PROFESSIONAL OBLIGATIONS WHEN ADVISING ON TAX AVOIDANCE

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Lawyers are frequently asked to advise upon the tax implications of transactions. Sometimes the advice sought includes advice upon the potential application of the anti-avoidance provisions. Giving advice on the substantive provisions themselves is not without difficulty and substantial uncertainty,[1] however, a separate question which lawyers may frequently need to consider and to answer, is the extent of the duty of care which they are bound to observe. It is common enough to find lawyers expressing their conclusions about the substantive provisions and the reasons for the conclusions. It is much less common, however, but perhaps more important, for the lawyer's advice to focus on what the client may need to have drawn to his or her attention to become aware of, and to evaluate, the risks that may arise from acceptance of the advice upon the substantive provisions or the entering into of the transaction.

The issue was one which I had to consider frequently when in practice. When asked for my view about whether the tax avoidance provisions applied to

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[1] The difficulty in predicting the application of the anti-avoidance provisions may be seen by tracking through the history of many of the reported cases. Unanimous decisions in one court have at times been followed by unanimous decisions the other way on appeal: see *Commissioner of Taxation v Spotless* (1995) 62 FCR 244 (Full Federal Court) and *Federal Commissioner of Taxation v Spotless* (1996) 186 CLR 404 (Full High Court). The history of the litigation in *Hart v Commissioner of Taxation* also saw changes in judicial outcomes: *Hart v Commissioner of Taxation* (2002) 121 FCR 206 (Full Federal Court) and *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216 (Full High Court). Significant differences in opinion cannot be explained as things of the past: in *Macquarie Finance Pty Ltd v Commissioner of Taxation* (2005) 146 FCR 77 the judges considered the application of Part IVA after the High Court decision in *Hart* but the judges reached different conclusions; at first instance Hill J applied Part IVA with reluctance; on appeal Gyles J thought the case a clear one for its application, whilst French and Hely JJ did not.

given circumstances, it was sometimes necessary to go beyond the specific questions asked of me and to say something about the risks which the client would bear when acting upon the opinion. The risks might be simply that I might have been wrong in the conclusions which I had reached; in that case it was useful to say something about how I had reached my conclusions to enable others to evaluate the strength of my conclusion and assess whether the risk was warranted. At times the risks were that, whether right or wrong, the Commissioner might be likely to take a different view or was likely to test the propositions inherent in the conclusion, or, perhaps, simply to embark upon an audit. In each case, the risks carried the potential for additional cost, inconvenience, relationship damage or reputational damage to which attention might have been drawn. At times the risks were in the assumptions about the facts upon which my views were sought. The facts were frequently not tested and, at times, might have appeared debatable. In all such cases, the prudent adviser should consider how far the duty to advise extends beyond the particular question or questions asked. The nature of the role of adviser is typically one of reliance by the person seeking the advice upon the expertise of the person giving it. The adviser will often be aware of many more issues and considerations about the advice sought that the person asking did not know about to ask. The probative strength of asserted facts is one such example: it is common for facts to be asserted as the basis of advice which an experienced lawyer may consider of little weight if tested or which may be difficult to prove. It may sometimes be incumbent upon the adviser to draw attention to such matters to enable those who will bear the risks to evaluate what they are and whether they are willing to bear them.

Duty to advise

Tax law has assumed the aura of a specialised area "outside the competence of most lawyers".[2] However that may be, it will frequently be the case that a non tax specialist will be called upon to consider the tax implications of transactions which are within the lawyer's non tax expertise. The simple sale and purchase of property may involve taxation consequences which will be deemed to fall within the competence of the ordinary reasonably competent conveyancing solicitor notwithstanding that the technical content of an issue to be considered may be tax law rather than conveyancing law.

The shape, structure and elements of a transaction may sometimes give rise to tax implications on which the non tax specialist must advise whether or not expressly sought. In *Tip Top Dry Cleaners Pty Ltd v Mackintosh*[3] Debelle J considered an action of professional negligence against accountants and solicitors in the context of a forward purchase contract for petrol. The structure of the transaction led to the taxpayers making a claim for a tax deduction which the Commissioner subsequently disallowed after an audit. The taxpayers sought to recover from its accountants and solicitors the damages said to arise from a failure to have been given proper advice on the tax consequences of the transaction as implemented. Debelle J considered the scope of a lawyer's duty saying that it depended upon the client's apparent need for advice; that is, that the scope of the duty owed to the client in question included the duty to give advice which it "appeared to need regardless of whether or not it had been specifically requested".[4] The partner who had held himself out "as an experienced adviser in revenue law" was held to have had a duty "to advise on all relevant issues arising" both under

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[2] GE Del Pont *Lawyers' Professional Responsibility* (3rd ed, 2006) 124; see also articles referred to in footnotes 193 and 194.

[3] [1998] 98 ATC 4346.

[4] Ibid, 4366 (Debelle J) citing *Carradine Properties Ltd v D J Freeman & Co* (1982) 126 Sol J 157.

the tax law as well as under the general law. He was held to have had a duty "to give comprehensive advice" to the client "which touched on all relevant matters".[5] This duty was held to include a duty not only to advise on whether the proposed transaction might come within the tax deductibility provisions of the legislation but also upon the possible application of the anti-avoidance provisions of the transaction.

Where a non tax expert seeks advice from a tax expert the former must still ensure that the expert is given all relevant information and both understands the advice received and that it is communicated to the client in a form that the client can understand.[6] The duty to give tax advice may, as I said, also be found to arise even though the lawyer is not an expert in tax. That was held to be so in *Hurlingham Estates Ltd v Wilde & Partners.*[7] In that case the plaintiff sued its solicitors in relation to a complex transaction involving the purchase of a company and the acquisition of the lease of premises from which it operated its business. The way the transaction was structured exposed the plaintiffs to a tax liability of about $140,000. The particular conveyancing and commercial partner who acted for the plaintiff was found to have had little knowledge of tax law and to be unqualified to give advice or even to recognise adverse tax consequences of a commercial transaction. It was nonetheless held that he had a duty to advise on the tax implications of the transaction. Lightman J said:

> It is to be expected that an intelligent layman, in the sense of a person unfamiliar with the law of taxation (and I must include within this category not merely Hurlingham [the client] but also Mr Rowe [the revenue practitioner]), would not have imagined that there was any risk of Hurlingham incurring any such liability, since it was agreed that

[5] See also *Stirling v Poulgrain* [1980] 2 NZLR 402 (SC); cf *Duchess of Argyll v Beuselinck* [1972] 2 Lloyd's Rep 172; *Cancer Research Campaign v Ernest Brown & Co* [1998] PNLR (Ch D); *Balkin v Peck* (1998) 43 NSWLR 706.
[6] *EVBJ Pty Ltd v Greenwood* [1988] 88 ATC 4,977.
[7] (1996) 37 ATR 261.

> Hurlingham should occupy a neutral non-profit and non-loss making role in the transaction. On the other hand, I would expect any reasonably competent solicitor practising in the field of conveyancing or commercial law to be aware of this concealed trap for the unwary. It is a matter he should have in mind in any transaction involving the grant of a lease and a related payment by the lessee to the lessor.[8]

The question of what tax advice ought to have been given was thus considered by reference to what a reasonably competent conveyancer and commercial lawyer had a duty to advise upon when accepting instructions to deal with a conveyancing and commercial transaction. The test derived from the authorities was said to be "whether, having regard to the terms of [the] retainer in all the circumstances which were known or should reasonably have been known by [the solicitor], [the solicitor] should reasonably have appreciated that [the client] needed his advice and guidance in respect of the tax liabilities to which entry into the transaction would expose it."[9] It did not matter that the terms of the retainer did not expressly require that advice be given on taxation. The outcome may be different if it may reasonably be apparent to the adviser that advice on tax is not needed by the client because, for example, it is within the "remit of someone else, eg a substantial client's expert tax department",[10] but the need to give advice on tax matters is not removed merely because the terms of the retainer did not expressly provide for advice on that topic.

The scope of the retainer

The test articulated in *Hurlingham Estates* is expressed in, understandably, general language. It casts the extent of the duty by reference to what should

[8] (1996) 37 ATR 261, 267.
[9] 37 ATR 261.
[10] 37 ATR 261, 267 (Lightman J) citing *Virgin Management Ltd v De Morgan Group* [1996] EGCS 16.

reasonably have been appreciated was needed by reference to the retainer.[11] The terms of the retainer (both express and implied) will, therefore, be important, and the extent of the duty will doubtlessly be influenced by a variety of factors including the nature of the transaction, the purpose for which the advice is sought and the circumstances in which the advice is required. In *Hawkins v Clayton*[12] Deane J expressed the content of the duty in tort in wide language. His Honour said:

> The solicitor, as a specially qualified person possessing expert knowledge and skill, assumes responsibility for the performance of professional work requiring such knowledge or skill. The client relies upon the solicitor to apply his expert knowledge and skill in the performance of that work. In the ordinary case, the only kind of damage which is likely to result from the negligence of the solicitor in the performance of his professional work is pure economic loss. In that context, the elements of assumption of responsibility and of reliance combine with that of the foreseeability of a real risk of economic loss to give the ordinary relationship between a solicitor and his client the character of one of proximity with respect to foreseeable economic loss.
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> […]
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> The content of the duty of care in a particular case is governed by the relationship of proximity from which it springs. It may, in some special categories of case, extend to require the taking of positive steps to avoid physical damage or economic loss being sustained by the person or persons to whom the duty is owed. Apart from cases involving the exercise of statutory powers or where the person under the duty has created the risk, the categories of case in which a relationship of proximity gives rise to a duty of care which may, according to circumstances, so extend are, like those in which there is a duty of care to avoid pure economic loss, commonly those involving the related elements of an assumption of responsibility and reliance. The relationship of solicitor and client is, as has been seen, a relationship of proximity which ordinarily involves the combination of those elements with respect to foreseeable loss which may be caused to the client by the performance of professional work. It is a relationship of proximity of a kind which may well give rise to a duty of care on the part of the solicitor

[11] 37 ATR 261, 267 (Lightman J).
[12] (1998) 164 CLR 539.

> which requires the taking of positive steps, beyond the specifically agreed professional task or function, to avoid a real and foreseeable risk of economic loss being sustained by the client. Whether the solicitor-client relationship does give rise to a duty of care requiring the taking of such positive steps will depend upon the nature of the particular professional task or function which is involved and the circumstances of the case. While the present case is plainly a borderline one and I am conscious of the force of the reasoning which has led the Chief Justice and Wilson J. to reach a contrary conclusion, it seems to me that, for the reasons which follow, the solicitors were under a relevant duty to take such positive steps.[13] (Emphasis added)

His Honour's observations in this respect have been described as "very much the exception rather than the rule"[14] but they do indicate the potential breadth of the duty. It may be that a lawyer who has fulfilled the terms of a retainer will rarely be held liable in tort along the lines expressed by Deane J,[15] but even so his Honour's observations are a useful measure of the extent of the retainer itself. At very least the observations serve as a starting point for the lawyer to consider what may need to be done to determine whether the duty arising in tort or contract has been adequately discharged.

Material risks

The adviser's task in that respect, in the context of advising on the application of the anti-avoidance provisions, is probably not limited to giving a view about whether the provisions apply (whether expressed with or without reasons). The obligation falling upon the adviser probably extends to advice about very many matters upon which the opinion may depend and upon the nature of the risks that may be assumed by entering into a transaction if the Commissioner of Taxation takes the view that the anti-avoidance provisions might apply. Some guidance may be obtained from the cases dealing with the obligations

[13] (1988) 164 CLR 539, 578-580.
[14] *GE Del Pont,* above n 2, 100 quoting from *Frost & Sutcliffe v Tuiara* [2004] 1 NZLR 782, [12].
[15] *GE Del Pont*, above n 2, 101.

of medical practitioners advising patients about prospective procedures or treatment. In that context the professional has been held to have a duty to disclose "all material risks",[16] which extended to warnings about the risks, side effects or complications[17] and alternative treatments.[18]

The application of the anti-avoidance provisions to any given situation is a matter of great complexity and, perhaps, uncertainty. It is common enough for tax advisers to say as much, at least in so far as it depends upon propositions of law about the construction of the anti-avoidance provisions. It is not quite so common for tax advisers to give advice about the reliability and strength of the underlying facts upon which the advice is given. It is common, for example, for tax advice to be given upon asserted facts which are untested or unchecked. I very much doubt that tax advisers need to undertake an audit of the facts or to require the client to prove the facts to be as asserted. Clients are, I think, at liberty to ask a tax adviser to give advice upon what are given as assumed facts; but I am much less confident that a tax adviser should not draw attention to what may appear to be the improbabilities of the facts as asserted or the unlikelihood of the facts as asserted being accepted either by the Commissioner of Taxation at first instance or subsequently by courts and tribunals. Advice is sometimes sought upon facts which may be inherently unlikely. In such circumstances the lawyer's duty when giving advice may extend to some testing of the evidence, some evaluation of its probative effect and some duty to warn the client about the reliability and strength that the assumptions may ultimately be found to have.

The lawyer's duty when giving tax advice in any given case may be to warn of any "material risk inherent"[19] in a transaction to which the anti-avoidance

[16] *Rogers v Whitaker* (1992) 175 CLR 479.
[17] *Chatterton v Gersom* [1981] QB 432.
[18] *F v R* (1983) 33 SASR 189 at 191.
[19] *Rogers v Whitaker* (1952) 175 CLR 479.

provisions might apply. In the context of medical negligence, a risk was held to be material if, in the circumstances of the particular case, a reasonable person in the patient's position, if warned of the risk, would be likely to attach significance to it[20] or if the practitioner is or shall reasonably be aware that the patient "if warned of the risk, would be likely to attach significance to it".[21] In meeting such a test it is plain that factors particular to the patient/client will be important.[22] Similar reasoning may apply to the tax adviser advising about the application of the anti-avoidance provisions. For many clients the potential application of the anti-avoidance provisions to their transactions may expose them to reputational risk that they are unwilling, or unable, to take. The tax adviser could, if not should, usefully consider, and perhaps enquire, whether the client's position is such that reputational risk makes the client averse to serious risks of the Commissioner applying the anti-avoidance provisions however strong the case may be on tax technical grounds.

The fact is that some taxpayers consider it important to have a relationship with the Commissioner which is not only legal and proper, but also perceived as being beyond question. It is obvious that many taxpayers wish to be seen in the community or by the Commissioner as being averse to taking aggressive tax positions, as good taxpaying corporate citizens, etc. The advice given to such taxpayers about the potential application of the anti-avoidance provisions may be inadequate if it fails to have regards to the possibility of risk to the relationship with the Commissioner whether or not economic loss is suffered.

An occasion in which economic loss may be suffered is in any audit that the Commissioner may undertake of a transaction upon which advice has been given. It is common enough for a tax adviser to express a view that the

[20] Ibid, 490.
[21] Ibid.
[22] See *F v R* (1983) 33 SASR 189 at 192-3.

Commissioner may take a different view about the application of the anti-avoidance provisions, but little is said about what that may mean in terms of cost to a taxpayer of managing an audit. In very many cases those costs can be so great as to render insignificant the apparent tax savings of a debateable transaction.

Ethical duties and adviser's duties

The breach of an adviser's duty to a client may expose the adviser to a claim in damages for the loss suffered by the client by reason of the breach. That may be a sufficient reason for advisers seeking to discharge their duty fully and adequately, however, the adviser may also be exposed to personal risk irrespective of the loss or damage suffered by the client. That risk in part arises from a potential failure to comply with the requisite professional standards of ethical behaviour in relation to the giving of advice or of acting as a professional in the relationship between client and legal adviser.

Some advice given by a lawyer may not fall within the scope of a professional relationship of lawyer and client. In *Leary v Federal Commissioner of Taxation*[23] Brennan J drew attention to the distinction between a lawyer acting in the role of professional adviser and one acting in the role of an entrepreneur. His Honour said:

> It has not been material to consider whether it is possible for the role of a professional adviser and the role of an entrepreneur properly to coincide or overlap, but the appearance of solicitors performing these respective roles in the present case leads me to invite attention to significant differences between the two functions. These differences do not arise out of any judicial view as to the lawfulness or morality of tax avoidance: as to which see Federal Commissioner of Taxation v. Westraders Pty. Ltd. (1980) 54 A.L.J.R. 460; Commissioners of Inland

[23] (1980) 47 FLR 414.

> Revenue v. Duke of Westminster [1936] A.C. 1; Latilla v. Inland Revenue Commissioners [1943] A.C. 377; In Estate of Vicars (1944) 45 S.R. (N.S.W.) 85, at p. 93; Re Weston's Settlements [1969] 1 Ch. 223, at p. 245. They arise because the field of professional activity is co-extensive with a lawyer's professional duty. That duty is to give advice as to the meaning and operation of the law and to render proper professional assistance in furtherance of a client's interests within the terms of the client's retainer. It is a duty which is cast upon a lawyer, as a member of an independent profession, whether his services are sought with respect to the operation of taxing statutes, the provisions of a contract, charges under the criminal law or any other of the varied fields of professional concern. It is a duty which arises out of the relationship of lawyer and client.
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> But activities of an entrepreneur in the promotion of a scheme in which taxpayers will be encouraged to participate falls outside the field of professional activity; those activities are not pursued in discharge of some antecedent professional duty. Entrepreneurial activity does not attract the same privilege nor the same protection as professional activity; and the promotion of a scheme in which particular clients may be advised to participate is pregnant with the possibility of conflict of entrepreneurial interest with professional duty.[24]

These considerations are relevant to a variety of matters which may give rise to direct personal risk to an adviser.[25] Those risks include the possibility of professional sanction, criminal prosecution, exposure to statutory penalty and exposure to penalty under the civil penalty regime.

[24] Ibid, 434-435.
[25] D. Graham Hill "The Ethics of tax practice "in G.S. Cooper and R.J. Vann (Eds), *Decision Making in the Australian Tax System* (Aust. Tax Research Foundation, 1985); D.G. Hill "The Role and Responsibility of the Tax Professional" 1989 *Taxation in Australia* 298.

Promoter and other penalties

In 2006 provisions were enacted directed to conduct with potential application to advice about the application of the anti-avoidance provisions.[26] The promoter penalties provisions are expressed broadly to proscribe two categories of conduct. The first is conduct that results in an entity being a promoter of a tax exploitation scheme.[27] The second is conduct that results in a scheme that has been promoted on the basis of conformity with a product ruling being implemented in a way that is materially different from that described in the product ruling.[28] Each prohibition employs terms and concepts which are specifically defined and that require careful consideration.

The point for present purposes is the potential application of the provisions to an adviser giving advice on the application of the anti-avoidance provisions with the possible consequence of civil penalties, injunctions or voluntary undertakings. A wide meaning is given to "tax exploitation scheme"[29] with potential application to many transactions with beneficial tax outcomes for taxpayers. An adviser may be a promoter of tax exploitation schemes in the circumstances identified in section 290-60:

> **Meaning of *promoter***
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> (1) An entity is a ***promoter*** of a tax exploitation scheme if:
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> (a) the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it; and
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> (b) the entity or an associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement; and
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> (c) having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.
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> (2) However, an entity is not a ***promoter*** of a tax exploitation scheme merely because the entity provides advice about the scheme.

[26] *Taxation Administration Act 1953*, Division 290.
[27] Section 290-50(1).
[28] *Taxation Administration Act 1953*, Section 290-50(2).
[29] *Taxation Administration Act 1953*, Section 290-65(1).

(3) An employee is not to be taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

This section requires careful, and many, readings. The triggers for its operation are broad and depend upon the meaning to be given to words which are capable of bearing broad meaning.

An exception is provided in the case of an adviser who merely provides advice about the scheme.[30] Several things should be noted about this exception. The first, and in my view the most striking, is that it is there at all. One clear conclusion to be drawn about its presence is that it was thought necessary. In other words that without it the prohibitions extended, or at very least might have extended, to the mere provision of advice. The second is that the exception is narrow: it excludes only the provision of advice where that is all that the adviser has done.

Special note should also be made of two aspects of risk under the provisions. One is the potential risk to employees. The potential exposure of risk to employees may require principals to take particular care about how they conduct their professional activities to remove such risks. Another is the indirect exposure that principals (for example partners of a firm) may have from the advice given and conduct undertaken by others in the firm. The provisions do have limitations, exclusions and qualifications to these risks, but the risks are there.

Consideration of these provisions should not cause us to forget the many other risks at law and under statues.[31] Division 284 contains many long standing penalties for the making of false or misleading statements and the like.

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[30] *Taxation Administration Act 1953*, Section 290-60(2).

[31] See Justice McHugh "Jeopardy of lawyers and accountants in acting on commercial transactions," (1988) *Taxation in Australia* 542.

Adviser's purpose

The extent to which an adviser's purpose in structuring a transaction may be relevant in any conclusion for or against a taxpayer has been the subject of some observation in judicial decisions. The issue arose in *Federal Commissioner of Taxation v Consolidated Press Holdings Limited*[32] where there was an issue about whether the relevant purpose under the provisions of s 177D of the *Income Assessment Act 1936* could be attributed to a taxpayer from the adviser. In that case the Court concluded that the purpose of an adviser could be attributed to one of the persons permitting the application of Part IVA, not being an adviser, and in doing so said:

> The finding made by Hill J, set out above, was criticised both in the Full Court and in this Court on the ground that, as the case was particularised by the Commissioner, the persons who entered into or carried out the scheme were CPIL(UK), MLG and ACP. They were the persons referred to in s 177D; not some unidentified advisors. There is no point in making a finding about what would be concluded concerning the purpose of an advisor unless that purpose is then attributed to a relevant person. It is reasonably clear that, albeit in a slightly elliptical fashion, Hill J was doing that. He was justified in doing so. As was mentioned above, it is to be expected that those who participate in a complex, international, commercial transaction will be concerned about its tax implications, and will seek expert advice. Attributing the purpose of a professional advisor to one or more of the corporate parties in the present case is both possible and appropriate. 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

[32] (2001) 207 CLR 235.

> inferred, was to avoid the consequence that the operation of Pt IVA depends upon the fiscal awareness of a taxpayer.[33]

It may be thought that these observations permit a conclusion about the application of Part IVA by reference to the actual subjective purpose contemplated by an adviser in securing a tax benefit. This has sometimes led to the Commissioner relying upon evidence of an actual purpose of an adviser in seeking to obtain a tax benefit as sufficient to explain, or at least as a factor relevant to, the application of the anti-avoidance provision. Conversely, but with similar reasoning, they have relied upon the passage to conclude that an adviser's actual purpose of achieving some object other than a tax benefit will be sufficient to defeat the application of the anti-avoidance provision. On the one hand tax officials are encouraged to seek the tax equivalent of "the smoking gun" and tax advisers are encouraged to record non tax commercial purposes as operative reasons for structures irrespective of the internal logic of the structure itself.

Subsequent to the decision in *Consolidated Press Holdings*, the High Court considered and determined *Commissioner of Taxation v Hart*[34] where Gummow and Hayne JJ said:

> In these matters, it is, of course, true that the money was borrowed to finance and refinance the two properties. Of course the loan was structured in the way it was in order to achieve the most desirable taxation result. But those are statements about why *the respondents* acted as they did or about why the lender (or its agent) structured the loan in the way it was. They 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 inquiry into

[33] 207 CLR 235, 265.
[34] (2004) 217 CLR 216.

> the subjective motives of the relevant taxpayers or others who entered into or carried out the scheme or any part of it.[35]

In the *Hart* case the court unanimously held that Part IVA did apply to the particular transaction by which the commercial objectives had been secured by the taxpayer. Indeed, it is in that context that the passage quoted above assumes significance. Their Honours contemplated that certain actual facts were neither determinative of the application of Part IVA, nor indeed even relevant to the question posed by s 177D(b). The facts that their Honours excluded from a proper consideration of Part IVA were statements about why taxpayers acted as they did or why taxpayers (or their agent) structured the transaction as it was. In other words, the actual reason for a taxpayer entering into a transaction, or the actual reason for the structuring of the transaction, will not provide an answer to whether Part IVA will apply. Furthermore, as their Honours made clear, statements about these matters are irrelevant to the statutory question and therefore do not form part of the consideration permitted by the section.

The two passages quoted from, respectively, *Consolidated Press Holdings* and *Hart* may be seen as consistently reaffirming that it is inappropriate to consider the application of Part IVA by reference to the actual knowledge (subjective knowledge) of any participant. The relevant purpose "of" the adviser as contemplated in *Consolidated Press Holdings* may be ascertained from the elements of the transaction rather than as a conclusion about a person's state of mind or objective. The attribution of such a purpose is similar to the adoption by a person of architectural plans of a structure. The critical feature is thus not the actual purpose of the architect (or the adviser) but that the purpose of the adviser is effectively incorporated into the structural plans as adopted by construction, action or implementation.

[35] (2004) 217 CLR 216, 243 [65].

An important feature in the design of Part IVA was that it should operate objectively in the sense that the operation of the anti-avoidance provisions was not made to depend upon the actual purpose of a taxpayer. In *Consolidated Press Holdings* the court inferred that one of the reasons for making s 177D turn upon objective matters was to avoid its operation being made dependent upon the "fiscal awareness of a taxpayer". The same may be said about the fiscal awareness of the taxpayer's adviser: that is, that the objective sought to be secured by Part IVA was to make the provisions depend upon objective matters rather than any person's actual state of mind or actual objective. Those objective matters are as consistent with the exclusion of the actual awareness of a taxpayer as they are with the exclusion of the actual awareness of the taxpayer's advisers. In each case the provisions can be seen to apply where a purpose can be discerned objectively (that is, on the face of the terms, operation and implementation of the transaction) without regard to an actual purpose of an adviser as a proven fact. On that view, recourse to an adviser's purpose is no more than a conclusion that the purpose may be discerned from what the adviser has implemented through the transaction (and relevantly discerned through a consideration of the circumstances identified by the eight factors) rather than by evidence of an actual purpose independent of the transaction itself. It is thus in the "scheme" that the conclusion about purpose depends: you determine purpose from what is done not from what is said.

In that context it is perhaps worth recalling that the "finding" referred to in the passage I have quoted is not the finding of an actual purpose of a tax adviser independent from a conclusion drawn from the result produced by the structure which was devised and subsequently adopted by the taxpayer. The relevant passage from the decision of the High Court setting out the "finding" of the primary judge was quoted in the High Court decision as follows:

Hill J concluded:

> "With some doubt I am of the view that a conclusion would be drawn that the dominant purpose of some person who participated in the scheme, and in particular those (perhaps not Mr Cherry, but there were others) who advised the group at Arthur Young and later Ernst & Young, was to bring about the result that a deduction would be allowed ... which, but for the scheme, would have been disallowed ... because of the application of s 79D. I reach this conclusion because it seems to me that the interest deduction was more immediate than the adoption of a neutral structure for non interference with tax credits."[36]

It can be seen from this that the purpose which was ascribed by Hill J of an adviser was that which he described as "to bring about the result that a tax deduction would be allowed". His Honour did not find as a fact that any person actually had any purpose of any such kind other than from what could be deduced and concluded from the way in which the transaction was structured. His Honour's "finding" followed from his understanding of what result the structure achieved rather than being a matter of evidence about what people actually thought or actually sought to achieve independently from what the structure did. His Honour's "finding" is, therefore, consistent with what was said by Gummow and Hayne JJ in *Hart* quoted above.

Alternative Postulate

It may be desirable to say something about the relevance and identification of the alternative postulate in advice about the application of the anti-avoidance provisions. It may be trite to say that anti-avoidance provisions are directed to certain conduct which is effective to prevent a higher tax burden than might otherwise have been. Embedded in the mischief sought to be undone is

[36] (2001) 207 CLR 235, 263 [93] citing from *CPH Property* (1998) 88 FCR 21, 42.

some notion of a comparison between what is and what ought to have been. Advice about the application of Part IVA must, therefore, identify the relevant comparator against which the avoidance is to be measured. In *Hart* it was said in the joint judgment of Gummow and Hayne JJ:

> In the present matters, the respondents would obtain a tax benefit if, in the terms of s 177C(1)(b), had the scheme not been entered into or carried out, the deductions "might reasonably be expected not to have been allowable". When that is read with s 177D(b) it becomes apparent that the inquiry directed by Pt IVA requires comparison between the scheme in question and an alternative postulate. To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed. To say, as Hill J did, that "the manner in which the scheme was formulated and thus entered into or carried out is certainly explicable only by the taxation consequences" assumes that there were other ways in which the borrowing of moneys for two purposes (one private and the other income producing) might have been effected. And it further assumes that those other ways of borrowing would have had less advantageous taxation consequences.[37]

In this passage their Honours draw attention to the conclusion required by s 177D to be made by reference to a comparison between two things. What was to be compared in that case was the terms of the transaction actually entered into, on the one hand, and how else the commercial objectives sought to be achieved might otherwise have been accomplished on the other. It is in that context that their Honours drew attention to the conclusion about the manner in which the actual scheme which was entered into was explicable only by the taxation consequences that it produced. In other words, that the dominant purpose contemplated by s 177D is to be found where a scheme (using that word in a neutral and non pejorative sense) is entered into which has some element which has no explanation other than the fiscal outcome

[37] *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 243.

which it produces. That is consistent with, and gives effect to, the view that Part IVA applies only to arrangements that may be described as "blatant, artificial or contrived" because it is in features that justify such a description that the operation of Part IVA will depend. It is also consistent with the view expressed by the then Treasurer in the explanatory memorandum when introducing the provisions, that they would not apply to arrangements of a normal business or family kind "including those of a tax planning nature". That is because the actual purpose of achieving a favourable taxation consequence would be neither determinative nor relevant to a consideration of whether the anti-avoidance provisions apply.

In each case the key to the application of the anti-avoidance provision must lie in the elements of structuring, which in popular language might be regarded as "blatant, artificial or contrived", to secure taxation consequences; or in the language of Gummow and Hayne JJ in a "comparison between the scheme in question and an alternative postulate where that alternative postulate" assumes the same commercial outcome as secured by the relevant scheme. The comparison required is between what was done with how else it might have been done. In other words what the actual scheme is to be compared with is an alternative means of achieving the same outcome; it is not an open inquiry into what else might have been done independently of the non tax outcomes which the actual scheme achieved. Their Honours emphasised that the conclusion about purpose will require a consideration of "what other possibilities existed", but those other possibilities are about other ways of achieving the same outcome rather than what other outcomes might have been open. That is why their Honours remarked that the conclusion expressed by Hill J assumed "that there were other ways in which the borrowing of moneys for this purpose (one of private and the other income producing) might have been effected".

It is not entirely clear whether the alternative to compare with the scheme is the same as that, or entirely governed by, the alternative hypothesis contemplated by the definition of tax benefit in s 177C. The definition contemplates a comparison between the tax effect of the scheme with what "would have" or "might reasonably be expected" to have occurred had the scheme not been entered into or carried out. The task here requires a prediction based upon the facts. That prediction must, of course, be more than a possibility and it must be at least "sufficiently reliable for it to be regarded as reasonable".[38] In *Peabody* the Commissioner had failed because it could not be established that a tax benefit was obtained by Mrs Peabody in the year of income.[39] In both *Peabody* (where the issue arose in the context of whether there was a tax benefit) and *Hart* (where the issue arose in the context of the conclusion about purpose) the alternatives contemplated were other ways of securing the commercial objectives which had been secured by the scheme.

In *Peabody* the Court concluded that the alternatives did not establish that Mrs Peabody would have, or that it might reasonably be expected that she would have, derived assessable income.[40] In *Hart* the alternatives available led Gummow and Hayne JJ to conclude that Part IVA did apply.[41] That was because the other "way in which the money might have been borrowed was" easily demonstrated on the facts,[42] which showed that the specific terms of the borrowing as effected "were explicable only by the taxation consequences" for the taxpayers.[43] In other words that a comparison with the alternatives available revealed that what was done had features which could only be explained by their tax effect. The conclusion was reached from "a

[38] *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, 385.
[39] Ibid, 384.
[40] Ibid, 385-6.
[41] (2004) 217 CLR 216, 244.
[42] Ibid, 244 [67].
[43] Ibid, 244 [68], emphasis is in the original.

consideration of how else the loan might have been arranged"[44] which revealed that some features of the transaction had only tax effects. The vice was not that the taxpayers wanted to secure tax benefits, but that they did so in a way that had no explanation other than the taxation consequences; those features might well be described by the popular description of "blatant, artificial or contrived".

This reasoning is also consistent with the argument which had been put by the Commissioner in *Spotless Services*. The critical test for the application of s 177D was the subject of recorded argument between bench and senior counsel for the Commissioner as follows:

> "[BRENNAN CJ. Is it your case that if, on examination of a scheme, there are steps in it which are explicable only by reference to a purpose of obtaining a tax benefit, and if those steps are sufficiently significant having regard to the whole of the scheme as to justify the conclusion that the dominant purpose of the scheme was to acquire that tax benefit, Pt IVA is attracted?] We would substitute "having regard to the matters set out in s 177D(b)" for "having regard to the whole of the scheme". The inquiry required by s 177D suggests the indicia by which the relevant conclusion is to be reached or rejected. If the conclusion be whether a person entered into the scheme for the dominant purpose of enabling the taxpayer to obtain a tax benefit, the inquiry (having regard to the eight matters) must necessarily be whether the scheme is so attended with elements of artificiality or contrivance primarily directed to the obtaining of the tax benefit that any commerciality of the scheme is overshadowed. Section 177D contemplates the possibility of its application to a commercial transaction. The mere presence of commercial elements will not oust the operation of Pt IVA. It is sufficient for its operation that it is concluded that the obtaining of a tax benefit was the dominant purpose of a person doing the things done or planned. That presupposes that a commercial purpose (ie, not the obtaining of the

[44] Ibid, 244 [69].

> tax benefit) was part of the purpose for entry into the scheme. Section 177D also contemplates that participants in a scheme other than the taxpayer do not or may not obtain a tax benefit: they too may not have entered into the scheme with tax benefit to them as their dominant purpose. [BRENNAN CJ. The elements of artificiality and contrivance, though sensible to those accustomed to s 260, lead to an evaluative judgment, do they not?] That is inevitable in the form of the section because one is directed only to eight particular matters. [TOOHEY J. The Act may require artificiality to be considered as part of the form and substance."[45] (my emphasis)

The reasoning in this part of the argument was that the conclusion to be reached under s 177D depended upon elements of artificiality or contrivance which overshadowed any commerciality which the scheme might otherwise have secured. The fact that the scheme might otherwise be commercial was to be assumed, but the scheme would fail not because a tax benefit was sought, but rather by whether it was obtained in a way, or which was "attended with elements", that were to be regarded as artificial or contrived.

The other judgments in *Hart* are to similar effect. Gleeson CJ and McHugh J said:

> As Hely J correctly observed in the Full Court (29), the fact that a particular commercial transaction is chosen from a number of possible alternative courses of action because of tax benefits associated with its adoption does not of itself mean that there must be an affirmative answer to the question posed by s 177D. Taxation is part of the cost of doing business, and business transactions are normally influenced by cost considerations. Furthermore, even if a particular form of transaction carries a tax benefit, it does not follow that obtaining the tax benefit is the dominant purpose of the taxpayer in entering into the transaction. A taxpayer wishing to obtain the right to occupy premises for the purpose of carrying on a business enterprise might decide to lease real estate rather than to buy it. Depending upon a variety of

[45] *Federal Commissioner of Taxation v Spotless Services Limited* (1996) 186 CLR 404, 408-9.

> circumstances, the potential deductibility of the rent may be an important factor in the decision. Yet, if there were nothing more to it than that, it would ordinarily be impossible to conclude, having regard to the factors listed in s 177D, that the dominant purpose of the lessee in leasing the land was to obtain a tax benefit. The dominant purpose would be to gain the right to occupy the premises, not to obtain a tax deduction for the rent, even if the availability of the tax deduction meant that leasing the premises was more cost-effective than buying them.[46]

Here their Honours accept that Part IVA may have no application where, all things being equal, a tax benefit may be the operative reason for a transaction being entered into. Thus, the potential deductibility of an outgoing may be important, and in that sense determinative, in a decision to enter into a transaction, without the necessary conclusion that Part IVA would be invoked. Indeed, as their Honours point out, without more "it would ordinarily be impossible to conclude" that the dominant purpose of the transaction was the tax benefit which it secured, notwithstanding its importance. What struck down the transaction in question was, thus, not that the tax benefits were important, but that the structure (that is, the way in which the transaction was entered into) depended entirely for its efficacy upon tax benefits generated by arrangements between the respondent and the lender that had "no explanation other than their fiscal consequences."[47]

Thus, their Honours also considered the critical feature to Part IVA is the presence in an otherwise commercial transaction of particular features directed only to securing a tax objective. It is that which may compel the conclusion that the dominant purpose of the transaction done <u>in that way was</u> to secure the tax benefit. Callinan J reached the same conclusion.[48] His Honour identified those features of the transaction directed to the obtaining of

[46] *Federal Commissioner of Taxation v Hart* (2004) 217 CLR 216, 227 [15].
[47] Ibid, 228 [18].
[48] Ibid, 262 [95].

a tax benefit and asked rhetorically what other purpose or purposes could have made commercial or other sense apart from the tax benefit which those features secured. In that context, his Honour noted the absence of material before the court which, by inference, might have been thought to justify the commerciality of those features of the transaction (that is, of the transaction done in that way) which were productive of the tax benefit.[49]

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[49] Ibid, 262 [95].