

Australia Taxation – Advanced

Module 1

General anti-avoidance provisions of Part IVA



Tax evasion, avoidance and planning



Tax evasion, avoidance and planning

Tax fraud and tax evasion are deliberate breaches of the law

- Blameworthy act or omission
- Generally requires intent, and knowledge that it will have a tax effect
- This is relatively easy to identify using powers of information gathering
- E.g. non-disclosure of assessable income
- E.g. claiming deductions for expenditure never incurred

Tax evasion, avoidance and planning

Tax avoidance is technically legal, but unacceptable

- Use of legal methods to reduce tax payable and/or increase tax refundable
- Legal 'loophole'...within the letter of the law but not the spirit
- Utilisation of tax laws in a way that was unintended by legislation
- The boundary with mere tax planning (e.g. incidental result) is not distinct
- E.g. selling and repurchasing shares to incur a capital loss and reduce taxable income
- E.g. artificially reducing taxable income to become eligible for a concession

Tax evasion, avoidance and planning

Tax planning or tax minimisation is legal and acceptable

- Financial affairs optimised to incidentally reduce tax payable
- Based on genuine economic activity and investment decisions
- Not artificial or contrived
- E.g. offsetting a capital gain against a capital loss
- E.g. making an election to apply concessional treatment

Amended assessment

- 🌿 S. 170(1) Commissioner's power to amend an assessment
 - 🌿 Subject to time limitations (after notice of assessment)

Individual, SBE or medium business entity with simple tax affairs	2 years
Individuals with complex tax affairs or business (not an SBE or medium business entity)	4 years
Fraud or evasion	No limit

- 🌿 Taxpayer may apply for an amended assessment
 - 🌿 E.g. where new information has come to light
 - 🌿 Amendment period refreshes when there is an amended assessment

Phoenix activity and tax avoidance

Coordinated strike on tax agents facilitating suspected phoenix activity and avoidance of tax

Eleven sites across Victoria were accessed yesterday by more than 250 ATO officers as part of a broad investigation into alleged phoenix activity and avoidance of tax.

Deputy Commissioner Jeremy Geale confirmed the access without notice at business and residential sites across Melbourne and Shepparton to gather information as part of a long-term compliance action into a range of tax mischief.

“We are examining a group of tax agents suspected of facilitating phoenix activity and promoting avoidance of tax involving GST, income tax and the failure to remit pay-as-you-go withholding tax payments.

“We suspect the agents have used phoenix techniques to assist clients to avoid paying tax on millions of dollars of income,” Mr Geale said.

The compliance action was triggered by complaints from concerned tax professionals and clients, as well as the ATO’s own intelligence.

Mr Geale explained the ATO rarely uses its formal access powers and the decision to undertake access without notice was not taken lightly.

<https://www.ato.gov.au/Media-centre/Media-releases/Coordinated-strike-on-tax-agents-facilitating-suspected-phoenix-activity-and-avoidance-of-tax/>



Part IVA – general anti-avoidance provisions

Question:

- How do you prevent undesirable behaviour which is technically legal but exploits laws in an unintended way (loopholes)?

Answer:

- Endlessly write new legal clauses as taxpayers find new ways to avoid the intended operation (play cat and mouse); **or**
- Write a general provision that distinguishes between acceptable and intended behaviour compared with unacceptable avoidance by artificial means



“Catch-all provision”

Specific and general anti-avoidance measures

Specific anti-avoidance measures

- E.g. Division 7A deemed dividends (discussed in Module 4)
- E.g. Controlled foreign company (CFC) regime (discussed in Module 8)
- E.g. Personal services income (PSI) regime (discussed later in this Module)

General anti-avoidance rules

- Last resort to ensure integrity of system
- Voids elements of a transaction directed towards tax avoidance
- Can apply even where specific measures are not breached
- ‘Sham’ transactions are not dealt with by anti-avoidance provisions
- E.g. Part IVA (ITAA36); Division 165 (ANTS99); s.67 (FBTAA86)

Where the Commissioner is of the opinion that a scheme has been entered into for which Part IVA applies:

- Tax is levied **not** on what actually happened, but rather on what might reasonably have happened had the scheme not been entered into.
- This requires a comparison with what might otherwise have happened to achieve the same commercial or non-tax outcomes.
- The Commissioner may cancel the tax benefit connected with a scheme.

The legislation!



Commonwealth Consolidated Acts

INCOME TAX ASSESSMENT ACT 1936

PART IVA--SCHEMES TO REDUCE INCOME TAX

177A Interpretation



'Scheme'

177B Operation of Part

177C Tax benefits



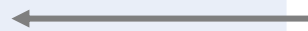
'Tax benefit'

177CB The bases for identifying tax benefits



'Annihilation and reconstruction approaches'

177D Schemes to which this Part applies



'Dominant purpose, based on 8 matters'

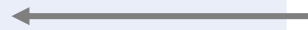
177DA Schemes that limit a taxable presence in Australia

177E Stripping of company profits

177EA Creation of franking debit or cancellation of franking credits

177EB Cancellation of franking credits--consolidated groups

177F Cancellation of tax benefits etc.



'Cancellation'

177G Amendment of assessments



Quiz – Part IVA

Which of the following would provide a taxpayer with a tax benefit under Part IVA?

- Amount in assessable income, but would not otherwise have been
- Amount excluded from deductions, but would not otherwise have been
- Capital loss incurred, but would not otherwise have been
- Withholding tax liability, but would not otherwise have been



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A tax benefit in connection with a scheme (e.g. lower assessable income, higher deductions, lower taxable income, lower withholding tax, higher offset)

Essential elements

There must be a **scheme**

"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. [s.177A ITAA36]

Single scheme,
multiple schemes,
sub-schemes

Defined widely to
capture both tax and
commercial elements

Defined narrowly to
focus on tax
minimisation
elements

Essential elements

There must be a **scheme**

Actual tax position
v
Alternative postulate

E.g. “might reasonably be expected to have been included ... if the scheme had not been entered into or carried out”

A **tax benefit** must be obtained

Annihilation
v
Reconstruction

Tax benefit

- I. Not in assessable income, but perhaps would otherwise have been
- II. Included in deductions, but perhaps would not otherwise have been
- III. Capital loss being incurred, but perhaps would not otherwise have been
- IV. Offset allowable, but perhaps would not otherwise have been
- V. No withholding tax, but perhaps would otherwise have been

[s.177C ITAA36]

Dominant purpose – the 8 matters to consider

manner in which the scheme was entered into or carried out

form and substance of the scheme

timing of the scheme and length carried out

result achieved in relation to the tax law

any change in financial position of relevant taxpayer resulting from scheme

any change in financial position of any person connected with the relevant taxpayer resulting from scheme

s. 177D
ITAA36

any other consequence for the relevant taxpayer or connected person

nature of the connection (business, family, other) between relevant taxpayer and connected person

Essential elements

There must be a **scheme**

No guidance on weighting or relative importance

A **tax benefit** must be obtained

Consideration of each factor and/or holistically

Entered into the scheme with a **dominant purpose** of obtaining the tax benefit

Intention of person entering the scheme (e.g. advisers)

Anti-avoidance and Part IVA



Consequences of Part IVA applying

Cancellation of tax benefit (s.177F)

- Including amounts in assessable income, denying deductions, etc

Scheme penalties

- 50% of the tax avoided (reduced to 25% if taxpayer has a reasonably arguable position)

Amended assessments

- General / Shortfall interest charge

Compensating adjustments

- Considering flow-on effects (e.g. to ensure no double taxation)

Application of general anti-avoidance rules

- Access the database**
- Browse database
- Searches >
- View last document
- Quick access**
- View legislation
- View a document

Practice Statement Law Administration



PS LA 2005/24

SUBJECT: Application of General Anti-Avoidance Rules

PURPOSE: This practice statement provides instruction and practical guidance to Tax officers on the application of Part IVA and other General Anti-Avoidance Rules (GAARs). Officers proposing to make a determination under section 177F (including for deemed tax benefits under section 177E), subsection 177EA(5) or 177EB(5) of the *Income Tax Assessment Act 1936*, to make a determination under subsection 67(1) of the *Fringe Benefits Assessment Act 1986*, to make a declaration under section 165-40 of the *A New Tax System (Goods and Services Tax) Act 1999*, or to rule on the application of Part IVA or other GAARs in a private ruling, Class Ruling or Product Ruling should follow this practice statement.

This practice statement also outlines the role and operation of the GAAR Panel of the Tax Office.

This practice statement will be subject to review from time to time in light of judicial or other consideration of the GAARs.



Part IVA warning signs

Arrangement out of step with ordinary family dealings

Arrangement seems more complex than necessary to achieve commercial objectives (e.g. circular flows)

Tax result of the arrangement appears at odds with its commercial or economic result (e.g. tax loss on profitable venture)

Arrangement results in little or no risk in circumstances where significant risks would be expected (e.g. put options)

Parties to the arrangement are operating on non-commercial terms or in a non-arm's length manner (e.g. low interest rates)

Discretionary family trusts

THE  AGE

BUSINESS SMALL BUSINESS FINANCE

Operating a business through a new family trust

It's tax effective and flexible business structures. It's called a discretionary family trust.

By Max Newnham

19 January 2017 – 3:52pm



Mochkin: dominant purpose of interposing trust was for asset protection

When it comes to owning and operating a business one of the most tax effective and flexible business structures is a discretionary family trust. It is not uncommon for a business to be started as a sole operator or a partnership of individuals, and then transfer the business to a family trust.

Because of a section of the tax act, being part IVA that effectively bans transactions where the sole or dominant purpose is obtaining a tax benefit, care should be taken initially when deciding how to own and operate a business.



Buying and selling shares can be a taxing business

By [Noel Whittaker](#)

21 August 2018 – 4:30pm



...

In commerce the term “wash sale” is used to describe the sale and purchase of the same asset within a short period of time. Because the sale and the purchase effectively cancel each other out the result is there is no change in exposure to the asset by the owner. For example, if a person sells Telstra shares just before June 30, and buys them back after June 30, the Tax Office may well take the view that the only purpose of the transaction was to reduce capital gains tax and so attack it under Part IVA.

But it’s a grey area – one person might hold Telstra shares and sell them prior to June 30 on the basis they were overpriced and would be cheaper after June 30. That would not be attacked by the Tax Office but the onus proving your motives is on the seller. Another person might have made a capital gain during the year, so decides to sell shares that carried a yet-to-be-realised capital loss clearly to reduce or eliminate a capital gain. That is a type of transaction that could come under scrutiny from the Tax Office.

Part IVA application

Ability to focus on one part of a broader scheme
(Peabody)

Reasonable alternative must have a realistic commercial purpose to make it likely to have occurred *(Peabody and RCI)*

Identifying the correct taxpayer obtaining the tax benefit *(Peabody)*

Complex and unusual steps to achieve higher after-tax return with no commercial sense indicates dominant purpose *(Spotless Services)*

Regardless of the overall commercial purpose of a wider scheme, a narrower view can identify tax avoidance *(Consolidated Press Holdings)*

Arrangements only explicable by the tax advantage obtained can be reconstructed *(Hart)*

Peabody case



Quiz – Part IVA provisions

Which of the following is *least* likely to trigger the Part IVA provisions?



- Using dividends to repay a home loan instead of the relevant investment loan
- Selling capital equipment to generate working capital and leasing it back from the buyer
- Entering a mass marketed investment product to generate deductions upfront with possible future gains
- Changing business entity from company structure to discretionary trust to split income payments

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Part IVA application

Investment loan repayments

- Watch out!
(*Hart*,
TD 2012/1)

Sale and leaseback

- Generally ok
(where no
contrivance)
(*Eastern
Nitrogen, Metal
Manufactures*)

Mass marketed schemes

- Watch out!
(*Budplan*)

Income splitting

- Watch out!
(*Mochkin*)

Dividend stripping and streaming

Dividend stripping

- Tax avoidance arrangement
- Seeks to remove/dilute value of a company for tax purposes prior to share disposal
 - E.g. Sale of shares to crystallise capital gain by vendor shareholder...then purchaser makes a franked distribution prior to subsequent sale (reducing capital gain, or increasing capital loss)
- Dividend imputation rules may deny franking credits
- Part IVA may apply to deny capital loss (where elements met)
- Section 177E may apply to original shareholder (no need to identify tax benefit/dominant purpose)

Dividend streaming

- Seeks to direct franking credits to shareholders to which they will be more valuable
- A range of specific provisions exist to limit/counter such arrangements
- Part IVA may apply where a purpose of the scheme was to enable a person to obtain a franking credit benefit

Quiz – Penalties Part IVA

Matt is a tax adviser who is liable for civil penalties under the promoter penalty regime (Div 290, Schedule 1, TAA). Matt received consideration of \$250,000 in respect of his role in the scheme. What is the maximum penalty for Matt?



- 🌿 \$250,000
- 🌿 \$500,000
- 🌿 5,000 penalty units
- 🌿 25,000 penalty units

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🌿 25,000 penalty units

The maximum penalty for individuals is the greater of:

- 5,000 penalty units; and
- Twice the consideration received.

A penalty unit is currently \$222, so the total penalty is \$1,110,000.

Twice the consideration received would be \$500,000.

The maximum penalty is therefore 5,000 penalty units.

[Note that 25,000 penalty units is for a body corporate.]

The role of advisers

Relevance of an adviser's purpose

- The adviser's purpose is relevant in considering the dominant purpose for entering the scheme
- Consider the purpose of the promoter, associated entities, and those who entered the scheme

Discharge of duty to client

- Taxpayer suffers penalties for entering the scheme, plus costs and reputation damage
- Adviser may be personally liable under contract law, tort of negligence, and sanctions under the TASA (fines, penalties, GIC)
- Adviser has a duty of care, so disclaimers are not enough – need to provide clients with explanations and guidance
- Consider applying for a private ruling

Adviser liability

- Promoter penalty regime (Div 290, Schedule 1 TAA) for promoters of schemes
- Civil penalties
 - Conduct that results in entity being promoter of tax exploitation scheme
 - Conduct that results in scheme being promoted with a product ruling that is not actually followed

Mastery – aim high





KNOWLEDGE EQUITY

The image features the text "KNOWLEDGE EQUITY" in a serif font. The word "KNOWLEDGE" is in a dark grey color, and the word "EQUITY" is in a light green color. The letter "E" in "EQUITY" is a slightly darker shade of green. The text is centered horizontally. Above and below the text are two identical stylized green leaf-like graphics, each consisting of three curved, overlapping shapes that resemble leaves or flames, pointing upwards and downwards respectively.