Tax and Society: Does The Tax Advice Industry Perform A Positive Role?
by Dr Steven Stern, Adjunct Professor, College of Law & Justice, Victoria University[1]
a paper for the Australasian Tax Teachers' Association Annual Conference 2017
hosted by the Victoria University of Wellington: January 2017

Considerable resources seem to be deployed around the world in the private corporate sectors to ensure that potential taxpayers with sizable contingent tax liabilities are able to minimise or even eliminate their payments of tax. The resources deployed in this industry could substantially exceed the resources that governments deploy to enforce their taxation laws.

Does the tax advice industry have any positive impacts upon society? If so, how can the positive effects become reinforced? What are its negative effects on society? Do the negative effects outweigh any positive results that the tax advice industry may produce? How can any negative effects be identified for elimination or minimization?

In turn, there is the issue of whether the tax advice industry should attract privilege; and, if so, the extent and nature of any such privilege?

This paper will seek to answer these questions and to identify the different manifestations of tax advice industry in the private corporate sectors. It will examine whether any useful results can arise from demarcating distinctions between tax evasion, tax avoidance and tax minimization, and the extent to which there should be a concept of legitimate financial planning which utilizes tax benefits.[2] For example, Parliament in Australia has often deployed tax benefits as a means of implementing the Government's fiscal policies.

Reducing reliance on the aged pension is an illustration. However, the Australian Taxation Office ("ATO") recently issued a taxpayer alert indicating it is reviewing arrangements where individuals are said to be diverting their personal services income to a Self-Managed Superannuation Fund ("SMSF") purportedly in order to minimize or avoid tax. The ATO alerts taxpayers of its concerns that SMSF members at or approaching retirement age are performing services for clients and then referring remuneration often at reduced rates for those services to a company, trust or other non-individual entity. This entity is then said by the ATO to be distributing the resultant income to an SMSF, of which the individual service provider is a

[1] BEc LLB (Mon); LLM PhD (Melb); CTA; Barrister-at-Law, List S Gordon & Jackson, Victorian Bar; Registered Tax Agent; Registered Trade Mark Attorney, Senior Fellow, Economic Society of Australia; Member, Australian Academy of Forensic Science Inc.
[2] *Fifty shades of grey*, as suggested by Professor Gordon Cooper, Patron of the Australasian Tax Teachers' Association.

member, as a return on investment. Income received by the SMSF is taxed at a concessional rate or is treated altogether as exempt; i.e. an exempt current pension income of an SMSF in the pension phase.

There also is the issue that different ways of implementing commercial objectives can have different tax effects on various parties; e.g. borrowing funds to purchase an asset or leasing it. Results of this nature raise the consideration of why should the implementation of a transaction so as to produce a specific tax effect not be regarded as a positive outcome for which the tax advice industry might be commended?

Does the answer lay in that it is not problematic for the beneficial financial consequences of a transaction to include extending to taxation benefits; but, rather, what is problematic is where the principal effect or purpose of the transaction is achievement of reduced, minimal or no tax, and that the nature and extent of privilege that may be afforded to the tax advice industry should reflect such an analysis. However, is such a "solution" more theoretical which might be difficult to apply practically in the full range of diversity in commercial life?

The proposition that there are substantial inherent difficulties in reaching an appropriate balance between, on the one hand, the beneficial financial consequences of a transaction including an extension to tax benefits; and, on the other hand, the achievement of tax benefits being the principal effect or purpose of a transaction or series of transactions is illustrated graphically by the statement made judicially in the United Kingdom that: it is ambitious "to determine finally the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion".[3]

Tax evasion, shams, phoenix companies, tax avoidance, tax mitigation

In *Commissioner of Inland Revenue v Challenge Corporation Ltd*,[4] Lord Templeman delivering the judgement of the Privy Council referred to "the discernible distinctions between a transaction which is a sham, a transaction which effects the evasion of tax, a transaction which mitigates tax and a transaction which avoids tax".[5]

<u>Tax evasion</u>

It seems that the tax advice industry would not perform any positive role were it to facilitate tax evasion. It would be performing a positive role by preventing tax evasion. The essential feature of tax evasion is that the legal liability to pay tax has

[3] *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474, 513 per Lord Scarman.
[4] [1987] AC 155.
[5] Ibid 167.

arisen. Either deliberately or unwittingly the taxpayer has contravened the law evading the obligation to make this payment of tax. The taxpayer has incurred an obligation to pay a specific tax which the taxpayer does not pay. Tax evasion can involve fraud; for example lying to the Commissioner. Tax evasion also occurs when a taxpayer does not inform the Commissioner of all the facts relevant to the assessment of tax. With tax evasion, there is some element of fault or illegality: it involves a failure to discharge an obligation which has arisen.[6] Tax evasion may be innocent.[7] Where tax evasion is innocent, reassessment is likely together with administrative penalties. Tax evasion may be fraudulent. There, criminal prosecution may reasonably be anticipated.[8] Tax evasion can encompass sham transactions. There, the parties disguise the transaction's real character. A sham would render such a transaction void.

Sham[9]

A sham is a transaction which is "so constructed as to create a false impression in the eyes of the tax authority".[10] A "sham" for the purposes of Australian law is:

> something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious limitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive.[11]

The tax advice industry would not seem to be performing any positive role by facilitating any such transaction. However, "the real difficulty in this case is not to determine the applicable principles of law but rather to characterise the transactions as a matter of fact".[12] So the circularity of transactions involving, say, a round robin of cheques does not necessarily establish that the transaction is a sham, even where no party has the funds to meet the cheques. Nor does the artificiality of a transaction give rise to its characterisation as a sham provided each document or step in the transaction had the effect that it purported to have and none of these documents or steps purported to do something different from what the parties had agreed to do. And nor does the complexity or elaborate nature of the transaction

[6] G T Pagone, *Tax Avoidance in Australia* (2010) 4 The Federation Press, Annandale NSW.
[7] *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155, 168 per Lord Templeman delivering the judgment of the Privy Council.
[8] Compare the dicta of Lord Templeman referred to and cited in ibid.
[9] See summary in Jennifer Batrouney QC, *Sham transactions and the Millar case* at https://www.vicbar.com.au/GetFile.ashx?file=BarAssocTaxFiles%2fSham+and+the+Millar+case_10+October+2016_Combined+papers.pdf accessed 1 December 2016.
[10] Ibid.
[11] *Sharrment Pty Ltd & Ors v Official Trustee in Bankruptcy* (1988) 82 ALR 530, 537 per Lockhart J.
[12] Ibid.

establish its character as a sham if the parties intended what is being transacted to be operative according to its tenor.[13] Mere circumstances of suspicion are insufficient to establish that a transaction is a sham. It must be shown that the outward and visible form does not coincide with the inward and substantial truth. Nor is a transaction a sham because it is carried out with any ulterior or particular purpose or object. The test is: has what is done been genuinely done?[14]

Where the Commissioner of Taxation alleges a sham, the Commissioner must show some basis to it; however, then it is the taxpayer who must lead evidence to rebut the allegation because of the onus provisions in the *Taxation Administration Act 1953(* Cth).[15] In *Raftland v Federal Commissioner of Taxation*,[16] the High Court of Australia suggested that the term "sham" may be used in a sense which is less pejorative than imputing the presence of an objective of deliberate deception or fraud. The term "sham" was still apt to deny the critical step in the taxpayer's case. A court may ascertain what may appear from an examination of the whole of the relevant circumstances and these were not confined to the terms of the pertinent instrument.[17] According to the most recent Australian authority, a party can have a subjective intention inconsistent with any finding that the transactions were a sham and even innocently omit to have disclosed facts which were germane to a tax assessment; however, nevertheless if the party is unable to provide evidence proving that the transactions were what they purported so as to convince the tribunal or trial judge, the party will not succeed on appeal in overturning a decision of the tribunal or trial judge that the transactions were a sham, which was in favour of the Commissioner of Taxation.[18]

Phoenix companies

It seems that the tax advice industry would not perform any positive role by facilitating phoenix activity. Phoenix activity involves the liquidation of a company with accrued debts. Those accrued debts often include tax debts and employee entitlements. It also involves the transfer of the company's assets to related parties. The directors incorporate a new company. They carry on business as before. They hope to be released from the debtors of the liquidated company. Phoenix activity is problematic for creditors, including the Federal Commissioner of Taxation. In

[13] Ibid.
[14] *Miles v Bull* [1969] 1 QB 258, 264 per Megarry J.
[15] A H Slater, "Sham and substance" (1999) 28 *Australian Tax Review* 197, 211.
[16] (2008) 238 CLR 516.
[17] Ibid at 532 per Gleeson CJ, Gummow and Crennan JJ.
[18] *Millar v Federal Commissioner of Taxation* (2016) FCAFC 96 (Davies and Pagone JJ, Logan J (dissenting)) – upheld Administrative Appeals Tribunal decision affirming penalisation of loan transactions involving a SMSF which were held to be a sham.

Australia, the fight against such practices has intensified. There are pushes to reformulate the law. There is increasing monitoring of suspected culprits. There is movement towards harsher penalties. There are various remedies available to the Commissioner for deterrence and recovery. They include winding up, freezing orders, *Mareva* injunctions, director penalty notices, garnishee notices, Pay As You Go withholding non-compliance tax, and security deposits.[19] Phoenix activity has been described as a "tax crime".[20]

Tax avoidance

The tax advice industry would not be performing any positive role by facilitating tax avoidance. However, it would be performing a positive role by facilitating tax minimisation where the taxpayer genuinely qualified for a reduction in taxation liabilities in accordance with the intention of Parliament. The traditional position at common law was enunciated in Australia by Isaacs J in *Scott v Cawsey*:[21]

> … fiscal Acts should receive a strict construction. … Where Parliament has in the public interest thought fit … to exact from individuals certain contributions to the general revenue, a Court should be specially careful, in view of the consequences on both sides, to ascertain and enforce the actual commands of the legislature, not weakening them in favour of private persons to the detriment of the public welfare, not enlarging them as against the individuals towards whom they are directed.[22]

This balancing act requires a careful distinction between tax minimisation in the sense of legitimate tax mitigation and tax avoidance.

Tax avoidance has been defined as occurring where:

> a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.[23]

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[19] Stephen Chen, "A look at how the Commissioner treats Phoenix companies" (August 2016) 51(2) *Taxation in Australia* 74.
[20] Ibid 77.
[21] (1907) 5 CLR 132.
[22] Ibid 154-5.
[23] *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155, 167 per Lord Templeman delivering the judgment of the Privy Council.

Tax avoidance is directed at preventing a tax obligation from arising in the first place.[24] It has been said judicially that the hallmark of tax avoidance is that the taxpayer reduces his or her liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such a reduction in tax liability.[25] In respect of the achievement of reduced, minimal or no tax, the taxpayer prevents the existence of circumstances from which the taxation liability would arise. Tax avoidance is directed to preventing a taxation liability from ever arising where, on the objective evidence, this outcome should be construed as the taxpayer's sole or dominant purpose.

So in seeking to ascertain whether or not there has been tax avoidance in respect of a particular transaction, the mere fact that entry into and carrying out of that transaction inherently has various tax consequences only becomes pertinent if the dominant purpose of obtaining a tax benefit is its prevailing, most influential or ruling purpose.[26] In the final analysis, the boundary between "illegitimate" tax avoidance and "legitimate" tax minimisation in the sense of tax mitigation in accordance with law may be so fine as to mandate expert tax advice.

<u>Tax minimisation</u>

So for present purposes, the material distinction is between tax mitigation and tax avoidance:

> A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in Inland Revenue Commissioners v Duke of Westminster [1936] AC 1, 19 , "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than otherwise would be." In that case, however, the distinction between tax mitigation and tax avoidance was neither considered nor applied.
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> Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an arrangement but from the reduction of income which he accepts or the expenditure which he incurs.

[24] G T Pagone, *Tax Avoidance in Australia* (2010) 4 The Federation Press, Annandale NSW.
[25] *Inland Revenue Commissioners v Willoughby* [1997] 1 WLR 1071, 1079 per Lord Nolan.
[26] *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 186 CLR 404, 416 per Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ.

> Thus when a taxpayer makes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.
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> When a taxpayer makes a settlement he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.
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> Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitles the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.
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> A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief.
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> When a member of a specified group of companies sustains a loss, section 191 allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.
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> Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.[27]

The hallmark of tax mitigation is that a taxpayer takes advantage of a fiscally attractive option afforded to the taxpayer by the tax legislation. The taxpayer must genuinely incur the economic outcome that Parliament intended to be incurred by those taking advantage of the provision.[28] The distinction between tax avoidance and tax minimisation in the sense of legitimate tax mitigation appears easier to state in formal or theoretical terms than to apply in practice.[29] For example, in respect of "purpose", where a taxpayer's chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it is said to follow that tax avoidance must be at least one of the taxpayer's purposes in adopting that course. It has been

[27] *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155, 167-8 per Lord Templeman delivering the judgment of the Privy Council.

[28] *Inland Revenue Commissioners v Willoughby* [1997] 1 WLR 1071, 1079 per Lord Nolan.

[29] Compare G T Pagone, *Tax Avoidance in Australia* (2010) 6 The Federation Press, Annandale NSW.

said that there is this purpose whether or not the taxpayer formed the subjective intention of avoiding tax.[30]

ATO issues warning on contrived trust arrangements

A practical application of the problem of where to draw the limit between acceptable tax minimization planning and unacceptable tax avoidance or even illegal tax evasion is illustrated in Australia by a Taxpayer Alert issued by the ATO on Thursday, 17 November 2016 cautioning against arrangements that minimise tax by creating artificial differences between the taxable net income and distributable income of closely-held trusts.[31]

The ATO announced that it is reviewing a class of arrangements detected by its Trusts Taskforce that appear designed to exploit the proportionate approach to trust taxation. It is concerned that the arrangements are being deliberately structured to exclude from the trust income much of the economic benefit that is reflected in the taxable net income of the trust. In doing this, the taxpayers seek to gain substantial tax benefits. Under the proportionate approach, the share of trust income to which a beneficiary is "presently entitled" determines the proportionate share of taxable net income that is included in the beneficiary's assessable income. One implication of this approach is that, if taxable net income exceeds trust income, the share of that net income included in a beneficiary's assessable income will be more than the amount of the beneficiary's income entitlement under the trust.

The ATO says that the underlying premise of the arrangements described in its Taxpayer Alert is that the taxable net income of the trust is assessed to the presently entitled beneficiary, while the economic benefits reflected in that net income are retained by the trustee, or passed to a different beneficiary in a purportedly tax free form. Under these arrangements, the rate of tax paid by the presently entitled beneficiary is lower (often significantly lower) than the rate of tax that would otherwise have been paid by the trustee and/or the beneficiary who receives the benefit.[32]

The role of large accountancy firms in tax avoidance

[30] *Inland Revenue Commissioners v Willoughby* [1997] 1 WLR 1071, 1079 per Lord Nolan.

[31] Australian Taxation Office, *Media Release: ATO issues warning on contrived tax arrangements* (17 November 2016).

[32] Australian Taxation Office, *Taxpayer TA2016/12: Trust income reduction arrangements* (17 November2016) . https://www.ato.gov.au/law/view/document?DocID=TPA/TA201612/NAT/ATO/00001&PiT=99991231235958 accessed 22 November 2016.

In the United Kingdom, the House of Commons Committee of Public Accounts published a report[33] the thrust of which was that:

- simplicity was the key to fighting tax avoidance;
- there was abuse of tax reliefs which had been intended to encourage investment in films or donations to charity;
- four big accountancy firms had developed internal guidelines seeking to draw where the line laid between tax planning and aggressive avoidance;
- however, any such endeavours did not stop them selling schemes with as little as a 50% chance of succeeding if challenged in court;
- so there was no clarity over where the firms drew the line between acceptable tax planning and aggressive tax avoidance.

The report noted that:

- Her Majesty's Revenue Commissioners were always constrained by resources;
- there was a close relationship that the four firms enjoyed with government; and
- this close relationship created the perception that the firms wielded undue influence on the tax system which they used to their advantage.

The firms seconded staff to government to provide technical advice on changes to tax laws. It was claimed that this practice had improved the quality of taxation legislation. It nevertheless was conceded that this practice may give the perception that the firms were able to influence legislation to help their larger clients to the disadvantage of smaller United Kingdom businesses. It could be a case of poacher, turned gamekeeper, turned poacher again when individuals who advised government had gone back to their firms and advised clients on how they could use those laws to reduce the tax they paid.

Central to the Committee's report was its finding that:

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[33] *Tax avoidance: the role of large accountancy firms* (15 April 2013) 4 The Stationary Office Limited, London at http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/870/870.pdf accessed 7 December 2016.

> There is no clarity over where firms draw the line between acceptable tax planning and aggressive tax avoidance.[34]

Taxation advisory services, including tax minimisation planning, themselves are legitimate

Changes to taxation liabilities are inherent in the conduct of everyday business. For example, payments that constitute tax deductible expenditures would ordinarily be anticipated as increasing the payee's tax. So what is problematic in their necessarily reducing the payer's tax? Only if the payee has been deliberately selected as an income tax exempt entity or other person in order to minimise or avoid tax would such a transaction seem potentially problematic from a fiscal point of view. A second example is that the transfer of income-producing assets inherently must tend towards reducing the transferor's tax and raising the transferee's tax. Again, the mere fact of there being a change in taxation liabilities should not itself be problematic. A third example is where a taxpayer is benefited by a financially attractive option provided by the taxation legislation in order to further the Government's fiscal objectives, resulting in the economic consequences that Parliament intended would occur by taxpayers taking advantage of such an option in thereby incurring the tax benefits. It should only be problematic if the avoidance or minimization of taxation was such a dominant feature of the transaction as sufficient to provide evidence that the economic objectives which Parliament intended in providing for the tax benefit have been effectively eliminated.

A fourth example is that a taxpayer's funds may be used to acquire an asset. This payment or expenditure should not be deductible as it would be a capital payment. However, the depreciation component for the costs of the asset becomes deductible. The asset when disposed of will be subject to capital gains tax. Available funds for the taxpayer's other activities will be reduced by virtue of the expenditure of the capital amount for purchase of the asset. However, where the taxpayer borrows funds for the purchase, deductions can be claimed for both the interest on the loan and for the depreciation component. The taxpayer should have more funds to pursue other activities than the taxpayer would have had without the loan.

A fifth example is where an asset is leased from a financier. Such issues should arise as how and when to calculate capital gains tax and on what "assets". These issues should arise for both lessor and lessee. Both lessor and lessee may be able to claim depreciation components in respect of the asset costs particularly where the lessor financier retains legal title to the asset as security.

[34] Ibid 5.

A device by which a taxpayer might avoid some of the burden of taxation should not of itself be seen in any sinister sense. As intimated above, any subject or citizen, “whether poor and humble or wealthy and noble, has the legal right so to dispose of his [or her] capital or income as to attract upon himself [or herself] the least amount of tax”.[35] The Court’s only function is to determine the legal result in so far they affect tax.[36] Taxpayers have been entitled "to order" their affairs "so that the tax attaching" under the pertinent legislation is less "than it otherwise would be". However unappreciative Commissioners of Inland Revenue or fellow taxpayers may be of their ingenuity, they cannot be compelled to pay an increased tax. The so-called doctrine of substance has seemed to be nothing more than an attempt to make taxpayers pay tax notwithstanding that they had ordered their affairs that the amount of tax sought from them was not legally claimable.[37] Where legal instruments are bona fide as contrasted with not intended to be acted upon only being used as a cloak to conceal a different transaction, the legal instruments must be given their proper legal effect.[38]

In seeking to draw the line between unacceptable tax avoidance and appropriate tax minimisation in the form of legitimate mitigation of tax liabilities, it seems important to identify the crucial finding in the pivotal case of *Inland Revenue Commissioners v The Duke of Westminster*,[39] which was that:

> the deeds are genuine deeds, i.e., that they were intended to create and do create a legal liability on the Duke to pay in weekly payments the annual sum specified in each deed, whether or not any service is being rendered to the Duke by the covenantee. Further, it is conceded that the sums specified in the deeds were paid to the covenantees under the deed.[40]

By contrast with the majority in the *Duke of Westminster* case, Lord Atkin found that there was other documentation, that is, a letter from the Duke’s solicitors and a signed acknowledgement by each payee which resulted in the substance of the transaction being different from what was set out in the deeds when read in isolation: “the substance of the transaction was that what was being paid was remuneration”[41] which would not have entitled the Duke as payer to deduct these

[35] *Inland Revenue Commissioners v The Duke of Westminster* [1936] AC 1, 8 per Lord Atkin.
[36] Ibid.
[37] Ibid 19-20 per Lord Tomlin.
[38] Ibid 21.
[39] [1936] AC 1.
[40] Ibid 21 per Lord Russell of Killowen.
[41] Ibid 15 per Lord Atkin.

payments from his liabilities for surtax,[42] as opposed to annuities which, as found by the majority,[43] did so entitle the Duke.

According to the majority, the other documentation "has no operation at all, and has no effect upon the legal rights and liabilities of the parties created by the deed … the legal rights and liabilities of the parties created by the deed remain unaffected":[44]

> the absolute obligation to pay irrespective of employment remains unaffected by the collateral documents, which recognize that Allman will in future have an unqualified right to a weekly payment of 38s from the respondent, whether the respondent employs him or not.
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> …
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> .. few employers would care to take the risk to which the respondent has left himself exposed – namely, that the servants may quit his employment and take their services elsewhere and yet continue to exact the covenanted weekly payments from him.[45]

It was admitted that the deeds were genuine and carried an obligation of payment according to their tenor irrespective of whether the various payees were or were not in the Duke's service at any material date. Correctly, the true nature of the legal obligation and nothing else was "the substance".[46] The essential characteristic of the *Duke of Westminster* case was the finding of the majority, notwithstanding Lord Atkin's dissenting finding, that the underlying documentation was genuine and that, while implementation of the transaction resulted in a substantial tax benefit for the taxpayer, it also resulted in the taxpayer becoming exposed potentially to the risk of incurring significant liabilities of a financial character to the taxpayer's then employee gardeners.

So the tax advice industry is performing a legitimate function in advising how taxpayers may reduce their taxation liabilities by incurring the risk of other significant financial liabilities.

Limitations of tax minimisation planning activities being legitimate

It seems clear that the underlying principle enunciated in the *Duke of Westminster* case continues to be good law within limitations.[47] There is a cardinal principle obliging a court to accept documents or transactions, found to be genuine. As such, it does not compel the court to look at a document or transaction in blinkers,

[42] Ibid 13-16.
[43] Ibid Lord Tomlin, Lord Russell of Killowen, Lord Macmillan and Lord Wright.
[44] Ibid 23-4 per Lord Russell of Killowen.
[45] Ibid 27-8 per Lord Macmillan.
[46] Ibid 29-31 per Lord Wright.
[47] *W T Ramsay v Inland Revenue Commissioners* [1982] AC 300.

isolated from any context to which it properly belongs. The context in which the document or transaction belongs may have been implementation of an intention for it to have effect as part of a nexus or series of transactions, which may be as many as say 15, or as an ingredient of a wider transaction intended as a whole. There is nothing in the *Duke of Westminster* doctrine to prevent it being so regarded. To do so, is not to prefer form to substance or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence. If that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.[48]

The principles enunciated in the *Duke of Wesminster* case do not necessitate being overruled.[49] However, they provide little or no guidance as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that attaches under the appropriate legislation.[50]

The *Duke of Westminster's* case was about a simple transaction. It was entered into between two real persons. Each had a mind of his own. They were the Duke and his gardener. Even though in the nineteen-thirties, and at a time of high unemployment, there might be reason to expect that the mind of the gardener would manifest some degree of subservience to that of the Duke. The kinds of tax avoidance schemes that have occupied the attention of the courts in recent years, however, involve inter-connected transactions between artificial persons, limited companies, without minds of their own but directed by a single master-mind.[51]

It seems to be a useful approach to examine where it is that courts have found the limits for tax minimisation activities to be legitimate in ascertaining the point where the tax advice industry ceases to perform a useful function, particularly where directed by a single "master-mind".

Devising an artificial loss equal to chargeable gain

Devising by a "master-mind" an artificial loss which is at least equal to any chargeable gain would seem to be such a point.

In *W T Ramsay v Inland Revenue Commissioners*,[52] the master-mind was the deviser and vendor of the tax avoidance scheme. There, the taxpayer company sold the freehold of land it was farming realising a chargeable gain, before deduction of any allowable losses. For the sole purpose of reducing the amount of the capital gains tax payable, the taxpayer company entered into a capital loss scheme. This scheme

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[48] Ibid per Lord Wilberforce.
[49] *Commissioners of Inland Revenue v Burmah Oil Co Ltd* (1982) 54 TC 200.
[50] Ibid 214 per Lord Diplock.
[51] Ibid.
[52] [1982] AC 300.

was admitted to have no commercial justification. It involved the taxpayer company in purchasing 68 shares in a newly formed investment company. The terms of the purchase included a premium of £2,719 sterling per share, £5 being payable on application and the balance on call. At the same time the taxpayer company entered into a loan agreement whereby it made two loans of £218,750 each for terms of 30 and 31 years respectively. Each loan carried interest at the rate of 11 per cent annually. The following month, under the terms of the loan agreement, the rate of interest on the first loan was reduced to zero, and that on the second loan increased to 22 per cent. On the same day, the investment company called on the taxpayer company to pay the balance of £184,654 due in respect of the 68 shares. The taxpayer company then sold the second loan on certain conditions to a finance company at its then approximate market value of £393,750. The purpose of the scheme was to ensure that the profit of the taxpayer company on the sale of that loan should be exempted from giving rise to a chargeable gain. Further loan and share transactions took place between the parties. In due course, following a decision that the investment company should be wound up, the first loan became repayable to the taxpayer company at par and the second loan (that had in the meantime been assigned by the finance company to a second investment company that was wholly owned by the first investment company) repayable at a price of £394,673. In consequence of those transactions the value of the shares of the first investment company were drastically reduced and an artificial capital loss thereby accrued to the taxpayer company.

The question was whether a certain loan was a "debt on a security" for the purposes of capital gains tax. If it was, then a chargeable gain on which corporation tax was payable accrued to the taxpayer company on its disposal. In the House of Lords, the Inland Revenue Commissioners raised the issue whether the tax avoidance scheme acquired and used by the taxpayer company should simply be disregarded as artificial and fiscally ineffective.

<u>Sale by taxpayer of reversionary interests in settlements</u>

There was a second appeal by a taxpayer in the *Ramsa*y case, namely, Denis Martin Edward Rawling, where the scheme was of quite a different nature but was also held to involve tax avoidance in respect of capital gains tax. This scheme involved the use of a settlement made in Gibraltar and administered by a trustee in Gibraltar, another settlement made in Jersey and administered by a trustee in Jersey, and six associated companies. The taxpayer bought for £543,600 a reversionary interest under the Gibraltar settlement. The trust fund held on the trusts of that settlement consisted of £600,000 cash owing to the trustee. Under the Gibraltar settlement the trustees had power to advance any part of the capital of the trust fund held on the trusts of the settlement to the trustees of any other settlement under which the person for the time being entitled to the Gibraltar reversion had an indefeasible

reversionary interest falling into possession not later than the vesting date under the Gibraltar settlement. On the exercise of such a power, the trustees were obliged under the Gibraltar settlement to make an advance to the income beneficiary under the Gibraltar settlement to compensate the income beneficiary for loss of income. The taxpayer had a reversionary interest under the Jersey settlement. That reversionary interest was indefeasible. It was to fall into possession on a date which was not later than the vesting date under the Gibraltar settlement. The trust fund settled on the trusts of the Jersey settlement consisted of £100 cash. The trustees of the Gibraltar settlement appointed £315,000 out of the capital of the trust fund held on the trusts thereof to the trustees of the Jersey settlement to be held on the trusts of that settlement. At the same time, the trustees of the Gibraltar settlement appointed £29,610 out of the capital of the trust fund held on the trusts thereof to the income beneficiary under the Gibraltar settlement. The taxpayer then sold the Gibraltar reversion to the income beneficiary under the Gibraltar settlement for £231,130. The trust fund held on the trusts of the Gibraltar settlement then consisted of £255,390 cash. On the same day, the taxpayer sold his reversionary interest under the Jersey settlement for £312,100. The trust fund held on the trusts of the Jersey settlement then consisted of £315,100 cash. In connection with the above scheme, the taxpayer paid to the purchaser of his reversionary interest under the Jersey settlement a procuration fee of £3,500 and interest of £6,115 on money lent to the taxpayer by the purchaser of the taxpayer's reversionary interest under the Jersey settlement.

The issue in this appeal related to whether the appellant taxpayer Rawling could take advantage of a provision which exempted from capital gains tax any gain made on the disposal of, amongst others, a reversionary interest under a settlement by the person for whose benefit the interest was created or by any other person apart from one who acquired the interest for consideration In money. In the House of Lords, the respondent Inspector of Taxes raised the same issue as in the first appeal relating to the artificiality of the scheme in question.

<u>Decision of House of Lords</u>

The House of Lords held that, although the separate steps of a scheme were "genuine" and had to be accepted under the doctrine of the *Duke of Westminster* case, the court could, on the findings of the general or special commissioners and of its own analysis in law, consider the scheme as a whole and was not confined to a step by step examination. Capital gains tax was a tax on gains (or gains less losses). It was not a tax on arithmetical differences. To say that a loss or gain which appeared to arise at one stage in an indivisible process, and which was intended to be and was cancelled out at a later stage, so at the end of what was brought as, and planned as, a single continuous operation was not such a loss or gain as the legislation was dealing with, was well and indeed essentially within the judicial

process. If a taxpayer entered into a transaction that did not appreciably affect the taxpayer's beneficial interest except to reduce the taxpayer's tax, the law would disregard it.

On the facts of the first appeal, it would be quite wrong and a faulty analysis to pick up and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely a reflection of the gain. The true view was, regarding the scheme as a whole, to find out that there was neither gain nor loss. In any event, on the assumption that it was permissible to separate from the scheme as a whole the step of the sale of the second loan, in the circumstances the second loan was a "debt on a security" within the exception contained in the applicable taxation legislation with the result that a chargeable gain accrued to the taxpayer on its disposal.

On the facts of the second appeal, it would be quite wrong and a faulty analysis to segregate from what was an integrated and interdependent series of operations one step, namely, the sale of the Gibraltar reversion and to attach fiscal consequences to that step regardless of the other steps and operations with which it was integrated. The only conclusion, which was consistent with the intention of the parties and with the documents regarded as interdependent, was to find that apart from a sum not exceeding £370 there was neither gain nor loss. In any event, even if the sale of the Gibraltar reversion was regarded in isolation, in the circumstances it did not give rise to an allowable loss.

For the commissioners considering a particular case, it is wrong and an unnecessary self-limitation to regard themselves as precluded by their own finding that documents or transactions are not "shams" and from considering what, as evidenced by the documents themselves or by the manifested intention of the parties, the relevant transaction is. They are not under the *Duke of Westminster* doctrine or any other authority, bound to consider individually each separate step in a composite transaction intended to be carried out as a whole.

Transmogrification of non-deductible debt into deductible loss

In *Commissioners of Inland Revenue v Burmah Oil Co Ltd*,[53] the master mind was Burmah, the parent company of the wholly owned subsidiary companies, between which the pre-ordained series of transactions took place. Burmah was acting in accordance with advice of the highest integrity who, in reliance on Lord Tomlin's *dictum* in the *Duke of Wesminster* case did not foresee the difference in approach to tax avoidance schemes involving inter-company transactions that could be adopted

[53] (1982) 54 TC 200.

by a superior Court by the time some nine years later when the particular scheme that they had devised nine years before in 1972 was eventually to come before it.[54]

The House of Lords noted expressly that the fact that the purpose of the scheme was tax avoidance did not carry any implication that it was in any way reprehensible or other than perfectly honest and respectable. It was the duty of Burmah's directors to take such lawful steps as were open to them to minimise the impact of tax on the company's profits. In carrying out this scheme they acted upon professional advice from reputable sources. The House of Lords took the view that in this regrettably intricate region of law the advice turned out to be erroneous, but the directors were not to be criticised on that account.[55]

There was a series of intra-group transactions. The only real asset involved in the whole series of transactions was the holding of an outside company's shares, British Petroleum Co Ltd, by the group's parent company, Burmah Oil Co Ltd. Were the shares to have been sold in the relevant tax year, 1972, to some third party, capital gains tax would have been payable on the net proceeds of the sale. What losses the taxpayer would have been able to offset against its capital gains was unknown, as it continued to retain the shares.

Burmah was at all material times the parent company of several companies including OMDR Holdings Ltd ('Holdings'), Manchester Oil Refinery Holdings Ltd ('MORH'), and Burmah Oil Trading Ltd ('BOTL'). In March 1969 Burmah, to secure certain fiscal advantages by way of relief under section 84 of the Finance Act 1965 (UK), sold and transferred to Holdings a substantial amount of stock which it held in the British Petroleum Company Ltd ('BP'). At all material times, Burmah was the beneficial owner of the entire issued share capital of Holdings. At the material times there was to a very great extent a common membership between the boards of Burmah, Holdings, MORH, and BOTL. The purchase price of £380,625,000 was left outstanding as a debt due by Holdings to Burmah. After deduction of the debt of £700,001 owed by Burmah to Holdings, the amount outstanding on loan account and due by Holdings to Burmah was £379,924,999.

In April 1971, for good commercial reasons, the BP stock was re-sold and transferred back by Holdings to Burmah. The market value of the BP stock had fallen since March 1969 and the price on re-sale was £220,625,000. As a result of the lower price on re-sale there remained at the completion of that transaction a large balance outstanding as a loan due by Holdings to Burmah amounting to £159,299,999. As Burmah and Holdings were members of the same group of companies, the transactions between them in March 1969 and April 1971 gave rise neither to

[54] Ibid 214-5 per Lord Diplock.
[55] Ibid 220 per Lord Fraser of Tullybelton.

chargeable gains nor to allowable losses. The transactions were carried out correctly as planned and were genuine transactions.[56]

Two transactions were then undertaken for good commercial reasons. First, Burmah transferred the shares to OMDR Holdings Ltd at market price. Second, when the market price had fallen, Holdings transferred the shares back to Burmah. As a result, there were entries in the books of both the parent and subsidiary companies which showed an unsecured indebtedness of Burmah to Holdings in the order of £160,000,000. This amount represented the extent of Holdings' insolvency. Holdings had no assets of its own. A bad debt which was not a debt on a security was not a deductible loss for the purposes of capital gains tax. A scheme consequently was designed to convert this debt into a loss on realisation of Burmah's shares in Holdings on liquidation of that subsidiary company. The essence of that scheme was that Burmah should subscribe £160,000,000 for a rights issue of fresh shares in Holdings. Holdings was thus put into a position of making a declaration of solvency and then going into voluntary liquidation. The £160,000,000 was the subject of two circles of book entries in the course of which the £160,000,000 indebtedness of Holdings to Burmah was transmogrified into a loss of the same amount (less a minor difference) upon the realisation of Burmah's shares in Holdings on Holdings' voluntary liquidation. The end result was that Burmah wrote off Holdings' indebtedness to it of £160,000,000 by itself providing Holdings of the money to pay it, ostensibly in the form of fresh capital. The real loss it sustained was of a debt and not on a security.[57]

On Tuesday, 12 December 1972, a series of events took place, of which the essential ones were these. MORH obtained from Burmah a loan of £159,299,999, being the exact amount of the debt owed by Holdings to Burmah. MORH then lent that amount to Holdings which in turn and on the same day repaid its debt to Burmah. The money thus went round in a small circle and returned to its starting point on the same day. The effect so far was that instead of Burmah being a direct creditor of Holdings for the sum mentioned, MORH were now interposed as creditor of Holdings and debtor of Burmah for that amount.

On Monday, 18 December 1972, another series of events took place of which the essential ones were these, while omitting reference to the various meetings of directors and to an extraordinary general meeting of Holdings which were all duly held (and which passed the appropriate resolutions). Holdings made a right issue of shares to its existing shareholders of 700,001 unissued ordinary shares of £1 each at £228 per share, in proportion to their existing holdings. Burmah applied for and was allotted 700,000 for which it paid £159,600,000 and BOTL applied for and was

[56] *Commissioners of Inland Revenue v Burmah Oil Co Ltd* (1982) 54 TC 200, 216 per Lord Fraser of Tullybelton.

[57] *Commissioners of Inland Revenue v Burmah Oil Co Ltd* (1982) 54 TC 200, 215 per Lord Wilberforce.

allotted one share for which it paid £228. The issue price of £228 per share which produced the total sum of £159,600,228 was the lowest price in complete pounds which when multiplied by 700,001 would produce more than £159,299,999. On the same day (18 December 1972), Holdings repaid to MORH the loan of £159,299,999 and MORH repaid that same amount to Burmah. That sum thus went round the same circle as the money that had gone round some six days' earlier on 12 December 1972 but in the opposite direction. The effect of these events was to eliminate the train of debts and to restore Holdings to solvency.

On Tuesday, 19 December 1972, Holdings took the first steps towards voluntary liquidation. On 29 December 1972 its only asset, a cash sum of £296,728.50 (being the balance of £300,229 of cash subscribed for its new shares after repaying its debt to MORH, less capital duty of £3,500.50 on its increased capital) was distributed to its members. Holdings was later dissolved.[58] Holdings had never traded, and the purchase and sale transactions described above were the only functions it ever carried out.[59] The necessary money was provided by Burmah, and its two circular journeys on 12 and 18 December 1972 undoubtedly took place as represented by entries in the bank statements.[60] In the present case the plan, though preconceived, was specially tailor-made for Burmah.[61]

The House of Lords held unanimously that the Court of Session which had dismissed the Crown's appeal against a decision in favour of the taxpayer Burmah had rightly decided that the new issue was part of a reorganisation of Holdings' capital, so it had been correctly decided in favour of the taxpayer that the allotment of new shares was not to be treated as an acquisition of those shares. There had therefore been no "acquisition … otherwise than … at arm's length", so market value could not be substituted for their issue price by virtue of the applicable legislation in the Finance Act 1965 (UK). However, the House of Lords unanimously allowed the Crown's appeal. The House of Lords went on to state that the *Ramsay* case marked a significant change in its approach to pre-ordained series of transactions, whether or not they included the achievement of a legitimate commercial end, into which steps with no purpose but tax avoidance were inserted. The principles stated in the *Ramsay* case applied to Burmah's scheme. So the increase in its loss was not allowable for purposes of capital gains tax. It was not a "real" loss.

<u>Preordained series of transactions or steps designed for tax benefit</u>

In *Furniss (Inspector of Taxes v Dawson*,[62] the taxpayers were a father and his two sons. They wished to sell their shares in two small family companies, the operating

[58] Ibid 217 per Lord Fraser of Tullybelton.
[59] Ibid 216 per Lord Fraser of Tullybelton.
[60] Ibid 220 per Lord Fraser of Tullybelton.
[61] Ibid 219 per Lord Fraser of Tullybelton.
[62] [1984] AC 474.

companies. They entered into a scheme designed to defer any liability to pay capital gains tax on the sale of their shareholding before the sale took place. They had an investment company incorporated which agreed to purchase from the taxpayers their shares in the operating companies at a price to be satisfied by the issue of 151,500 shares of one penny each at a premium of 99 pence per share, and further agreed to sell those shareholdings on to the real pre-identified purchaser of the operating companies for £151,500, which transactions took place. The interposed investment company thus acquired beneficial ownership of the shares in the operating companies and had control of them. The issue was whether Schedule 7 to the Finance Act 1965 (UK) was to apply to the share exchange so that for tax purposes the shares in the interposed company were to be identified with the shares in the operating companies and treated as the same asset with the result that no liability to capital gains tax would arise until the taxpayers disposed of their shares in the interposed investment company.

Peter Millett QC and Robert Carnwath for the Crown submitted that it was not necessary for the House of Lords to overrule the *Duke of Westminster* case. The Crown submitted that the *Duke of Westminster* case could easily be distinguished. The Crown did not say it was wrongly decided. The Crown did say that a myth had grown up about it. The Crown submitted that this myth should finally be discarded. According to the Crown submissions, the myth was that the *Duke of Westminster* case decided that in tax cases the court looks at the form and not the substance. The Crown submitted that this was a misreading of Lord Tomlin's judgment. According to the Crown, it was not necessary to depart from the decision in the *Duke of Westminster* case. This decision had been that a taxpayer was to be taxed by reference to what the taxpayer had done, not might have done but did not do. The Crown's submissions were that the Commissioners decide what the taxpayer did do, and it then becomes a question of law what the correct analysis of it is. The court must analyse the transaction itself by the ordinary principles and see what it was. When the Commissioners ascertain what the taxpayer has done, and the court applies the correct analysis of it, neither must do so in blinkers. The Crown submitted that the *Duke of Westminster* case did not help the court to determine whether there were two interdependent transactions or two legally separate transactions.[63]

The House of Lords held that the correct approach to tax-saving schemes was that, where there was a pre-ordained series of transactions or a single composite transaction, steps inserted that had no commercial or business purpose other than avoiding a liability to tax were to be disregarded, the end result being looked at and taxed according to the terms of the particular statute in question. This approach was not to be confined to self-cancelling transactions and nor to arrangements where the

[63] Ibid 509-10.

parties were contractually bound to take each step. The inserted introduction of the interposed investment company had no business purpose, as opposed to business effect, other than the deferment of tax. It was accordingly to be disregarded. The result was that there had been a disposal by the taxpayers in favour of the pre-identified purchaser of the operating companies in consideration of a sum of money paid with the concurrence of the taxpayers to the interposed investment company. Capital gains tax was payable accordingly. Moreover, the House of Lords enunciated that where there was a pre-ordained series of transactions; that is, a single composite transaction, and whether that transaction contained steps that were inserted without any commercial or business purpose apart from a tax advantage are facts to be found by the commissioners. These may be primary facts or, more probably inferences to be drawn from the primary facts. An appellate court should interfere with such inferences of fact only where they were insupportable on the basis of the primary facts found.

Does fiscal nullity provide an answer?

Relevance

Does identification of the point where the tax advice industry transposes from acceptable tax minimisation mitigation to unacceptable tax avoidance be facilitated by the fiscal nullity doctrine, as it has become known, to be part of the law governing the interpretation of tax legislation?[64] A strong case has been put forward that such a fiscal nullity doctrine is part of the law governing the interpretation of tax legislation.[65] In a comprehensive paper, the proponent of this case has defined the term "fiscal nullity" as referring to the concept that:

> a court may treat certain transactions as having no effect for tax purposes where it is appropriate to do so in order to give effect to the purpose of the relevant taxing provisions. This explanation is not intended to limit the potential scope of the fiscal nullity doctrine and it is recognised that courts will further develop and refine the doctrine.[66]

It has been pointed out that the House of Lords first articulated the fiscal nullity doctrine in *W T Ramsay v Inland Revenue Commissioners*.[67] It has been argued that what the court relied on in *Ramsay* was on ordinary principles of statutory interpretation. Nevertheless, it was pointed out that the case was widely viewed as

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[64] Allegra McLeod Crawford, *The Fiscal Nullity Doctrine in New Zealand*, LLM Research Paper Laws:516 Submitted for the LLB (Honours) Degree in the Faculty of Law in the Victoria University of Wellington (2013) at http://researcharchive.vuw.ac.nz/xmlui/bitstream/handle/10063/3211/thesis.pdf?sequence=2 accessed 23 November 2016.

[65] Ibid.

[66] Ibid 8.

[67] [1982] AC 300.

creating a judge-made general anti-avoidance rule, known as the doctrine of fiscal nullity. It has been stated that this misconception was probably caused by the approach of the courts in the cases that followed *Ramsay*; in particular, the court's application of the fiscal nullity doctrine in *Furniss (Inspector of Taxes) v Dawson*.[68] Lord Brightman's precise formulation of the doctrine in that case is said to have suggested that the doctrine was a judicial rule that went beyond statutory interpretation. Lord Steyn in *Inland Revenue Commissioners v McGuckian*[69] is cited that the principle of fiscal nullity enunciated in *Ramsay* was developed as a matter of statutory construction founded on a broad purposive interpretation giving effect to the intention of Parliament and was therefore based on an orthodox form of statutory interpretation. Lord Cooke's observation in the same case is also referred to that while the fiscal nullity doctrine is commonly seen as being specific to the construction of tax legislation, it would be more helpful to recognise the doctrine as an application to tax legislation of the general approach to statutory interpretation whereby weight is given to the purpose of the legislation.[70] The decision of the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson*[71] is also cited that a taxing statute was to be applied by reference to the ordinary principles of statutory construction by giving the provision a purposive construction in order to identify its requirements and then deciding whether the actual transactions answered to the statutory description; that before any question arose as to whether elements of a transaction were to be disregarded as having no commercial purpose the requirements of the particular provision had to be identified; and that where a claim fell within the statutory provision the question of whether other transactions had a commercial purpose was irrelevant.[72]

It is conceded by the proponent of the case that the fiscal nullity doctrine is part of the law governing the interpretation of tax legislation that:

- in jurisdictions outside the United Kingdom there is support for the view that the fiscal nullity doctrine operates as a judge-made general anti-avoidance rule;
- fiscal nullity reflects the particular legal context in the United Kingdom at the time that the House of Lords decided *Ramsay*; and
- fiscal nullity is not applicable in jurisdictions where the tax legislation includes a statutory general anti-avoidance provision.[73]

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[68] [1984] AC 474.
[69] (1997) 69 TC 1, 80.
[70] Ibid 84.
[71] [2005] 1 AC 684.
[72] See Crawford, op cit for more details.
[73] Crawford, op cit.

It is explained that In New Zealand the most significant decision relating to the fiscal nullity doctrine is *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*.[74] In that case the Supreme Court, by a majority (Tipping, McGrath and Gault JJ), took an approach that was inconsistent with treating fiscal nullity as being part of New Zealand law. Given the significance of this decision to any discussion of fiscal nullity in New Zealand, the reasoning of the majority in this case is analysed with a view to demonstrating how the court could have taken a fiscal nullity approach in that case. Other possible grounds for arguing that the fiscal nullity doctrine is not part of New Zealand law are then considered. These grounds are specified as that:

- fiscal nullity is not compatible with the existence of a general anti-avoidance provision in New Zealand's income tax legislation;
- fiscal nullity is not reconcilable with the *Duke of Westminster* principle analysed above; and
- fiscal nullity produces too much uncertainty in the application of tax legislation.

It is argued that the better view is that fiscal nullity is part of the law because fiscal nullity is merely an application to tax legislation of the purposive approach to statutory interpretation.[75]

The Supreme Court of Canada has considered whether a corporate taxpayer with the avowed purpose of reducing its taxes can establish an arrangement whereby future profits are routed through a sister subsidiary in order to avail itself of the latter corporation's loss carry-forward.[76] It was held that the transaction there was not a sham. It was not constructed to create a false impression. The appearance created by the documentation was the reality. The fact that an otherwise valid transaction was entered into by parties who were not at arms' length or that it might be reversed was insufficient to have the concept of a sham transaction extended to the transaction. The sale and transfer of the business was complete in law. There was no commitment or enforceable agreement to reverse the sale. The transaction created the legal relations between the parties which the parties intended to create. There was a long standing principle that a person might order his or her affairs so as to attract the least tax liability, in accordance with what was enunciated in the *Duke of Westminster* case. This principle was too deeply entrenched in Canadian law to be rejected in the absence of clear statutory authority. No such authority had been advanced in the case. The fiscal nullity doctrine as expounded in the *Ramsay* and *Burmah* cases in the United Kingdom was rejected on the grounds that it reflected

[74] [2008] NZSC 115; [2009] 2 NZLR 289.
[75] Crawford, op cit.
[76] *Stubart Investments Ltd v The Queen* [1984] 1 SCR 536.

the role of the court in a regime where the legislature had enunciated taxing edicts in a detailed manner but had not superimposed a general guideline for the elimination of mechanisms designed and established only to deflect the plain purpose of the taxing provision.[77]

In the United Kingdom, it has over the past decade been decided that "the view that the principle enunciated in *Ramsay* created new jurisprudence applicable to taxing statutes to the effect that transactions or elements in transactions which had no commercial purpose were to be disregarded … this conclusion from the cases was going too far":[78]

> … the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found.[79]

In Australia, the High Court has decided that the existence of a general anti-avoidance provision in the taxation legislation, such as section 260 or Part IVA of the *Income Tax Assessment Act 1936* (Cth),[80] is inconsistent with the adoption of something like a fiscal nullity approach to the construction of specific statutory provisions in the taxation legislation, so it is impermissible to draw an imputation or implication in an individual provision of a purpose of inhibiting tax avoidance irrespective of the provision's actual words. According to the High Court, the principle of fiscal nullity propounded by the House of Lords in England is not appropriate to be adopted in the construction of the Act generally or in the construction and application of specific provisions, such as section 51 in respect of deductions. The Act, previously in section 260 and now in Part IVA, makes specific provision on the topic of what may be called tax minimisation arrangements. It thereby excludes any implication of a further limitation upon that which a taxpayer may or may not do for the purposes of obtaining a tax advantage. Section 260 and now Part IVA have made it impossible to place upon other provisions of the Act a qualification which they do not express for the purpose of inhibiting tax avoidance. [81]

The inherent complexity in modern taxation planning involving any potential use of the tax avoidance provisions is illustrated by recent judgments handed down in the Full Court of the Federal Court of Australia in *Channel Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation*[82] which by a majority[83] held that for the

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[77] Ibid 560-1 per Estey J.

[78] G T Pagone, *Tax Avoidance in Australia* (2010) 14 The Federation Press, Annandale NSW.

[79] *Barclays Mercantile Business Finance Ltd v Dawson* [2005] 1 AC 684, 695-6 per Lord Nicholls of Birkenhead.

[80] More recently in respect of Goods and Services Tax, *A New Tax System (Goods and Services Tax) Act 1999* (Cth) Division 165 (Anti-avoidance).

[81] *John v Federal Commissioner of Taxation* (1989) 166 CLR 417, 434 per Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ; *Federal Commissioner of Taxation v Patcorp Investments Ltd* (1976) 140 CLR 247, 292 per Gibbs J.

[82] [2015] FCAFC 57; (2015) 321 ALR 261.

Commissioner of Taxation to apply Part IVA to a scheme of arrangement involving the formation of an income tax consolidated group, the correct entity to which to issue a determination and corresponding assessment (or amended assessment) is the group member who would have derived the tax benefit had the income tax consolidated group not been formed. The minority decision[84] rested heavily on the primacy of Part IVA being to the effect that "the consolidation provisions did not in any way prevent a determination and an assessment being made in respect of the Headco or Subco and therefore all options were available to the Commissioner".[85]

Transfer pricing

Businesses inevitably and increasingly often have to operate in more than one country. Offshore business entities themselves must be considered legal and perfectly appropriate. A business in one country may wish to hold some of its funds in other currency, such as United States dollars. A business may wish to avoid falling under Islamic inheritance jurisprudence if an owner dies. An offshore tax haven occurs where the primary provision of services to non-resident people or businesses requires little or no disclosure of information when doing business or offers low taxes.[86]

The ATO has enunciated that if an Australian taxpayer has international transactions with a related party – such as a loan from the taxpayer's foreign subsidiary- the taxpayer's Australian tax can be affected if the amounts for the transaction do not comply with the arm's length principle under the transfer pricing rules. According to the ATO, some multinational businesses attempt to shift their profits to low-tax jurisdictions by setting unrealistic prices for their actual commercial or financial dealings with their related parties. The ATO has stated that businesses with related party international dealings may have their transfer pricing reviewed or audited by it, with the possibility of pricing adjustments and penalties. The ATO says that it is more likely to review dealings where the scope of a business's international dealings with related parties is more significant and broader. The ATO has identified businesses with significant levels of dealings whose tax performance is low compared to industry standards at the greatest risk of review.[87]

Australia's transfer pricing rules seek to avoid the underpayment of tax in Australia by having businesses price related party international dealings according to what is

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[83] Alssop CJ, Edmonds and Gordon JJ.
[84] Pagone and Davies JJ.
[85] As summarized by Clint Harding and Peter Scott, "Part IVA and consolidated groups: grazing on uncertainty" (September 2015) 50(3) *Taxation in Australia* 132, 134.
[86] For example, see "Mossack Fonseca papers" *Panama Papers* at https://en.wikipedia.org/wiki/Panama_Papers, accessed 8 December 2016.
[87] Australian Taxation Office, *Transfer pricing* (16 February 2016) at https://www.ato.gov.au/Business/International-tax-for-business/Transfer-pricing/ accessed 6 December 2016 .

expected from independent parties in the same situation. The ATO's position is that pricing for international dealings between related parties should reflect the right return for the activities carried out in Australia, the Australian assets used (whether sold, lent or licensed), and the risks assumed in carrying out these activities. The ATO cites pricing which is not in accordance with Australia's transfer pricing rules as being often referred to as "international profit shifting". The ATO requires Australian taxpayers carefully to consider the terms and conditions of any international dealings with related parties to ensure their business outcomes properly reflect economic activity in Australia. It states that Australia's double tax agreements and domestic law require pricing of goods and services and allocation of income and expenses between related parties to accord with the arm's length principle.[88]

It is able to be illustrated by the issue of transfer pricing that highly skilled tax advice is essential to both taxpayers and taxation commissioners; and that it is very much in the interests of the revenue that taxpayers access independent and highly skilled expert tax advisory services.

To this end, the tax advice industry seems essential to advise taxpayers in respect of the arm's length principle and comparability; application of the arm's length principle; arm's length methodologies; documentation requirements; simplification of transfer pricing record keeping; drawing up a compliant international dealings schedule; and assessment of transfer pricing risk.

What if the tax advice industry is able to demonstrate that, as a result of an investment by a multinational concern, there has been substantially more jobs, capital, wealth and value created in the country? It might be hard to value intangible assets which may be sold for $100 per asset, but might generate $1000 in income, ten times more than the sale and purchase price. Has the sale been below value? The concept of an arm's length transaction might represent an outdated environment which has become redundant in today's different environment. Once, in order to operate in a country, a concern had to have a full service entity in the country. With related party transactions, there are no market forces which independently can operate to influence the terms of any pertinent contract. The "parties" are able to write what is wanted by any "master-mind" behind the transaction. The value chain can be fragmented and profit allocated at the absolute discretion of any "master-mind". When dealing with related parties, any "master-mind" does not have to worry about patent and other intellectual property protections. The "master-mind" does not have to worry about enforcing any

[88] Australian Taxation Office, *International transfer pricing – introduction to concepts and risk assessment* (28 October 2016) at https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/International-transfer-pricing---introduction-to-concepts-and-risk-assessment/ accessed 6 December 2016.

agreement between the related parties. These are not independent parties dealing with each other.[89]

There are two principal methodologies to deal with transfer pricing: profit apportionment and profit split. The first reflects an approach taken in the United States towards allocation of taxation liabilities in respect of State taxes in respect of transactions across State boundaries. The second reflects a derivative of the arms' length principle. The first seeks to allocate profit by a multinational group to the various jurisdictions in which the multinational operates. Value is often reflected in intangibly generated assets which are not recorded on the balance sheet as contrasted, say, with sales of goods to independent third parties and land. Consensus is needed at an international level as to how to calculate the global profit apportionment in respect of intangible assets. The second approach is meant to be transactional. There, the focus is on controlled transactions, not total profit. For a valuation, one does not look at assets, employees or sales, but one tries on an economically rational basis to allocate profits by analogy with partnerships. The second approach is used where the underlying issues are more complex. With "hard-to-value" transactions, "hard" is not used for no reason. They can be really hard to value. It can be necessary to sit with officers of taxation commissioners and take them through the value chain, so they can be satisfied that value is being taxed where it is being added.[90]

Tax advice privilege?

The United Kingdom Supreme Court has held that, at common law, legal advice privilege was universally understood as applying only to communications between a client and its lawyers, acting in their professional capacity, in connection with the provision of legal advice. So understood, the ambit of privilege was clear, consistent and certain. It was accepted and allowed for by the rules and practices of the courts and in legislation. It would therefore be an extension beyond the long-established and current limits of the privilege if it were to apply to legal advice given by professional persons other than lawyers. There was no evidence establishing a pressing need for such an extension, the consequences of which were difficult to assess. However, it would be likely to lead to lack of clarity and uncertainty. The question whether the privilege should be extended raised issues of policy which should be left to the Parliament. Parliament had enacted legislation that had extended the privilege but not in respect of tax advice given by accountants, on the basis that it was otherwise limited to members of the legal profession. It would be inappropriate for the court to extend the law of privilege to cover advice given by a

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[89] Adapted from the author's notes of presentation by Damien Preshaw in a Panel Discussion on "The future of transfer pricing" (30 November 2016) *International Fiscal Association Australian Branch* at KPMG's Melbourne office, Level 36,Tower 2, 727 Collins Street, Melbourne, Victoria 3000.
[90] Ibid.

firm of accountants to the taxpayer company on the tax law aspects of a proposed transaction. Accordingly, legal advice privilege would not be extended to communications in connection with advice given by professional persons other than lawyers, even where the advice was legal advice which the professional person was qualified to give.[91]

In New Zealand, since 21 June 2005, there has been a non-disclosure right for tax advice documents.[92] It has been pointed out that in a global environment of increased information sharing between revenue authorities and where governments increasingly seek more revenue through tax enforcement, it is uncertain how the non-disclosure right will continue to be interpreted by New Zealand courts.[93] The uncertainty is said to be caused by the decision (despite the early stated intentions to do so) not to extend legal professional privilege to accountants but rather to create a separate statutory right. The result has been that the legal application of the non-disclosure right must now be determined separately rather than being part of the development of the law relating to legal professional privilege. Moreover, the adjudicators involved in testing the limits of the non-disclosure right are anticipated to be lawyers.[94] It has been held in New Zealand that the non-disclosure right afforded by the New Zealand legislation is much more confined that legal professional privilege. The statutory protection created for tax advice documents is accordingly significantly narrower than the scope of legal professional privilege both as to the information protected from disclosure and the conditions attaching to its application. The statute should not be construed as if it were an extension to legal professional privilege with the constraints that entails. Accordingly, the Commissioner of Inland Revenue was entitled to the names and identification numbers of all persons to whom an accountant had given advice in relation to a particular kind of proposed transaction,[95] notwithstanding the existence of such *obiter dicta* as, in Australia, of the Federal Court of Australia in *Federal Commissioner of Taxation v Coombes*[96] that:

> While the disclosure of the name of the client is not in itself a matter within the privilege, it will be protected where so much has been divulged with regard to the legal services rendered or the advice sought that to reveal the

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[91] *R v Special Commissioner of Income Tax & Anor (Institute of Chartered Accountants of England and Wales intervening)* [2013] 2 AC 185 per Lord Neuberger of Abbotsbury PSC, Lord Hope of Craighead DPSC, Lord Walker of Gestingrthorpe, Lord Mance and Lord Reid JJSC. (Lord Clarke of Stone-cum Ebony and Lord Sumpton dissenting).

[92] *Tax Administration Act* 1994 (NZ), ss 20B to 20G; Kirsty Keating and Niels Campbell, *Privilege for Tax Advice* (2011) Ernst & Young and Bell Gully Tax Conference.

[93] Kirsty Keating and Niels Campbell, *Privilege for Tax Advice* (2011) Ernst & Young and Bell Gully Tax Conference.

[94] Ibid.

[95] *Commissioner of Inland Revenue v Blakely* [2008] NZHC 223; (2008) 23 NZTC 21,865.

[96] [1999] FCA 842; (1999) 92 FCR 240 (legal professional privilege does not attach to the information required and Mr Coombes obliged to furnish Commissioner with that information).

> client's name would be to disclose the whole relationship and confidential communications.[97]

In Australia, the Australian Law Reform Commission has published a report entitled *Privilege in Perspective: Client Legal Privilege in Federal Investigations*.[98] It recommended the establishment of a tax advice privilege. This tax advice privilege was to protect tax advice (as contrasted with "source" and "tax contextual information") provided by an independent professional accounting adviser who was a registered tax agent for the purpose of what was then section 251A of the *Income Tax Assessment Act 1936* (Cth),[99] where specifically claimed and supported by any necessary certificate) from access by the Federal Commissioner of Taxation through exercising its statutory coercive information-gathering powers to that effect.[100] In support of its recommendation, the Australian Law Reform Commission noted that Australian taxation law is complex. The self-assessment system requires taxpayers to have a good understanding of their rights and obligations before they can make an assessment of their tax liability before they can make an assessment of their taxation liability. This system was the justification for the taxation legislation making allowances for accountants to give legal advice on taxation law.[101] The Australian Law Reform Commission noted that the ATO had provided an administrative concession to tax accountants in that regard.[102] In response, the Commonwealth of Australia Treasury released a discussion paper in relation to tax advice.[103] This discussion paper explored whether there should be legislation providing for a tax advice privilege. Arguments for such a privilege derived from the public policy of allowing full and frank communications between client and adviser. Those arguments against such a privilege stemmed from the desirability, in the interests of justice, of ensuring the fullest possible access to the facts relevant to a case. Treasury sought responses on various issues and questions. These issues included the problems experienced with the Accountants' Concession. It asked: whether the system should be changed to provide for a tax advice privilege? If so, it asked: what

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[97] Ibid [28]; 251 per Sunberg, Merkel and Kenny JJ.

[98] Australian Law Reform Commission, *Privilege in Perspective: Client Legal Privilege in Federal Investigations*, Report No 107 (2008).at http://www.alrc.gov.au/sites/default/files/pdfs/publications/ALRC107.pdf accessed 7 December 2016.

[99] Now the *Tax Agent Services Act* 2009 (Cth).

[100] Australian Law Reform Commission, op cit recommendation 6.6 on pages 11 and 12.

[101] Ibid [6.276] on page 303.

[102] Ibid page 31, [6.224] page 291-2; [6.243] 297; [6.255] 299[; 304 [6.280]; Australian Taxation Office, *Accountants' concession* (9 Februry 2015) at https://www.ato.gov.au/Forms/Accountants--concession-form-1---AC1/ accessed 8 December 2016.

[103] Department of Treasury, *Privilege in relation to tax advice*, Discussion Paper, April 2011.at http://archive.treasury.gov.au/documents/2005/PDF/DP_Privilege_in_relation_%20to_tax_advice.pdf accessed 7 December 2016.

model would be most suitable to serve the policy objectives of such a privilege?[104] Submissions closed in July 2011. No legislation has yet to be proposed.

The compelling reason for privilege to attach to tax advice has been put forward by H & R Block, Tax Accountants, in a circular to Australian registered tax agents pertaining to the challenge presented to tax agents increasing each tax season with more compliance burdens on tax agents, advances in accounting software and the growing use of free lodgment systems, including my Tax:

> The reality is that no matter how user-friendly the product and how slick the marketing, my Tax is operating in an environment of extreme complexity. Put simply, most taxpayers don't understand tax and are nervous about doing it themselves. And, frankly, they are right to be nervous, so there will always be a need for clear, knowledgeable and reliable advice – and the move to digitalisation will increase the need for professional help, not reduce it.[105]

Conclusion

The view that there is a distinction between acceptable tax planning and aggressive tax avoidance raises an important issue. There are different ways of implementing commercial objectives. These different ways can have different tax consequences on various parties; for example, in respect of leasing an asset or borrowing the funds to purchase it. Why should implementation of a transaction to produce a specific tax effect not be regarded as anything but a positive outcome for which the tax advice industry should be commended?

The answer might be that it is not problematic for the beneficial financial consequences of a transaction to include extending to taxation benefits; but, rather, what is problematic is where the principal effect or purpose of the transaction is achievement of reduced, minimal or no tax.

However, is such a "solution" more theoretical which might be difficult to apply practically in the full range of diversity in commercial life? What might broadly be a useful test is whether the underlying economic benefits of a tax mitigation strategy as transacted have been realised as intended by Parliament or whether, contrary to the intention of Parliament, they have been passed on or retained by someone, and if so how, who does not incur the tax in respect of those economic benefits. In the final analysis, this test is one of statutory interpretation.

[104] Ibid at [95] pages 18 and 19.

[105] H & R Block, *Evolving within today's tax industry* (5 December 2016).

The complexity of commercial activity may make it difficult to apply even such a test. For this purpose, the notion of "economic benefit" might be broadened to include the genuine and real exposure on the taxpayer's part to a substantial risk of incurring significant financial liability, which risk is inherent in the transaction that minimises or eliminates the taxpayer's tax liability. The degree of commercial justification for a scheme also appears highly pertinent. For this purpose, taxpayers seem to require highly skilled tax advice, which while informed by the applicable taxation legislation and relevant case law, has a highly commercial orientation distinguishing it from traditional legal services.

The reality of business activity which inherently is complex inevitably result in the taxation system's underlying complexity. This complexity then necessarily must become reflected in the applicable taxation Acts. Consequently, proclamations by politicians and media about being able to address tax avoidance through simplified taxation laws seems a pious wish without real prospects of ever being successfully implemented. Moreover, the ramifications of technological change and the global taxation environment can render the application of traditional notions of taxation jurisdiction increasingly difficult: e.g. "source", "residence", "permanent establishment", and "money".[106]

Given the complexity of commercial activity and the underlying taxation legislation, the tax advice industry performs a positive role for society. This positive role should be reflected in the nature and extent of the privilege that should be afforded to clients of the tax advice industry. The recommendations of the Australian Law Reform Commission should be implemented to confer an appropriate tax advice privilege as recommended by the Commission.

[106] For recent examples, see *Blank v Commissioner of Taxation* [2016] HCA 42 (9 November 2016) (interest of former employee in incentive profit participation scheme under Swiss law calculated on basis of company profit); and *Bywater Investments Limited v Commissioner of Taxation*; *Hua Wang Bank Berhad v Commissioner of Taxation* [2016] HCA 45 (16 November 2016) ("Australian resident", "central management and control", "company's constitutional organs", "corporate residence", "formal organs", "place of effective management", "real business", "residency", "rubber-stamp", "superior or directing authority", and "usurp functions of board of directors").