

The article provides discussion on whether there is a higher level of likelihood that a mass marketed scheme may be captured by the application of the general anti-avoidance rules and identifies the features of a mass marketed scheme that may make them more likely to be impacted by those rules.

Part IVA and mass marketed schemes

INTRODUCTION

Mass marketed tax schemes have been on the radar of the *Australian Tax Office* in recent years.¹ Typically these schemes were sold by way of prospectuses (and excluded offers) and have included financing, agriculture, entertainment and franchise schemes. The primary question addressed in this article is whether because of their characteristics mass marketed schemes are likely to come within the ambit of the general tax anti-avoidance rules.²

According to Kotler,³ in mass marketing, the seller engages in the mass production, mass distribution and mass promotion of one product for all buyers. In its broadest sense mass marketing is the provision of one standardised (undifferentiated) marketing mix, whereby one product, pricing, promotional and distribution strategy is used for the total market. The concept of mass marketing appears to suggest that the relevant scheme is marketed to the public at large but like any mass promotion of products or services there is no guarantee that there will be a large demand for the product or service being promoted. It is noted that while an undifferentiated product is being promoted in a mass marketed scheme the taxpayers

involved in the relevant schemes may choose to have a smaller or larger involvement or investment in the scheme.

MASS MARKETED SCHEME CASES

Having identified the meaning of “mass marketing” it is then necessary to determine which tax related schemes are mass marketed. The Australian Tax Office⁴ has published a list of six investment scheme cases that it considers to be mass marketed.⁵ In five of the cases the Courts confirmed the Commissioner’s view that the deductions were not allowable. The five cases are as follows:

- *Federal Commissioner of Taxation v Sleight* [2004] FCAFC 94
- *Puzey v Federal Commissioner of Taxation* [2003] FCAFC 197
- *Krampel Newman Partners Pty Ltd v Federal Commissioner of Taxation* [2003] FCA 123
- *Vincent v Federal Commissioner of Taxation* [2002] FCAFC 291
- *Howland-Rose and Ors v Federal Commissioner of Taxation* [2002] FCA 246

In each of these cases the particular scheme was promoted widely through promotional

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material including the use of prospectuses and in most cases the number of taxpayers involved was substantial.

In Sleight's case the investment involved the cultivation and maintenance of a tea-tree farm for the purpose of producing and selling tea-tree oil and there were over 700 investors involved. The taxpayer made the investment after visiting the plantation site and reading the prospectus for the project. The prospectus clearly set out the tax effective nature of the investment.

In the Puzey case the investment was for the purpose of producing timber from a sandalwood plantation and there were over 300 investors involved. The taxpayer was aware at the time of making the investment that it was a "tax-effective investment".

In the Krampel Newman case, the scheme which related to the investment in films was essentially marketed or promoted by solicitors and accountants to their clients none of whom, on the evidence, had any particular interest in, or past experience of, producing or exploiting animated films. It is noted that the numbers of investors in this scheme was not large and the level of mass marketing of the relevant investment was not very extensive by comparison with the other mass marketed schemes considered in this article. For this reason this article does not discuss this case comprehensively.

In the Vincent case the taxpayer invested in a cattle breeding program under which she leased cows for the purpose of having them implanted with embryos and then selling the resultant calves. There were over 420 investors involved in the investment scheme.

In the Howland-Rose case the investment was for the purpose of conducting a business of manufacture and sale of specified tea tree oil products. However when the investment was made the activity was in the research and development phase and no income earning activity had commenced. There was a staggering 2,300 investors involved and the investment was made in accordance with a prospectus

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which indicated that the investment was a "tax-effective investment".

In addition to the cases of Sleight, Puzey, Vincent and Howland-Rose this article also discusses the case of *Federal Commissioner of Taxation v Hart & Anor* [2004] HCA 26; 2004 ATC 4599.

The rationale for including the Hart case in this article is based on the fact that the promotion of the split loan facility was performed in a mass marketed manner to unsophisticated investors. The taxpayers in that case borrowed funds from Austral which marketed a loan specifically for persons wishing to finance the acquisition of an income-producing asset and a private residence. In the Full Federal Court decision, Hill J set out the manner in which the split-loan facility was promoted.⁶

While they were looking at possible houses for purchase and use as a residence in place of the Jerrabomberra property they obtained from the office of a real estate agent a brochure produced by Austral Mortgage ("Austral") and advertising what the brochure referred to as "Wealth Optimiser". ... Wealth Optimiser was the name given by Austral to a financial product which it was promoting and which was said to be suitable for persons who wished to borrow money to be used both to purchase a residence and an investment property. ... A brochure they were given dwelt upon the tax advantages which it was said might accrue to borrowers.

It is evident from this quote that the brochure and information on the financing facility was freely available to any property investor with a private residence and a rental property. It is suggested that the vast majority of taxpayers investing in residential properties for income earning purposes also have a private residence. Accordingly an argument could be sustained that the split-loan facility was mass marketed to all potential property investors. It is noted that other financing facilities such as sale and leasebacks⁷ may be promoted by financial

institutions to businesses but it is considered that the promotion of these facilities is not undertaken in an undifferentiated manner and the target audience would mostly consist of sophisticated investors using professional financial and legal advisers.

This article derives its discussion and analysis from the five cases of Sleight, Puzey, Vincent, Howland-Rose and Hart as well as other established authorities on the application of the general anti avoidance rules.

OVERVIEW OF PART IVA

The general anti-avoidance provisions are contained in Part IVA of the *Income Tax Assessment Act 1936*.⁸ The relevant legislation is designed to ensure that Part IVA is a provision of "last resort" and that it only applies where all other specific provisions have been applied.⁹ In other words it will not apply where a transaction has been set aside by a specific anti-avoidance provision.¹⁰ In addition where a particular transaction is a sham¹¹ or has no legal effect there will be no need to apply the general anti-avoidance provisions as the transaction will be inherently ineffective. The general anti-avoidance rules commenced operation from 27 May 1981 and replaced previous rules contained in s 260.¹² Where Pt IVA applies, the Commissioner may cancel the relevant tax benefit and, in addition, impose penalty tax.

Part IVA applies where there is tax avoidance. Avoidance arrangements generally comply with the literal meaning of the law but exploit inconsistencies and anomalies and gain a tax benefit not intended by the legislation. It is noted that avoidance of tax is something less than evasion of tax. Evasion of tax is a deliberate overstatement of deductions or an understatement of income. The general anti-avoidance rules in Part IVA apply to

schemes entered into with the sole or dominant purpose of obtaining a tax benefit not intended by the legislation.

In essence there are a number of features that must be present for Part IVA to apply:

- There must be a scheme which is defined very broadly to include any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings and any scheme, plan, proposal, action, course of action or course of conduct, s 177A;
- There must be a tax benefit derived in connection with the scheme, s 177D. A tax benefit includes an amount not included in the assessable income of a taxpayer or a deduction being allowable to the taxpayer, s 177C;
- There must be a reasonable expectation that in the absence of the scheme the relevant tax benefit would not arise.¹³ This is what is called the “reasonable expectation test”,¹⁴ and
- There must be a dominant purpose to derive a tax benefit from the scheme, s 177D.

BLATANT, ARTIFICIAL, CONTRIVED

The Treasurer when introducing the Part IVA legislation stated the objective of the law or the policy underlying the law as follows:

.. Pt IVA is designed to operate against “blatant, artificial, or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs”.¹⁵

While the Treasurer’s comments are clear they are not automatically taken into account by the courts in interpreting the application of Part IVA because they do not form part of the actual legislation. However where the courts seek to determine the objective of Part IVA then ss 15AA and 15 AB of the *Acts Interpretation Act 1901*

provide that the courts can take into account other material such as the treasurer’s speeches when introducing the legislation to determine the objective of the legislation. This article will demonstrate from the language used by the courts that mass marketed schemes that are blatant, artificial or contrived are likely to be caught by Part IVA.

To adhere to the policy underlying Part IVA the Commissioner when issuing an amended assessment is unlikely to apply Part IVA unless he considers that a scheme is in some respect blatant, artificial or contrived. The question that could be posed is whether mass marketed schemes are more likely to be blatant, artificial or contrived. The fact that the schemes or arrangements are actively promoted to investors may suggest that the arrangements are to some extent blatant, artificial or contrived. While it is conceded that there is some commonality in the meaning of the three terms their recognition by the courts is now discussed separately.

Blatant

The term “blatant” is defined¹⁶ as an action that is flagrantly obvious or undisguised. It would include actions that are offensively conspicuous. Clearly if the promoter of a mass marketed scheme is marketing the scheme then the scheme would be by definition flagrantly obvious. The promotion of the scheme in association with identified tax advantages would also support a contention that the arrangement and associated tax benefits are undisguised. Hill J in *Sleight*¹⁷ made reference to the fact that the tax advantages were clearly set out in the prospectus, as follows:

In marketing the scheme to his clients Mr Sleight used a document that had been prepared by the management team of the Northern Rivers project for the purpose of supplying basic information to interested persons before the prospectus was

registered. That document, Mr Sleight agreed, emphasised the tax effectiveness of an investment in the project. The document, in describing the features of the project, referred to one as “Tax effective, tax effective, tax effective.” The emphasis is telling.

Hill J¹⁸ went on to identify a mini web of intrigue associated with the investment in mass marketed investments, as follows:

Nor was the particular investment the only investment of its kind undertaken by Mr Sleight. Mr Sleight’s tax return showed that he claimed deductions in the year of income for a very similar scheme with similar tax advantages, but this time involving cotton. ... It seems that some of the documents in the cotton scheme had been used in the present scheme with “cotton seed” crossed out and “tea tree seed” substituted. Mr Sleight was also involved in an investment involving cattle breeding being, as he agreed, “the transaction involved in the Vincent case”..

In their joint decision in *Puzey, Hill and Carr JJ* made it clear that they considered that the investment was a highly promoted tax scheme, as follows:¹⁹

...the promotional material explained that a participant would be able to obtain “tax refund”, sufficient to meet the payments required to obtain the seedlings for planting. It was sold by canvassers and others on behalf of the promoters as “tax effective”....

In *Vincent, Hill, Tamberlin and Hely JJ* identified that the scheme was highly publicised and that many parties were encouraged to invest:²⁰

The application to the Court was a test case in the sense that there were several hundred people who had in one way or another become involved with a cattle breeding project involving a number of companies associated with an accountant, ...

Similarly in *Howland Rose and Ors*²¹ the prospectus set out the tax and cash flow consequences of making an investment in the venture. While the prospectus stated

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Part IVA is designed to operate against blatant, artificial, or contrived arrangements

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that the tax benefits could not be guaranteed the illustrative tables used indicated that the investment would be cash flow positive from the tax savings alone.²²

The manner in which the prospectus in Hart identified the tax benefits could be viewed as very conspicuous. Comment on this matter was made by Gummow and Hayne JJ as follows:²³

Much of this material was tendered in evidence at trial. It included elaborately worked examples illustrating how quickly the home loan could be paid off and how large were the tax benefits which could be obtained.

It is clear from this quote and the earlier extracts that the tax benefits in the schemes were in no way disguised. In fact it could be suggested that the promotion of the tax benefits was done in a blatant manner by publicising those benefits to any participant who should wish to be involved.

Artificial

An "artificial"²⁴ transaction is one that is made by human skill and labour as opposed to something that occurs naturally. An artificial arrangement would include an arrangement that is an imitation of a real arrangement or a substitute for a real arrangement and may include a non-genuine transaction. Mass marketed schemes are more likely to be artificial where they seek to create investments or arrangements that may not otherwise exist. By comparison arrangements that occur normally in the course of a business or income earning activity may be less likely to be fabricated to achieve a tax benefit. The existence of artificial transactions was of concern to Hill J in Sleight as follows:²⁵

.. it should be noted that the financial structure that the management agreement, loan agreement and indemnity agreement created was not necessary to the success of a tea tree project. Presumably the promoters, for example,

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could have still received the same amount of return by limiting the first year management fee to the actual cash outlay of the investor, and then adjusting the management fee in subsequent years to achieve this result. Arguably, an investor would thus have a legitimate, albeit significantly reduced, tax deduction for his cash outlay because it was actually a necessary cost of the project. This fact points towards a dominant tax incentive purpose because it could be objectively determined or concluded that an investor, who had a dominant commercial purpose, would prefer the project with a normal structure, rather than one which was so structured that it maximised the deductions available by the use of a somewhat artificial structure.

In relation to the artificial nature of some mass marketed schemes it is necessary for the promoters to clearly set out the relevant tax advantages in a prospectus. The inclusion of this information in a prospectus while ensuring that potential participants are aware of the tax advantages may in fact assist in identifying an objective purpose (generating a tax benefit) which may assist the Commissioner or the Courts to conclude that Part IVA applies. This was suggested by Conti J in Howland Rose and Ors:²⁶

An objective analysis must be chiefly based upon the contents of the Prospectus.....

Thus if a prospectus sets out potential tax benefits as an attribute of an investment this is likely to create the necessary tax related purpose for Part IVA to apply. Conti J went on to clarify this matter further:²⁷

Thus, what has been earlier extracted extensively from the Prospectus, and in particular that which is set out in [17-18] above, provided all prospective applicants for syndicate participations with information to the effect that irrespective of an entirely adverse financial outcome to their involvement in the BPS, in the sense of recovering no monetary return, if tax deductibility was allowed by the Commissioner to the extent calculated in the Prospectus, all tax-paying applicants would achieve a return of surplus funds over their cost of acquisition...t.

Conti J appears to be suggesting that based on the information in the prospectus the investment has no real commercial basis and was designed in an artificial way that an investor was sheltered by the tax benefit from any negative commercial aspects of the investment. In other words reliance on the tax benefits propounded in the prospectus meant that there was no real commercial risk associated with the investment.

Contrived

Where a transaction is "contrived",²⁸ it is a plan hatched by human ingenuity to bring about a particular result. Mass marketed schemes may in certain cases be devised to achieve a particular tax result such as creating an arrangement where a tax deduction would be available whereas no tax deduction would exist in the absence of such an arrangement. In other words in the absence of the contrived arrangement is it expected that no transaction may have been entered. In Puzey, Hill and Carr JJ suggested that the transaction was contrived as follows:²⁹

It is clear that had Mr Puzey not entered into the scheme he would not have had the deductions which became available to him.

Furthermore in relation to the contrived nature of the investment Hill and Carr JJ commented:³⁰

the time payments were made was structured to allow a participant like Mr Puzey to receive a refund of tax after lodgement of the 1997 tax return and obtain a variation of the PAYE instalments for the 1998 year of income to permit the participant to make the cash payment required to be made of \$28,000 over the two income tax years.

In fact Hill and Carr JJ went on to make the observation that the scheme was contrived to ensure that the tax system funded the investment, as follows:³¹

The scheme thus produced the result that a participant such as Mr Puzey could finance his cash participation through the tax system by obtaining a tax refund in the 1997 year and by applying for a variation of PAYE tax instalments.

A similarly designed monthly loan repayment schedule was used in Howland

Rose³² to enable salary and wage investors to match their increased cash flow arising as a result of s 221D³³ reduction in tax withheld with the requirements for repaying part of the loan. It is clear from this discussion that the relevant mass marketed schemes were contrived or designed in such a fashion to ensure that the investor bore neither the commercial risk nor the negative cash flow consequences associated with the investment.

In *Hart* the Federal Court was clearly aware that the financing facility was designed for a particular purpose. In the statement of facts, Gyles J observed:³⁴

In order to acquire the Fadden property, borrowed funds were arranged by Austral Mortgage Corporation Pty Ltd (“Austral”). Austral marketed a facility called the “Wealth Optimiser Loan”, a loan specifically designed for persons wishing to finance the acquisition of an income-producing asset and a private residence.

It was also clear to Gyles J in *Hart* that the arrangement was contrived or artificial:³⁵

The contractual provisions involving the split between Loan Accounts 1 and 2 are an artificial feature of the arrangements

When the three terms (blatant, artificial and contrived) are taken as a whole it could be argued that for Part IVA to apply there must be an undisguised plan of action, designed rather than naturally occurring that is planned and carried out to gain a tax benefit. It is suggested that based on the foregoing discussion that the very nature of mass-marketed schemes makes it likely that the courts will find that the scheme is blatant, artificial or contrived.

THE EXISTENCE OF A SCHEME

The general anti-avoidance rules require that there be a scheme present and a “scheme” is defined broadly in s 177A to include any agreement, arrangement or understanding. The question of course is whether the courts have found mass marketed “schemes” easy to identify.

In *Sleight*³⁵ the court had little difficulty in identifying the relevant scheme. The parties agreed that the scheme extended to the “making and implementation of the

various agreements that comprised the Project”.

The tax benefit relied upon was Mr Sleight’s proportion of the deduction of \$25,445 claimed by the partners in the 1995 year of income. Similarly in *Vincent, Hill, Tamberlin and Hely JJ* had little difficulty identifying the relevant scheme:³⁶

There is no dispute in the present case that there is a scheme and no dispute as to how the scheme is to be identified.

In the *Puzey, Hill and Carr JJ* clarified the relevant scheme and the tax objective as follows:³⁷

The scheme, as identified by the learned Primary Judge at [at 4869] [88] was: “the presentation and execution of a seedling purchase agreement under which the cost of seedlings was calculated to provide to a participant in the project an outgoing in an amount able to provide a tax benefit.” so that the tax saved would cover payments to be made by the participant ...

In *Howland Rose and Ors, Conti J* described the relevant scheme as:³⁸

In summary, the scheme so particularised comprised the Prospectus and all pro forma documentation set out in the Prospectus, certain additional documents collateral to the transactions said to be contemplated by the Prospectus, and the carrying into effect of all such documents by the parties thereto.

The Full High Court decision in *Hart* also found the prospectus useful in identifying the scheme and Gleeson CJ and McHugh J³⁹ in their joint decision put it as follows:

The identification of the tax benefit, and the identification of the scheme, are inter-related. The benefit was not the whole of the interest on loan account 2 (the investment part of the borrowing); it was that part of the interest which resulted from the special, or non-standard, features of the arrangements between the lender and the borrowers. Those were the features to which the respondents were invited to pay attention in deciding whether to enter into the particular transaction. Those features, which defined the “wealth optimiser structure” and distinguished it from “standard financing arrangements”, were definitive of the scheme in connection with which the tax benefit, identified by all four members of the Federal Court, was obtained.

In addition Gleeson CJ and McHugh J⁴⁰ in reaching their conclusion that the relevant interest was not deductible further clarified the particular scheme to which the tax benefit related as follows:

It was the tax benefit so obtained, and applied in reduction of the home loan, that was the wealth optimising aspect of the structure. It was the wealth optimising aspect of the structure, not divorced from the borrowing, but giving the borrowing its distinctive character, that constituted the scheme.

Based on the foregoing discussion on the identification of a scheme it would appear that by setting out the nature of the scheme in a prospectus or similar document this assists the court to identify the relevant scheme in addition to identifying the relevant tax benefit.

TAX BENEFIT

Section 177D provides that there must be a tax benefit derived in connection with the scheme for Part IVA to apply. Section 177C provides a definition of a tax benefit and when a tax benefit arises. Tax benefits specifically recognised by income tax legislation will be excluded from the operation of the general anti-avoidance rules.⁴¹ In other words where a taxpayer has made an agreement, choice, declaration, election or selection available under the law⁴² this will not be considered to be a tax benefit for the purpose of Part IVA.

In *Sleight* the court had no problem in concluding that the tax benefit was Mr Sleight’s proportion of the deduction of \$25,445 claimed by the partners in the 1995 year of income. In *Puzey, Hill and Carr JJ* similarly had no problem in identifying the relevant tax benefit:⁴³

The tax benefit is the deductions to which Mr Puzey became entitled as a result of the scheme.

In *Howland Rose and Ors, Conti J* described the relevant tax benefit as:⁴⁴

The tax benefits asserted by the Commissioner to have been obtained by the Applicants in connection with the scheme comprised the tax deductions attributable to the research and development fees paid to ATTORI, the management fees paid to BARM, the interest

“ in many mass marketed schemes the relevant prospectus clearly identifies the relevant tax benefits ”

paid over two years to PGF, and part of the borrowing costs....

Justices Gummow and Hayne in Hart⁴⁵ identified the relevant tax benefit as follows:

The amount of tax benefit identified, and disallowed, was calculated by taking the difference between the interest which the respondents claimed to be deductible (all interest charged to that part of the loan used for the investment property) and the interest which would have been charged on that part of the loan had it been a loan requiring periodical payments sufficient to pay both principal and interest over the term of the loan which the respondents had taken.

It is concluded that based on the fact that in many mass marketed schemes the relevant prospectus clearly identifies the relevant tax benefits that this action will unquestionably assist the Commissioner and the courts to identify the relevant tax benefit.

REASONABLE EXPECTATION TEST

It is clear from the definition of a tax benefit that for a tax benefit to occur there must be a reasonable expectation that in the absence of the scheme an amount of assessable income would be derived by the taxpayer or an allowable deduction would not have been available to the taxpayer.⁴⁶ This is what is called the “reasonable expectation test”. To apply this test requires a comparison between the actual tax position of the taxpayer as a result of the scheme and what might reasonably be expected to have been the taxpayer’s position had the taxpayer not entered into the scheme. In Sleight, the reasonable expectation test was discussed as follows:⁴⁷

There will be relevantly a tax benefit obtained in connection with a scheme where there is a deduction allowable to the taxpayer in relation to a year of income where the whole or a part of

that deduction would not have been allowable, or might reasonably be expected not to have been allowable to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out. Here there is no contest.

It is clear from this language that the facts of the case made for a facile application of the reasonable expectation test. In Puzey, the reasonable expectation test was easily satisfied as follows.⁴⁸

It is clear that had Mr Puzey not entered into the scheme he would not have had the deductions which became available to him.

Gleeson CJ and McHugh J in Hart⁴⁹ indicated as follows, that the prospectus in explaining the “wealth optimiser structure” set out the information necessary to satisfy the reasonable expectations test:

That finding turned upon what was found to be a reasonable expectation as to what deduction would have been allowable if the relevant scheme had not been entered into or carried out. Gyles J based his finding as to that expectation on the information given to the respondents about the proposed loan, which invited them to compare the financing of a home loan and an investment/ business loan using “standard financing arrangements”, on the one hand, with the “wealth optimiser structure” that was ultimately adopted, on the other.

It would appear that as many of the mass marketed schemes do not generally arise in the normal course of a business transaction that it is very likely that if the relevant scheme was not entered into or carried out no transaction at all would have occurred. Thus it is most likely that no tax benefit would exist in the absence of the relevant scheme. By comparison, while the transaction in Hart may occur in the normal course of financing property investments the prospectus in that case clearly identified the tax benefit and what was most likely to occur if a participant did not undertake the financing in the manner identified in the prospectus. In other words the promotion

of mass marketed schemes is likely to provide additional information to enable the Commissioner and the courts to find information to satisfy the reasonable expectation test.

DOMINANT PURPOSE

The most important requirement for the operation of the general anti-avoidance provisions is that the relevant taxpayer must have a dominant purpose to derive a tax benefit from the identified scheme. For a dominant purpose to exist the tax related purpose must be the “ruling, prevailing or most influential” purpose.⁵⁰ Part IVA does not require consideration of evidence of the subjective purpose or motivation of a particular person and relates only to the objective purpose of the particular taxpayer.⁵¹ In the context of mass marketed schemes it is noted that the conclusion as to dominant purpose may be reached not only with respect to the dominant purpose of the taxpayer, it may be reached by reference to the dominant purpose of any other person or persons so long as they are persons who entered into or carried out the scheme or any part of it.⁵² Likewise, the purpose of an adviser may be attributed to the taxpayer in certain cases.⁵³ In relation to purpose, French J at first instance in Vincent⁵⁴ stated:

In this case I have already found, in connection with the issue of deductibility under s 51(1), that the obtaining of a tax deduction was not Ms Vincent’s dominant purpose in entering into the project. That finding however does not obstruct the application of Part IVA to Ms Vincent’s claimed deduction. In my opinion, whatever the subjective purpose of Ms Vincent and her state of knowledge about the true nature of the scheme into which she entered, a reasonable person would conclude, having regard to the eight listed factors, that those taxpayers who entered into the project did so with the dominant purpose of obtaining a tax benefit in connection with it. From an objective point of view there was little other benefit to be derived.

This extract demonstrates that it was not necessary for the taxpayer to hold the relevant dominant purpose it was sufficient that an objective purpose could be determined by interpreting the actions of

the taxpayer and their advisers. Section 177D provides that there are eight factors to take into account in determining whether a dominant purpose exists. This article will now proceed in analysing court decisions in relation to the application of those eight factors in mass marketed schemes.

The manner in which the scheme was entered into or carried out

A feature of many mass marketed investments is the presence of internal funding arrangements. This occurs where an entity related to the company managing the investment provides finance to a party investing in the project. Hill J⁵⁵ indicated that he was concerned with this method of financing as follows:

Further, a number of the cheque transactions involved exchanges of cheques generally called "round robins". .. While a round robin is perfectly legally effective to create real relationships between parties, it must be said that it is a feature of many tax avoidance schemes where no real money is involved and may point to a tax avoidance purpose....

It is evident that while Hill J is satisfied that round robin financing arrangements may be satisfactory their habitual presence in mass marketed schemes appears to give a flavour of tax avoidance because parties in many cases seek to gear-up their investment by related party loans where the eventual liability for paying back the loan is dependant on the commercial viability of the project. The lack of commercial viability of an investment in the absence of the relevant tax benefits has been a focus of the courts in determining the dominant purpose in mass marketed schemes. In *Sleight*, the court was concerned as to the commercial viability of the tea-tree investment and Hill J stated:⁵⁶

The commercial investment in tea trees was, as the prospectus pointed out, attendant with risk. Without the tax benefits which the opinions in the prospectus suggested should be available, the commercial returns were far from encouraging.

When discussing the manner in which the scheme was entered into and carried out in *Puzey, Hill and Carr JJ*, noted the following:⁵⁷

Of particular importance, not only to this factor, but also to others, was that this was a case where what was certain was, or at least was promoted to be, the taxation deductions. What was uncertain, was the project's investment consequences. These were highly speculative. So long as the taxation deduction was available, however, the uncertainty carried with it little cost. The sandalwood plantation was a commercial gamble. There was a chance of some profit from it. But it was the taxation consequences that were certain. Or so at least it appeared.

It would appear from these comments that the court was left in no doubt that the tax effectiveness of the investment was the primary supporting factor and that the prospect of commercial success was very minimal. The court having made this observation appeared to be destined to form a conclusion that the dominant purpose for entering into the transaction was to gain the relevant tax benefits.

In *Howland Rose and Ors*,⁵⁸ Conti J set out very clearly his main concerns in relation to the manner in which the scheme was funded as follows:

The surplus moneys obtainable by participants over the first two fiscal years of participation, by reason of the difference between the monetary value of the income tax deductibility obtainable by participants in respect of that period of time... the fact that the borrowing would be undertaken pursuant to non-recourse lending arrangements whereby the participant would only be required to repay principal as to \$6,000 and interest as to \$3,600, plus the minor fees of \$500 for "business establishment" and "loan application", totalling \$10,100 in respect of each borrowing of the principal sum of \$24,000 ... the consequence that participants (with one exception out of 2721 participants) purportedly achieved a "deduction acceleration factor of nearly 300 per cent", that is to say, they generated tax deductions of \$27,720 over two years out of \$10,100 outlaid in cash.

It is evident that Conti J had grave concerns in relation to the manner in which the scheme was entered into and carried

out. It is suggested that his comments could be viewed as stating that the scheme was fabricated to achieve the relevant tax benefits. It is noted that some of his comments in this extract address issues in categories (iii), (iv) and (vii) of para (b) of s 177D.

In the Full Federal Court decision in *Hart*,⁵⁹ Hill J commented on the manner in which the investment was entered into as follows:

While the scheme did permit the borrowing of monies for the two purposes indicated, one private and the other income producing, the manner in which the scheme was formulated and thus entered into or carried out is certainly explicable only by the taxation consequences.

Gleeson CJ and McHugh J⁶⁰ in their concluding comments in *Hart* indicated that the manner in which the wealth optimiser facility was entered into and operated indicated a tax avoidance purpose:

The "wealth optimiser structure" depended entirely for its efficacy upon tax benefits generated by arrangements between the respondents and the lender that had no explanation other than their fiscal consequences. What "optimised" the respondents' "wealth" was the tax benefit earlier described: not the deductibility of interest as such; but the deductibility of additional interest on loan account 2 contrived by the particular form of the borrowing transaction.

The foregoing analysis on the manner in which the scheme was entered into or carried out would appear to suggest that mass marketed schemes have a certain similarity in the manner in which the schemes are structured to achieve the largest tax deduction either through additional gearing with little attendant risk to the participant or other means including inflating the costs associated with participating in the investment as happened in the *Puzey* case.

Form and substance

In arriving at a conclusion as to whether there is a dominant purpose to achieve a tax benefit the form and substance of the arrangement must be considered. In *Sleight*, Hill J clarified his understanding of

the form and substance of an arrangement as follows:⁶¹

There is a difference between the form and the substance of the present scheme. In form there is an option whether to farm alone or to employ the management company. There is a management agreement and financing and interest payments. The form, involving pre-payment of management fee and interest is, it may be concluded readily, designed to increase the taxation deductions available to an investor. The substance is, however, quite different. As Senior Counsel for the Commissioner put it, in substance the investor is a mere passive investor in what, once the tax features are removed, is a managed fund where no deduction would be available

In *Puzey*,⁶² the court concluded that while the legal form of the arrangement appeared to indicate that the taxpayer was liable to make two payments of \$40,000 the substance of the arrangement was that the taxpayer was only liable to make two payments of \$14,000.

In relation to the form and substance of the scheme *Conti J* in *Howland Rose and Ors*⁶³ identified the form of the scheme as:

- the form of the scheme involved Participants purportedly paying an amount of \$24,000 each to ATTORI as consideration for ATTORI developing and testing products in accordance with the terms of the Budplan Personal Syndicate Deed

It is noted that *Conti J* uses the term “purportedly” suggesting that the apparent form of the transaction was a mere façade for what was really happening. In relation to the substance, *Conti J* went on to state:⁶⁴

- in substance the scheme involved:
 - (i) no actual contribution of any cash pursuant to the purported loan transactions;
 - (ii) the funding of ATTORI to carry out its contractual obligations as to product development and testing activities out of cash made available by the Participants’ loan repayments;
 - (iii) the conduct of the affairs of the Budplan Personal Syndicate on a basis which was highly unlikely ever to produce any commercial return to the Participants from the development and exploitation of products;

- (iv) the limitation of a Participant’s involvement to the signing of the Prospectus documentation, and the making of payments of \$9,600 over two years;
- (v) the structuring of legal arrangements, in particular the limited recourse loans, in such a way as to ensure the Participants would become entitled to claim deductions over two years in an amount of \$27,720 while they would be protected from financial liability for any amount greater than \$9,600.

It is evident from these extracts that the Courts seek to identify the substance of the particular arrangement and are unlikely to be influenced by the legal form of particular arrangements. In other words the Court decisions are adhering to the objectives of Part IVA which is to review both the form and substance of particular arrangements.

The time at which the scheme was entered into and length of the period during which the scheme was carried out

It has often been observed that mass marketed investments are effected close to the end of the income year and this feature of an arrangement appears to colour a particular arrangement with a flavour of tax avoidance as pointed out by *Hill J* in *Sleight*.⁶⁵

This factor clearly points to taxation as a predominating purpose. The scheme was entered into on the last day of the year of income. This was not accidental as it was necessary for a large portion of the deductions to be incurred in the 1995 year of income. If what may be called the tea tree or investment purpose predominated, then there would be no need for a “flurry of activity” to occur, as it did, at the end of the year of income. The investment could be entered into at any time.

Similar comments were made by *Hill* and *Carr JJ* in *Puzey*, as follows:⁶⁶

Mr *Puzey* entered the scheme by exercising his option to do so on 3 June 1997, that is to say shortly before the end of the 1997 year of income. The cheque exchanges which took place all took place close to the end of the 1997 and the 1998 years of income....

It is suggested that while these extracts are quite clear the mere fact that an investment was made or an arrangement entered into

just before the end of an income year will not automatically colour that transaction with a tax avoidance purpose. What the Courts are saying is that where a particular arrangement is designed and implemented in such a way to ensure the timing of the tax benefit is achieved over the achievement of the commercial objectives this will assist in forming a conclusion that the tax objectives of the scheme are dominant.

The result in relation to the operation of the Act apart from Part IVA

To evaluate this condition we need to determine what the taxpayer achieved from the scheme in the absence of Part IVA applying. *Hill J* in *Sleight* stated his opinion clearly as follows:⁶⁷

Apart from Part IVA the scheme operates to provide to Mr *Sleight* deductions in the 1995 and 1996 years of income considerably in excess of the funds he contributes with his wife, namely deductions totalling \$12,722 in respect of the management, administration and indemnity fees and interest and in the 1996 year of income a deduction of \$2009 in respect of interest. This points to taxation as a predominant purpose.

Similar comments and analysis on this point are provided by the Courts in the other mass marketed cases being reviewed in this article.

Change in the financial position of the relevant taxpayer resulting from the scheme

The financial impact of the scheme must be considered to determine if a dominant purpose of tax avoidance is present. *Hill J* indicated that the benefits of a tax deduction were dominant in *Sleight* as follows:⁶⁸

Mr *Sleight* outlaid in cash together with his wife the sum of \$4,745 in the 1995 year and \$9,409 in the 1996 year. For this they obtained tax deductions, amounting to \$25,445 in the year of income and \$2009 in respect of interest in the 1996 year of income. They also obtained an investment in the tea trees to be planted and tended and harvested... The commercial interest in tea trees which the outlays obtained was considerably less certain than the tax benefit.

The court in Puzey considered that the taxpayer did not bear any financial risk from the investment which delivered tax deductions but appeared very sceptical of the commercial potential of the relevant investment and Hill and Carr JJ stated their thoughts as follows:⁶⁹

There was a possibility, although it was speculative, that the plantation would be successful and that Mr Puzey would become entitled to a share of the sale of timber.

In other words the Court recognised that the taxpayer's financial position would be enhanced by the availability of the tax deduction but not negatively impacted by the more speculative investment in the timber plantation. In Hart the High Court⁷⁰ made mention of some additional consequences of the taxpayer entering into the relevant scheme as follows:

In this Court, the Commissioner submitted that there were three other relevant changes in the financial position of the respondents that had been brought about by the scheme they would pay less tax and would have more disposable income than they would have had if they had taken a loan on other terms because interest would continue to accrue and be capitalised on that part of the loan used for the investment property, the amount owing on that account would increase to an amount well above the value of the investment property although the interest rate charged was commercially competitive, it was nevertheless marginally higher than would have been charged under the Austral standard principal and interest loans (for both home and investment financing) that were available to the respondents.

It would appear from this analysis that if the tax benefit received from the relevant scheme provides a net benefit to the taxpayer then it is likely that the taxpayer's financial position will be enhanced by the tax benefit alone. This would assist in coming to a conclusion that the tax benefit is the dominant purpose or participating in the scheme.

Change in the financial position of others with a connection to the taxpayer

To address this requirement there must be a change in the financial position of another

“ If what may be called the tea tree or investment purpose predominated, then there would be no need for a “flurry of activity” to occur, as it did, at the end of the year of income ”

person that has a connection with the taxpayer. There will not always be a change to the financial position of another person associated with the taxpayer as Hill J stated in Sleight.⁷¹

This is not a case where a taxpayer received a tax benefit and a person associated with him or her received some collateral capital payment. No doubt the promoter companies made money out of the scheme, but they would hardly seem to be entities having any real connection of a business nature with Mr Sleight as that expression is used in s 177D(b)(vi).

In the other cases being analysed in this article the Courts did not provide substantive discussion on changed financial circumstances of others connected with the taxpayer and it is suggested that the underlying reason for this is because the promoters of the schemes were the parties who sought to gain financially from the particular schemes and these promoters were not necessarily connected with the participants in the scheme.

Any other consequences for the taxpayer or other person referred to in section 177D(b)(vi)

It is necessary to identify if there are any other consequences for the taxpayer or another person connected with the taxpayer. There may not always be other consequences as Hill J stated in Sleight:⁷²

It is difficult to see any relevant matter under this heading pointing one way or the other.

The nature of any connection between the taxpayer and any person referred to in s 177D(b)(vi)

It may be necessary in some cases to investigate and evaluate the nature of the connection between the taxpayer and other persons having a connection with the taxpayer. Of course if no party connected with the taxpayer is impacted then this condition will not be relevant as Hill J stated in Sleight.⁷³

This factor is likewise neutral.

It can be seen from the foregoing discussion of the eight factors to be considered in determining whether a dominant tax related purpose exists that the Courts are very influenced by the manner in which the particular mass marketed arrangement is entered into, the form and substance of the arrangement and the timing of when the arrangement is entered into.

COURT CONCLUSIONS – PART IVA

Having analysed the application of the eight factors in s 177D it is necessary to form a conclusion as to whether there is a dominant tax avoidance purpose present. The language used by the courts in concluding that Part IVA applied to mass marketed schemes is quite interesting. For example Hill J concluded in Sleight as follows:⁷⁴

..... I think that it is more likely than not that a reasonable person faced with having to draw the conclusion which s 177D requires would conclude that Mr Sleight entered into or carried out the scheme with the dominant purpose of obtaining the tax benefits available to him given the uncertainty attendant on the other deductions he had claimed and the uncertainty of the investment yields which the project might realise.

A similar conclusion was arrived at in Puzey, where Hill and Carr JJ stated:⁷⁵

When these matters are considered there is no doubt that it would be concluded that Mr Puzey, entered into and carried out the scheme for at least the dominant purpose of obtaining for himself the taxation deductions Taxation was the prevailing purpose; any return from the sale of sandalwood was both speculative and secondary.

The court in Vincent,⁷⁶ found it relatively easy to conclude that Part IVA applied to deny the deductions claimed in the 1996 year. In coming to his conclusion that Part

IVA applied *Conti J* in *Howland Rose and Ors*⁷⁷ appeared to be left in no doubt that the objective purpose of the scheme was to derive a tax benefit as the following extracts from his conclusion indicate:

Given the circumstances that the Prospectus demonstrated, as set out in [17] above, that participation would result in a cash surplus to participants of the order exemplified variously in [18] above, notwithstanding an entire loss of the participant's invested funds in research and development which might be wholly unsuccessful, there was in my opinion no commercial rationale, or "no sense", for participation in the BPS arrangements, without being able to underwrite the "no cash loss" situation held out by the terms of the Prospectus.

In *Hart*, the High Court while coming to a conclusion that the split loan in question had a dominant purpose of tax avoidance struggled with the concept of a tax avoidance scheme and the fact that the form of the scheme is what gave it the tax avoidance purpose. In the non-mass marketed case of *Macquarie Finance Ltd v FC of T*,⁷⁸ Hill J endeavoured to rationalise the reasoning used by the High Court in coming to its conclusion that Part IVA applied in *Hart*. In essence it would appear from Hill J's discussion in *Macquarie Finance* that he concluded that the High Court was persuaded by the form in which the borrowing took place in *Hart* and not necessarily the purpose of the overall borrowing. It is suggested that the Courts in *Hart* had more difficulty in applying Part IVA when compared with the other mass marketed cases discussed in this article. Notwithstanding, *Gummow and Hayne JJ* concluded that Part IVA applied as follows:⁷⁹

It follows that the conclusion required by having regard to the eight identified matters was that asserted by the Commissioner. Having regard to those matters it would be concluded that the dominant purpose of the respondents in entering into and in carrying out the scheme was to obtain the tax benefit which the Commissioner's determination cancelled.

It would appear from these conclusions that in some cases there will be difficulty in applying Part IVA to certain arrangements.

Nevertheless, the definitive language used by the courts in the mass marketed cases (other than *Hart's* case) discussed in this article would suggest that the respective courts were satisfied that the dominant purpose in each case was to derive the relevant tax benefits.

CONCLUSION

This article has analysed the operation and interpretation of the general tax anti-avoidance provisions as they apply to mass marketed schemes. This article draws the following conclusions and observations:

The results of the methodology used by the courts in analysing mass marketed schemes suggests that the courts consider that many of those schemes are likely to be blatant, artificial or contrived arrangements designed to achieve a tax benefit.

The use of a prospectus and other publicly available information to promote mass marketed schemes appears to assist the courts in identifying the relevant scheme and the tax benefits associated with the scheme. In addition the information provided to potential participants in mass marketed schemes can assist the courts in satisfying the reasonable expectation test.

The manner in which mass marketed schemes are entered into, the timing of when they are entered into and financed appears to assist in concluding that a dominant purpose to derive a tax benefit exists. The courts are also concerned that the relevant mass marketed schemes lack commerciality or a rationale for their existence other than the gaining of a tax benefit. ■

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REFERENCE NOTES

- 1 Michael Carmody, Commissioner of Taxation, in a speech entitled, "Taxation Current Issues and Future Directions", delivered to the Australian Institute of Company Directors, Perth, 1 May 2001.
- 2 Part IVA *Income Tax Assessment Act 1936* (ITAA 36).
- 3 Kotler, P 2003, *Marketing Management*, 11th edn, Prentice Hall, New Jersey, p. 279.
- 4 <http://www.ato.gov.au/atp/content.asp?doc=/content/27144.htm>
- 5 In addition the ATO has published a list of employment benefit schemes that it considers are not mass-marketed schemes. These can be accessed at: <http://www.ato.gov.au/atp/content.asp?doc=/content/30245.htm>.
- 6 *Hart and Anor v FCT* 2002 ATC 4608 at para 4612.
- 7 *Eastern Nitrogen Ltd v FC of T* 2001 ATC 4164.
- 8 Part IVA consists of ss 177A to 177H in the *Income Tax Assessment Act 1936* (ITAA 36).
- 9 Sections 177B(3) and 177B(4) provide that Part IVA only comes into operation after all other provisions of the ITAA 97 and ITAA 36 have been applied.
- 19 For example the personal services income rules in Part 2-42 of the ITAA 97.
- 20 Sham transactions are a façade or a pretence but not a real transaction because of the lack of legal effect. See *Nabru Nominees Pty v FCT* (1997) 37 ATR 97; 97 ATC 4902.
- 21 ITAA 36.
- 22 In *Essenbourne Pty Ltd v FC of T* 2002 ATC 5201 the court held that Part IVA would not apply because in the absence of the relevant scheme a deduction would have been available to the taxpayer under another tax provision.
- 23 Section 177C ITAA 36.
- 24 Comments of the then Treasurer when introducing the general anti-avoidance legislation.
- 25 *Macquarie Concise Dictionary*, Third edition, 1998.
- 26 At ATC 4493.
- 27 At ATC 4493.
- 28 At ATC 4796.
- 29 At ATC 4744.
- 30 *Howland-Rose and Ors v FCT* [2002] FCA 246; 2002 ATC 4200.
- 31 *Conti J* having concluded in *Howland-Rose* that the relevant deductions were denied under the general deduction provisions considered it appropriate that he should discuss the application of Part IVA for completeness.
- 32 At ATC 4614.
- 33 *Macquarie Concise Dictionary*, Third edition, 1998.
- 34 At ATC 4494.
- 35 At ATC 4267.
- 36 At ATC 4268.
- 37 *Macquarie Concise Dictionary*, Third edition, 1998.
- 38 At ATC 4795.
- 39 At ATC 4796.
- 40 At ATC 4797.
- 41 *Howland-Rose and Ors v FCT* [2002] FCA 246; 2002 ATC 4200.
- 42 ITAA 36.
- 43 *Hart & Anor v FC of T* 2001 ATC 4708 at ATC 4710.
- 44 At ATC 4710.
- 45 *FCT v Sleight* [2004] FCAFC 94; 2004 ATC 4477.
- 46 At ATC 4758.
- 47 At ATC 4795.
- 48 At ATC 4268.
- 49 At ATC 4602.
- 50 At ATC 4603.
- 51 Section 177C(2).
- 52 An election, choice, etc under the ITAA 97 and ITAA 36.
- 53 At ATC 4795.
- 54 At ATC 4268.
- 55 At ATC 4607.
- 56 Note that Part IVA also applies to capital losses and foreign tax credits.
- 57 At ATC 4491.
- 58 At ATC 4795.
- 59 At ATC 4602.

- 60 *FC of T v Spotless Services Limited & Anor* 96 ATC 5201.
- 61 *FC of T v Zoffanies Pty Ltd* 2003 ATC 4942 at 4954; *Eastern Nitrogen Ltd v FC of T* 2001 ATC 4164 at 4177.
- 62 *FC of T v Spotless Services Limited & Anor* 96 ATC 5201 (at ATC 5207; CLR 418).
- 63 *FC of T v Consolidated Press Holdings Ltd & Anor* 2001 ATC 4343 at 4360.
- 64 At ATC 4518-4519.
- 65 At ATC 4493.
- 66 At ATC 4493.
- 67 At ATC 4796.
- 68 At ATC 4269.
- 69 *Hart & Anor v FCT* 2002 ATC 4608 at ATC 4623.
- 70 *FCT v Hart & Anor* 2004 ATC 4599 at ATC 4602.
- 71 At ATC 4494.
- 72 At ATC 4796.
- 73 At ATC 4269-70.
- 74 At ATC 4269-70.
- 75 At ATC 4495.
- 76 At ATC 4796.
- 77 At ATC 4495.
- 78 At ATC 4495.
- 79 At ATC 4797.
- 80 *FCT v Hart 2004* ATC 4599 at ATC 4613.
- 81 At ATC 4496.
- 82 At ATC 4496.
- 83 At ATC 4496.
- 84 At ATC 4496.
- 85 At ATC 4797.
- 86 *Vincent v FCT* [2002] FCAFC 291; 2002 ATC 4742.
- 87 At ATC 4270-71.
- 88 2004 ATC 4866.
- 89 *FCT v Hart & Anor* 2004 ATC 4599 at ATC 4615.