

PART IVA AND PEABODY

by

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Synopsis

Part IVA of the Income Tax Assessment Act (the Act) contains the Act's major "fall-back" anti-avoidance provisions, ie, the anti-avoidance provisions of last resort. Part IVA was introduced into the Act in 1981. Until recently, no major cases had been decided on Part IVA to assist in its interpretation, as a result there has been some uncertainty as to the application of the provisions in practice.

In 1993 the Full Federal Court made its first decision on Part IVA in *Peabody v FCT*¹ (*Peabody's case*). The appeal by the Commissioner from this decision was heard in the High Court in November 1993 and their judgment was handed down on 28 September 1994.² Although the High Court confirmed the Full Federal Court's decision in favour of the taxpayer, Mrs Peabody, a number of issues were dealt with quite differently from the Federal Court and it may be that the decision is more in favour of the Commissioner than was first thought.

This article examines the decision and its implications and will conclude that although this was the opportunity for the High Court to make some authoritative statements in respect of the interpretation and application of Part IVA, it appears to the authors that they did not do so. It is disappointing that their Honours did not provide guidelines on how a tax avoidance scheme should be identified. Considering the importance of the decision and its ramifications for the taxpaying community, it is disappointing that the judgement was so short and did not examine all of the interpretative issues associated with Part IVA.

Introduction

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In 1993 the Full Federal Court made its first decision on Part IVA in *Peabody v FCT*³ (*Peabody's case*). The appeal by the Commissioner of Taxation from this decision was heard in the High Court in November 1993 and their judgment was handed down on 28 September 1994.⁴ Although the High Court confirmed the Full Federal Court's decision in favour of the taxpayer, Mrs Peabody, a number of issues were dealt with quite differently from the Federal Court and it may be that the decision is more in favour of the Commissioner than was first thought.

This article will examine the decision and its implications.

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1 93 ATC 4104.

2 (1993-1994) 181 CLR 359.

3 *Supra* n.1.

4 *Supra* n.2.

Facts

In order to understand *Peabody's* case it is necessary to examine the details of the transactions entered into and their rationale as these are very complicated. The facts of this case are summarised below:

The Pozzolan group of companies (Pozzolan group) was in the fly ash business. The Pozzolan group was originally owned 62% by Peabody interests and 38% by Mr Kleinschmidt (Mr K). The Peabody interests were held by TEP Holdings Pty Ltd (TEP) as corporate trustee for the Peabody Family Trust. The beneficiaries of the Peabody Family Trust included Mrs Peabody (Mrs P).

For sometime, Mr Peabody (Mr P) had been considering a public float of the Pozzolan group with Peabody interests to retain 50%.

On 14 October 1985 Mr P and Mr K agreed that Mr K would sell the whole of his interest in the Pozzolan group to Peabody interests. Mr K did not want public disclosure of the purchase price of his shares.

The public float was expected to raise substantially more than the price to be paid to Mr K. There were some difficulties associated with whether it would be necessary to make a public disclosure in the prospectus in relation to the amount paid to Mr K for his shares.

It was necessary for the Peabody group to borrow to purchase Mr K's shareholding. If traditional finance was sought to fund the purchase of the shares, the interest rate would be in the range of 18 to 20%. It was, however, possible for the financing to be done via debt dividends, ie, the financier invests in the borrowing corporation and is repaid by way of dividends rather than interest. This gives rise to an inter-company dividend rebate to the financier which in this case reduced the financing costs to 11.7%. The shares are then redeemed by the borrowing company as repayment of the loan. In order to obtain this financing it was necessary for the Peabody group to set up a new corporation as the only other corporation in the group (TEP - the trustee company) could not undertake borrowings. The company which undertook the borrowings was Loftway Pty Ltd (Loftway). The shares in Loftway were owned 100% by TEP.

The following steps (identified by the Commissioner as the scheme at the Full Federal Court level) then occurred:

1. Loftway purchased Mr K's shares which represented a 38% interest in the Pozzolan group (the post-CGT shares);
2. Loftway issued preference shares to Westpac;
3. Loftway's post-CGT shares in the Pozzolan group were converted into "Z" class shares;
4. Step 3 reduced the value of the post-CGT shares in the Pozzolan group;
5. The Pozzolan group passed a special resolution to remove the right of "Z" class shareholders to receive preferential dividends;
6. TEP made a loan to Loftway to enable the redemption of Westpac's preference shares;
7. The public float of Pozzolan Industries Ltd occurred without the post-CGT shares as they were now worthless;
8. Loftway redeemed the preference shares owned by Westpac;
9. Loftway sold the post-CGT shares to TEP for \$476; and
10. TEP transferred these shares to Pozzolan Industries Ltd for nominal consideration.

The Commissioner assessed Mrs P (as a beneficiary of the Peabody Family Trust) on the basis that her assessable income from the trust included the difference basically between what was received upon the public float and what was paid to Mr K for his shares i.e. on the basis that s26AAA applied when the shares were floated.

Part IVA and the Decision

Part IVA is the general anti-avoidance provision of the Act and comprises sections 177A to 177G. It was introduced in 1981 to overcome perceived shortcomings with the previous general anti-avoidance provision, s260 and applies to transactions entered into after 27 May 1981.

Despite the fact the legislation was effective from 1981, tax practitioners had to wait 11 years until 1992⁵ for the first detailed judicial consideration of these provisions. Previous consideration had been confined to the Administrative Appeals Tribunal (AAT).

This part of the article will consider the interpretation and application of Part IVA. Section 177D is the operative provision of Part IVA and contains three elements which must be satisfied for Part IVA to apply as follows:

1. there must be a “*scheme*”;
2. there must be a “*tax benefit*”; and
3. the sole or dominant *purpose* of entering into the scheme must have been to obtain a tax benefit.

If all the above elements are present, the tax benefit is cancelled under s177F and the Commissioner may make other compensating adjustments. In addition, in order for the Commissioner to be successful, it is important for him to identify the correct taxpayer. Each of these elements and the identification of the correct taxpayer will be considered in detail below.

1. “Scheme”

Before Part IVA will apply it is necessary to identify a “scheme”. The correct identification of the scheme is crucial to the effective operation of Part IVA for the following reasons:

1. the tax benefit must arise from the scheme; and
2. the person must have entered into the scheme for the purpose of enabling the taxpayer to obtain a tax benefit.

“Scheme” is defined in s177A in very broad terms to mean any agreement, arrangement, course of action etc whether legally enforceable or not. Section 177A(3) further widens the definition to include a unilateral scheme. The definition is so broad that “it is difficult to think of an event of significance to tax liabilities which would not constitute a scheme⁶”.

As it is defined so widely, it is a fairly simple matter to determine whether or not a scheme exists. Difficulties arise, however, when it becomes necessary to identify where a scheme begins and ends, ie, in determining how wide or narrow the identification of the scheme should be. For example, should it extend to the entire transaction or just to that portion of the transaction whose predominant purpose is to obtain a tax benefit?

In *Peabody’s case* the “scheme” was identified by the Commissioner as including the taking of 10 steps⁷. These steps commenced with the purchase of Mr K’s shares by Loftway and ended with the public float and the subsequent steps to dispose of Loftway’s interests in the Pozzolanic Group. Included in the steps were the financing arrangement with Westpac and the resolution in relation to the “Z” class shares (the post-CGT shares).

The Full Federal Court did not provide the Commissioner with any guidance as to how a scheme was to be identified. Instead, it merely restricted the “scheme” to the one identified by him⁸. Their Honours stated

“it is abundantly clear that the determination, which the Commissioner is authorised to make under s177F must depend upon the scheme which he has identified ... this court cannot stand in the shoes of the Commissioner and exercise discretions which the legislature has committed to the Commissioner.”

5 *Peabody v FCT* (1992) 92 ATC 4585.

6 N Forsyth QC ‘The General Structure of Part IVA’ (Sep 1981) *Australian Tax Review* 132 at 133.

7 *Supra* n.1 at 4109.

8 *Supra* n.1 at 4116.

Therefore they concluded it was for the Commissioner, with little guidance in the legislation, to correctly identify the scheme.

The identification of the scheme by the Commissioner meant that he was unsuccessful before the Full Federal Court, as the determination of other matters, such as the tax benefit and the relevant purpose, hinged upon the scheme he had identified. The Commissioner's scheme incorporated steps 1 - 10 referred to earlier and not just step 3 in relation to the devaluation of the "Z" class shares, resulting in the taxpayer easily demonstrating that the sole or dominant purpose in relation to the scheme was commercial.

The decision of the Full Federal Court left the Commissioner in the unenviable position of needing to identify a scheme correctly in the first instance without any real guidelines on how he was supposed to achieve this. If the Commissioner could not correctly identify the scheme the chances were that he would be unsuccessful in his attempts to apply Part IVA⁹.

Fortunately for the Australian Taxation Office (the ATO), a similar position was not taken by the High Court. In relation to the issue of whether the scheme has been correctly identified the ATO has good cause to feel comforted by the High Court decision. In essence, the Court decided that although the Commissioner may be required to provide details of the scheme he relied upon in coming to his conclusions, he should be entitled to state his case in other ways. The High Court could see no reason why the Commissioner should not be entitled to change his view as to the scope of the scheme provided the interests of justice were met. The Court allowed the Commissioner to rely upon the scheme as identified by O'Loughlin J at first instance. That scheme included only the devaluation of the post-CGT shares and their subsequent disposal. This decision by the High court relieves the Commissioner from the pressure of needing to correctly identify the scheme in the first instance in order to be successful under Part IVA. The ability of the Commissioner to change the scope of the "scheme" in order that he may be more successful is concerning particularly in view of the fact that (as will be seen below) the High Court appears to have placed few restrictions upon the Commissioner in terms of how closely he can identify the scheme.

There is one other major issue in relation to the requirement that there be a scheme in order for Part IVA to apply. As will be seen below, there is some debate about whether a wide or narrow view of the definition of scheme should be adopted.

The concept of a wide and narrow view in relation to the definition of scheme comes from Harris and Knight¹⁰ who argue that "scheme" can be interpreted in two ways:

- a *narrow view* of the definition of "scheme". Under this view there can only be **one** scheme associated with a course of conduct. This is the only scheme and it may contain a number of parts or steps; and
- a *wide view* of the definition of "scheme". This view accepts there may be **schemes within schemes** in a course of conduct, ie, in relation to any particular transaction it may be possible to identify several schemes. This appears to be the view which was adopted by the High Court.

The Full Federal Court canvassed this issue¹¹. Hill J.'s statement clearly endorses the *narrow view* of the definition of scheme i.e. there is only **one scheme**, but it may have many parts as opposed to the wide view which is that there may be schemes within schemes.

9 See for example *Spotless Services Limited v FCT* (1993) 93 ATC 4397 where the Commissioner lost because he identified the scheme too narrowly as he failed to identify a critical part of the scheme and also comments of the Full Federal Court decision in *Peabody's case* 93 ATC 4104 at 4116.

10 PA Harris and M Knight 'Part IVA: High Court Your Move!' (1994) 28 *Taxation in Australia* No 7 399 at 401.

11 *Supra* n.1 at 4111 when Hill J. said that "the scheme may consist of a series of steps or a course of action. This is not to say that where, as a matter of fact, a scheme consists of a course of action comprising several steps, the Commissioner may isolate out of that course of action one step and classify that as a scheme. Reference in Part IVA to "part of a scheme" (cf s177A(5)) suggests rather that, in a case where a series of steps constitutes a scheme, that whole series of steps is to be considered, the individual steps being seen as parts of the scheme rather than each step being capable of being seen as a scheme in itself".

It is difficult to discern which view the High Court has taken as there are two conflicting statements throughout the judgement. One of these statements reflects adoption of the narrow view¹² and the other reflects adoption of the wide view¹³. It may be that the Court was not as careful with the use of the term “scheme” throughout the judgement as it could have been. It would appear on balance that the High Court has adopted the wide view of a scheme, i.e. there may be schemes within schemes. If some of their Honours statements are taken literally there should be concern by taxpayers at just how closely the Commissioner may be able to identify a scheme.

The adoption of this stance by the High Court may make it possible for the Commissioner to identify the scheme as being the step which involves the tax planning aspects. By identifying the scheme so closely, it makes it much easier for the Commissioner to prove that the relevant tax benefit and purpose exist. This may result in the inability of taxpayers to undertake tax planning.

There are a number of arguments why the narrow view should be preferred:

- such an interpretation is in keeping with the spirit of the legislation (see discussion below in relation to “purpose” and comments contained in the Explanatory Memorandum to the *Income Tax Laws Amendment Bill No (2) 1981* (Explanatory Memorandum));
- the more closely a scheme is identified (eg, if the High Court’s view above is adopted) the easier it will be to identify a tax benefit and the required dominant purpose in relation to that scheme. Such an approach could make tax planning impossible as every tax planning step could constitute a scheme with the relevant purpose and tax benefit and therefore attract Part IVA. The authors acknowledge that the alternative extreme view i.e. identifying the scheme very broadly so it is all encompassing, is also untenable. As suggested by Burton¹⁴:

“the more conduct that falls within a particular scheme, the more difficult it may become ... to identify a tax benefit similarly, the more that a particular scheme embraces, the more likely it is that a range of purposes underlying the scheme may be apparent, so that it becomes more difficult to identify the requisite dominant purpose”.

It appears that if the scheme is identified too closely, it will remove a taxpayer’s choice to structure his or her affairs in a tax advantageous manner. If the scheme is identified too broadly, it becomes almost impossible for Part IVA to apply. A mid-point somewhere between the two extremes would appear to be preferred. The mid-point should be biased toward identifying the scheme broadly rather than closely; and

- part IVA specifically contains references to “parts of a scheme”¹⁵. This supports the conclusion the legislature intended the narrow view to be adopted, ie, that in relation to any particular transaction there is only one scheme although it may contain many parts. Interpreting Part IVA using the narrow view promotes certainty when it comes to interpreting words such as “part of a scheme”.

12 For example where the High court states “But Pt IVA does not provide that a scheme includes part of a scheme and it is possible, despite the very wide definition of a scheme, to conceive of a set of circumstances which constitutes only part of a scheme and not a scheme in itself. That will occur where the circumstances are incapable of standing on their own without being “robbed of all practical meaning”. In that event, it is not possible in our view to say that those circumstances constitute a scheme rather than part of a scheme”.

13 For example where the High court makes the statement that “... if within a *wider scheme* which has been identified, the Commissioner seeks also to rely upon a *narrow scheme* as meeting the requirements of Pt IVA ...”. This statement tends to show that the High Court has adopted the wide view of the definition of “scheme”. In addition, the court subsequently makes the following statement: “... that of course, does not mean that if *part of a scheme* may be identified as a *scheme in itself* the Commissioner is precluded from relying upon it as well as the wider scheme”. (All italics added)

14 M Burton ‘Part IVA and Distributions from Discretionary Trusts’ (Oct/Nov 1992) *The CCH Journal of Australian Taxation* 18 at 19.

15 See s177D and s177A(5).

2. “Tax Benefit”

The second requirement which must be satisfied for Part IVA to apply is that a relevant tax benefit must be identified in connection with a scheme.

“Tax benefit” is defined in s177C(1) to mean an amount that has not been included in assessable income, or has been allowed as an allowable deduction and which might reasonably be expected not to have been the case if the scheme had not been carried out. The tax benefit may be obtained by *any* taxpayer (not necessarily the one with the relevant purpose - see below), but it must be a benefit obtained in connection with the scheme.

The result is that s177C requires a reconstruction of the relevant scheme. That reconstruction is subject to “what might reasonably be expected” a phrase that is further governed by the words “had the scheme not been entered into”.

Forsyth¹⁶ has said:

“Because s 177C(1) asks a hypothetical question, there will of course be room for doubt in many cases as to what answers should be given, for quite often situations arise where one cannot say with certainty what would have happened if the particular scheme in question had not been entered into.”

This is further complicated by the fact that neither the legislation, its Explanatory Memorandum nor the Treasurer’s Second Reading Speech to *Income Tax Laws Amendment Bill No(2) 1981* (the Second Reading Speech) provide guidance on how this is to be achieved.

In *Peabody’s* case the High Court was required to look at what is meant by the wording in s177C “... might reasonably be expected to have been [the case]...if the scheme had not been entered into or carried out” when determining whether a tax benefit existed.

The High Court confirmed the Full Federal Court’s decision on this point.¹⁷ Their Honours stated that the use of the words “reasonable expectation” require more than a possibility, there must be a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out. This prediction must be sufficiently reliable for it to be regarded as reasonable.¹⁸

Mr Justice Hill delivering the judgment of the Full Federal Court had concluded that the phrase “reasonable expectation” was not used in the sense of prediction as to the future but rather in the sense of supposition or hypothesis. What is clear is that the expectation must be one which is reasonable and not one which is unreasonable, irrational or absurd.¹⁹

Both Courts rejected the Commissioner’s argument that if Loftway had not purchased the post-CGT shares it was a reasonable expectation that TEP Holdings would have. There was uncertainty as to whether TEP could have paid rebatable dividends to Westpac pursuant to s46 which was crucial to the obtaining of cheaper finance, so its purchase of Mr K’s shares was not a viable option.

Dealing with the second phrase in the section “had the scheme not been entered into” neither the Full Federal Court nor the High Court interpreted this as referring to the entire scheme as constituted by the course of conduct resulting in the flotation of the Pozzolan Group shares. Although this would seem a literal reading of the section, if there had been no flotation there would be no tax benefit and such an interpretation would potentially cripple the effectiveness of Part IVA.

16 ‘The General Structure of Part IVA’ (1981) September *Australian Tax Review* 132 at 133-134.

17 *Supra* n.2 at 385.

18 *Ibid.*

19 *Supra* n.1 at 4112.

The Full Federal Court looked at the potential reconstruction of the scheme as eliminating only part of the scheme (the part dealing with the purchase of the shares by Loftway) and decided that it was not reasonable to expect that TEP would have purchased the shares instead.²⁰ The High Court confirmed this and pointed out that the rationale of having Loftway as an intermediary purchaser of the shares was necessary for the obtaining of the rebate on the dividends which was fundamental to the financing of the purchase of Mr K's shares.²¹

The High Court also looked at the reconstruction from the alternate perspective if the devaluation of the Loftway shares had not taken place and concluded that in this situation no profit could reasonably have been expected to flow to Mrs Peabody.²²

The Court therefore concluded that upon any of the proposed reconstructions it was not a reasonable expectation that a tax benefit would have been obtained by Mrs Peabody.

Both Courts have interpreted the concluding words of s177C as referring to "any part of the scheme" with the result that part of the scheme (whichever scheme that may have been) was disregarded and the potential reconstruction hypothesised on the assumption that the other parts of the scheme were present.

Some difficulties may arise in the future as to the uncertainty which this interpretation could give rise to. In looking at the hypothetical reconstruction of a complex commercial transaction which part or parts of the transaction will the courts decide to eliminate and on what basis? The Full Federal Court in its decision eliminated one aspect of the scheme. The High Court confirmed this, however, it also looked at an alternative reconstruction. What if there are a number of options? As Knight and Harris state:

"If those options would result in differing amounts of tax becoming payable, will it ever be reasonable to expect that the parties would engage in a course giving rise to the highest level of taxation, or any other level but the lowest level?"²³

3. Purpose

The third requirement for Part IVA to apply is that the sole or dominant purpose of entering into the scheme was to obtain a tax benefit. This is determined by having regard to eight factors listed in s177D.

The meaning of "purpose" is further expanded in s177A(5) in the following terms:

"A reference in this Part 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."

The general effect of s177A(5) is that the "sole or dominant purpose" of entering into the scheme must have been to obtain a tax benefit. It would appear that the relevant purpose need not be that of the person to derive the tax benefit. Further, it is not necessary that the benefit obtained is the benefit sought to be obtained.

As with the other elements discussed previously, s177D leaves some matters uncertain. The matters which arose because of *Peabody's* case are:

- (a) who is to reach the conclusion that a party to the scheme (or part of the scheme) did so with the sole or dominant purpose of obtaining a tax benefit?
- (b) how are the eight listed matters to be weighed against each other?; and
- (c) is the dominant purpose to be found in relation to the scheme as a whole or in relation to only part of a scheme?

20 *Supra* n.1 at 4117.

21 *Supra* n.2 at 385.

22 *Ibid.*

23 P Harris and M Knight 'Part IVA: High Court, Your Move!' (1994) February *Taxation in Australia* 399 at 402.

a. Who is to reach the conclusion?

The concluding paragraph of s177D states “it would be concluded that ...”. This raises the issue of who is to reach the conclusion, ie, the court, the Commissioner or the reasonable person?

Munn²⁴ when talking about the factors to which regard is to be had takes the view that “the first difficulty, if not uncertainty, is to establish by whom it is to be concluded. It is certainly not the Commissioner. Presumably, it is the Court in the end, but before then, it is probably the reasonable man [or woman] making an objective assessment.”

Although not specifically discussing this issue both the Full Federal Court and the High Court made an objective evaluation of the facts in relation to the factors listed in s177D and came to the conclusion that there was an overall commercial purpose. The Full Federal Court does refer to the Commissioner having regard to each of the factors in s177D(b)²⁵ but it then weighed these factors up for itself.²⁶

b. How are the 8 listed matters to be considered?

Section 177D states that the Part will apply, if having regard to the eight listed factors, a certain conclusion is reached. The legislation does not contain guidelines as to what weight is to be given to each of these factors or how they are to be combined. It is not certain whether tax considerations must outweigh non-tax considerations on balance or whether each non-tax reason is to be considered in isolation to determine its importance. It is quite plausible that this has been intentionally done, as the relevant weight to be given to each factor will vary from case to case.

In August 1981 Mr Boucher²⁷ the then Second Commissioner of Taxation commented on the interpretation of the eight listed matters and the dominant purpose when he said:

“Having regard to *all* those things, the task for the Commissioner and all other reasonable men or women is to determine whether *it would be* concluded that the scheme was entered into for the sole or dominant purpose of obtaining the tax benefit in question. Note that it is not “could” be concluded, or “might reasonably be concluded”, but “*would*” be concluded. And it is not “would be asserted” (or affirmed) (ie, predicated) - it is *would be concluded*. In other words, the sole or dominant tax purpose must be a very clear one.”

The ATO’s view is that the evidence in relation to these factors must overwhelmingly point to a tax avoidance purpose.

Mr Justice Hill considered that the factors referred to in s177D clearly direct attention to both tax and non-tax matters and that what is required is a balancing of the two. He looked at the scheme in its entirety from the acquisition of the shares, to the financing, to the flotation and considered that the dominant features were commercial.²⁸

The High Court did not really consider this issue except to agree with the Full Federal Court that the decision to finance the purchase of Mr K’s shares through Loftway was a rational commercial decision.

c. Is the dominant purpose to be found in relation to the whole of the scheme or a part only of the scheme (a sub-scheme)?

One of the major issues arising in relation to determining the relevant purpose is whether it is necessary to identify it in relation to the whole of the scheme or in relation to only part of the scheme. This difficulty arises as a result of the wording of the concluding paragraph in s177D.

24 ‘Part IVA ITAA: A Practitioner’s View’ (1981) October *The Australian Accountant* 606 at 607.

25 *Supra* n.1 at 4113-4114.

26 *Supra* n.1 at 4117-4118.

27 *Part IVA* Statement, Supplement to Taxation in Australia, August 1981, p (i) at p (vi).

28 *Supra* n.1 at 4117-4118.

This issue is further compounded when one has regard to the previous discussion in relation to how broadly the term "scheme" should be interpreted.

While it may be arguable that s177D could be read so that the relevant purpose would relate to only part of a scheme it is arguable that the relevant purpose must be found in relation to the scheme as a whole. This conclusion is reached by a number of commentators²⁹.

This view is supported by the Explanatory Memorandum³⁰ where it states that (*italics added*):
 "...section 177D makes Part IVA applicable as a matter of law to *a scheme* if a taxpayer has obtained a benefit under it and, on the basis of an objective view of features of *the scheme* and its surrounding circumstances, it would be concluded that *the scheme* was, in tax terms, a "blatant" one, that is, it was entered into by a person for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit ... the relevant purpose is, having regard to *the scheme as a whole*, to be tested in relation to the involvement of a person in either a part of the scheme or the whole of it."

Further reasons for arguing that the relevant purpose must be found in relation to the scheme as a whole and not to part only of a scheme include:

- sections 177D and 177A(5) do contain references to "part of a scheme", however the reference to "part of a scheme" in s177A(5) is to ensure that arrangements may be caught by Part IVA although the person with the relevant dominant purpose had only an active part in "part of the scheme."³¹ It is also included to confirm that as long as tax considerations dominate, those considerations do not have to permeate every aspect of the scheme;
- if all references in Part IVA to "scheme" were intended to mean "sub-schemes", there would be no need to make specific reference to "part of a scheme" in ss177D and 177A(5);
- Part IVA itself begins "This Part applies to any scheme". This provides support for the view that the dominant purpose is to be found in relation to the scheme as a whole;
- the concluding words of s177D(b) refer to the purpose of obtaining a tax benefit "...in connection with the scheme" not a part of the scheme as would have been the case if this is what the legislature had intended; and
- if a dominant purpose of tax planning is needed to be found in relation to part only of a scheme, it would not be possible for any form of tax planning to occur. Every commercial transaction is structured in a manner designed to ensure the minimum amount of tax possible is paid. This means that at least one part (or a sub-scheme) is generally designed specifically with a tax benefit in mind. If Part IVA were interpreted so that it applied in any situation where a sub-scheme had the relevant dominant purpose it would force taxpayers to place themselves in situations where the maximum amount of tax possible was paid. This interpretation is not in accordance with the spirit of the legislation as enunciated by the Explanatory Memorandum.³² This argument is endorsed by Scholtz³³

29 Refer J Cassidy 'Observations on the Application of Part IVA: Peabody v Federal Commissioner of Taxation' 21 *Australian Business Law Review* 424 at 431 and T Murphy 'Part IVA: The Broadest Ambit' 25 *Taxation in Australia* 531 at 534. For a contrary view refer P Harris and M Knight 'Part IVA: High Court, Your Move' 28 *Taxation in Australia* 399 at 403.

30 At pp 12 and 13.

31 This is confirmed at p 13 of the Explanatory Memorandum where it is stated that "it has been a feature of tax avoidance schemes of the kind that Part IVA is directed against that a considerable number of parties and of connected transactions are involved, and provisions against such schemes would fail in their purpose if limited to purposes of persons who were involved in the schemes in their entirety." Refer also to p 12 where it is stated that "the relevant purpose is, having regard to the scheme as a whole, to be tested in relation to the involvement of a person in either a part of a scheme or the whole of it."

32 *Ibid* at 2-3.

33 'Anti-avoidance Provisions: Part IVA' October/November 1991 *The CCH Journal of Australian Taxation* 32 at 37.

where he concludes that an interpretation such as outlined above would lead to “the untenable proposition that if a finding of dominant purpose could be made in relation to any part of a scheme, however small, and without due regard to the significance of that purpose in the context of the entire scheme, Part IVA would apply.”

The Full Federal Court concluded that Mr P entered into or carried out the whole of the scheme with a dominant commercial purpose being the acquisition of the shares from Mr K and the flotation of a public company. The High Court did not discuss this issue but certainly accepted the commercial nature of the transaction.

In conclusion the authors believes the only tenable position is that the relevant dominant purpose must be found in relation to *the scheme*. As discussed previously, the major difficulty lies in identifying the scheme. If it is possible, as would seem to follow from the High Court’s decision in *Peabody* that the Commissioner is entitled to identify the relevant scheme very narrowly (provided that this scheme can stand alone) then it will be easier for him to establish the necessary dominant purpose of tax avoidance in relation to the whole of that narrowly defined scheme. For example, in *Peabody* one scheme which appears to have been identified by the High Court was the devaluation of the shares held by Loftway. Assuming there was a tax benefit (and it seems there was in relation to Loftway) Mr P’s purpose in devaluing the post-CGT shares was dominantly to obtain that benefit. There was certainly no other reason as it was not necessary from a financing point of view or to ensure the success of the flotation, Loftway could have sold the post-CGT shares to Pozzolanac Industries Ltd to do that. The dominant reason why the group companies devalued these shares was to increase the value of the pre-CGT shares and avoid Part IIIA and s26AAA.

Identification of the correct taxpayer

The end result of the High Court decision appears to be that on a reconstruction it was not reasonable to expect that Mrs P would have derived one third of any amount assessable on the sale of the Pozzolanac group shares. There have been suggestions that perhaps the Commissioner attacked the wrong taxpayer and that they would have received a more favourable result if they had chosen differently³⁴. The Commissioner chose to attack Mrs P as a beneficiary of the Peabody Family discretionary trust. It may well be that he had little choice but to choose one of the beneficiaries as they were the only taxpayers involved in the transaction with any remaining assets.

As discussed above, it can be seen that most of the elements for Part IVA to apply existed in *Peabody’s case* (or at least may have existed if a different taxpayer had been chosen by the Commissioner). The alternative taxpayers for the Commissioner to attack would have been either Loftway or Westpac. The difficulties with these suggestions are:

a. Loftway

Although the Commissioner may have been technically successful in applying Part IVA against Loftway³⁵, it would have been a hollow victory as Loftway has no assets to attack³⁶; and

³⁴ See for example G Cooper ‘The High Court decision in Peabody: A pyrrhic victory?’ (1994) No 51 *Butterworths Weekly Tax Bulletin* 898 at 899 where he states “the High Court decision is sending a clear message to the ATO that they picked the wrong taxpayer”.

³⁵ If the Commissioner had chosen Loftway he may have been more successful in proving that the relevant tax benefit existed. This is as instead of deriving a s26AAA profit during the year of income from the public float, Loftway derived no assessable income.

³⁶ After the public float Loftway was left in the position of owning \$500 worth of “Z” class shares in the Pozzolanac group and having a substantial debt owing to TEP.

b. Westpac

Westpac placed itself in a position to avail itself of a rebate. This provides the Commissioner with the additional hurdle to overcome of proving that changing income from one type into another, eg, interest to dividends to obtain a rebate constitutes a tax benefit under Part IVA. That the Commissioner did not choose to attack this taxpayer may provide comfort to other taxpayers who wish to undertake similar exercises³⁷.

Conclusion

Part IVA is a complicated piece of legislation which is difficult to apply with any degree of certainty to practical situations. Many interpretation difficulties have been identified throughout the article. For these reasons the tax advising community has been watching the progress of *Peabody's* case. The outcome of the High Court's determination has been expected to have major ramifications whether or not it is favourable to the ATO.

ATO representatives have previously stated that if they lost the case they might seek possible amendments to the legislation to ensure that it was effective³⁸. The Commissioner clearly considered that the circumstances present in *Peabody's* case constituted tax avoidance and he will be keen to ensure the legislation "catches" such arrangements. Such action would limit taxpayers opportunities to minimise tax when organising commercial transactions.

In view of the decision of the High Court it may not be necessary for the Commissioner to seek to have the legislation amended. It would appear that if he had attacked a different taxpayer that he may well have succeeded before the High Court.

This was the opportunity for the High Court to make some authoritative statements in respect of the interpretation and application of Part IVA, but it appears to the authors that they did not do so. At neither the Full Federal Court nor the High Court level was it explicitly stated what the Court thought constituted a scheme, nor were guidelines provided on how to identify the scheme. One is left to wonder whether the courts did not comment upon the scope of the scheme as they were uncertain of its scope themselves. As a result, even after the long awaited decision it still is not clear just what the scheme encompassed in *Peabody's* case was. All that is known is that the Commissioner was allowed to change his mind in relation to what it was and in the final analysis was allowed to run with the suggested scheme made by O'Loughlin J. The High Court allowed the Commissioner to rely upon this scheme, but passed no comment upon whether or not it was the correct scheme³⁹.

Although as a result of the High Court decision, correctly identifying the scheme may no longer be such an issue for the Commissioner, it is submitted that the legislation should be amended to provide guidance to assist with the identification of a scheme. Such matters could include insight into whether the narrow or wide interpretation of "scheme" is to be adopted and also how to identify the precise scope of a scheme.

Considering the importance of the decision and its ramifications for the taxpaying community, it is disappointing that the judgement was so short and did not examine all of the interpretative issues associated with Part IVA.

37 It is not possible to claim intercompany dividend rebates in a similar situation to *Peabody's* case due to ss 46C and 46D.

38 Address by Mr Ron Mills, Chief Tax Counsel, Australian Taxation Office to the 6th Annual Australasian Tax Teachers' Conference Sydney, 20 January 1994.

39 The High court stated "before us the Commissioner sought to rely upon the narrower scheme identified by the judge at first instance and, in our view, he was entitled to do so" 181 CLR 359 at 383.

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