Part IVA of the Income Tax Assessment Act 1936 (Cth) ("the Act") was enacted as a result of legislative and public concern and dissatisfaction with the level of tax avoidance and the manner in which the legal system dealt with the problem. At the time of its introduction, it was considered that its predecessor, s 260 of the Act, was completely ineffective as an instrument to forestall and deter tax avoidance, and that the literal approach adopted by the High Court to the interpretation of the Act when Barwick was the Court’s Chief Justice, was such so as to encourage more aggressive and artificial tax minimisation practices. Although the Barwick High Court was blamed for the failure of s 260, that result can more logically be explained by reference to the inherent nature and character of general anti-avoidance provisions. Part IVA has the same essential characteristics as those of its predecessor and is likely to suffer the same fate.

1. BACKGROUND

General anti tax avoidance provisions have proved to be a popular policy instrument particularly in jurisdictions where the practice of tax avoidance was considered to be at an unacceptably high level and where governments had for political and other reasons been unable to effect extensive and comprehensive tax reform by way of a response to the problem.

The perceived need for such provisions in common law jurisdictions was often justified on the basis that the courts have either:

- failed to develop a broad common law judicial anti avoidance doctrine; or
- adopted statutory interpretation methods that are more formal than substantive and, as such, allowed or provided scope for taxpayers to obtain unintended tax advantages.

There are many different approaches to the development and design of general anti avoidance provisions. This is so primarily because they must be designed with a specific system in view and there are fundamental structural and jurisprudential differences between alternative tax systems which necessarily call for different and more targeted system specific approaches particularly with reference to tax rates, timing of income recognition, deductibility of expenses and the assessability of receipts. Nevertheless, for any general anti avoidance provision to operate effectively there are some basic design characteristics or elements that are usually regarded as necessary.

The expression and formulation of such elements may vary but essentially general anti avoidance provisions require some form of a “transaction” or “scheme” in respect of which the taxpayer obtains a “tax benefit”. Unless there is a tax benefit there will be no basis for the application of any general anti avoidance provision and in this respect the arrangement must produce a result which can be described as a proscribed tax avoidance benefit. Further, general anti avoidance provisions normally require relevant conclusions as

* The views expressed in this article are those of the author and not necessarily those of KPMG.
to the state of mind of taxpayers who carried out or participated in the scheme.

As there are fundamental structural and jurisprudential differences between alternative taxation systems, the design and operation of general anti avoidance provisions must be examined and evaluated by reference to the broader context of the system in which they are designed to operate and to the wider policy objectives of the institution of taxation in general. In this respect, the objective and operation of such provisions must be evaluated by reference to broadly recognised and accepted principles of optimal taxation which define and prescribe the requisite criteria for evaluating the tax system, namely equity, simplicity, efficiency, the rule of law and the right of taxpayers to organise their affairs within the law.

The objective of dealing with tax avoidance with a view to producing a more equitable system of taxation and the means adopted to that end must be consistent with the general objectives of taxation. If, on balance, the means adopted produce negative and undesirable effects in social and economic terms, then they must give way to more acceptable means even if the alternatives are perceived to be less effective. To that end, some of the fundamental tenets of our legal system are:

- Liability to taxation must be imposed by Parliament. The role of the Commissioner is only to administer the law as established by the legislature. The interpretation of the law is exclusively within the purview of the judicial function.
- Taxation laws must be certain in their terms and capable of consistent operation such that liability to taxation is reasonably determinable in any circumstance and not arbitrary.
- The exercise of discretionary power should be closely scrutinised by Parliament and supervised by the courts.

Legislation which adversely affects the rights of citizens, whether as taxpayers or otherwise, must be clear in its terms because Parliament has complete control over the process of legislation and is guided by the executive with a massive bureaucratic machine. For that reason, it is submitted that it is unwarranted to presume that through oversight, Parliament has failed to express or articulate its intentions of subjecting the particular taxpayer to taxation. Unless liability to taxation is imposed in clear terms, taxpayers must remain outside the operation of the relevant tax Act. Dr Spry noted the effect of general anti avoidance provisions on the issue of certainty and said:

It is of particular importance that individual taxpayers should be able to establish with reasonable certainty the amount of tax that they will bear if they take any of the particular courses of action that are open to them, and it is of the nature of general tax avoidance provisions such as s 260 to give rise to undue uncertainty. Some such provisions, of course, are more uncertain than others; but none of them permits a state to exist where taxpayers can arrange their affairs with reasonable confidence.

There is no doubt that income tax legislation cannot describe with a reasonable degree of particularity all the circumstances conceivable upon which it is intended to operate because:

- there are an infinite range of circumstances and factual combinations which may attract the operation of the tax laws; and
- it is not possible to foresee and anticipate taxpayer reaction and adjustments to the law.

However, it must be a guiding objective of tax legislation that, as a minimum, it must provide intelligible and ascertainable standards and criteria

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that define, condition and qualify its operation.

The object of this article is to undertake a theoretical and conceptual analysis of the general anti avoidance provisions in Pt IVA of the Income Tax Assessment Act 1936 (Cth) (“the Act”). This article submits that:

- As a general expression of law directed at tax avoidance, Pt IVA does not disclose a coherent rule or principle that can be applied with a reasonable degree of certainty and consistency.
- This characteristic is contrary to generally accepted principles of taxation law and policy.
- By reason of this characteristic, Pt IVA will eventually suffer the same fate as that of s 260.
- An approach which looks to the purpose and policy of the Act, as a guide to its meaning and operation, is more likely to produce, on balance, results that are consistent with legislative intention.

2. PART IVA: THE CRITERIA OF OPERATION

In 1981, Pt IVA was inserted in the Act as a general anti avoidance provision to deal with schemes to reduce income tax. It replaced s 260 which had proved to be somewhat ineffective as a measure to counter tax avoidance arrangements. It comprises ss 177A-177G of the Act. As Hill J of the Federal Court observed, Pt IVA was inserted to provide a general measure to replace the earlier anti-avoidance provision in s 260 which at that time “stood somewhat discredited”.2

In FC of T v Spotless Services Ltd & Anor,3 the Full High Court said that Pt IVA is as much a part of the statute under which liability to income tax is assessed as any other provision thereof and that Pt IVA is to be construed and applied according to its terms and not under the influence of “muffled echoes of old arguments”.4 Viewed in this way, it is necessary to determine whether the terms of Pt IVA disclose a rule or principle which is sufficiently coherent to guide and target its operation to what can truly be described as tax avoidance arrangements.

Unlike s 260, Part IVA is not self-executing. It requires the Commissioner to make a determination cancelling a tax benefit where the objective criteria specified in para (b) of s 177D are satisfied. In particular, it is necessary that the taxpayer has obtained a tax benefit in connection with a scheme to which Pt IVA applies. In this sense, the operation of Pt IVA is predicated on the existence of the following three elements: a “scheme”, a “tax benefit” and a relevant “dominant tax avoidance purpose”.

2.1 The Requirement of a Scheme

The expression “scheme” is defined in s 177A in very wide terms to include various arrangements, undertakings, plans and courses of action. The scope of this definition is expanded by s 177A(3) which expressly includes a unilateral scheme with-in the notion of scheme.

The Commissioner has significant discretion in the identification and particularisation of the relevant scheme by reference to which he seeks to apply Pt IVA. Within a wider scheme which has been identified, the Commissioner is permitted to rely upon a narrower scheme as meeting the requirements of Pt IVA. This is possible provided:

- the decision to rely upon the narrower scheme does not cause embarrassment or surprise to the other side; and

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2 Peabody v FC of T (1993) 93 ATC 4104, 4110 ("Peabody").
3 96 ATC 5201 ("Spotless").
4 Ibid 5205.
5 Peabody v FC of T 94 ATC 4663.
the circumstances are capable of standing on their own as a scheme within s 177A without being robbed of all practical meaning.\textsuperscript{6}

If the Commissioner erroneously identifies the relevant scheme for the purposes of the part, that will result in the wrongful exercise of discretion conferred under s 177F only if the tax benefit which the Commissioner purports to cancel is not a tax benefit within the meaning of Pt IVA. That is unlikely to be the case if the error goes to the mere detail of the scheme relied upon by the Commissioner.\textsuperscript{7}

2.2 The Requirement of a Tax Benefit

According to s 177C, a “tax benefit” arises where:

- an amount is not included in the assessable income of the taxpayer where that amount would have been included or might reasonably be expected to have been included in that assessable income for the relevant year of income if the scheme had not been entered into or carried out; or

- a deduction is allowable where the whole or part of that deduction would not have been or might reasonably not have been allowable to the taxpayer in the relevant year of income if the scheme had not been entered into or carried out.

A reasonable expectation requires more than a possibility. It involves prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.

2.3 The Requirement of a Dominant Tax Avoidance Purpose

Part IVA applies to a scheme where having regard to a number of objective factors including:

- the manner in which the scheme was entered into;

- its form and substance; and

- the result in relation to the operation of the Act that, but for Pt IVA, would have been achieved by the scheme;

it would be concluded that one of the scheme participants who entered into or carried out the scheme, or any part of the scheme, did so for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme.

In its ordinary meaning the word “dominant” refers to the ruling, prevailing or most influential purpose. In this sense, where facts show that the taxpayers took steps which maximised their after-tax return and they did so in a manner indicating the presence of the dominant purpose to obtain a tax benefit within the terms of the part, then the necessary criteria for the operation of Pt IVA are met.\textsuperscript{8}

2.4 General Analysis

The notions of scheme and tax benefit are by their very nature not capable of distinguishing between unacceptable tax avoidance and acceptable tax planning. The requirement of scheme is defined in such wide terms as to encompass all forms of conduct regardless of its character and legal and practical effects. In addition the very notions,
employed to describe the particular incidents or conduct to which Pt IVA is intended to apply are common to both tax planning and tax avoidance. Both forms of conduct must entail some arrangement, undertaking or course of action. This explains why the question whether there is a scheme to which the part applies is rarely disputed in court. The parties usually concede the existence of a scheme and move on to other matters.9

Similarly, the concept of tax benefit refers to what can reasonably be expected in the circumstances but for the scheme. Tax planning by definition entails some tax gain otherwise it fails its essential objective.

The notion of tax benefit is particularly problematic because tax Acts contain a range of choices that taxpayers are able to make which have different tax consequences. Where taxpayers merely make a choice between alternatives that the Act itself lays open to them, can it be said that there is a tax benefit? Part IVA sought to anticipate this problem by including s 177C(2) which permits choices expressly provided for by the Act provided that the relevant scheme was not entered into or carried out for the purpose of creating any circumstance or state of affairs the existence of which is necessary to enable the choice to be made or exercised.

It will be noted that the section is limited to choices “expressly provided for” by the Act and hence does not necessarily apply to choices that are merely open under the Act. In Case W58,10 the Administrative Appeals Tribunal noted that while the Act recognises partnerships, trusts and companies, the use of one or other of these vehicles is not a choice expressly provided for in the Act. Although this is a tribunal decision, it is unlikely that a court would adopt an expansive notion of choices expressly provided for in the Act because choices are normally exercised predominantly for taxation rather than commercial reasons. This necessitates a shift in the focus of the relevant inquiry away from taxpayer purpose to the all significant legislative purpose and policy.

The mental element in Part IVA focuses on the objectively determined purpose of any of the participants in the scheme or a part of the scheme. The policy said to underlie Pt IVA was that it was directed at blatant, artificial and contrived arrangements, but was not intended to cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs under the Act.11

The Second Reading Speech suggested that in order to confine the scope of the proposed provisions to schemes of the blatant paper variety, Pt IVA was expressed so as to render ineffective a scheme only in circumstances where having regard to the scheme itself and to surrounding circumstances and practical results, it can be concluded that the scheme was entered into for the sole or dominant purpose of obtaining a tax benefit in the relevant statutory sense. In this way reliance was placed

9 See, for example, Peabody 94 ATC 4663; WD & HO Wills (Australia) Pty Ltd v FC of T 96 ATC 4223 (“Wills”); and Spotless 96 ATC 5201.
10 89 ATC 524.
11 The Second Reading Speech and Explanatory Memorandum to the Income Tax Laws Amendment Bill (No 2) 1981 (Cth).
exclusively on the notion of purpose to distinguish between transactions to which Pt IVA is directed being those that are contrary to the purpose and policy of the Act and those that are of an acceptable tax planning character.

Dominant purpose conclusions under s 177D raise two issues in relation to:

- the threshold of dominance required; and
- the manner in which purpose is to be characterised.

These issues create a major difficulty in determining the stage at which the relevant tax purpose passes the requisite threshold of dominance because that threshold is a matter of impression and degree and hence there will necessarily be significant differences in opinion as to what constitutes a dominant purpose. Further, there is greater difficulty in determining the relevant purpose to be considered so as to ascertain whether it passes the threshold of dominance.

It is generally accepted in Canada, the United States and Australia that there is no necessary dichotomy between commercial and tax avoidance purposes, particularly because both seek to achieve the same practical results. Taxation laws exist as an economic reality in the business world which must plan their affairs around it. A tax dollar is just as effective as any other derived from commercial activities. In this respect the shape and form that transactions take may be influenced by, if not the product of, tax considerations. In view of the fact that taxation laws are a significant part of the legal order within which commerce is conducted, that is only to be expected.\textsuperscript{12}

In \textit{Spotless},\textsuperscript{13} the Full Federal Court considered the potential application of Pt IVA to an arrangement which involved an investment offshore where, as a result of the operation of the foreign taxation laws and the existing Australian taxation laws, the net return, after payment of all applicable taxes and other costs, was higher than in Australia. The Court concluded that in investing offshore it cannot objectively be said that the dominant purpose of the taxpayer was to obtain a tax benefit. The purpose was to obtain the maximum return on the money invested after payment of all applicable costs including tax. In this regard the interest rate offered on the investment offshore would admit of a rational commercial decision to invest there in preference to Australia.

The High Court rejected the dichotomy between a rational commercial decision on the one hand and a dominant purpose to obtain a tax benefit on the other. The Court said that a taxpayer may enter into or carry out a scheme, within the meaning of Pt IVA, for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit where that dominant purpose is consistent with the pursuit of commercial gain in the course of carrying on a business. In other words, a decision to avoid or minimise liability to taxation can itself admit of a rational commercial decision.

In the \textit{Spotless}, \textit{Peabody v FC of T}\textsuperscript{14} and \textit{WD & HO Wills (Australia) Pty Ltd v FC of T}\textsuperscript{15} cases the Federal Court sought to place some sensible limits on the potential scope of Pt IVA by denying it any operation on arrangements which are explicable by reference to commercial purposes and considerations. Whilst that is a sound approach on policy grounds because it promotes a degree of certainty in commercial dealings, it creates problems in distinguishing “commercial” from “tax” purposes.

\textsuperscript{13} 96 ATC 5201.
\textsuperscript{14} 93 ATC 4104.
\textsuperscript{15} 96 ATC 4223.
The High Court in *Spotless* recognised the fact that there is no necessary dichotomy between commercial and tax purposes and, accordingly, Pt IVA applies in accordance with its terms. That is, if taxpayers take steps to maximise their after tax return and they do so in a manner indicating a dominant purpose to obtain a tax benefit, then the criteria which must be met before the Commissioner is able to make determinations under s 177F are satisfied.16

Dominant purpose conclusions can arguably be made in many ordinary tax planning arrangements. In *Spotless*, the High Court concluded that the dominant purpose of the taxpayers in taking steps to ensure that the source of the interest was located offshore was to achieve a tax benefit in Australia in the form of the exemption under former s 23(q) of the Act. Without that benefit the proposal would have made no sense.17

On the reasoning of the High Court in *Spotless*, it is submitted that Wills case was incorrectly decided. In *Wills*, Sackville J of the Federal Court considered an arrangement where the taxpayer set up a captive insurance company in Singapore, being a wholly owned subsidiary to provide insurance coverage within the same group, in order to obtain insurance coverage for various risks which it was unable to obtain from other insurance companies. His Honour found that having regard to the matters specified in s 177D(b) the scheme identified by the Commissioner had two commercial purposes. It enabled the taxpayer to obtain indemnity against risks that otherwise would not have been available to it, and it provided the group with a more effective risk management scheme.18

It is submitted that the commercial purposes identified by the trial judge were not sufficient to preclude the making of dominant purpose conclusions within s 177D(b) because it is at least arguable that the dominant purpose of the taxpayer in establishing the scheme was to obtain a tax benefit in Australia in the form of a tax deduction for the insurance premiums. Without that benefit, the scheme would make little sense because it merely provided protection from risks or claims to the extent of accumulated premiums. Beyond that the taxpayer would have to bear the risk of claims for damages.

In view of the terms of Pt IVA and the manner in which it has been interpreted and applied by the High Court, it has a substantial and broad operation that extends to arrangements of all kinds regardless of whether they are of a tax planning character. In effect the Commissioner is given, in Pt IVA, “a carte blanche” power to impugn arrangements of all kinds unguided by any discernible general principle or rule.

Under the existing system of self assessment, taxpayers are required to determine their liability to taxation with significant penalties in the event of failure to correctly determine that liability. Taxpayers are entitled and expected to minimise tax and the Commissioner is charged with the power of administering the Act which includes Pt IVA. Yet Pt IVA does not disclose a clear principle that is capable of practical and consistent application to guide taxpayers in determining their liability and the Commissioner in administering the Act. This is an inherent feature of general anti avoidance provisions and does not necessarily reflect on the goodwill of the Commissioner.

Resort to the purpose of Part IVA does not advance the search for a general rule or principle any further. As stated earlier, in the Explanatory Memorandum it was indicated that Pt IVA is directed at blatant, artificial and contrived arrangements. Clearly expressions like blatant and contrived have no fixed and consistent meaning. Further, the word artificial conveys little, if any, guidance as to the intended operation of the part because the notion of

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16 *Spotless* 96 ATC 5201, 5206.
17 Ibid 5210.
18 *Wills* 96 ATC 4223, 4254.
artificiality can refer to transactions which are characteristically abnormal or uncommon. In this sense tax avoidance itself, if sufficiently practiced, could become normal and common and hence cease to be artificial. It is submitted that the composite expression “blatant, artificial and contrived”, as an attempt by the Treasurer to define the limits of Pt IVA, fails to express any recognisable principle that is of any use to taxpayers, the Commissioner or the courts.

If Pt IVA is considered to be directed at transactions which can truly be described as tax avoidance, being transactions which result in a tax benefit contrary to the purpose and policy of the Act, then its presence in the Act cannot be justified because:

- The fundamental object of statutory construction in every case is to ascertain legislative intention by reference to the language of the instrument viewed as a whole. In performing that task the court looks to the operation of the statute according to its terms and to legitimate aids to construction. The rules of statutory interpretation which include the golden, literal and mischief rules are not rules of law but rather merely seek to emphasise a decisive factor. That factor is whether the meaning assigned is one that is intended by the legislature.19

- To that extent, the interpretation and application of the provisions of the income tax legislation by courts necessarily foreclose the question whether the impugned scheme is consistent with the purpose and policy of the legislation. In other words, statutory interpretation gives effect to legislative intention as determined and the resulting tax benefit cannot constitute tax avoidance in the sense defined in this article. In consequence, Pt IVA has no defined or discernible role to play.

Alternatively, if Pt IVA is considered to be a separate and independent provision designed to deny all tax benefits that satisfy its literal terms, then in its terms and operation it does not distinguish between benefits which are contrary to the purpose and policy of the Act and those that are not. In this sense it does not contain any mechanism that defines its role and limits its operation to transactions that are contrary to the purpose and policy of the Act, thereby leaving the matter to the discretion of the Commissioner.

This raises a question as to how taxpayers, the Commissioner and the courts are able to assess whether and when Pt IVA applies. The presumption is that Pt IV must have been enacted for a purpose and could not have been intended to operate at large. In other words, statutes are inherently purposeful utterances by the legislature. Hence the inquiry is back where it began. What is the purpose of Pt IVA?

The point being made is that given the breadth of the terms of Pt IVA, it is necessary to develop some principle or rule to define, guide and target its operation to particular and identifiable transactions. It is difficult to conceive, from a tax policy perspective, any purpose other than it is intended to counter and deter transactions which result in tax advantages contrary to the policy of the Act. If this proposition is accepted, then it must be conceded that to the extent that the fundamental object of statutory interpretation in every case is to ascertain and give effect to legislative intention, then any tax benefit which results following the interpretation and application of the Act by the courts is by definition outside the scope of Pt IVA.

It is logical and reasonable to assume that, in enacting the specific and particular provisions which affect assessable income or add to or increase deductions, the intention of the legislature is that those provisions should have effect according to their tenor so that taxpayers who bring themselves within the purview of such provisions which purport to confer a tax benefit should be entitled to have that benefit. That intention would fail if Pt IVA is permitted to avoid any arrangement which

19 Cooper Brookes (Wollongong) Pty Ltd v FC of T 81 ATC 4292, 4301 (per Mason and Wilson JJ).
brings the taxpayer within a specific and particular provision of the Act which conferred a tax benefit. In other words, in performing its task of protecting the provisions of the Act and ensuring that their operation gives effect to legislative intention, Pt IVA cannot be allowed to negate legislative intention expressed in the Act's specific and particular provisions.

Accordingly, it is necessary to read down Pt IVA in order to provide for the intended operation of the ordinary and charging provisions of the Act. It is submitted that the interpretation of Pt IVA by the High Court in Spotless cannot stand because it leaves the provision with an undefined broad operation that is not conducive of certainty and consistency. Spotless is, as it were, “as good as it gets” and it is predicted that the ordinary operation of the legal system and the doctrine of precedent would ultimately prove to be a major force that militates against such breadth, leading to the gradual reduction in its scope. It is neither inconceivable nor should it be surprising that Pt IVA may suffer the same fate as that of its predecessor s 260.

4. PART IVA - POLICY CONSIDERATIONS

There are recognised policy objectives and standards which form the benchmarks by reference to which the operation and efficacy of taxation laws in general and the Australian taxation system in particular are assessed and evaluated.

Such fundamental principles command wide support and acceptance in Australia and other jurisdictions, and are reflected in the design and operation of the taxation system as a whole. In this respect, they set out the relevant criteria and benchmarks by reference to which Pt IVA should be assessed and evaluated. Whilst different countries may ascribe different value, weight and priority to such principles, the principles form the core criteria or standards traditionally employed by the courts and tax theorists in assessing any aspect of income taxation which necessarily includes Pt IVA. These standards are:

1. certainty of liability to taxation;
2. the rule of law;
3. the right of taxpayers to plan their taxation and financial affairs within the law;
4. equity; and
5. efficiency and neutrality.

In Australia and other democratic societies, it is generally accepted that the ends do not justify the means and the democratic integrity of our system of law depends almost entirely upon the legitimacy of its processes and means. For this reason, Pt IVA as a general expression of law that affects liability to taxation and as an instrument for the control of tax avoidance, must itself be justified and legitimate. Whether and the extent to which that is the case, depends on its impact on the generally accepted and fundamental legal and taxation principles and policies identified.

4.1 Certainty of Liability

It is submitted that the criterion of certainty in relation to the terms and operation of general anti avoidance provisions is the most significant criterion because it underpins all the other standards, including the institution of law and the legitimacy of the power of the State to exact taxation from its subjects.

The importance of certainty in the operation of law in general underlies the development of the doctrine of precedent and stare decisis. Sir Anthony Mason, writing extra-judicially, identified a number of competing policy justifications that call
for the need to observe the doctrine of stare decisis including the need for certainty and predictability, and indicated that the doctrines of stare decisis and precedent are adhered to more strictly in areas of the law where certainty is considered to be of greater significance.20

It is submitted that taxation is one such area where there are stronger and more compelling policy justifications for insisting upon a higher degree of certainty than other areas of the law because:

- taxation has an impact on so many persons at so many points in time;
- taxpayers have strong feelings in relation to their liability to taxation;
- taxation often determines the viability or commerciality of transactions and plays a significant role in commercial decision making and choices; and
- in Australia, as in many other countries, taxpayers are required to self assess their liability to taxation and there are serious penalties imposed upon those who fail to correctly assess and discharge that liability.

Further, policy considerations that militate against uncertainty include the proposition that uncertainty in taxation law is contrary to generally recognised and accepted principles of sound taxation such as equity, efficiency and the rule of law. The OECD Committee on Fiscal Affairs identified certainty as a “right” in the sense that taxpayers have a right to a high degree of certainty as to the tax consequences of their actions.21 The Committee recognised that certainty may not always be possible, particularly in circumstances involving the application of anti-abuse legislation aimed at taxpayers seeking to circumvent the intent of the legislation, but nevertheless it is clearly a goal that taxpayers should be able to anticipate the consequences of their ordinary personal and business transactions.22

Similarly, the Carter Commission recognised that taxpayers should be able to determine promptly, with great certainty and at modest cost, the tax consequences of a proposed course of action before making a decision. Obscure law, and law that is not consistently enforced, creates uncertainty.23 When the liability to taxation under relevant law cannot readily be determined, it is impossible for taxpayers to know in advance what they are free to do. Further, uncertain law is retroactive in effect because the effect of the law is known only after the event. It also penalises those anxious to obey it and eventually creates contempt for the law.

Uncertainty can derive from a number of factors. More particularly, it can derive from the principles and polices relied on to condition the operation of a general anti avoidance provision, the terms used to describe its elements, whether and the extent to which the operation of such provision is predicated upon the exercise of discretions and its relationship with the other provisions of the Act. Absolute certainty is difficult if not impossible to achieve because:

- there is an inherent element of indeterminacy in language (more particularly the English language) as an instrument for the conveyance of ideas and hence in any expression of rules or principles; and

20 A Mason, "The Use and Abuse of Precedent" (1988) 4 Australian Bar Review 93, 111. This view is also reflected in the general reasoning of the High Court of Australia in Western Australia v Commonwealth (1975) 134 CLR 201, and in John v FC of T 89 ATC 4101.
21 OECD Committee on Fiscal Affairs, Taxpayers' Rights and Obligations: A Survey of the Legal Situation in the OECD Countries (1990) 12 ("OECD Committee").
22 Ibid.
resort to generalised and broad terms and principles is arguably unavoidable because of the unforeseeability and unpredictability of factual circumstances that call for the application of taxation laws and the complexity of the subject matter with which they deal.\textsuperscript{24}

It therefore follows that the critical question is whether the Act or the legislature has provided standards or rules that can be identified, defined and consistently applied to a broad range of circumstances. Whilst it may be impossible to foresee and anticipate all possible factual combinations, a standard or rule can produce a relatively high degree of certainty where it provides a coherent and intelligible principle that spells out and defines the limits of its practical operation.

There is a point at which a purported law is so uncertain and devoid of meaning that it ceases to promulgate a coherent and discernible standard or rule to guide and define its operation. In such circumstances, particularly where the legislature has vested plenary discretionary power in the relevant administering authority to do whatever it considers reasonable in the circumstances, that law fails to prescribe the limits of its operation and arguably loses or never acquires the character of law.

In circumstances of conceptual uncertainty or uncertainty of the relevant guiding principle, differences in the emphasis, characterisation or evaluation of facts and in values could increase the likelihood of variations in decisions and conclusions. This proposition is supported by the history of the former general anti avoidance provision in s 260 of the Act,\textsuperscript{25} which was drafted in extremely broad and generalised terms and as such did not define the limits of its operation. Changes in the composition of the High Court significantly affected its scope and there were occasions where differences in factual emphasis led to differences in results.

To promulgate a prohibition or restriction in terms that are uncertain in the sense described below communicates less information than more precise forms of communication. Such form of communication, if constitutionally valid, leaves significant scope for and encourages policy development by the courts. It is an ordinary incident of the judicial function to ascertain the meaning of the relevant statute and determine its applicability to the facts in issue. In discharging that function, judges are vested with the power and are obliged to make a decision on the facts. In order to promote certainty and predictability in decisions and the law, common law courts relied on the doctrine of precedent which requires judges to provide reasons for their decisions to guide and enable other courts to discern some principle or rule for application in similar cases.

In circumstances where a general standard or provision fails to prescribe a clear and coherent rule, courts would, in discharging their function, seek to gradually define its requirements and parameters with a view to developing a rule or principle that provides for certainty and predictability in future determinations. This is an inevitable and unavoidable aspect of common law systems where greater emphasis is placed upon the certainty and predictability of law. In this regard, in the Australian context, there is a degree of tension between the ordinary operation of the judicial process and the need for generality in terms and principle in the design and drafting of general anti avoidance provisions in order to deal with unforeseeable tax


\textsuperscript{25} And its New Zealand counterpart in the Land and Income Tax Act 1954 (NZ), s 108.
That characteristic arguably explains the complete emasculation of former s 260. It was enacted in extremely broad terms that, if given literal effect, could have applied to a wide range of situations which, on a realistic view of the Act, the legislature could not have intended. High Court decisions gradually defined the scope of the provision in a manner that produced certainty but deprived it of any significant practical operation.

Where the courts are called upon to add content to and define the parameters of a general anti-avoidance provision there is much scope for variation over time as the composition of the court changes and the operation of the judicial process defines its inner and outer limits. To the extent that a general anti-avoidance provision operates to impose liability to taxation in circumstances where such liability does not or ought not exist, it is not for the courts to ascribe such content by determining by whom and the circumstances in which taxation is payable. Such a determination is essentially political in character and should be made within the democratic process by the legislature which is answerable to the general body of voters. This poses a question as to how is that different from other cases?

Where a provision prescribes a general principle and policy that defines and guides its application, the courts proceed to determine the meaning of that provision by reference to such a policy and then apply it to the facts in issue. That does not mean that the courts are imposing liability, rather they are merely facilitating the process of the imposition of such liability by Parliament. Where a provision fails to disclose a principle or policy to guide and determine the circumstances to which it applies, then there must be an expectation that the courts should give content to such a provision and determine the policy that guides its application. In such circumstances, in imposing liability to taxation, the courts will in effect exceed their function.

There is no generally accepted standard or benchmark by reference to which the degree of certainty can be determined. Certainty is a matter of impression and degree, and the point at which the degree of uncertainty reaches a level that can be described as “unacceptable” involves value judgments that can produce diametrically opposed conclusions. Further, judgments as to whether and the extent to which a particular principle is uncertain involves a degree of subjectivity such that there is much scope for reasonable disagreement on the issue.

26 In Australia certainty of taxation laws is an essential element of the constitutional concept of tax. The High Court distinguished a tax in the constitutional sense from an arbitrary exaction and insisted that to be treated as a tax the liability to pay must be imposed by reference to ascertainable criteria with sufficiently general application and not as a result of some administrative decision based upon individual preference unrelated to any test laid down in the Act: DFC of T v Truhold Benefit Pty Ltd 85 ATC 4298, 4301 (per Gibbs CJ, Mason, Wilson, Deane and Dawson JJ). In this respect an uncertain impost is not a law with respect to the subject matter of the taxation power under s 51(ii) of the Commonwealth Constitution. This point is made only for the purpose of highlighting the views of the High Court on the need for certainty in taxation laws and is not intended to show or argue that Pt IVA is unconstitutional. Nevertheless, the High Court has been tolerant of significant uncertainty in taxation matters. In Hepples v FC of T 91 ATC 4808, the Court considered the meaning and ambit of ss 160M(6) and (7) of the Income Tax Assessment Act 1936 (Cth) in their previous form. Various members of the Court made comments on the ambiguity of the provisions concerned. Mason CJ (at 4810) described the provisions as "extraordinarily complex" and noted that "they must be obscure, if not bewildering, both to the taxpayer who seeks to determine his or her liability to capital gains tax by reference to them and to the lawyer who is called upon to interpret them". Similarly, McHugh J said (at 4839) that one reading of the former s 160M(6) was sufficient to confirm the statement of Hill J in FC of T v Cooling 90 ATC 4472, that the subsection "is drafted with such obscurity that even those used to interpreting the utterances of the Delphic oracle might falter in seeking to elicit a sensible meaning from its terms".

27 For example, in dealing with the distinction between expenditure on revenue account and outgoings of capital, Lord Green MR commented that "in many cases it is almost true to say that a spin of the coin would decide the matter almost as satisfactorily as an attempt to find reasons": IR Commrs v British Salmond Aero Engines Ltd [1938] 2 KB 482, 488. In contrast Dixon J of the Australian High Court, considered the distinction and found that it is not so uncertain and indefinite as to remove the matter from the operation of reason and place it exclusively within that of chance: Hallstroms Pty Ltd v FC of T (1946) 72 CLR 634, 646.
Although there is no generally accepted benchmark by reference to which the degree of uncertainty can be measured, the concept essentially refers to circumstances where the relevant law fails to provide a coherent, intelligible and ascertainable rule or standard that prescribes and defines the limits of its theoretical and practical operation. In this sense, uncertainty has both a theoretical dimension which looks to the meaning of a provision and a practical dimension which looks to the manner and predictability of the application of the provision to particular circumstances.

It follows that Pt IVA, is for the purposes of this article, considered to be uncertain because:

- it does not disclose a principle or standard that focuses and targets its operation to incidents and circumstances intended by the legislature;
- more than one conclusion is reasonably open or justified on the facts to which it applies; and
- its actual operation does not always run in tandem with its express terms.

The lack of principle or rule to guide and target the operation of Pt IVA to the specific and particular transactions that the legislature intended leaves much scope for uncertainty as to liability. Such lack of principle creates a real potential for inconsistency between the findings of the High Court and those of the Federal Court in *Spotless*.  

This is particularly problematic because, under the present system of self assessment in Australia, taxpayers are required to determine their own liability to taxation and in this sense interpret and apply relevant taxation provisions to their state of affairs. Failure to correctly determine such liability can result in serious consequences in terms of penalties and failure of the relevant actual or contemplated transaction. The presence of Pt IVA complicates the process of the determination of liability to taxation and, to the extent that it does not disclose a coherent principle, it provides significant scope for commercial uncertainty.

In this context, it should be noted that the rulings system provides scope for taxpayers to ascertain the Commissioner’s view as to whether Pt IVA applies to their actual or contemplated arrangement but does not resolve the question of what the law is. In other words, there is no necessary coincidence between what the Commissioner considers the law to be and what the law actually is. Rulings are often relied upon as a matter of course and treated as law, particularly by taxpayers and advisers who are not properly trained in statutory interpretation and those with limited financial and practical means to ascertain the law. In this sense, the system of rulings itself undermines the rule of law.

**4.2 The Rule of Law**

As a general expression of principle, Pt IVA provides scope for discretionary application and hence arbitrariness. To the extent it does not disclose a coherent rule or standard there is scope for uncertainty in determining the manner and circumstances in which it is intended to apply and there is a corresponding widening of the discretionary element that inheres in its administration by the Commissioner. Both uncertainty in the terms of Pt IVA and the extent to which its operation is predicated on the

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28 96 ATC 5201; 95 ATC 4775.
exercise of discretion by the Commissioner have consequences on the rule of law.

The rule of law is one of the most fundamental principles that guides and underpins the very system of government and law in Australia. It is a highly textured concept or expression that imports and lends itself to extremely wide interpretations. As a concept it has a chameleon like quality in the sense that it has a changing and shifting content and meaning. The origin of the rule of law has been traced back to Aristotle and its influence manifested in the Magna Carta and the American Declaration of Independence. It has been observed that much of administrative law is a by product of the rule of law.

The very concept of the rule of law was born out of distrust of discretionary or arbitrary power. The principle seeks to elevate the law above all social institutions including Parliament, the executive and the courts and hence the principle has alternatively been described as predominance or supremacy of law. It is generally accepted that the rule of law serves to underpin and further democratic principles. In that regard, it has been observed that every truly democratic system of government rests upon the rule of law, and no system is truly democratic if it does not.

Brennan J explained that the essence of judicial review lies in the enforcement of the rule of law over executive action where executive action is prevented from exceeding the powers and functions assigned to the executive by law. The High Court has accepted that the Australian system of governance is government under the Constitution. That Constitution is an instrument framed in accordance with many traditional conceptions, among those the rule of law forms an assumption.

There is no single formulation or conception of the rule of law. However, alternative formulations have identified a number of essential characteristics of the principle. The first formulation postulates that the rule of law refers to equality before the law. That is the subjection of every person and institution to the laws of the land administered by the ordinary courts. In this sense the law is supreme over all and everything must be done according to law such that powers exercised by officials must be authorised by and have legitimate foundations in law.

The second formulation is essentially a derivative of the first. The rule of law is taken to refer to the absence of arbitrary or wide discretionary power or authority on the part of the government or its officials. It will be noted that the first character-

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31 Re Buchanan (1964) 65 SR(NSW) 9, 10. See also X v Morgan-Grampian (Publishers) Ltd [1991] 1 AC 1, 49 (per Lord Bridge) and Independent Commission Against Corruption v Cornwall (1993) 116 ALR 97, 128-130.
32 Church of Scientology v Woodward (1982) 154 CLR 25, 70 (per Gibbs CJ, Mason, Brennan, Murphy and Aickin JJ).
33 Australian Communist Party v Commonwealth (1951) 83 CLR 1, 193 (per Dixon J). Alternatively the rule of law has been seen as a more direct implication from Chapter III of the Federal Constitution; see for example the comments of Murphy J in McGrav-Hind (Aust) Pty Ltd v Smith (1979) 144 CLR 633, 670; and those of Brennan, Deane and Dawson JJ in Lim v Minister for Immigration (1992) 176 CLR 1, 27-29. See also the comments of the Canadian Supreme Court in Re: Manitoba Language Rights [1985] 1 SCR 721("Manitoba"). There the Court adopted a similar approach and found that the rule of law is a fundamental postulate of the Canadian constitutional structure because "the Constitution, as the supreme law, must be understood as a purposive ordering of social relations providing a basis upon which an actual order of positive laws can be brought into existence. The founders of this nation must have intended, as one of the basic principles of nation building, that Canada be a society of legal order and normative structure: one governed by the rule of law. While this is not set out in a specific provision, the principle of the rule of law is clearly a principle of our Constitution" ([1985] 1 SCR 721, 750-751). Similar comments were made in the context of the United Kingdom. For example, Lord Diplock described the rule of law as a constitutional principle in Black-Clawson Ltd v Papierwerke AG [1975] AC 591, 638; cited in Corporate Affairs Commission of NSW v Yull (1991) 172 CLR 319, 346 (per McHugh J). For other references, see Wade and Forsyth, above n 30, ch 2 and AV Dicey, Introduction to the Study of the Law of the Constitution (10th ed, 1965) ch IV.
istic essentially precludes the existence and influence of arbitrary power and wide discretionary authority on the part of the government and its officials.\textsuperscript{35}

The third formulation is that identified by de Smith who suggested that the law should conform to certain minimum standards of justice, both substantive and procedural.\textsuperscript{36} Such standards predicate:

- that the law affecting individual liberty ought to be reasonably certain or predictable;
- where the law confers wide discretionary powers there should be adequate safeguards against their abuse;
- like should be treated alike; and
- persons ought not be deprived of their liberty, status or any other substantial interest unless they are given the opportunity of a fair hearing before an impartial tribunal.

This proposition and its manifestations seek to emphasise the significance of certainty of the law in the sense of the subjection of citizens only to known or ascertainable legal rules.\textsuperscript{37}

The concept of the rule of law presupposes a coherent system of rules and principles that defines and distinguishes the rights and obligations of its subjects.

From the foregoing formulations of the principle of the rule of law, it is reasonable to conclude that there is a necessary antithesis between the rule of law and arbitrary power or authority; and there is a necessary positive relationship between uncertainty and arbitrariness. In this sense certainty of the law constitutes the essence of the rule of law.

In relation to Pt IVA, whilst it may not be possible to say that it is unconstitutional, there are reasonable and sufficient grounds for the conclusion that its presence in the Act undermines the rule of law because:

- it does not disclose a coherent rule or principle that facilitates certainty and consistency in its operation; and
- in its practical operation, it confers broad discretionary power upon the Commissioner to determine the circumstances which call for its application.

The presence of uncertainty in the Act by reason of Pt IVA means that taxpayers will not be able to determine their liability to taxation under the relevant tax law. Moreover, the potential for inconsistency in the operation of the Act and the attachment of liability to taxation under it means that taxpayers in same or similar circumstances would be treated differently thereby undermining the principle of equality before the law.

\textsuperscript{35} This aspect of the rule of law is no longer adhered to strictly because discretionary power is recognised as an essential and ordinary incident of modern government. Courts in common law countries have developed an elaborate system of administrative law to control the conferment and exercise of discretionary power. Essentially such principles seek to ensure that power is conferred and exercised according to procedures, principles and constraints contained in the law and that affected citizens are free to seek redress. Examples of such principles include the creation of a series of requirements which condition the exercise of discretionary power such as reasonableness and natural justice. Much of the development of administrative law reflects a judicial recognition that Parliament has become a less effective instrument to hold the executive accountable: \textit{R v Toohey: Ex Parte Northern Land Council} (1981) 151 CLR 170, 222 (per Mason J).


\textsuperscript{37} Nitikman, above n 34, 1426.
4.3 Right or Freedom to Plan

In Australia and other common law countries, there is universal judicial recognition of a right in taxpayers to arrange and conduct their affairs in a manner that minimises or eliminates their exposure or liability to taxation. In the context of corporations, the law imposes an obligation upon the directors to act in the best interests of the company. That arguably includes an obligation to conduct the affairs of the company in a way that minimises its liability to taxation. The nature and extent of such a right is necessarily defined by law which may include a general anti avoidance provision like Pt IVA. The words right or freedom are open textured concepts with descriptive and normative dimensions. Disagreement as to their meaning and content is not limited to different readings of evidence within generally accepted systems of values, rather it extends to and is the product of fundamental difference in values, ethics, morality and ideology.

The legal notion of rights is considered to form one of the sub-classes of legal advantages, the others being liberties and powers. The three advantages correspond to the three legal burdens of duty, disability and liability. Williams defined the concept of legal liberty as an occasion on which an act or omission is not a breach of duty. In this sense liberty is simply the absence of a duty to act otherwise. It follows that almost every act is the exercise of a liberty and there can be a liberty to perform a legal duty. The Carter Commission expressed similar views on rights and obligations and said that while laws generally restrict the freedom of individuals by imposing sanctions on certain courses of action, they indirectly define the liberty of individuals. In this sense the individual is at liberty to do without hindrance that which is not proscribed by law.

In this sense, there is a correlation between rights or liberties and obligations or duties because a liberty exists and is defined by reference to the presence or absence (and the extent) of relevant obligations. The presence of taxation creates an obligation upon persons to make certain transfers of property to the State. In the absence of taxation, persons are free to derive any form of income or engage in any form of transaction without risking exposure to taxation. The imposition of taxation limits that freedom by prescribing a set of conditions that, if and when satisfied, expose the relevant taxpayer to taxation. In this respect the taxation legislation imposes a positive duty in prescribed

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38 Examples include: Jaques v FC of T (1923-1924) 34 CLR 328; IRC v Duke of Westminster [1936] AC 1; Cridland v FC of T 77 ATC 4538, 4539 (per Mason J); FC of T v Gulland; Watson v FC of T; Pincus v FC of T 85 ATC 4765, 4777 (per Brennan J); FC of T v Westraders Pty Ltd 80 ATC 4357, 4358 (per Barwick CJ); Gregory v Helvering (1935) 293 US 465; WT Ramsay Ltd v IRC [1982] AC 300, 323 (per Wilberforce LJ); Sturart Investments Ltd v The Queen (1984) 10 DLR (4th) 1; Carter Commission, above n 23, Vol.3, 541; Royal Commission on the Taxation of Profits and Income, Final Report (1955) para 1017 ("Radcliffe Commission").

39 This point was made by Lord Fraser in IRC v Burmah Oil Co Ltd [1982] STC 30. In that case his Lordship said that "it was the duty of Burmah's directors to take such lawful steps as were open to them to minimise the impact of the tax on the company's profits" ([1982] STC 30, 37).

40 It is not possible nor necessary to examine fully the nature and content of the terms right and freedom. It is sufficient for the purposes of this article to simply identify some of the leading conceptions of the terms in question so as to be able to recognise the nature of the right to plan in Australia and to draw conclusions as to the impact of Pt IVA upon it. For examples of writings that deal with the various dimensions of these concepts see: G Williams, "The Concept of Legal Liberty" (1956) 56 Columbia Law Review 1129; HLA Hart, "Between Utility and Rights" (1979) 79 Columbia Law Review 828; J Rawls, "The Priority of Rights and Ideas of the Good" (1988) 17 Philosophy & Public Affairs 251.

41 R Scruton, A Dictionary of Political Thought (1983).

42 Williams, above n 40, 1139. He argued (at 1142) that although the concept of right and freedom are used interchangeably, there is some difference between the two in that right "conjures up the idea of something that can be insisted on, whereas a liberty is purely a negative expression". There is no reason in principle or logic why the inverse is not true because the presence of legally recognised rights necessarily defines the nature and extent of obligations as in the case of constitutionally entrenched rights.

43 Carter Commission, above n 23, 14.

44 The idea that persons are free to engage in any conduct that is not proscribed by law without any penalty is not foreign to common law systems of law in that much of the criminal and civil law is predicated upon such a principle. For example in tort law it is generally accepted and recognised that, unless there is some antecedent express or implied positive obligation to do so, there is no obligation to render assistance to others. Lack of such an obligation creates a right or liberty not to render assistance.
circumstances. Outside the circumstances prescribed by the legislation taxpayers are a fortiori free to conduct their affairs without tax consequences.

In Australia, the Income Tax Assessment Act 1936 (Cth) and the Income Tax Assessment Act 1997 (Cth) prescribe conditions and set out objective criteria that, if and when satisfied, attach and impose liability to taxation. In this respect, the Acts set out and define the parameters of liability to taxation, and the relevant acts, circumstances or events that fall outside their limits must be free from taxation. On this reasoning taxpayers are free to choose courses of action that minimise their liability to taxation. That right or freedom exists only to the extent that the legislation does not impose a positive requirement upon the taxpayer to maximise his/her liability to taxation. Where such an obligation exists then either the relevant right or freedom is eliminated or it is reduced to a point where it has no practical significance.45

Such a positive obligation would be contrary to equity because taxpayers will be fixed to their particular circumstances and will be taxed on what they could have returned in the way of income rather than on what they actually have returned. Further, there will be significant administrative problems in determining and assessing the maximum hypothetical liability that each taxpayer could have incurred in his/her particular and specific circumstances. It is therefore not surprising that no known system has ever adopted that option. This explains the recognition and acceptance by the Australian High Court of the choice principle in their decisions pertaining to the operation of former s 260 of the Act. That principle essentially asserts that the presence of choices within the Act “ipso facto” entails a right to exercise same.

The exercise of such a right is necessarily conditioned and defined by parameters and guidelines set by law which may include a general anti avoidance provision like Pt IVA. Since the ability of taxpayers to exercise their right to minimise their liability to taxation primarily depends on the extent to which the operation of the taxation law (and more particularly Pt IVA) is predictable and determinable, any uncertainty in the process of determination of liability to taxation consequent upon the operation of Pt IVA necessarily translates into uncertainty as to the extent and circumstances in which taxpayers are able to exercise such a right.46

In addition to equity and administrative necessity, there are other policy considerations that justify the recognition of such a right. In a system that embraces the market mechanism as the appropriate mechanism to effect the allocation of national resource, there is an implied acceptance that individuals are better able to judge what is in their best interests and the optimal way of organising their affairs. It follows that the complete negation of a right to choose amongst alternative courses of action would be inconsistent with the nature of the political and economic order to which Australia ascribes.

The other option of limiting such a right by means of Pt IVA may be an attractive alternative that may serve to raise revenue. However, its impact upon liability to taxation may create an element of uncertainty in so far as the ability of taxpayers to choose amongst alternative courses of action is concerned. That could deter taxpayers from engaging in conduct that can be economically beneficial and in this sense have both equitable and efficiency consequences.

A more compelling policy consideration is that

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45 It will be noted that the presence of general anti avoidance provisions like Pt IVA in a system that imposes such a positive obligation creates as much uncertainty as to liability to taxation as a system that gives taxpayers a right to minimise because in both instances taxpayers have to determine their liability to taxation and to the extent that such a provision impacts on the certainty of that process there will be problems in determining what the minimum or maximum liability to taxation may be.

46 The above arguments do not only comprehend the right to choose amongst alternative courses of action that are available under the relevant Act, but also extend to a choice of the form of transaction or arrangement because in the same way it can be argued that unless Parliament creates an obligation to adopt a particular form then taxpayers must be free to choose the particular form which, in their view, is most suitable.
put forward by the OECD Committee on Fiscal Affairs. The Committee noted that taxpayers’ rights should be seen in the broader context of human rights and the international obligations that most countries have entered into. The Committee noted a number of basic principles which apply to the protection of taxpayers including the right to pay no more than the correct amount of tax, and added that taxpayers should pay no more tax than is required by the tax legislation. The Committee noted, however, that whilst it is acceptable to reduce tax liability by legitimate tax planning, it is essential to distinguish between this form of tax planning and other forms of tax minimisation which go against the intent of the legislature.47

On this reasoning taxpayers have a right to reduce their liability to taxation by legitimate means provided that the manner and circumstances in which it is done do not undermine the intent or policy of the Act.

As a result of the presence of Pt IVA in the Act, taxpayers are unable to determine with any reasonable degree of certainty their true liability to taxation and any decision on the application of the part to their actual or contemplated arrangement carries a significant risk of penalty if subsequently found to be wrong. As such, Pt IVA undermines the ability of taxpayers to determine their true and correct liability to taxation and in this sense limits their ability to minimise such liability.

4.4 Equity

Equity has been regarded as the traditional normative standard to be applied in the evaluation of the structure and operation of the tax system and its particular incidents that reduce or limit the exposure of taxpayers to such liability like exemptions, deductions, rebates and credits. The influence of equity theory is manifested in a range of tax characteristics, examples of which include the progressive rate structure of taxation, the extension of the tax base to include fringe benefits and capital gains, and the grant of specific deductions, credits and rebates to particular taxpayers in prescribed circumstances.

As a standard, equity commands wide support.48 The principal policy justification for the pursuit of equity in the design and structure of the tax system is that an equitable tax structure strengthens confidence in and stability of the social and political system.49 It has been argued that fairness is a desirable characteristic of taxes because, apart from the ethical desirability of equity, there is the practical need for taxes to be acceptable to the tax-paying public. If taxes are generally perceived to be inequitable the consequences may range from widespread evasion to revolution.50

The concept of equity is exceedingly difficult to define and harder still to measure. Meanings assigned to equity often reflect conflicting value systems, perceptions and expectations. There is, however, general consensus that the concept of equity has two dimensions. The horizontal dimension, namely “horizontal equity”, predicates that persons in similar or equal economic circumstances should be treated similarly or equally; and the vertical dimension, namely “vertical equity”, affirms that persons in different situations should be treated differently - those more favourably placed should bear a more appropriate share of the burden.51

The nature of the concept of equity and its

47 OECD Committee, above n 21, 10 and 12.
50 Allan, above n 48, 36.
51 Asprey Committee, above n 23, 12; White Paper, above n 48, 14.
employment as a standard raises a number of issues in relation to its measurement and priority over other conflicting objectives of taxation. There is much disagreement as to the criteria, weight and factors which must be considered in determining when are taxpayers in similar economic circumstances. Basically both dimensions or descriptions draw on and reflect the ability to pay principle, which in itself has serious practical and theoretical deficiencies.

It is recognised that the tax system as a whole is a reflection of a range of compromises and equity is but one of the considerations which must be balanced against other competing considerations. For this reason it is incorrect to describe any system as equitable or inequitable, rather a system may have equitable and inequitable characteristics and on balance may be more or less equitable than another system. In this sense equity is a relative concept, and at any point in time, any system has its own peculiar form of equity created by the legislature which has determined to impose liability upon particular taxpayers in a broad range of circumstances and to subject such liability to a range of concessions, exemptions and qualifications.

That being the case, the operation of Pt IVA should be adjudged against the broad objective of equity and against the particular equity of the system. To the extent that taxpayers are unable to take advantage of opportunities offered by the Act to minimise their liability to taxation, they are paying more tax than is otherwise due and payable under the proper application of the law. In this sense, Pt IVA operates to produce, in certain circumstances, a result where the incidence to taxation falls otherwise than as the legislature intended.

Further, any inconsistency in the application of Pt IVA means that persons in similar or equal economic circumstances are not necessarily treated similarly or equally; and persons in different situations are not necessarily treated differently. In this way, Pt IVA undermines the broader principle of equity and the specific equity of the system.

4.5 Efficiency or Neutrality

Efficiency or neutrality is also a widely accepted criterion or standard by which the operation of a particular tax or tax system is judged. Assuming some degree of elasticity in demand, any significant tax will have the effect, to some extent, of discouraging the activity upon which it is imposed. Efficiency as a criterion requires that the tax system should not influence economic choices, and in this sense, as far as possible, have a neutral effect on economic decisions. Another aspect of efficiency is that compliance and administration costs of tax laws constitute “dead weight” losses to the economy and as such should be minimised.

Efficiency assumes that non-neutrality in the operation of taxation laws corresponds with a reduction in the real income of society. In other words, it assumes that any distortion in resource

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53 Asprey Committee, above n 23, 12-15; Carter Commission, above n 23, ch 7. There is much support for the use of the notion of income as a measure of ability to pay. It has, however, been difficult to define the nature of income and the particular characteristics of receipts which it comprehends.

54 See, for example, the references for the criterion of equity.
allocation guided and controlled by the market and the price mechanism reduces efficiency which in turn means that society is not maximising the returns from the use of its resources. This further assumes that national welfare is better served by maximising output rather than by some other criteria that looks to the specific and particular needs and wants of society and the individual. In this sense, this criterion looks to national gains rather than the fairness of the distribution of such gains.

This criterion is relevant to conclusions as to the need for or desirability of Pt IVA in that it requires an evaluation of:

- the relative effects of any uncertainty and/or deterrent effect of the part upon business or economic decision making; and
- the costs to taxpayers of compliance with the requirements of the part and their administration by the revenue authority.

There will necessarily be both equitable and efficiency consequences to the extent that Pt IVA:

- operates upon and by reference to unforeseeable arrangements;
- produces unpredictable results;
- applies to situations not within its original scope; or
- deters legitimate activity.

The principal policy justification in favour of using efficiency as a criterion is that efficiency promotes better use of national resources and increases national output and wealth. Efficiency links with equity in that output gains should be distributed equitably. Moreover, non-neutrality leads to disparate treatment of different groups of taxpayers thereby having negative consequences on the equity of the system.

The lack of principle and inability of taxpayers and the Commissioner to determine liability to taxation in particular circumstances could deter conduct that is economically beneficial and promote conduct that is not the most efficient in the circumstances. In order to avoid a dispute with the Commissioner, many taxpayers may opt for a safe harbour of transactions, being transactions which have traditionally been permitted or prevalent or transactions which the Commissioner indicated would not be impugned.

Other taxpayers may choose to bear the risk of uncertainty as to the taxation consequences of their transactions and factor that risk into their transactions. In this sense, Pt IVA can deter commercially innovative transactions which evolve to service new commercial and economic development. All these factors combine to create a situation that is conducive of inefficiency and non-neutrality.

5. CONCLUSIONS

This article identifies a conceptual flaw in Pt IVA as a general expression of principle directed at tax avoidance. That flaw is that it does not provide a reasonably coherent and discernible rule that guides and defines its operation. It was established that this undermines broadly accepted principles of law and taxation. More particularly it creates a significant element of uncertainty in the operation of the Act as a whole.

Unquestionably, the notion of certainty is relative and calls for the evaluation of a range of matters and the development of some standard or benchmark by reference to which the extent of uncertainty is measured. However, the legislature may determine that the level of uncertainty and the other consequences that flow from the presence of Pt IVA in the Act are not such as to justify its rejection as an instrument to combat the problem of tax avoidance.

Where there is no alternative solution to the problem of tax avoidance, then the legislature may have no choice but to adopt some form of a general anti avoidance provision. However, it is
submitted that the principle enunciated by the High Court in *Cooper Brookes (Wollongong) Pty Ltd v FC of T*, which looks to the purpose and policy of the Act as a guide to its meaning, provides a more coherent approach which, on balance, is more likely to produce results that are consistent with legislative intention. Where the ordinary and charging provisions operate as intended, there can be no tax avoidance and no policy justification for the application of a general anti avoidance provision like Pt IVA.

It is recognised that the search for the purpose and policy of the Act may create significant difficulties because revenue legislation does not necessarily have a totally coherent scheme, pattern and discernible objectives and policies. This would necessarily cause problems in the determination of the meaning of the relevant provisions and the circumstances that justify or call for their application. Nevertheless, the approach that seeks to discern the purpose and policy of the Act is on balance more likely to lead to a solution to the problem of tax avoidance that best reflects the intention of Parliament as expressed in the statute.

Necessarily, the determination of the purpose and policy of the Act and its particular provisions can be achieved more effectively where each group of provisions directed at particular purposes and policies are preceded by a clear expression of such objectives and policies by reference to which they can be interpreted and applied. This approach does not only clarify legislative intention in relation to the particular set or group of provisions but also encourages a more purposive and less literal approach to the interpretation of income tax legislation.

To that end, it is submitted that a general expression of policy and purpose in relation to the whole Act would be less effective in terms of its ability to achieve the objectives of clarity and certainty because often income tax legislation seeks to give effect to inconsistent and conflicting objectives which cannot be accommodated by a general expression of purpose and policy. Further, even where the objectives of the Act are consistent, in view of the variety of the subject matter with which the Act deals, it will necessarily call for a highly generalised expression of purpose and policy which would require focusing in particular circumstances and hence may not achieve the clarity and certainty hoped for.

Moreover, the terms and scheme of the income tax legislation can be simplified and streamlined. That further clarifies the objectives and policies of the legislature and creates a system that encourages an approach to statutory interpretation that places a provision within its broader context and so preserves the integrity of the whole legislation. The complete re-write of the Australian income tax legislation could arguably further that objective.

In addition to the above measures which are designed to clarify the meaning and application of the tax legislation, the legislature could implement measures that actually reduce the opportunities and incentives for tax avoidance. Such measures include:

- The removal of the sources of tax avoidance rather than the enactment of provisions to deal with vague and unforeseeable expectations of how specific and particular provisions may be exploited. Examples of this kind of a response include the enactment of appropriate provisions to deal with the taxation of fringe benefits, capital gains and controlled foreign corporations.
- Structural reform which may include a serious consideration of a broad based consumption tax and other forms of taxation. The introduction of other forms of taxation arguably reduces opportunities for tax avoidance and removes excessive reliance on income taxation.
which reliance increases the amount of tax chargeable and hence the incentive to avoid it.

Income tax legislation is no longer a simple device employed to raise revenue to meet the costs of governing the community. Income tax legislation is also employed by governments to give effect to and attain selected economic and social policy objectives. Thus, the statute is a mix of fiscal, social and economic policy objectives. Such policy measures can include tax expenditures of various kinds, incentives and penalties designed to transfer income, encourage or discourage, or redirect specific and particular activities.

To give effect to such policies often requires lengthy and complicated provisions designed to target the intended taxpayers or activity. It is submitted that a consideration of alternative taxation measures to give effect to such policies would necessarily reduce the need for such provisions. For example, the use of tax expenditures and concessions can be replaced in whole or part by appropriate transfer payments through the social security system and where industry is concerned some other organisation can be used to assess and target such benefits in a way that gives effect to the specific purposes and policies of the legislature.

It is submitted that, irrespective of whether these measures are adopted, an interpretative technique which provides a means of applying the tax legislation so as to affect only the conduct of taxpayers which has the designed effect of defeating the intention and policies of the legislature would promote rather than interfere with the proper administration and objectives of the legislation. In this way, such an approach provides a better solution to the problem of tax avoidance than that provided in Pt IVA. However, where the above suggestions are adopted, the purpose and policy approach can more effectively achieve consistency and certainty in the operation of the legislation and preserve the integrity of the legislation.

Therefore, it is submitted that there are sound policy bases for a shift away from reliance upon general anti avoidance provisions to a more focused and comprehensive response to the problem of tax avoidance. That combined with a more purposive and substantive approach to statutory interpretation would render measures like Pt IVA redundant.

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