The Commissioner releases updated guidance on Part IVA: PSLA 2005/24

28 September 2016

In brief

On 16 September 2016 the Commissioner of Taxation (Commissioner) released the long awaited update of Practice Statement Law Administration (PSLA) 2005/24, providing renewed guidance on his approach to administering the General Anti-avoidance Rules (GAARs) under both the income tax and goods and services tax (GST) laws.

Whilst ultimately not binding upon the Australian Taxation Office (ATO), the views expressed provide a helpful blueprint to the processes and considerations that ATO officers will bear in mind when examining when and how a GAAR may apply. Those who rely upon the PSLA may also be eligible for penalty and interest remission, making it is an important document for taxpayers to be aware of.

Following the release of an earlier consultation draft on 14 August 2015 PwC met with Jonathan Woodger (the ATO's Deputy Chief Tax Counsel and Chair of the GAAR Panel) to discuss our key observations. The discussions were primarily focussed on a number of technical aspects of the Commissioner's guidance to which PwC suggested be revised in the interest of providing greater clarity to both the ATO and taxpayers alike.

The now finalised version of PSLA 2005/24 has addressed some of PwC's proposals put forward.

We examine details on the more significant changes appearing within the updated PSLA 2005/24.

In detail

Technical issues

By and large, the updated version of PSLA 2005/24 has a clear focus on articulating the Commissioner's views on the changes to Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) resulting from the *Taxation Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (the 2013 Amendments).

The 2013 Amendments were primarily directed at altering the test for identifying a tax benefit to address alleged 'deficiencies' revealed through a number of Federal Court cases. This was said to be achieved via the insertion of the new section 177CB in order to both:

- clarify that there were two alternate bases upon which a tax benefit could be identified:

- the ‘annihilation’ approach (a comparison of the tax outcomes of the scheme against those of an alternate postulate which removes the scheme in its entirety), and
- the ‘reconstruction’ approach (a comparison of the tax outcomes of the scheme against those of an alternate postulate involving a substituted set of arrangements), and

- revise the scope of the enquiry able to be performed under the latter ‘reconstruction’ approach.

Whilst the 2013 Amendments have had operative effect for all schemes entered into on or after 16 November 2012, the updates made to PSLA 2005/24 provide the Commissioner’s most substantive interpretative guidance made publicly available to date.

Section 177CB replaces section 177C

In the draft version of PSLA 2005/24 the Commissioner outlined his view that the new section 177CB was inserted to wholly ‘replace’ the statutory prediction mandated by section 177C. This is despite the latter provision being retained following the 2013 Amendments.

Based on this premise, the Commissioner considers that having identified an alternate postulate that satisfies the conditions of subsection 177CB(3) and (4) “a tax benefit can be immediately calculated”.

PwC raised the following alternate view during the course of the consultation process:

- Subsection 177CB(1) notes that the section applies *“to deciding, under section 177C”* whether any of the identified tax effects would, or might reasonably be expected, to have occurred in the absence of the scheme. Correspondingly, section 177C is the provision which takes primacy for identifying a tax benefit capable of potential cancellation, and
- As a consequence, it is apparent that the examination under section 177CB operates to merely add specified parameters upon which that prediction required under section 177C is to be completed – as opposed to wholly replacing it.

Whilst acknowledging that such an approach is “literally open”, the Commissioner has ultimately maintained his ‘replacement’ stance in the final version of PSLA 2005/24. The consequences of this position follow below.

Past case law on section 177C is no longer relevant

As a result of the Commissioner considering that section 177CB replaces section 177C when identifying a tax benefit for all schemes subject to the 2013 Amendments, he correspondingly considers it can no longer be the case that all existing jurisprudence relating to section 177C remain authoritative when examining the presence of a tax benefit. The PSLA indeed forewarns that cases such as *RCI Pty Ltd v FCoT* [2011] FCAFC 104 and *FCoT v Futuris Corporation Limited* [2012] FCAFC32 *“should be treated with extreme caution*.”

Whilst PwC agrees that aspects of some existing authorities on section 177C may no longer be applicable as a consequence of the restriction upon the section 177C enquiry provided by the new subsection 177CB(4)(b), we consider the present guidance within PSLA 2005/24 risks misinterpretation. In particular, we see little basis upon which it could be concluded that the fundamental jurisprudence established in cases such as *FCoT v Peabody* (1994) 181 CLR 359 (which requires the statutory prediction to be “sufficiently reliable” and “more than a possibility”) was sought to be disturbed as a result of the 2013 Amendments.

In adopting an alternate view, PSLA 2005/24 does not provide any express guidance as to which authorities (if any) remain relevant nor, critically, does it provide any guidance as to the threshold the prediction must now satisfy in order to identify a tax benefit post the 2013 Amendments. The absence of such guidance is thought to signal an intent by the Commissioner to test the bounds of the new statutory

enquiry and potentially adopt an expansive approach in his compliance activities until such time as a matter is elevated for judicial review.

Taxpayers should take particular note of this possibility when evaluating arrangements potentially subject to Part IVA. As a practical matter, it is always advisable that taxpayers consider the application of the Part's three elements, rather than stopping at the second after concluding that no tax benefit exists.

Can there be more than one alternative postulate?

In addition to the absence of guidance on the threshold required for the statutory prediction, PSLA 2005/24 is unclear on whether more than one alternate postulate may be identified for the purposes of the tax benefit test.

In taking the view that only certain aspects of the existing jurisprudence on section 177C are no longer relevant, PwC considers there is no need to depart from the findings in *RCI Pty Ltd* on this matter. In that case, the Full Federal Court held that you need only determine "*the most reliable prediction"* – that is, the one and only postulate for comparison.

Whilst PSLA 2005/24 welcomingly notes that in the event there are two *equally reasonable* postulates, the 2013 Amendments do not require the Commissioner to pursue the one which produces the highest tax, it does not settle the fundamental question of whether multiple postulates of differing degrees of reasonableness may nonetheless be identified for the purposes of the required comparison.

Tax consolidation

For the first time, PSLA 2005/24 now provides guidance on the Commissioner's view regarding the permissible means by which Part IVA may apply to schemes involving the interaction of tax consolidation. These views reflect the Commissioner's position following the separate findings of the Federal Court in *CoT v Macquarie Bank Limited* [2013] FCAFC 13 and *Channel Pastoral Holdings Pty Ltd v CoT* [2015] FCAFC 57.

Notwithstanding the complex and somewhat opposing decisions reached in these cases, PSLA 2005/24 now provides that, in the Commissioner's view, he is at large in his ability to issue both Part IVA determinations and corresponding assessments to an individual company, notwithstanding that it may be a subsidiary member of a consolidated group (and would not have been a subsidiary member under his alternate postulate upon which the tax benefit is based).

Whilst PwC expressed apprehension with the generality of the statements proposed, the final version of PSLA 2005/24 ultimately takes the view that a scheme involving an entity joining a consolidated group is "no bar" to the issuing of Part IVA determinations and assessments to subsidiary members or head companies, as required.

Procedural / administrative issues

Part IVA and private ruling applications

The earlier draft version of PSLA 2005/24 removed the former prescriptive guidance concerning the action to be taken by ATO officers when a taxpayer applies for a private ruling on matters not including Part IVA, but where the ATO nonetheless considers that the Part may apply.

During the consultation process, PwC recommended that this former guidance be reinstated in the interest of ensuring such concerns by an ATO officer are communicated to taxpayers in a transparent manner.

In response, the final version of PSLA 2005/24 has partially addressed this issue.

Indeed whilst the former guidance required ATO officers to include prescribed wording in an issued ruling where it was either “not clear”, or it “seemed”, that Part IVA may apply to the arrangement at issue or a wider arrangement to which it was a part, the updated version of PSLA 2005/24 now leaves this issue wholly at the officer’s discretion.

Moving forward, where an ATO officer has such concerns they need only *“consider whether the private ruling should include an appropriate message or warning about the potential application of Part IVA*.” As a practical matter, taxpayers should now be more upfront and forthright when querying the Commissioner’s views regarding the impact of Part IVA in a ruling scenario, even where a question on Part IVA is not part of the ruling sought.

The takeaway

Whilst the renewed guidance is welcomed from the perspective of ‘signposting’ the ATO’s view on these critically important areas of legislation, the updated PSLA 2005/24 could arguably have gone further in reducing uncertainty for taxpayers and ATO officers alike.

In reaching his conclusions, the Commissioner has drawn heavily upon the extrinsic materials accompanying the 2013 Amendments given the absence of any matters yet elevated for judicial review. Overall, the correct application of the 2013 Amendments will only be clarified upon matters being heard before the Federal Court. Given the primacy the court places on the text of the provisions we consider the guidance provided by the extrinsic materials may ultimately be of little utility when seeking to interpret and apply the current tax benefit test.

Finally, whilst this interpretive uncertainty is likely to remain for some time, a successful defence to Part IVA will still fundamentally turn on the taxpayer’s ability to provide cogent evidence about their objective purpose in entering into the arrangement at issue. None of the updates to PSLA 2005/24 signal an intent on the part of the Commissioner to lessen his focus on the evidence, meaning this remains a critical consideration for taxpayers to bear in mind.

Let’s talk

For a deeper discussion of how these issues might affect your business, please contact:

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