section be obtained, by a taxpayer in connection with a scheme to which this Part applies:

(a) the Commissioner may determine that the taxpayer is subject to withholding tax under section 128B on the whole or a part of that amount; and

(b) if the Commissioner makes such a determination, he or she must take such action as he or she considers necessary to give effect to that determination.

(2B) A determination under paragraph (1)(c) or subsection (2A) must be in writing.

(2C) Notice of the determination must be given to the taxpayer and, in the case of a determination under subsection (2A), to the person who paid the amount.

(2E) A failure to comply with subsection (2C) does not affect the validity of a determination.

(2F) If the Commissioner makes a determination under subsection (2A), the amount that the Commissioner determines is taken to be subject to withholding tax is taken to have been subject to withholding tax at all times by virtue of such provision of section 128B as the Commissioner determines.

(2G) If the taxpayer is dissatisfied with a determination under paragraph (1)(c) or subsection (2A), the taxpayer may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

(3) Where the Commissioner has made a determination under subsection (1) or (2A) in respect of a taxpayer in relation to a scheme to which this Part applies, or the Commissioner has made a DPT assessment in respect of a taxpayer in relation to a scheme to which this Part applies, the Commissioner may, in relation to any taxpayer (in this subsection referred to as the ***relevant taxpayer***):

(a) if, in the opinion of the Commissioner:

(i) there has been included, or would but for this subsection be included, in the assessable income of the relevant taxpayer of a year of income an amount that would not have been included or would not be included, as the case may be, in the assessable income of the relevant taxpayer of that year of income if the scheme had not been entered into or carried out; and

(ii) it is fair and reasonable that that amount or a part of that amount should not be included in the assessable income of the relevant taxpayer of that year of income;

determine that that amount or that part of that amount, as the case may be, should not have been included or shall not be included, as the case may be, in the assessable income of the relevant taxpayer of that year of income; or

(b) if, in the opinion of the Commissioner:

(i) an amount would have been allowed or would be allowable to the relevant taxpayer as a deduction in relation to a year of income if the scheme had not been entered into or carried out, being an amount that was not allowed or would not, but for this subsection, be allowable, as the case may be, as a deduction to the relevant taxpayer in relation to that year of income; and

(ii) it is fair and reasonable that that amount or a part of that amount should be allowable as a deduction to the relevant taxpayer in relation to that year of income;

determine that that amount or that part, as the case may be, should have been allowed or shall be allowable, as the case may be, as a deduction to the relevant taxpayer in relation to that year of income; or

(c) if, in the opinion of the Commissioner:

(i) a capital loss would have been incurred by the relevant taxpayer during a year of income if the scheme had not been entered into or carried out, being a capital loss that was not incurred or would not, but for this subsection, be incurred, as the case may be, by the relevant taxpayer during that year of income; and

(ii) it is fair and reasonable that the capital loss or a part of that capital loss should be incurred by the relevant taxpayer during that year of income;

determine that the capital loss or the part, as the case may be, should be incurred by the relevant taxpayer during that year of income; or

(d) if, in the opinion of the Commissioner:

(i) an amount would have been allowed, or would be allowable, to the relevant taxpayer as a foreign income tax offset if the scheme had not been entered into or carried out, being an amount that was not allowed or would not, apart from this subsection, be allowable, as the case may be, as a foreign income tax offset to the relevant taxpayer; and

(ii) it is fair and reasonable that the amount, or a part of the amount, should be allowable as a foreign income tax offset to the relevant taxpayer;

determine that that amount or that part, as the case may be, should have been allowed or is allowable, as the case may be, as a foreign income tax offset to the relevant taxpayer; or

(da) if, in the opinion of the Commissioner:

(i) an amount would have been allowed, or would be allowable, to the relevant taxpayer as an innovation tax offset if the scheme had not been entered into or carried out, being an amount that was not allowed or would not, apart from this subsection, be allowable, as the case may be, as an innovation tax offset to the relevant taxpayer; and

(ii) it is fair and reasonable that the amount, or a part of the amount, should be allowable as an innovation tax offset to the relevant taxpayer;

determine that that amount or that part, as the case may be, should have been allowed or is allowable, as the case may be, as an innovation tax offset to the relevant taxpayer; or

(e) if, in the opinion of the Commissioner:

(i) an amount would have been allowed, or would be allowable, to the relevant taxpayer as an exploration development incentive tax offset if the scheme had not been entered into or carried out, being an amount that was not allowed or would not, apart from this subsection, be allowable, as the case may be, as an exploration development incentive tax offset to the relevant taxpayer; and

(ii) it is fair and reasonable that the amount, or a part of the amount, should be allowable as an exploration development incentive tax offset to the relevant taxpayer;

determine that that amount or that part, as the case may be, should have been allowed or is allowable, as the case may be, as an exploration development incentive tax offset to the relevant taxpayer; or

(f) if, in the opinion of the Commissioner:

(i) an amount of a franking credit would have arisen, or would arise, in the franking account of the relevant taxpayer in relation to an exploration credit, being an amount that did not arise, or would not, apart from this subsection, have arisen, as the case may be, in the franking account of the relevant taxpayer in relation to the exploration credit; and

(ii) it is fair and reasonable that the amount, or a part of the amount, should arise, in the franking account of the relevant taxpayer in relation to the exploration credit;

determine that that amount or that part, as the case may be, should have arisen, or arises, as the case may be, in the franking account of the relevant taxpayer in relation to the exploration credit;

and the Commissioner shall take such action as he or she considers necessary to give effect to any such determination.

(4) Where the Commissioner makes a determination under subsection (3) by virtue of which an amount is allowed as a deduction to a taxpayer in relation to a year of income, that amount shall be deemed to be so allowed as a deduction by virtue of such provision of this Act as the Commissioner determines.

(5) Where, at any time, a taxpayer considers that the Commissioner ought to make a determination under subsection (3) in relation to the taxpayer in relation to a year of income, the taxpayer may post to or lodge with the Commissioner a request in writing for the making by the Commissioner of a determination under that subsection.

(5A) Subsection (5B) applies if the taxpayer considers that the Commissioner ought to make the determination under subsection (3) because the Commissioner has made a DPT assessment in respect of a taxpayer in relation to a scheme to which this Part applies.

(5B) Despite subsection (5), the request may be posted to or lodged with the Commissioner only after the end of the period of review (within the meaning of section 145-15 in Schedule 1 to the Taxation Administration Act 1953) for the DPT assessment.

(6) The Commissioner shall consider the request and serve on the taxpayer, by post or otherwise, a written notice of the Commissioner's decision on the request.

(7) If the taxpayer is dissatisfied with the Commissioner's decision on the request, the taxpayer may object against it in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

177G Amendment of assessments

Nothing in section 170 prevents the amendment of an assessment at any time if the amendment is for the purpose of giving effect to subsection 177F(3).

177H Diverted profits tax—objects

(1) The primary objects of the DPT provisions are:

(a) to ensure that the Australian tax payable by significant global entities properly reflects the economic substance of the activities that those entities carry on in Australia; and

(b) to prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements between related parties.

(2) In addition, the DPT provisions (in combination with Division 145 in Schedule 1 to the *Taxation Administration Act 1953*) have the object of encouraging significant global entities to provide sufficient information to the Commissioner to allow for the timely resolution of disputes about Australian tax.

177J Diverted profits tax—application

Scheme for a purpose including obtaining a tax benefit etc.

(1) This Part also applies to a scheme, in relation to a tax benefit (the ***DPT tax benefit***) if:

(a) a taxpayer (a ***relevant taxpayer***) has obtained, or would but for section 177F obtain, the DPT tax benefit in connection with the scheme, in a year of income; and

(b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:

(i) enabling the relevant taxpayer to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

(ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme;

whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers; and

(c) the relevant taxpayer is a significant global entity for the year of income mentioned in paragraph (a); and

(d) a foreign entity is an associate (within the meaning of section 318) of the relevant taxpayer at any time in the year of income mentioned in paragraph (a); and

(e) that foreign entity:

(i) is the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme; or

(ii) is otherwise connected with the scheme or any part of the scheme; and

(f) the relevant taxpayer is not any of the following:

(i) a managed investment trust (within the meaning of the *Income Tax Assessment Act 1997*);

(ii) an entity covered by paragraph 275-20(4)(f) of that Act (foreign collective investment vehicle with a wide membership);

(iii) an entity covered by paragraph 275-20(4)(h) of that Act (entity owned by foreign government etc.) that is a foreign entity;

(iv) a complying superannuation entity (within the meaning of that Act);

(v) a foreign pension fund (within the meaning of that Act); and

(g) it is reasonable to conclude that none of the following sections apply in relation to the relevant taxpayer, in relation to the DPT tax benefit:

(i) section 177K ($25 million income test);
(ii) section 177L (sufficient foreign tax test);
(iii) section 177M (sufficient economic substance test).

Have regard to certain matters

(2) For the purposes of paragraph (1)(b), have regard to the following matters:
(a) the matters in subsection 177D(2);
(b) without limiting subsection 177D(2), the extent to which non-tax financial benefits that are quantifiable have resulted, will result, or may reasonably be expected to result, from the scheme;
(c) the result, in relation to the operation of any foreign law relating to taxation, that (but for this Part) would be achieved by the scheme;
(d) the amount of the tax benefit mentioned in paragraph (1)(b).

Deferral of foreign tax liabilities

(3) For the purposes of paragraph (1)(b), a deferral of a taxpayer's liabilities to tax under a foreign law is taken to be a reduction of those liabilities, unless there are reasonable commercial grounds for the deferral.

Modification where thin capitalisation provisions apply

(4) Subsection (5) applies if:
(a) Division 820 of the *Income Tax Assessment Act 1997* (about thin capitalisation) applies to the relevant taxpayer for the year of income mentioned in paragraph (1)(a); and
(b) the DPT tax benefit includes all or part of a debt deduction (within the meaning of that Act); and
(c) the calculation of the amount of the DPT tax benefit involves applying a rate to a debt interest (within the meaning of that Act).

(5) For the purposes of the DPT provisions, in calculating the amount of the DPT tax benefit, apply the rate to the debt interest the entity actually issued (rather than the debt interest that would have existed if the scheme had not been entered into or carried out).

Modification where foreign entity is CFC

(6) Subsection (6A) applies if:
   (a) the foreign entity mentioned in paragraph (1)(d) is a CFC (within the meaning of Part X); and
   (b) an amount of attributable income (within the meaning of that Part) of the foreign entity has been included as a result of the operation of that Part in the assessable income of:
      (i) the relevant taxpayer; or
      (ii) an associate (within the meaning given by section 318) of the relevant taxpayer, if the associate is a Part X Australian resident (within the meaning of that Part) and is not a trust or partnership.

(6A) For the purposes of the DPT provisions, reduce the DPT tax benefit to the extent to which the amount included in assessable income as mentioned in paragraph (6)(b):
   (a) would not have been so included if the scheme had not been entered into or carried out; and
   (b) is directly referable to the DPT tax benefit.

Schemes outside Australia

(7) This section applies whether or not the scheme has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

Non-limitation in relation to other provisions in this Part

(8) This section:
   (a) does not limit section 177D, 177DA, 177E, 177EA or 177EB; and
   (b) is not limited by those sections.

177K Diverted profits tax—$25 million income test

(1) This section applies in relation to the relevant taxpayer, in relation to the DPT tax benefit, if the sum of the following does not exceed $25 million:

(a) the assessable income of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a);

(b) the exempt income of the relevant taxpayer for that year of income;

(c) the non-assessable non-exempt income of the relevant taxpayer for that year of income;

(d) the assessable income of each entity covered by subsection (2) for that year of income;

(e) if the DPT tax benefit is a tax benefit mentioned in paragraph 177C(1)(a)—the amount of the DPT tax benefit.

(2) An entity is covered by this subsection if for the year of income mentioned in paragraph 177J(1)(a):

(a) the entity is an associate (within the meaning given by section 318) of the relevant taxpayer; and

(b) both the entity and the relevant taxpayer:

(i) are members of the same global group; and

(ii) are significant global entities because they are members of that group.

177L Diverted profits tax—sufficient foreign tax test

(1) This section applies in relation to the relevant taxpayer, in relation to the DPT tax benefit, if the amount worked out under subsection (2) (foreign tax liability) equals or exceeds 80% of the amount worked out under subsection (6) (reduced Australian tax liability).

Foreign tax liability

(2) The amount is the total of the increases in liability for foreign income tax (within the meaning of the *Income Tax Assessment Act 1997*) of each entity covered by subsection (5) that results, will

result, or may reasonably be expected to result, from the scheme during a foreign tax period that corresponds to the year of income mentioned in paragraph 177J(1)(a).

(3) The regulations may provide for a method of working out increases in foreign tax liability for the purposes of subsection (2):

(a) for all situations; or

(b) for specified situations.

(4) If the regulations provide for such a method, apply that method in working out increases in foreign tax liability for the purposes of subsection (2) in relevant situations.

(5) An entity is covered by this subsection if:

(a) the entity is a foreign entity; and

(b) the entity is the relevant taxpayer or an associate (within the meaning given by section 318) of the relevant taxpayer; and

(c) the entity:

(i) is the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme; or

(ii) is otherwise connected with the scheme or any part of the scheme.

Reduced Australian tax liability

(6) The amount is:

(a) if the DPT tax benefit is a tax benefit mentioned in paragraph 177C(1)(a), (b), (ba) or (bc)—the amount of the tax benefit multiplied by the standard corporate tax rate; or

(b) otherwise—the amount of the DPT tax benefit.

(7) If the relevant taxpayer must withhold an amount in respect of withholding tax as a result of the tax benefit, reduce the amount worked out under subsection (6) by the amount withheld.

177M Diverted profits tax—sufficient economic substance test

(1) This section applies in relation to the relevant taxpayer, in relation to the DPT tax benefit, if the profit made as a result of the scheme by each entity covered by subsection (2) reasonably reflects the economic substance of the entity's activities in connection with the scheme.

(2) This subsection covers an entity if:

(a) the entity is the relevant taxpayer or an associate (within the meaning given by section 318) of the relevant taxpayer; and

(b) any of the following apply:

(i) the entity entered into or carried out the scheme or any part of the scheme;

(ii) the entity is otherwise connected with the scheme or any part of the scheme.

(3) However, subsection (2) does not cover an entity if the entity's role in the scheme is minor or ancillary.

(4) In determining whether the profit made as a result of the scheme by an entity reasonably reflects the economic substance of the entity's activities in connection with the scheme, have regard to:

(a) the functions that the entity performs in connection with the scheme, taking into account assets used and risks assumed by the entity in connection with the scheme; and

(b) the documents covered by section 815-135 of the *Income Tax Assessment Act 1997*, to the extent that they are relevant to the matters mentioned in paragraph (a) or to any other aspect of the determination; and

(c) any other relevant matters.

177N Diverted profits tax—consequences

If this Part applies to a scheme because of section 177J:

(a) section 177P applies to the relevant taxpayer mentioned in section 177J; and

(b) the Commissioner cannot make a determination under subsection 177F(1) or (2A) in relation to the scheme merely because of section 177J.

177P Diverted profits tax—liability

(1) The relevant taxpayer is liable to pay tax at the rate declared by the Parliament on:

(a) if this Part applies to a scheme in respect of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a), in relation to one DPT tax benefit—the DPT base amount for that DPT tax benefit; or

(b) if this Part applies to a scheme in respect of the relevant taxpayer for the year of income mentioned in paragraph 177J(1)(a), in relation to more than one DPT tax benefit—the sum of the DPT base amounts for those DPT tax benefits.

Note: The tax is imposed by the *Diverted Profits Tax Act 2017* and the rate of the tax is set out in that Act.

(2) The ***DPT base amount*** for a DPT tax benefit is:

(a) if the DPT tax benefit is a tax benefit mentioned in paragraph 177C(1)(a), (b), (ba) or (bc)—the amount of the DPT tax benefit; or

(b) otherwise—the amount of the DPT tax benefit divided by the standard corporate tax rate.

(3) The tax is due and payable at the end of 21 days after the Commissioner gives the relevant taxpayer notice of the assessment of the amount of the tax for the year of income mentioned in paragraph 177J(1)(a).

Note: For assessments of the amount of the tax see Divisions 145 and 155 in Schedule 1 to the *Taxation Administration Act 1953*.

177Q Diverted profits tax—general interest charge on unpaid diverted profits tax or shortfall interest charge

If an amount of diverted profits tax or shortfall interest charge that an entity is liable to pay remains unpaid after the time by which it is due to be paid, the entity is liable to pay the general interest charge on the unpaid amount for each day in the period that:

(a) starts at the beginning of the day by which the amount was due to be paid; and

(b) finishes at the end of the last day on which, at the end of the day, any of the following remains unpaid:

(i) the diverted profits tax or shortfall interest charge;

(ii) general interest charge on any of the diverted profits tax or shortfall interest charge.

Note: The general interest charge is worked out under Part IIA of the *Taxation Administration Act 1953*.

177R Diverted profits tax—when shortfall interest charge is payable

An amount of shortfall interest charge that an entity is liable to pay under section 280-102C in Schedule 1 to the *Taxation Administration Act 1953* is due and payable 21 days after the day on which the Commissioner gives the entity notice of the charge.