

## **PART IVA: THE RELEVANCE OF SUBJECTIVE PURPOSE IN DRAWING THE CONCLUSION UNDER SECTION 177D**

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*It is beyond question that the schemes to which the general anti-avoidance provisions in Pt IVA of the Income Tax Assessment Act 1936 (Cth) apply are intended to be determined by an objective test or inquiry under s 177D. This was initially made clear at least by the Explanatory Memorandum to Pt IVA, if not by the text of the provisions. The Explanatory Memorandum stated that the provisions of Pt IVA were designed to apply where, on an “objective view” of a particular arrangement, its features and its surrounding circumstances, the conclusion as to sole or dominant purpose would be reached under s 177D(b).<sup>1</sup> It is widely thought that this objective test or inquiry leaves no room to consider the subjective purpose, intention or motive of a taxpayer or others who enter into or carry out a scheme.<sup>2</sup> This article discusses whether this proposition is correct by undertaking a review of court cases in which the issue has been addressed. By way of introduction to the discussion, an outline of Pt IVA is provided and some observations are made on the meaning of subjective purpose, intention and motive.*

### I INTRODUCTION

#### *A Outline of Pt IVA*

The application of the general anti-avoidance provisions in Pt IVA is governed by s 177D. Basically, the provisions can apply to a scheme where:

- (a) a taxpayer has obtained a tax benefit in connection with the scheme, and
- (b) having regard to the factors listed in s 177D(b), it would be concluded that a person who entered into or carried out that scheme, or a part of it, did so for the purpose of enabling the taxpayer to obtain a tax benefit in connection with the scheme.

The provisions of Pt IVA are not, however, self-executing and do not simply apply of their own force. To enliven the provisions the Commissioner of Taxation must first exercise the discretion under s 177F to make a determination to, broadly speaking, cancel a tax benefit to which Pt IVA applies. The making of such a determination is therefore the “pivot” upon which the operation of Pt IVA turns.<sup>3</sup>

Under s 177F(1), there are two prerequisites to the Commissioner being able to exercise the discretion to make a Pt IVA determination. The two prerequisites are:

- 1 A tax benefit has been obtained by a taxpayer in connection with a scheme; and

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<sup>1</sup> House of Representatives, *Income Tax Laws Amendment Bill (No 2) 1981*, Explanatory Memorandum at 2 and 12.

<sup>2</sup> See for example the *Australian Tax Handbook 2007*, Deutsch et al, at [44 210]. It can be noted at the outset that this approach could be considered to be contrary to that suggested by the Explanatory Memorandum. At 2, it is stated that one of the limitations on the former general anti-avoidance provisions in s 260, that Pt IVA was intended and designed to overcome, was that s 260 did not allow an enquiry into the “purposes or motives” of persons entering into an arrangement. Rather, the enquiry under s 260 was limited to examining only the arrangement itself. Therefore, on one view it can be said that the Explanatory Memorandum indicates that Pt IVA was intended, amongst other things, to allow an enquiry into a person’s “purpose or motive”. It must be acknowledged, however, that this view is not free from doubt and there may be disagreement on the point.

<sup>3</sup> *FCI v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 413.

2 The scheme is one to which Pt IVA applies.

It is the second of these prerequisites that is more important to this article.

A scheme is one to which Pt IVA applies if the conclusion under s 177D(b) can be drawn having regard to its listed factors. The factors are:

- i) the manner in which the scheme was entered into or carried out;
- ii) the form and substance of the scheme;
- iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- iv) the result in relation to the operation of this Act that, but for Pt IVA, would be achieved by the scheme;
- v) any change in the financial position of the taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- vi) any such change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer;
- vii) any other consequence for the taxpayer or that connected person of the scheme having been entered into or carried out; and
- viii) the nature of any connection (whether of a business, family or other nature) between the taxpayer and that connected person.

The conclusion to be drawn, having regard to these eight factors, is the conclusion of a “reasonable person”. The relevant question is whether, having regard to those factors, a reasonable person would conclude that a person entered into or carried out the scheme, or a part of it, for the purpose of enabling the taxpayer to obtain a tax benefit in connection with the scheme.<sup>4</sup>

Where a scheme or part of it is entered into or carried out by a person for more than one purpose, the required conclusion is as to the person’s dominant purpose.<sup>5</sup> A dominant purpose is the “ruling, prevailing or most influential purpose”.<sup>6</sup> There is no definition, however, of the word “purpose” either in Pt IVA itself or elsewhere in the 1997 or 1936 *Income Tax Assessment Acts*.<sup>7</sup>

### *B Purpose, intention and motive*

The *Macquarie Dictionary* defines “purpose” as: “1. the object for which anything ... is done ... 2. an intended or desired result; end or aim. 3. intention ...”. These meanings may be compared with those of “intention”, which is defined as: “1. the act of determining mentally upon some action or result; a purpose ... 2. the end or object intended”. The meanings of purpose and intention can also be compared with the definition of the word “motive”: “1. something that prompts a person to act in a certain way ... 2. the goal or object of one’s actions”. The definitions of all three words indicate that there is some overlap between their ordinary meanings, particularly the words “purpose” and “intention”. On the other hand, the primary meanings of these two words – essentially the intended object, end or result of an act – can be contrasted with the primary meaning of “motive”, which is concerned more with the reasons why an act is done.

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<sup>4</sup> *FCT v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 422.

<sup>5</sup> See s 177A(5) of the *Income Tax Assessment Act 1936* (Cth).

<sup>6</sup> *FCT v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 416. Interestingly, this meaning of “dominant” is different to that given in the Explanatory Memorandum at 8 of “a purpose that outweighs all other purposes put together”.

<sup>7</sup> It is perhaps worth noting that in *Newton v FCT* (1958) 98 CLR 1 at 8, the Privy Council said the word “purpose”, in the former s 260 of the *Income Tax Assessment Act 1936* (Cth), meant “not motive, but the effect which it is sought to achieve – the end in view.”

That there is a difference between the meanings of “purpose” and “motive” was pointed out by Gibbs J in *XCO Pty Ltd v FCT*.<sup>8</sup> The taxpayer took an assignment of debts owed by a loss company that had been taken over by the holding company of the taxpayer. It was intended at the outset that a small amount of a debt would be repaid to the loss company immediately, which would result in a profit, so that a ruling could be obtained from the Commissioner as to whether debt repayments would be taxable. Gibbs J held that the amount was assessable income under the second limb of the former s 26(a). In reaching this decision, his Honour rejected an argument by the taxpayer that the purpose of making the profit was only to obtain the tax ruling. His Honour said:<sup>9</sup>

To attribute any weight to this fact would be to confuse motive with purpose. The purpose of the scheme was to make a profit, even though the motive for making the profit was to lay the foundation for a test case. It hardly needs saying that the motive with which a profit is made is irrelevant to the question whether the scheme which yielded the profit was a profit-making scheme.

The meanings of “purpose” and “motive” were commented on by Brennan J in *Magna Alloys and Research Pty Ltd v FCT*.<sup>10</sup> His Honour first acknowledged that their meanings are not always clear and that the word “purpose” is susceptible of ambiguity. He agreed with Lord Wright in *Crofter Hand Woven Harris Tweed Co Ltd v Veitch* who had said the “words ‘motive’, ‘object’, ‘purpose’, are in application to practical matters difficult strictly to define or distinguish.” Lord Wright also said that “motive” is often used as meaning “purpose”.<sup>11</sup> Lord Simon LC in that case also observed that confusion may arise from such words as “motive” and “intention” which had been used interchangeably in the past.<sup>12</sup>

Brennan J then acknowledged the distinction between “motive” and “purpose”, as well as a distinction between two types of purpose – objective and subjective – as follows:

... Motive means ... the reason why a taxpayer decides to incur the expenditure. Purpose may be either a subjective purpose – the taxpayer’s purpose – where it means the object which the taxpayer intends to achieve by incurring the expenditure; or it may be an objective purpose, meaning the object which the incurring of the expenditure is apt to achieve. Both motive and subjective purpose are states of mind and they are to be distinguished from objective purpose, which is an attribute of a transaction. An objective purpose is attributed to a transaction by reference to all the known circumstances; whereas subjective purpose and motive, being states of mind, are susceptible of proof not by inference alone but also by direct evidence, for a state of mind may be proved by the testimony of him whose state of mind is relevant to a fact in issue.

In saying this, his Honour was addressing the relevance of purpose and motive to ascertaining deductibility under the former s 51(1). Further, what he said about objective purpose was in the context of the purpose of a transaction and not of a person. Nevertheless, it is considered that the statement supports that where a subjective purpose or a motive is to be determined regard can be had to a person’s testimony as to their actual state of mind, as well as to all the known circumstances. A conclusion as to subjective purpose or motive may therefore be proved by direct evidence from the person as well as by inference from the known circumstances. This approach differs from that in determining an objective purpose, in which case such a purpose is to be attributed or inferred only by reference to those circumstances. Accordingly, evidence of a person’s actual state of mind would be irrelevant to determining an objective purpose on the basis that it is not a known circumstance.

Finally, it may be noted that the courts do accept that a person’s testimony may be the best evidence of their subjective purpose, object or state of mind in entering into a transaction.

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<sup>8</sup> (1971) 124 CLR 343.

<sup>9</sup> (1971) 124 CLR 343 at 350-351.

<sup>10</sup> (1980) 49 FLR 183 at 185.

<sup>11</sup> [1942] AC 435 at 469.

<sup>12</sup> [1942] AC 435 at 444 where his Honour referred to Lord Dunedin in *Sorrell v Smith* [1925] AC 700 at 724.

However, such evidence has to be tested “most closely, and received with the greatest caution”.<sup>13</sup> A reason for testing such evidence closely before accepting it is that a person’s recollection as to a past state of mind is apt consciously or unconsciously to be distorted and at times be unreliable.<sup>14</sup> Another reason is that such evidence is often self-serving and should therefore be approached with a degree of scepticism unless it is supported by other independent corroborating evidence. Consequently, it may be said that a person’s testimony is not decisive of the conclusion on their subjective purpose, object or state of mind. That testimony must still be examined against and judged in light of the known circumstances of a case. In view of this, subjective purpose could be more accurately referred to as subjective purpose determined objectively.

## II SCHEMES TO WHICH PT IVA APPLIES – CONCLUSION ON SOLE OR DOMINANT PURPOSE

As indicated, in drawing the conclusion under s 177D(b) about a person’s sole or dominant purpose, a reasonable person must have regard to the eight factors listed in the paragraph. An issue that arises at the outset is whether the listed factors are exhaustive, so that regard cannot be had to any other factor, or whether the listed factors are merely inclusive, which would allow regard to other factors not listed where they are considered relevant by the reasonable person.<sup>15</sup>

On the one hand, it may be noted that the word “only” does not appear after the words “having regard” in the text of s 177D(b). The inclusion of this word would have left little doubt on the issue, so that a reasonable person could have regard only to the listed factors and to no other factors. A more certain outcome would have resulted by the insertion in the text of the words “this is an exhaustive list” (cf s 177EA(18)), or even an express exclusion such as “but without regard to” to a specified factor.<sup>16</sup> On the other hand, it may also be noted that the text of s 177D(b) does not include the expression “without being limited to” or an equivalent expression such as “amongst other factors”, or the words “this is not an exhaustive list”. Again, this would have left little doubt on the issue, but with the contrary outcome. Further, the text does not include as a listed factor “any other relevant circumstances”, which would have similarly allowed regard to other factors not listed as long as they are considered relevant.<sup>17</sup>

The second and related issue that arises is what regard, if any, can be had to the subjective purpose, intention or motive of a person in drawing the conclusion under s 177D(b). In other words, can any regard be had to a person’s actual state of mind as to their object or intended result, or as to why the person acted as they did. Such matters are not expressly included in the text of the factors listed in s 177D(b). The question is then whether or not this forecloses the answer to the issue.

The following cases assist in providing the answers to these two issues.

### *A Peabody*

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<sup>13</sup> *Pascoe v FCT* (1956) 11 ATD 108 at 111, per Fullagar J where his Honour also cited Cussen J in *Cox v Smail* [1912] VLR 274 at 283.

<sup>14</sup> *Gauci v FCT* [1975] HCA 54; (1975) 135 CLR 81 at 86.

<sup>15</sup> cf *Minister for Aboriginal Affairs v Peko-Wallsend Ltd* (1986) 162 CLR 24 at 39.

<sup>16</sup> See for example s 82KJ of the *Income Tax Assessment Act 1936* (Cth) which has the exclusion “(but without regard to any benefit relating to the [acquisition](#) or possible [acquisition](#) of the [property](#) referred to in paragraph (c))”.

<sup>17</sup> cf s 165-15(1) of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

The two issues just mentioned were first addressed by Hill J in the Full Federal Court in *Peabody v FCT*.<sup>18</sup> The case involved the application of Pt IVA to a scheme involving a conversion of purchased shares that resulted in their value shifting to other shares already held by the trustee of a family trust of which the taxpayer was a beneficiary. Another result of the share conversion was to avoid the possible application of the former s 26AAA that would have included in assessable income a profit arising from a sale by the trustee into a public float of the unconverted purchased shares, if the sale had happened within 12 months of their purchase.

Hill J (with whom Ryan and Cooper JJ agreed) made the following observation on the two issues:<sup>19</sup>

It will be seen that the determination of what schemes fall within s 177D requires an objective conclusion to be drawn, having regard to the matters referred to in par (b) of the section, but no other matters. It is notable that the actual subjective purpose of any relevant person is not a matter to which regard may be had in drawing the conclusion.

This observation ruled out, in absolute terms, any regard being had to actual subjective purpose in drawing the conclusion under s 177D(b) because that type of purpose is not listed as one of the factors in the section. The observation was not, however, material to Hill J's decision that the requisite conclusion as to dominant purpose could not be drawn where the scheme involving value shifting of the purchased shares, also encompassed the financing of that share purchase by the issue of redeemable preference shares and the ultimate floatation of a public company.<sup>20</sup> The relevance of a person's actual subjective purpose to this conclusion was not at issue in the case. Therefore, his Honour's observation about the relevance of that purpose was obiter in nature.

On the appeal to the High Court,<sup>21</sup> the case was decided without the Court having to address whether the requisite conclusion as to dominant purpose under s 177D(b) could be drawn. However, the High Court did decide that the existence of the Commissioner's discretion to cancel a tax benefit under s 177F(1) does not depend on the Commissioner's opinion or satisfaction that there is a tax benefit or that, if there is a tax benefit, it was obtained in connection with a Pt IVA scheme. Rather, the High Court held that those are "posited as objective facts".<sup>22</sup> Consequently, an error made by the Commissioner in identifying a scheme as being one to which Pt IVA applies, or as to the connection of a tax benefit with such a scheme, will result in the wrongful exercise of the discretion under s 177F(1) only if the tax benefit cancelled by the Commissioner is not a tax benefit within the meaning of Pt IVA. Put in another way, the correct application of Pt IVA is not determined by the Commissioner's opinion as the existence of its required elements. Rather, it is determined by an "objective" assessment of the facts irrespective of any opinion or view held by the Commissioner.

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<sup>18</sup> *Peabody v FCT* (1993) 40 FCR 531.

<sup>19</sup> *Peabody v FCT* (1993) 40 FCR 531 at 542.

<sup>20</sup> Hill J instead concluded that the whole scheme encompassing those steps was entered into or carried out by Mr Peabody with a dominant commercial purpose, namely the acquisition of shares from Mr Kleinschmidt and the floatation of a public company.

<sup>21</sup> *FCT v Peabody* [1994] HCA 43; (1994) 181 CLR 359.

<sup>22</sup> *FCT v Peabody* [1994] HCA 43; (1994) 181 CLR 359 at 382.

*B Spotless Services*

An objective approach to the interpretation and application of the prerequisites to the Commissioner exercising the discretion to make a Pt IVA determination was confirmed and further developed by the High Court in *FCT v Spotless Services Ltd*.<sup>23</sup> There the taxpayers were Australian resident companies that invested surplus funds in the Cook Islands. The investment was made by the taxpayers sending an officer to the Cook Islands who drew a cheque for the amount invested and delivered it to a Cook Islands bank. On maturity the invested funds plus interest (less Cook Islands withholding tax levied at 5%) were paid to the companies in Australia. The taxpayers sought to take advantage of the former s 23(q) to achieve an increased after tax return, since the interest income would be exempt from tax in Australia.<sup>24</sup> Even though the Cook Islands interest rate actually payable was about 4% below the Australian bank bill rate, the after tax return would have been greater than that achievable by investing in Australia because the Cook Islands interest would have been exempt from tax in Australia.

In a joint judgment, Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ confirmed an objective approach to the interpretation and application of the prerequisites to the Commissioner making a Pt IVA determination by starting with the approach laid down in *Peabody*, namely that the existence of a tax benefit obtained in connection with a Pt IVA scheme is posited as an “objective fact”, and then referring to the eight factors listed in s 177D(b) as “objective criteria” and to matters that answer their description as “objective facts”. Their Honours said:<sup>25</sup>

The Commissioner is empowered to make a determination only where the objective criteria specified in par (b) of s 177D are met. In particular, it is necessary that the taxpayer has obtained a “tax benefit” in connection with a “scheme” to which Pt IVA applied. This litigation requires determination of a dispute as to whether, in respect of the taxpayers in question here, those objective criteria were met.

Later their Honours said:<sup>26</sup>

The eight categories set out in par (b) of s 177D as matters to which regard is to be had “are posited as objective facts”. That construction is supported by the employment in s 177D of the phrase “it would be concluded that ...”.

In saying this, their Honours applied to s 177D(b) what the Court in *Peabody* had said in the broader context of addressing the nature of the prerequisites to the Commissioner making a determination to apply Pt IVA.

While the High Court in *Spotless Services* did not expressly address the issue of the relevance of the subjective purpose of a person to the conclusion on dominant purpose under s 177D(b), it may be noted that at first instance<sup>27</sup> Lockhart J made a similar observation to that made by Hill J in *Peabody*. Lockhart J said:

Of the eight circumstances listed in [s 177D(b)] to which the Commissioner must have regard, none of them involves the subjective purpose or intent of a person to obtain a tax benefit; the circumstances predicate objective tests.

On the appeal, the High Court neither approved nor disapproved of Lockhart’s observation on the issue.

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<sup>23</sup> *FCT v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404.

<sup>24</sup> At the time, the effect of s 23(q) was that the interest income received from the investment was exempt from income tax in Australia if it had been derived from a source in the Cook Islands and was not exempt from tax there.

<sup>25</sup> *FCT v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 413-414.

<sup>26</sup> *FCT v Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404 at 421- 422.

<sup>27</sup> *Spotless Services Ltd v FCT* 93 ATC 4397 at 4418.

*C CC (New South Wales)*

In *CC(New South Wales) Pty Ltd (in liq) v FCT*,<sup>28</sup> the taxpayer was a construction company that was appointed to manage the construction of a multi-storey residential apartment building project being undertaken by Quay Apartments Pty Ltd (QA) as trustee of a unit trust. The principal unit holder and financier of the unit trust went into receivership and the taxpayer's parent, Concrete Constructions Pty Ltd (CC), acquired the units in the trust and the shares in QA, and assumed all of QA's liabilities. At that time, the unit trust had accumulated tax losses of \$50,000. The apartment building project was completed and at the end of that income year the accounts of the unit trust showed accumulated tax losses of \$6.427 million. The taxpayer then secured other construction management contracts and purported to enter into those contracts as agent for QA, in that company's capacity as trustee of the unit trust, under an undisclosed principal-agent agreement. The taxpayer claimed that the income paid to it under the contracts was derived by QA and could be offset against the past year tax losses of the unit trust. The Commissioner made determinations under Pt IVA and issued amended assessments that included the construction management contract income in the assessable income of the taxpayer.

The taxpayer's appeal to the Federal Court challenging the amended assessments was dismissed. Sackville J upheld the Commissioner's argument that the agency agreement made between the taxpayer and QA was ineffective in law to create the relationship of agent and principal. Although it was not strictly necessary to do so, his Honour also decided that, had the agency agreement been effective, the appointment of the taxpayer as agent of QA and the performance of the construction management contracts was a scheme to which Pt IVA would have applied.<sup>29</sup>

In reaching this decision, Sackville J noted that an argument put by the taxpayer about the commerciality of the scheme, being to provide liquidity to QA to assist it to meet its liabilities, was based on the actual motivation of persons involved being relevant to the question posed by s 177D(b). His Honour rejected the basis of this argument and cited Hill J's observation in *Peabody* as support for this. Sackville J also considered that the observation was consistent with the way the joint judgment *Spotless Services* stated the question to be answered under s 177D(b).<sup>30</sup>

*D Eastern Nitrogen*

The taxpayer in *Eastern Nitrogen Ltd v FCT*<sup>31</sup> entered into a sale and leaseback transaction with financiers under which it sold plant to the financiers and leased it back for five years in return for rental payments. At the end of the lease the taxpayer was to buy back the plant at an agreed residual value. The taxpayer claimed deductions for the rental payments, as well as valuation and establishment fees. The Commissioner made a determination under Pt IVA disallowing part of the deductions.

At first instance, the Federal Court dismissed the taxpayer's challenge to the validity of the Pt IVA determination.<sup>32</sup> Drummond J held that the sale and leaseback transaction was a scheme to which Pt IVA applied because the taxpayer's dominant purpose in entering into the

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<sup>28</sup> *CC (New South Wales) Pty Ltd (in liq) v FCT* 97 ATC 4123.

<sup>29</sup> However, Sackville J's reasons for holding that Pt IVA would have applied were stated more briefly than if the application of Pt IVA had been the only live issue in the case.

<sup>30</sup> *CC (New South Wales) Pty Ltd (in liq) v FCT* 97 ATC 4123 at 4146-4147.

<sup>31</sup> *Eastern Nitrogen Ltd v FCT* [2001] FCA 366; (2001) 108 FCR 27.

<sup>32</sup> [1999] FCA 1536; 99 ATC 5163.

scheme was to obtain tax benefits in the form of deductions for the lease rental payments. In his reasons, his Honour analysed extensive evidence relating to the taxpayer's subjective purpose for entering into the transaction. He concluded that the taxpayer's dominant purpose, in the sense of its subjective purpose for entering into the transaction, was to obtain the tax benefit available from the full deductibility of the rental payments.

In response to a submission by the Commissioner that evidence of subjective intention, and as to what was sought to be achieved from the transaction, was irrelevant to the conclusion under s 177D(b), Drummond J said the following:<sup>33</sup>

79 In my opinion, the Commissioner goes too far in submitting that evidence of the Eastern Nitrogen witnesses who were involved in considering and agreeing upon the sale and lease back transaction as to their subjective intentions and as to what they sought to achieve for Eastern Nitrogen from the transaction is irrelevant to consideration of whether the conclusion referred to in s 177D is established. I reach this view with hesitation, given the contrary conclusion of Sackville J in *CC (New South Wales) Pty Ltd (In Liq) v Federal Commissioner of Taxation* (1997) ATC 4,123 at 4,146 - 4,147. But as Sackville J there pointed out, neither in *Federal Commissioner of Taxation v Peabody* (1994) [181 CLR 359](#) nor in *Spotless* has the High Court expressly considered the point. ...

80 Evidence of the subjective intentions of scheme participants is, I think, well capable of assisting in the proper understanding of the activities engaged in and well capable in other ways of being relevant, at least to proof of the matter or issue the subject of s 177D(b)(i), in view of the wide meaning the term "manner" was said to have in *Spotless* at 420.

In *Spotless Services*, the High Court had said that manner "includes consideration of the way in which and method or procedure by which the particular scheme in question was established".

The taxpayer's further appeal to the Full Federal Court was allowed with the Court holding that Pt IVA did not apply because the taxpayer's dominant purpose in entering into the sale and leaseback transaction was to not to obtain a tax benefit. Rather, the dominant purpose was to obtain a very large financial facility on the best terms reasonably available. Carr J (with whom Sundberg J agreed) further specifically held that the primary judge had erred in law in adopting an approach to determining dominant purpose under s 177D which allowed subjective intention to be considered where it assists in understanding activities engaged in and is relevant to proof of "manner" in s 177D(b)(i).<sup>34</sup> Carr J expressed the view that the conclusion required by s 177D was not directed at a person's actual dominant purpose or motive but to the purpose as objectively assessed. The person's subjective state of mind was therefore not relevant for the purposes of Pt IVA.<sup>35</sup>

#### *E Consolidated Press Holdings*

In *FCT v Consolidated Press Holdings Ltd*,<sup>36</sup> the taxpayer was to invest in two associated foreign resident companies that would participate in the takeover of a company in the United Kingdom. The investment was to be made as equity that would give rise to dividends that might carry United Kingdom tax credits or be tax exempt. To use this tax relief it was necessary for the Australian resident company receiving the dividends to be in a taxable position. This might not have been the case if the Australian resident company had substantial Australian borrowings. Relying on the advice of its accountant, Mr Cherry, another Australian resident company (MLG) was inserted between the taxpayer and the

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<sup>33</sup> [1999] FCA 1536; 99 ATC 5163 at 5179.

<sup>34</sup> *Eastern Nitrogen Ltd v FCT* [2001] FCA 366; (2001) 108 FCR 27.

<sup>35</sup> *Eastern Nitrogen Ltd v FCT* [2001] FCA 366; (2001) 108 FCR 27 at 44 [82] and 45 [87-88].

<sup>36</sup> *FCT v Consolidated Press Holdings Ltd* [2001] HCA 32; (2001) 207 CLR 235.



associated companies. The taxpayer then borrowed money and used the borrowings to subscribe for shares in MLG. In turn, MLG invested in the associated companies and tax credit relief was available to MLG.

Another consequence of this structure was that the interest deductions on the taxpayer's borrowings were immediately deductible, rather than being quarantined by s 79D. Under s 79D, a deduction that related to foreign source income was limited to the amount of that income and any excess deduction is carried forward. The effect of s 79D and this consequence had not been referred to in the accountant's advice and had not been considered by the companies. However, the accountant had previously been advised by counsel and believed that s 79D did not apply to the type of structure adopted.

At first instance in the Federal Court,<sup>37</sup> Hill J held that Pt IVA applied to the scheme involving the acquisition by the taxpayer of shares in MLG and the acquisition by MLG of shares in the associated companies. In regard to the conclusion to be drawn under s 177D(b), his Honour noted:<sup>38</sup>

As the High Court pointed out in *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) [186 CLR 404](#) the conclusion which is to be drawn under s 177D depends entirely upon objective facts. Subjective motivation will be irrelevant to the conclusion. Hence, whether or not Mr Cherry or others had a purpose of ensuring tax deductibility to [the taxpayer] of the interest deductions to which it was otherwise entitled would not be relevant in arriving at that conclusion.

His Honour concluded (but with some doubt) that the dominant purpose of the taxpayer's advisors was to bring about the result that a deduction would be allowed to the taxpayer which, but for the scheme, would not have been allowable because of the application of s 79D. He reached this conclusion because the interest deduction was more immediate than the adoption of a neutral structure for non interference with tax credits.<sup>39</sup>

The taxpayer challenged Hill J's decision on Pt IVA in appeals to the Full Federal Court<sup>40</sup> and then the High Court<sup>41</sup> but both challenges were dismissed. Before the Full Federal Court, one of the grounds on which the taxpayer attacked Hill J's reasoning on Pt IVA was that his Honour failed to have regard to all the factors set out in s 177D(b) in reaching his conclusion that Pt IVA applied. The Full Federal Court dealt briefly with this ground of attack as follows:<sup>42</sup>

In ACP's submission, it was said that these were "the only matters to be taken into account". That latter proposition is not warranted by the language of the section or by the characterisation of the eight matters as "necessary" to be taken into account.

The Court did not further expand on its reasons for this conclusion, given its view that the argument was not really apposite to the main thrust of the taxpayer's appeal on Pt IVA.

On the taxpayer's appeal to the High Court, the taxpayer argued that, as neither the accountant nor the companies involved had considered the application of s 79D, it was difficult to say the scheme was entered into to avoid the section. In addition, the taxpayer argued that it was impermissible to attribute the accountant's purpose to the taxpayer. The Commissioner responded by arguing that in applying s 177D one looks to the objective purpose of parties to the scheme and so the accountant's subjective purpose did not matter.

In a unanimous decision, the High Court dismissed the appeal and held that the scheme was one to which Pt IVA applied as a dominant purpose of a person who participated in the scheme, including the taxpayer's advisor, was for the taxpayer to obtain a tax benefit. In

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<sup>37</sup> *CPH Property Pty Ltd v FCT* [1998] FCA 1276; (1998) 88 FCR 21.

<sup>38</sup> *CPH Property Pty Ltd v FCT* [1998] FCA 1276; (1998) 88 FCR 21 at 41.

<sup>39</sup> *CPH Property Pty Ltd v FCT* [1998] FCA 1276; (1998) 88 FCR 21 at 42.

<sup>40</sup> *FCT v Consolidated Press Holdings Ltd* [1999] FCA 1199; (1999) 91 FCR 524.

<sup>41</sup> *FCT v Consolidated Press Holdings Ltd* [2001] HCA 32; (2001) 207 CLR 235.

<sup>42</sup> *FCT v Consolidated Press Holdings Ltd* [1999] FCA 1199; (1999) 91 FCR 524 at 552 [94].

doing so, the High Court noted, but without expressly approving or disapproving, that Hill J had applied the decision in *Spotless Services* in observing that the conclusion to be drawn under s 177D depends on objective facts and is not concerned with subjective motivation of a person who entered into or carried out a scheme or a part of it.<sup>43</sup>

In regard to Hill J's conclusion about the dominant purpose of the taxpayer's advisor, which was upheld by the Full Federal Court, the High Court said that attributing the purpose of an advisor to a person who entered into or carried out a scheme was justifiable and appropriate. The Court pointed out:<sup>44</sup>

In some cases, the actual parties to a scheme subjectively may not have any purpose, independent of that of a professional advisor, in relation to the scheme or part of the scheme, but that does not defeat the operation of s 177D. If, in the present case, there had been evidence which showed that no director or employee of any member of the Group had ever heard of s 79D, that would not conclude the matter in favour of the taxpayer. One of the reasons for making s 177D turn upon the objective matters listed in the section, it may be inferred, was to avoid the consequence that the operation of Pt IVA depends upon the fiscal awareness of a taxpayer.

Although it does not appear to be entirely clear that the High Court was referring to the professional advisor's objective purpose, as opposed to their subjective purpose, that this is so is supported by the Court's reference to s 177D turning on objective matters. It is further supported by the Court's conclusion that the advisor's dominant purpose was for the taxpayer to obtain a tax benefit even though the advisor had not considered the application of the section that had been avoided by the scheme to result in the tax benefit.

#### *F Zoffanies*

The question of whether subjective intention can be taken into account under s 177D was directly at issue in *FCT v Zoffanies Pty Ltd*.<sup>45</sup> In that case, Macquarie Bank Ltd (MBL) and its subsidiaries entered into a research and development syndicate. A subsidiary, MS3, paid the owner of technology used in the syndicate a licence fee and paid interest on funds borrowed to pay the fee. As a result of deductions for the licence fee and interest, MS3 incurred a loss and it transferred that loss to the taxpayer, another subsidiary of MBL. The taxpayer claimed part of the transferred loss as a deduction. The Commissioner made a determination under Pt IVA against MS3 that reduced to nil its deductions for the licence fee and interest. The Commissioner also issued an amended assessment that reduced to nil the taxpayer's claim for the transferred loss.

On a review by the Administrative Appeals Tribunal (AAT),<sup>46</sup> it found in favour of the taxpayer and held that Pt IVA did not apply. The AAT was of the view that while MS3 obtaining a tax benefit was undoubtedly an important purpose of the scheme, a reasonable person would conclude that it was not the dominant purpose. Rather, the dominant purpose was the making of an investment in the syndicate. In reaching this conclusion, the AAT relied particularly on the evidence of an employee of MBL who could be seen to be the relevant mind of the taxpayer, including "his stated reasons" for MBL's and MS3's involvement in the syndicate.<sup>47</sup>

On the appeal to the Full Federal Court,<sup>48</sup> one of the Commissioner's arguments was that the AAT erred by applying a wrong test in reaching the conclusion it drew under s 177D.

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<sup>43</sup> *FCT v Consolidated Press Holdings Ltd* [2001] HCA 32; (2001) 207 CLR 235 at 263 [89].

<sup>44</sup> *FCT v Consolidated Press Holdings Ltd* [2001] HCA 32; (2001) 207 CLR 235 at 264 [95].

<sup>45</sup> *FCT v Zoffanies Pty Ltd* [2003] FCAFC 236; (2003) 132 FCR 523.

<sup>46</sup> *Zoffanies Pty Ltd v FCT* [2002] AATA 758; 2002 ATC 2129.

<sup>47</sup> *Zoffanies Pty Ltd v FCT* [2002] AATA 758 [171]; 2002 ATC 2129 at 2157 [171].

<sup>48</sup> *FCT v Zoffanies Pty Ltd* [2003] FCAFC 236; (2003) 132 FCR 523.

Specifically, it was submitted the AAT applied a test of subjective purpose rather than an objective test of purpose, as required by s 177D. The Full Federal Court agreed and held that the AAT had applied the wrong test to s 177D. The Court set aside the AAT's decision on the application of Pt IVA and remitted the proceeding to the AAT to apply the correct objective test of purpose in determining whether Pt IVA applied.

Hill J in the Full Court referred to the conclusion as to dominant purpose required under s 177D and said:<sup>49</sup>

... it is clear from the terms of the section itself that that conclusion is one that must be reached having regard to the eight matters stipulated in s 177D(b) and no other matters. It follows that while the conclusion required to be drawn is one that requires consideration of the purpose or dominant purpose of a person, including the taxpayer, that conclusion can not take into account evidence of the actual purpose of a taxpayer or other person, save and except so far as that could be forensically relevant to any one of the matters specifically referred to in s 177D(b) for example, the manner in which the scheme was entered into. None of the eight matters refer to the actual purpose of any person. It also follows that generally, at least, evidence of what may be referred to as the actual or subjective purpose of the taxpayer is irrelevant. However, it may well be the case, as in the present circumstances, that evidence of subjective purpose might be admissible for the purpose of the determining some other issue in the case, for example, here, the provisions dealing with deductions for research and development expenditure. ...

54 It is sometimes said that the conclusion under s 177D is a conclusion of objective purpose. That way of putting it is correct if what is meant by it is that the conclusion is not one drawn from evidence of the actual purpose of the relevant taxpayer or other taxpayers.

...

This general and therefore more relaxed approach of Hill J to the relevance of actual or subjective purpose can be contrasted with the approach of Gyles and Hely JJ. In the judgment of Gyles J (with whose reasons Hely J agreed), his Honour stated his reasons in absolute terms in deciding that the AAT had erred in law by taking into account findings as to the actual purpose and motive of the taxpayer in considering the dominant purpose under s 177D(b). His Honour added<sup>50</sup> that he had:

no great surprise at the nature of the error. The difference between the actual purpose of a taxpayer, on the one hand, and the purpose which is to be imputed to the taxpayer based upon an exclusive set of criteria, on the other hand, is not without subtlety and has been misunderstood before.

### *G Sleight*

The taxpayer in *FCT v Sleight*<sup>51</sup> invested in a tea tree oil project that involved him carrying on a tea tree farming business by engaging a managing company. To make the investment, the taxpayer entered into a loan with a finance company under which repayments of principal were to be met only from the net profit of the farm business. The loan funds were not actually advanced to the taxpayer but were paid on his behalf under a "round robin" finance arrangement that involved cheques being drawn to the managing company, to pay the taxpayer's management and other fees, and then back to the finance company. None of the funds were actually spent in the business operations. The managing and finance companies were connected with the promoter of the project.

At first instance in the Federal Court,<sup>52</sup> Nicholson J held that Pt IVA did not apply to deny the taxpayer deductions for management and certain other fees because the taxpayer's

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<sup>49</sup> *FCT v Zoffanies Pty Ltd* [2003] FCAFC 236; (2003) 132 FCR 523 at 538 [53].

<sup>50</sup> *FCT v Zoffanies Pty Ltd* [2003] FCAFC 236; (2003) 132 FCR 523 at 545 [91].

<sup>51</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211.

<sup>52</sup> *Sleight v FCT* [2003] FCA 896; 2003 ATC 4801.

purpose in entering into the project was not dominantly to obtain a tax benefit. Although his Honour had no doubt that the tax benefit was a significant element in the taxpayer's purpose, he concluded that it was not the ruling, prevailing and most influential purpose. In drawing this conclusion, his Honour relied on the taxpayer being convinced that the project was commercial and that this view formed a fundamental part of his purpose for entering into the project.<sup>53</sup>

On the Commissioner's appeal to the Full Federal Court,<sup>54</sup> it was held that the taxpayer was not entitled to deductions for the management and other fees because Pt IVA applied. The taxpayer's dominant purpose for entering into the project was to obtain a tax benefit, given the uncertainty attendant on certain other deductions he had claimed and the uncertainty of the investment yields that might be realised by the project. It was also relevant that the funds borrowed by the taxpayer were not used for the establishment or operation of the plantation, and that his actual cash payments for the project were funded out of a tax refund that resulted from the deductions claimed.<sup>55</sup>

One of the grounds advanced by the Commissioner for challenging the decision on Pt IVA at first instance was that Nicholson J had impermissibly had regard to the taxpayer's subjective purpose in reaching his decision. The Commissioner submitted this was contrary to the authorities that showed the relevant purpose was to be assessed objectively. Hill J (with whose reasons Hely J agreed) implicitly acknowledged the correctness of this submission by setting out, as one of the propositions on the provisions in Pt IVA decided by the High Court and the Full Federal Court, the following:<sup>56</sup>

Part IVA does not authorise consideration of evidence of the subjective purpose or motivation of a particular person. The subjective state of mind of a person is not a matter listed in s 177D(b) to which regard may be had. Rather the section requires consideration of the eight matters listed in s 177D(b) and no other matters. The subjective state of mind of a person is not such a matter. Hence the section seeks to establish the conclusion which would be reached by reference to what may be referred to as objective factors, that conclusion being however, a conclusion as to the purpose of a person who entered into or carried out the scheme ...

Carr J expressed a similar view in saying that the assessment of the factors in s 177D(b) is not intended to result in a factual finding about a person's actual dominant purpose and so the subjective purpose of the person is not relevant.<sup>57</sup> His Honour then specifically addressed the primary judge's reliance on the taxpayer being convinced the project was commercial, and on this view forming a fundamental part of the taxpayer's purpose for entering into it, and he said that this indicated an impermissible reliance on the subjective purpose or motivation of the taxpayer.<sup>58</sup>

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<sup>53</sup> *Sleight v FCT* [2003] FCA 896; 2003 ATC 4801 at 4824[145].

<sup>54</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211.

<sup>55</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211 at 235 [94].

<sup>56</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211 at 229 [67].

<sup>57</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211 at 253 [205].

<sup>58</sup> *FCT v Sleight* [2004] FCAFC 94; (2004) 123 FCR 211 at 257 [238].

*H Hart*

In *FCT v Hart*,<sup>59</sup> the taxpayers wanted to buy a new home to live in and refinance their existing home to become a rental property. They obtained a loan marketed by a bank as a “wealth optimiser” product that had two main features. The first feature was that the loan could be split into two facilities. The taxpayers used one facility to buy a new home and the other was used to refinance the loan on their existing home, which then became a rental property. The product also had the feature that allowed a borrower to elect that all repayments on the loan be directed to the home loan facility. This allowed the home loan (or non-tax deductible portion of the borrowing) to be paid off sooner than would otherwise have been the case. The taxpayers made this election. As no repayments were directed to the rental property loan facility, interest incurred on that facility accrued and was capitalised. The result was that a greater amount of interest was incurred on the rental property loan facility (or the tax-deductible portion of the borrowing) than would have been the case if a borrower had allocated repayments against both the rental property and home loan facilities. The taxpayers claimed a deduction for the total interest on the rental property loan facility.

At first instance in the Federal Court, Gyles J held that Pt IVA applied to the split loan arrangement.<sup>60</sup> This decision was reversed on the taxpayers’ appeal to the Full Federal Court, which held that the taxpayers entered into the arrangement for the dominant purpose of obtaining a loan to finance the acquisition of a new home and to refinance and lease out the former home.<sup>61</sup> The leading judgment was delivered by Hill J (with whose reasons Conti J agreed) who said of the relevance of subjective purpose to that conclusion:<sup>62</sup>

the task of the Court is not to consider the subjective purpose of a particular person, whether the taxpayer or a person who entered into or carried out a part of the scheme. The purpose in question is to be determined objectively having regard to the eight factors. This is implicit and probably explicit in the judgment of the High Court in *Spotless* at 423 and the judgment in *Consolidated Press* at [95]. It is explicit in the judgment of the full Court of this Court in *Eastern Nitrogen Ltd v Federal Commissioner of Taxation* 2001 ATC 4164 at 4177 per Carr J, with whom Lee and French [sic]<sup>63</sup> JJ agreed.

The Commissioner’s appeal to the High Court<sup>64</sup> was allowed with the Court holding that the taxpayers’ dominant purpose in entering into the split loan arrangement with the “wealth optimiser” features, and their directing all repayments to the home loan facility, was to obtain a tax benefit of a greater interest deduction. Although three separate judgments were delivered and it is difficult to extract from them a clear ratio for the decision, a common strand to their reasoning was that the “wealth optimiser” features of the arrangement were explicable only by the tax benefit obtained.

In the High Court, only Gummow and Hayne JJ expressly dealt with the relevance of subjective purpose or motive to the conclusion required under s 177D(b). After initially stating that “the inquiry required by Pt IVA is an objective, not subjective, inquiry”,<sup>65</sup> their Honours said:<sup>66</sup>

statements about why the taxpayers acted as they did or about why the lender (or its agent) structured the loan in the way it was ... are not statements which provide an answer to the question posed by s 177D(b). That provision requires the drawing of a conclusion about purpose from the eight identified objective matters; it does not require, or even permit, any

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<sup>59</sup> *FCT v Hart* [2004] HCA 26; (2004) 217 CLR 216.

<sup>60</sup> *Hart v FCT* [2001] FCA 1547; (2001) 189 ALR 584.

<sup>61</sup> *Hart v FCT* [2002] FCAFC 222; (2002) 121 FCR 206.

<sup>62</sup> *Hart v FCT* [2002] FCAFC 222; (2002) 121 FCR 206 at 223 [55].

<sup>63</sup> The third judge was actually Sundberg J.

<sup>64</sup> *FCT v Hart* [2004] HCA 26; (2004) 217 CLR 216.

<sup>65</sup> *FCT v Hart* [2004] HCA 26; (2004) 217 CLR 216 at 233 [37].

<sup>66</sup> *FCT v Hart* [2004] HCA 26; (2004) 217 CLR 216 at 243 [65].

inquiry into the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.

Their Honours therefore specifically rejected as being relevant that the taxpayers entered into split loan arrangement because of their desire to buy a new home to live in and refinance their existing home to become a rental property.

### *I Macquarie Finance*

The taxpayer in *Macquarie Finance Ltd v FCT*<sup>67</sup> was a subsidiary of Macquarie Bank Ltd (MBL) that made a public offer of stapled income securities. These securities consisted of preference shares issued by MBL and loan notes issued by the taxpayer. The object of the issue of the securities was to raise additional capital for MBL. It was a further object that the capital so raised would fall within the category known as Tier 1 capital for the purposes of the minimum capital requirements prescribed by the Australia Prudential Regulation Authority. The greater the proportion of Tier 1 capital in a company meant that the amount of borrowings raised by the company was greater. The taxpayer claimed a deduction for an amount paid as “interest” on the notes. The Commissioner disallowed the claim and the taxpayer applied to have that decision reviewed by the Federal Court.

An issue in the case was whether Pt IVA applied to disallow the “interest” paid on the notes, assuming it was allowable as a general deduction. At first instance,<sup>68</sup> Hill J held that the “interest”, if it had been an allowable deduction, constituted a tax benefit that the taxpayer obtained from a scheme involving the issue of the securities having particular features that included a payment direction under a procurement agreement. His Honour further held that the scheme was one to which Pt IVA applied.

One of the questions addressed by Hill J was whether it was correct to take into account the raising of Tier 1 capital as a purpose of a person who entered into or carried out the scheme. His Honour referred to the view of Gummow and Hayne JJ in *Hart* that s 177D(b) did not permit or require consideration to be given to subjective motives and said:<sup>69</sup>

That is clearly correct, with respect, but leaves open the question why the objective circumstances including the manner in which the scheme was entered into would not have led to the same conclusion anyway. If the facts had been that the taxpayers first were introduced to the borrowing transaction before they had considered the acquisition of a new residence and using the existing residence for income producing purposes, the point made by their Honours would have been more easily understood. My understanding of the facts in *Hart* does not suggest this to be the case.

Hill J later observed that a strict application of the view taken by Gummow and Hayne JJ in *Hart* might be thought to exclude the raising of Tier 1 capital as a purpose, because it was a subjective matter. However, he did not think it correct to exclude it both because that was not the approach adopted by Gleeson CJ and McHugh J, and perhaps Callinan J, and because the need for Tier 1 capital could be objectively determined.<sup>70</sup>

In regard to the conclusion as to dominant purpose under s 177D(b), Hill J therefore took the view that ultimately the question for decision was whether, having regard to the eight factors in s 177D(b), it would be concluded that the dominant purpose of some person who entered into or carried out the scheme with the particular features was the obtaining for the taxpayer of tax deductions for the “interest”, or whether it would be concluded that the dominant purpose of persons who entered into or carried out the scheme with its particular

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<sup>67</sup> *Macquarie Finance Ltd v FCT* [2005] FCAFC 205; (2005) 146 FCR 77.

<sup>68</sup> [2004] FCA 1170; (2004) 210 ALR 508.

<sup>69</sup> [2004] FCA 1170; (2004) 210 ALR 508 at 537 [100].

<sup>70</sup> [2004] FCA 1170; (2004) 210 ALR 508 at 540 [110].

features was the obtaining of Tier 1 capital.<sup>71</sup> After having regard to the eight factors in s 177D(b), his Honour concluded (with some reluctance) that the taxpayer obtaining a deduction for the “interest” was the taxpayer’s and MBL’s dominant purpose in entering into and carrying out the scheme. Essentially, he was of the view that this purpose outweighed, although only marginally, the commercial purpose of obtaining Tier 1 capital through the issue of the stapled income securities and the commercial attractions associated with debt financing that took that form.<sup>72</sup>

On the taxpayer’s appeal to the Full Federal Court,<sup>73</sup> a majority comprising French and Hely JJ (with Gyles J dissenting) overturned the decision on Pt IVA. The majority held that Pt IVA did not apply because the dominant purpose of the persons who entered into or carried out the scheme was not to obtain a tax benefit in connection with it.

In reaching this decision, Hely J (with whom French J agreed) noted that there may be room for a difference of opinion as to whether Hill J’s findings, that the obtaining of Tier 1 capital through the issue of the stapled securities was a significant purpose of MBL and that there were commercial attractions associated with such debt financing, involved an impermissible inquiry about why MBL structured the transaction in the way it did, as suggested by Gummow and Hayne JJ in *Hart*. However, Hely J was of the opinion that Hill J was correct to conclude that the need for Tier 1 capital and the comparative advantages and disadvantages of debt and equity were matters capable of being objectively determined. Moreover, Hely J pointed out they were matters to which regard may be had in relation to s 177D(b)(vii), which requires consideration of “any other consequence” of the scheme having been entered into or carried out.<sup>74</sup>

Hely J then reviewed all eight factors in s 177D(b) but specifically took into account the commercial purpose of the obtaining of Tier 1 capital and the commercial advantages associated with the debt financing through the stapled securities. His Honour concluded that the dominant purpose of those engaged in the issue of the stapled securities was to secure to the MBL Group all of the commercial advantages associated with debt financing (including, but not limited to tax deductibility of interest) whilst at the same time qualifying as Tier 1 capital.<sup>75</sup> In this regard, his Honour essentially weighed up differently to Hill J the factors of manner, form and substance, taxation result and other consequences of the scheme.

#### *J Calder*

In *Calder v FCT*,<sup>76</sup> the taxpayer invested in a tea tree oil project and claimed deductions for management fees, farm fees and interest incurred on a limited recourse loan used to fund the investment. The taxpayer’s financial obligation was significantly self-funded as a result of the structure of the investment, and by the immediate and later deductions generating tax savings to cover the cash commitment required without risk to his own funds. Further, the amounts of the fees and the loan were not made by the exchange of cash but by “round robin” type transactions effected by accounting entries in the books of the promoter companies.

At first instance in the Federal Court,<sup>77</sup> Nicholson J held that Pt IVA applied because the taxpayer’s dominant purpose in entering into the investment was to obtain a tax benefit of the deductions claimed. In reaching this decision, his Honour rejected an argument by the

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<sup>71</sup> [2004] FCA 1170; (2004) 210 ALR 508 at 540 [110].

<sup>72</sup> [2004] FCA 1170; (2004) 210 ALR 508 at 540 [112].

<sup>73</sup> [2005] FCAFC 205; (2005) 146 FCR 77.

<sup>74</sup> [2005] FCAFC 205; (2005) 146 FCR 77 at 132 [212].

<sup>75</sup> [2005] FCAFC 205; (2005) 146 FCR 77 at 133-138 [215-239].

<sup>76</sup> *Calder v FCT* [2005] FCAFC 254; (2005) 226 ALR 643.

<sup>77</sup> [2005] FCA 911; 2005 ATC 4760.

taxpayer that him not relying on his tax refund to make his initial cash investment, and him later making additional cash payments for voluntary harvest levy fees, was objective evidence that supported the taxpayer sought a commercial return from the investment. His Honour dealt with the argument as follows:<sup>78</sup>

These factors favour a finding, not relevant here, that the [taxpayer] had a subjective purpose of seeking commercial returns. They do not objectively support that the [taxpayer] did not enter the scheme for the purpose of obtaining a tax benefit in connection with it as his dominant purpose. These factors are therefore neutral.

The taxpayer's appeal to the Full Federal Court was dismissed. In a joint judgment, the Court comprising French, Stone and Siopis JJ initially pointed out<sup>79</sup> that the list of factors in s 177D are exhaustive of the considerations relevant to dominant purpose and then said:<sup>80</sup>

Section 177D mandates consideration of an objective purpose. That is to say the purpose which could be inferred by "a reasonable person".

The Court then accepted that the subjective state of mind of a taxpayer or, in the case of a company, the company's directors is irrelevant to the conclusion to be drawn under s 177D(b).<sup>81</sup> Their Honours cited the passage from the judgment of Gummow and Hayne JJ in *Hart* at [65] and added:<sup>82</sup> It does not follow from the irrelevance of the subjective state of mind of the taxpayer that objective factors, tending to indicate that a particular purpose was subjectively held by a person, may not also be relevant to the determination of the objective purpose which could be inferred by a reasonable person.

The Court later specifically addressed the taxpayer's argument that the primary judge had erred in treating as irrelevant to the determination of the taxpayer's purpose under s 177D(b) his lack of reliance on the tax refund and the payment of the harvest levy fees. The Court held that the primary judge had correctly treated those factors as supporting the finding of a subjective purpose of the taxpayer that was irrelevant. But the Court also pointed out:<sup>83</sup>

The mere fact that evidence might support a finding of a subjective purpose of seeking commercial returns does not mean that such evidence may not also be relied upon in ascertaining what a reasonable person might have concluded about [the taxpayer's] purpose in investing in the project.

### III CONCLUSION

The cases discussed in this article show that, with one exception, the courts have consistently treated the list of eight factors in s 177D(b) as being exhaustive, so that a reasonable person must have regard only to the listed factors and no other factors in drawing the conclusion under the section about a person's sole or dominant purpose. The exception is the Full Federal Court in *Consolidated Press* where the Court briefly stated that such a proposition is neither warranted by the language of s 177D(b) nor by the characterisation of the eight factors as "necessary" by the High Court in *Spotless*.

The cases also show that the courts have consistently approached the issue of the conclusion to be drawn about purpose under s 177D(b) as being a conclusion as to the objective purpose of the person and not their subjective purpose, or their subjective intention or motivation. A person's objective purpose is the purpose that is inferred by a reasonable person<sup>84</sup>, rather than

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<sup>78</sup> [2005] FCA 911; 2005 ATC 4760 at 4771 [57].

<sup>79</sup> [2005] FCAFC 254; (2005) 226 ALR 643 at 668 [91].

<sup>80</sup> [2005] FCAFC 254; (2005) 226 ALR 643 at 669 [95].

<sup>81</sup> [2005] FCAFC 254; (2005) 226 ALR 643 at 669 [96]. The Court referred to *Eastern Nitrogen Ltd v FCT* (2001) 108 FCR 27 at 45 per Carr J (Sundberg J agreeing) as authority for this.

<sup>82</sup> [2005] FCAFC 254; (2005) 226 ALR 643 at 669 [96].

<sup>83</sup> [2005] FCAFC 254; (2005) 226 ALR 643 at 671 [105].

<sup>84</sup> *Calder v FCT* [2005] FCAFC 254; (2005) 226 ALR 643 at 669 [95].



a conclusion as to the person's subjective or actual purpose<sup>85</sup> or, in other words, their actual state of mind.<sup>86</sup> It therefore follows, as was pointed out by the High Court in *Consolidated Press*, that the operation of Pt IVA does not depend on the fiscal awareness of a taxpayer, and that the operation of s 177D in particular is not defeated by the fact that parties to a scheme subjectively may not have any purpose at all.<sup>87</sup>

The courts have not, however, been consistent in their approach to the issue of what regard, if any, can be had to the subjective purpose, intention or motivation of a person in drawing the conclusion under s 177D(b) as to objective purpose. Whereas the cases initially indicated that no regard whatsoever could be had to subjective purpose, intention or motivation, the more recent cases indicate a change in that approach. This change may be said to have started with Drummond J in *Eastern Nitrogen* (although his Honour was overruled on appeal) who was of the opinion that subjective intentions of scheme participants is well capable of assisting in the proper understanding of the activities engaged in, and well capable of being relevant under s 177D(b)(i) to prove the "manner in which the scheme was entered into or carried out". The change in approach is then evident in *Zoffanies* where Hill J similarly said that evidence of the actual purpose of a taxpayer or other person cannot be taken into account in drawing the conclusion under s 177D, "save and except so far" as that purpose could be forensically relevant to any of the matters referred to in s 177D(b), for example, the manner in which a scheme was entered into.

The change is also evident in *Macquarie Finance*, although the approach was given a different emphasis, where Hill J initially accepted as clearly correct the view of Gummow and Hayne JJ in *Hart* that s 177D(b) does not permit or require consideration to be given to subjective motives and, consequently, statements about why a taxpayer acted as they did. But Hill J then pointed out that this left open the question why objective circumstances, including the manner in which a scheme is entered into, would not have allowed consideration of why the taxpayer acted as they did. His Honour therefore concluded in *Macquarie Finance* that it was not correct for evidence of the commercial purpose of the form of a transaction, and its associated commercial attraction, to be excluded on the ground that it was a subjective matter. His reasons were, first, this was not the approach adopted by a clear majority in *Hart*, and secondly, that commercial purpose and attraction could be objectively determined. This view by Hill J was upheld by the Full Federal Court where it was also pointed out that evidence of that commercial purpose and commercial attraction was a matter to which regard could be had under s 177D(b)(vii) as "any other consequence" of a scheme having been entered into or carried out.

The change in approach was then confirmed by the Full Federal Court in *Calder* that held, despite the subjective state of mind of a taxpayer being irrelevant to the conclusion to be drawn under s 177D(b), it did not follow that objective factors, tending to indicate that a particular purpose was subjectively held by a person, are not also relevant to determining the objective purpose that could be inferred by a reasonable person. Further, the mere fact that

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<sup>85</sup> *FCT v Zoffanies Pty Ltd* [2003] FCAFC 236; (2003) 132 FCR 523 at 538 [54].

<sup>86</sup> It may be noted that this latter point is not novel under the law. It is similar to the approach that is adopted under Contract Law to determining contractual intention, or the intention to create legal relations or be legally bound. Contract Law is not concerned with the "real" intentions of the parties, but with the "outward manifestations of those intentions": *Taylor v Johnson* (1983) 151 CLR 422 at 428. The objective test in Contract Law is not based on actual intention of the parties but on an inference to be drawn from the subject matter and nature of the agreement, and from other circumstances: *Placer Development Ltd v Cth* (1969) 121 CLR 353 at 367. Therefore, it is not the subjective belief or understanding of the parties that determines the issue. What matters is what a reasonable person in the position the parties would have understood: *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 179 [40].

<sup>87</sup> *FCT v Consolidated Press Holdings Ltd* [2001] HCA 32; (2001) 207 CLR 235 at 264 [95].

evidence supports a finding of a subjective purpose of seeking commercial returns does not mean that such evidence may not also be relied on in determining what a reasonable person would have concluded about a person's purpose in entering into or carrying out a scheme.

The changed approach is, in the author's view, more desirable than retaining the absolute rule that a person's subjective purpose, intention or motive can never be relevant to drawing the conclusion as to sole or dominant purpose under s 177D(b). The absolute rule leads to an overly technical approach that leaves the court or decision maker unnecessarily restricted or "blinkered" in what can lawfully and properly be considered in reaching the conclusion required under s 177D(b). No good reason is readily apparent for leaving out of consideration evidence of the subjective purpose, intention or motive of a person entering into a scheme, especially where this exposes or reflects on a commercial purpose of the person entering into the scheme that may not otherwise be apparent. Of course, this is always subject to such evidence being relevant to any of the eight factors listed in s 177D(b).

The changed approach can also be said to be consistent with the Explanatory Memorandum in two respects. First, it assists in overcoming one of the limitations on the former general anti-avoidance provision in s 260 of not allowing an enquiry into "the purposes of motives" of persons entering into schemes. Secondly, a person's subjective purpose, intention or motive is arguably part of the surrounding circumstances of a scheme.

But, courts and the decision maker must always bear uppermost in mind that it is not a conclusion about a person's subjective purpose that is to be made under s 177D(b). The required conclusion is as to a person's objective purpose as inferred by a reasonable person having regard to the eight factors listed in the section.

It must be finally said, however, that the changed approach to the relevance of subjective purpose, intention and motivation to the conclusion under s 177D(b) cannot be regarded as settled until the High Court, or least of majority of the court, directly rules on the issue.