

THE SPIN OF A COIN - IN SEARCH OF A WORKABLE GAAR

By Dr Justin Dabner

By broadly interpreting the general anti-avoidance rule in Part IVA of the Income Tax Assessment Act 1936, the High Court, in FCT v Spotless Services Ltd 96 ATC 5201, has exposed the inadequacies of the provision. The rejection of the "commercial transaction exception" has generated considerable uncertainty and trenchant criticism by the tax advisory profession. The provision is now unworkable.

A new approach is mandated. The Review of Business Tax proposal that Part IVA be applied according to the underlying policy of the tax laws suggests the way forward. Such an approach would assimilate the Australian position with proposals considered in the United Kingdom and New Zealand and the approach achieved in Canada. However, it would involve a departure from the traditional literal approach to interpreting tax laws.

Critics might question where is the protection of taxpayers that is the basis for the literal approach. This must be founded in a clear expression of objects, an independent review board and a sensible rulings, dispute resolution and penalty regime.

"...Parliament generally changes the law for the worst...the business of the judges is to keep the mischief out of its interference within the narrowest possible bounds."¹

1. INTRODUCTION

There is almost universal agreement amongst commentators that the best measure to tackle tax avoidance is structural, institutional and administrative reform to reduce the opportunities for avoidance. Measures identified include base

broadening, the lowering of tax rates, the removal of tax incentives and tax expenditure programs, the removal of progressive and differential tax rates and changes to tax collection and enforcement.²

Whilst institutional and administrative reforms are not inconceivable³ and the lowering of tax rates and base broadening is government policy in most countries,⁴ the political process underlying the formation of taxation laws will ensure that

¹ Pollack, *Essays in Jurisprudence and Ethics* (1882) 85.

² Review of Business Taxation, *A Tax System Redesigned* (July 1999), Recommendations 6.1 to 6.5 (<http://www.rbt.treasury.gov.au/publications/paper4/index.htm>); R Krever, "The Ghost of the Duke of Westminster laid to rest in Australia?" (1997) 45 *Canadian Tax Journal* 122, 130; V Krishna, "The Tension between the Westminster Principle and Abusive Tax Avoidance" (1997) 7 *Canadian Current Tax* 65; V Krishna, "The Illusive Interest Deduction" (1998) 8 *Canadian Current Tax* 89; RA McLeod, "An Economic Approach to Taxation Avoidance" (1996) 2 *New Zealand Journal of Taxation Law and Policy* 171; NF Orow, "Part IVA - Seriously Flawed in Principle" (1998) 1 *Journal of Australian Taxation* 57; NF Orow, "The Future of Australia's General Anti-Avoidance Provision" (1995) 1 *New Zealand Journal of Taxation Law and Policy* 225; NF Orow, "Towards a Conceptually Coherent Theory of Tax Avoidance - Parts 1 and 2" (1995) 1 *New Zealand Law of Taxation Law and Policy* 288 and 307; L Muten, "The Swedish Experiment with a General Anti-Avoidance Rule" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 307; J Waincymer, "The Australian Tax Avoidance Experience and Responses: A Critical Review" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 247; CH Gustafson, "The Politics and Practicalities of Checking Tax Avoidance in the United States" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 349; M Brooks and J Head, "Tax Avoidance: In Economics, Law and Public Choice" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 53; M Gammie, "Tax Avoidance and the Rule of Law: The Experience of the UK" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 181; I Richardson, "Reducing Tax Avoidance by Changing Structures, Processes and Drafting" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 327.

³ In fact, changes within the Australian Tax Office in the last 15 years have been quite dramatic.

⁴ As has been the move to introduce broad based indirect taxes. This would please Gammie, above n 2, who recommends reliance on transaction taxes rather than income tax.

there are adequate differentials inherent in the system to encourage and accommodate avoidance techniques. Structural reform premised solely on anti-avoidance is a utopian dream. Therefore, the anti-avoidance rules to protect governments' prime revenue raising tool is likely to remain a feature of our tax laws.

Recently in the United Kingdom a debate occurred over whether the best avenue to tackle tax avoidance was statutory or judicial. In Australia, Germany, Sweden, New Zealand and Canada the debate has evolved into being over the best form of statutory provision. Specific anti-avoidance provisions have been generally discounted in favour of some form of general anti-avoidance rule ("GAAR").

It has been suggested that there are two main approaches to a GAAR, one focussing on the acceptability of the form of a transaction in the context of a taxpayer's ultimate objective, and the other focussing on a taxpayer's purpose.⁵ The German approach reflects the former whilst the New Zealand, Swedish,⁶ Canadian⁷ and Australian⁸ approach reflects the latter.

A third approach is to define tax avoidance in terms of the defeat of the policy apparent in the legislation ("purposive approach"). Both the Swedish and the Canadian GAARs contain a purposive element as well as focussing on the taxpayer's purpose. Whereas in Sweden, this

element is one of the tests to trigger the GAAR, in Canada it is a defence to its application.

The purposive approach has achieved considerable support in recent years as the next best option to structural reform. It has received high level sponsorship in both the United Kingdom and New Zealand. In addition, the Review of Business Taxation ("Ralph Review")⁹ embraced a purposive approach, although there is, as yet, no indication that the government will adopt this recommendation.

Such an approach is not without critics who point to the difficulties in identifying the policy behind tax legislation. Some argue that tax avoidance is most likely to arise where there is no clear principle underlying the legislation.¹⁰ The inevitable result will be the exercise of discretion and uncertainty and the problem with a GAAR is that it will often emasculate the fact that a discretion is being exercised resulting in the absence of legal and political controls.¹¹

This article examines the application of the current Australian GAAR. It has been suggested that the Australian GAAR is drafted in a highly technical style in comparison with the European and Canadian provisions.¹² One implication is that it might actually act as a roadmap to new tax avoidance opportunities.¹³ Furthermore, to the extent that the GAAR is a direction to the judiciary, this direction may be obscured.

⁵ GS Cooper, "Conflicts, Challenges and Choices – The Rule of Law and Anti-Avoidance Rules" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 13. Cooper, at pages 32-39, summarizes the design issues for a GAAR identifying some of the different approaches that have been adopted.

⁶ Although the original Swedish GAAR contained elements of both approaches. See L Muten, "The Swedish Experiment with a General Anti-Avoidance Rule" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 307.

⁷ In Canada, the two approaches were considered a choice, not a combination. See BJ Arnold, "The Canadian General Anti-Avoidance Rule" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 221.

⁸ Although there have been recent calls for the inclusion of an alternative principal effect test.

⁹ Review of Business Taxation, above n 1, Recommendations 6.1 to 6.5.

¹⁰ M Gammie, "Tax Avoidance and the Rule of Law: The Experience of the UK" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 181. At pages 200-202, he also doubts whether identifying tax avoidance based on a taxpayer's purpose is satisfactory.

¹¹ Thus, the suggestion that it would be preferable for this grant of discretion to be expressly acknowledged and then attention focussed on how the rights of taxpayers and the government can be appropriately balanced. In fact the provision of a general discretion to the tax administration could be described as a fourth approach to implementing a GAAR. This approach raises issues relating to uncertainty and the maintenance of the rule of law. Gammie sees no problems with the use of administrative discretion to tackle tax avoidance provided that a ruling system is in place to minimize uncertainty, special review procedures exist to deal with the political issues that arise and the exercise of discretion does not conflict with government policy. However, ultimately Gammie believes that the best approach is structural change and in particular, reliance on a more robust tax base: above n 1 at 216.

¹² F Vanistendael, "Judicial Interpretation and Role of Anti-Abuse Provisions in Tax Law" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 131.

¹³ *Report of the Royal Commission on Taxation* (1966) Volume 3, 554-556.

It will be observed that since the High Court decision in *FC of T v Spotless Services Ltd*¹⁴ rejected a commercial justification exception to the application of the GAAR, considerable uncertainty exists as to the scope of the provision. Accordingly, this would appear to support the criticisms of the provision and the calls for it to be amended.

If it is proposed to amend the GAAR to mandate a purposive approach to interpretation, then is there any evidence that such an approach will be any more effective and, if so, what is the best way to implement it? As noted above, Canada has enacted a GAAR that contains a purposive element. There are mixed views amongst Canadian commentators as to whether the provision is effective. The first decisions are emerging and whilst the provision has, arguably, achieved the correct results, a decision of the Supreme Court is awaited. Unfortunately, recent Supreme Court decisions on the predecessor to the GAAR would suggest that the Court is likely to adopt a restrictive interpretation of the GAAR.

Given the attitude of the High Court of Australia, as reflected by the decision in *Spotless*, such an approach is currently inconceivable in this country. Thus, the Canadian legislative approach possibly has something to offer Australia.

2. INHERENT TENSIONS IN THE TAX SYSTEM

The traditional common law position is that tax laws are to be construed strictly and the words given their literal meaning ("literalist approach"). One rationale for this approach is the protection of taxpayers who may be subject to penalties and interest should they incorrectly interpret these laws. It is to be contrasted with the purposive approach to statutory interpretation that requires legislation to be interpreted in such a manner as to further its purpose, an approach that, in the

context of tax legislation, typically favours the revenue collecting authorities.

At the same time, the "Duke of Westminster Principle"¹⁵ mandates that taxpayers are free to arrange their affairs to minimise taxation. However, most tax systems operating in common law jurisdictions contain a GAAR designed to render ineffective arrangements to avoid taxation. In Australia, these provisions are contained in Part IVA of the *Income Tax Assessment Act 1936* ("ITAA36").

The inevitable tension created by these opposing positions is illustrated by the history of the Australian GAAR. The original Australian GAAR, s 260, was very broadly drafted. A literalist High Court rendered the provision impotent with the result that it was replaced by Part IVA.¹⁶

Faced with this history it is not surprising that the Australian Tax Office ("ATO") was reluctant to allow the judiciary an opportunity to consider Part IVA. For 8 years, the ATO argued that it was awaiting the appropriate test case whilst cynics suggested that the uncertainty generated by the absence of a consideration of Part IVA by the judiciary was to the ATO's advantage.

Undoubtedly, Part IVA is drafted broadly and the early decisions on it, whilst not universally in the favour of taxpayers, suggested that a strict approach to its interpretation, similar to the approach taken to s 260, was to occur. The early cases focussed on:

- whether a dominant purpose meant a purpose more significant than all other purposes combined or simply a more significant purpose than any other one purpose;
- whether the ATO could select out a sub-scheme from an arrangement for the purpose of applying the provisions;

¹⁴ 96 ATC 5201 ("*Spotless*").

¹⁵ *IRC v Duke of Westminster* (1935) All ER Rep 259.

¹⁶ It is ironic that soon after the enactment of Part IVA a reconstituted High Court re-interpreted s 260 and restored its integrity. See *FC of T v Gulland* 85 ATC 4765.

- to what extent the provisions permitted taxpayers a choice as to how to structure their affairs;
- the basis for selecting the alternative arrangement by which to judge the existence of a tax benefit;
- whether the provisions applied to new arrangements or only, for example, to redirections of existing income streams; and
- when an unacceptable tax benefit was derived.¹⁷

Fundamental to most of these issues was whether Part IVA could apply to an arrangement that had an overall commercial justification. Grounds to suspect that Part IVA must contain such a limitation arose from the tension between Part IVA and the Duke of Westminster principle. This was enlivened by the Second Reading Speech to the Bill that introduced Part IVA¹⁸ which acknowledged its application to "blatant, artificial and contrived" schemes but not normal family or business dealings.

This begged the question as to what was an artificial scheme as distinct from a normal business dealing. Surely the minimisation of expenses such as taxation was a business concern, in which case how could an arrangement directed to this end be offensive?

The High Court decision in *Spotless*¹⁹ ended this speculation. It signaled in the words of one writer "a fundamental shift in direction", a "shift in atmospherics".²⁰

The case involved a taxpayer who chose to invest in the Cook Islands rather than in Australia even though the interest rate on offer was less. However, the investment made commercial sense given the low rate of tax in the Cook Islands and the tax exemption on the interest when received in Australia.

The High Court was not impressed by any argument based on the Duke of Westminster Principle or that in the absence of this arrangement the taxpayer may nevertheless not have had an Australian tax liability as they may still have invested elsewhere. The High Court also refused to countenance any argument that Part IVA only applied to the diversion of an existing income stream or that the requirement of a dominant purpose necessitated that a tax avoidance purpose be more influential than all other purposes combined. Most significantly, the Court stated that it was a false dichotomy to distinguish between commercial transactions and tax avoidance.²¹

Although alarmists might suggest that the delicate balance between the GAAR and the Duke of Westminster principle has been upset and the decision mandates that taxpayers must arrange their affairs so as to pay the maximum or, at least, a fair amount of tax, the summary of the facts above does not do justice to their complexity. The arrangements involved paper shuffling, the signing of contracts in the Cook Islands and a round robin of funds. The Court commented on the elaborateness of these activities as well as the involvement of a tax haven. It has been suggested that it is these factors that distinguish the case from a taxpayer who simply selects a tax effective investment over an alternative investment.²²

¹⁷ For a discussion of the interpretive issues relating to Part IVA, see P Harris, "Australia's General Anti-Avoidance Rule - Part IVA has Teeth but are Some Missing?" [1998] *British Tax Review* 124.

¹⁸ *Income Tax Laws Amendment Act (No 2) 1981*.

¹⁹ Discussed in J Passant, "Spotless: Removing the stain of tax avoidance in Australia" [1997] *British Tax Review* 131.

²⁰ Y Grbich, "Does Spotless exorcise Barwick's ghost" in R Deutsch (ed), *Tax Catchups - A Prospect Intelligence Report* (1997) 88, 89. For a similar view see MJ Watts, "Part IVA of the Income Tax Assessment Act after Spotless - A Brave New World?" (1998) 72 *The Australian Law Journal* 303.

²¹ The difficulties in identifying the scope of the commercial and family dealings gloss are well illustrated by the decision in *Osborne v FC of T* (1995) 95 ATC 4323 discussed in J Cassidy, "Osborne v FCT - The Lost Opportunity?" (1999) 3 *The Tax Specialist* 9. In that case the Federal Court managed to avoid this issue thereby leaving unresolved the question whether incorporating a business was an ordinary commercial arrangement.

²² See R Vann and R Allerdice, "Through a Spotless Glass, Darkly" (1997) 31 *Taxation in Australia* 368, 370; B Kamenetzky, "Spotless!" (1997) 31 *Taxation in Australia* 364, 367 and P Harris, above n 17, 134-135.

However, it is difficult to accept that this can be the basis upon which an anti-avoidance principle can be found. What is elaborate for one person may not be for another. Also would this mean that simple tax avoidance schemes would escape Part IVA?

Whilst the ATO must have been delighted with this victory, there was possibly a concern that it was too comprehensive and might lead to a judicial or, perhaps, legislative counter-reaction to the width of the GAAR. Accordingly, the ATO was quick to comment that the decision was substantially influenced by the manner in which the commercial objects of the arrangement were sought to be achieved. So called "badges of tax avoidance" were identified and further guidance promised to taxpayers in the form of case notes in respect of private ruling requests and the establishment of a Part IVA panel of external tax experts. It was emphasised that so long as taxpayers conducted their affairs in a manner that was reasonably to be anticipated then any resultant tax benefit would not be impugned.²³

Notwithstanding these sentiments, the ATO is faced with the dilemma that many of the tax planning arrangements that it has approved in the past, for example Everett assignments, salary sacrifice and even negative gearing, would now most likely be subject to Part IVA. Furthermore, the comments in the Second Reading Speech and the Explanatory Memorandum purporting to limit the application of Part IVA to blatant, artificial and contrived schemes are at odds with the decision.²⁴

Possibly the ATO's greatest fear is that in due course *Spotless* will be seen as an extreme case and restricted to its facts.²⁵ On the other hand,

practitioners are concerned at the considerable uncertainty generated by the decision and its potential to jeopardise the viability of proposed commercial transactions.

With a view to determining whether these concerns are well founded it is instructive to examine subsequent decisions that have applied *Spotless*.

3. JUDICIAL TREATMENT OF SPOTLESS

Two months after *Spotless* was handed down, the Federal Court was required to rule on whether an arrangement to direct profits into a loss company was subject to Part IVA. In *CC (NSW) Pty Ltd (in Liq) v FC of T*,²⁶ the Court endorsed the view that a commercial rationale is no defence to the application of Part IVA. In any event, the Court did not accept the commercial rationale argued by the taxpayer.

The Court also rejected the standard argument that there was no tax benefit because had this arrangement not been implemented then the reasonable hypothesis was that some alternative means of sheltering the income would have been chosen. There was simply no evidence to support the taxpayer's argument.

Shortly after this decision, another more complex scheme designed to take advantage of tax losses was also held to be subject to Part IVA in the Administrative Appeals Tribunal ("AAT") decision in *Clough Engineering Ltd v FC of T*.²⁷ Again, any notion that there was a commercial justification for the arrangement was rejected, having regard to the unilateral nature of the scheme, the round robin of funds, the backdating

²³ M D'Ascenzo, "Part IVA - Post Spotless" (1998) 1 *Journal of Australian Taxation* 3. Also see "Part IVA - Where to Draw the Line", an address by the Federal Commissioner of Taxation, M Carmody to the *13th National Convention of the Taxation Institute of Australia* (19 March 1997).

²⁴ As the generally held view that Part IVA enacted the objective predication test enunciated in *Newton v FC of T* (1958) 98 CLR 1, one implication of *Spotless* is that Part IVA permits reference to a taxpayer's subjective purpose: MJ Watts, "Part IVA of the Income Tax Assessment Act after Spotless - A Brave New World?" (1998) 72 *The Australian Law Journal* 303.

²⁵ Acknowledged by A Greenbaum, "Anti Avoidance Principles - New Directions for Tax and Business Resulting from the High Court decision in Spotless" (1997) 25 *Australian Business Law Review* 142, 146.

²⁶ 97 ATC 4123. Discussed in D Carbone, "*CC (New South Wales) Pty Ltd v FC of T: Part IVA can Apply to Loss Trusts*" (1999) 2 *Journal of Australian Taxation* 437.

²⁷ 97 ATC 2023.

of documentation and the fact that the scheme was substantially implemented by internally created documents and bookkeeping entries.

It could be suggested that these decisions were relatively straightforward and the real test for the scope of the application of *Spotless* would be an overall commercial transaction that happened to contain elements of tax avoidance. Such a situation had sidelined the application of Part IVA in the earlier High Court decision in *FC of T v Peabody*.²⁸ However, if the ATO is free to select a sub-scheme for the purpose of identifying the dominant purpose and the existence of a tax benefit and/or if the commerciality of the arrangement does not preclude the application of Part IVA then it is difficult to envisage why Part IVA cannot apply to such an arrangement.²⁹

Such was the conclusion in *FC of T v Consolidated Press Holdings Ltd (No 1)*.³⁰ A domestic company had been interposed between a company in receipt of foreign dividends and the source of the borrowings to acquire the foreign investment. This had the consequence of precluding the quarantining of interest deductions against foreign income with the result that the interposed company could enjoy an unfettered interest deduction. At the same time, foreign tax credits could also be utilised because the absence of an interest liability in the company in receipt of the foreign dividends ensured that it would be in a taxable position. These arrangements had been established in the wider context of the acquisition of foreign businesses.

The Full Federal Court affirmed the decision by Hill J at first instance³¹ on the application of Part IVA, holding that the Part could apply to parts of a scheme notwithstanding that the overall

scheme had a commercial justification. It was permissible to focus on a sub-scheme that was motivated by a desire to derive a tax benefit. Furthermore, where there were two equal purposes, one directed at obtaining a tax benefit and the other not,³² as achieving the tax benefit was more immediate, this was the dominant purpose.

It was also clear that in identifying the dominant purpose, the purpose of the tax advisers could be considered.

If a commercial justification is no defence then, as discussed earlier, what of the common commercial transactions, at least to some extent motivated by tax considerations, upon which the ATO has ruled favourably in the past? One example might be a sale and leaseback arrangement under which a taxpayer might raise cheaper finance by allowing the financier to access the tax deductions associated with ownership of an asset. The ATO has traditionally taken the view that such arrangements are tax effective within certain limits, such as that the sale be at market value.³³

The Federal Court decision in *Eastern Nitrogen Ltd v FC of T*³⁴ concerned such an arrangement, although admittedly, the sale was not at market value. Having concluded that the whole arrangement was ineffective given that the asset was a fixture and the right to possession had never passed to the financier, the Federal Court stated that, in any event, Part IVA would have applied. The Court emphasised that since *Spotless*, commerciality was not sufficient to immunise a scheme from the reach of Part IVA as had widely been thought to be the case prior to that decision.

²⁸ 94 ATC 4663 ("*Peabody*"). For a considered analysis of *Peabody* see J Waincymer, "The Australian Tax Avoidance Experience and Responses: A Critical Review" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 285-304. The differences between *Spotless* and *Peabody* are discussed in J Hart, "Spotless Approach to the Tax Law" [1997] 2 *New Zealand Tax Planning Report* 9. Also see Grbich, above n 19, 97-101.

²⁹ The unavailability of a commercial justification as a defence renders the debate as to whether a sub scheme may be selected for the purposes of applying Part IVA irrelevant. See the discussion by B Kamenetzky, above n 22, 367.

³⁰ 99 ATC 4945.

³¹ 98 ATC 4983.

³² The definition of "tax benefit" in Part IVA at the relevant time did not extend to ensuring the availability of tax credits.

³³ See *Taxation Ruling* TR 95/30.

³⁴ 99 ATC 5163 ("*Eastern Nitrogen*").

Whilst the matter may never have been contested by the ATO if the sale had not been at an inflated price, there is little in the decision to indicate that this was the critical factor that subjected the arrangement to Part IVA. On the authority of this decision, it is very difficult to rationalise how the ATO could continue to endorse sale and leaseback arrangements.

Some doubt has since been created by the contrary view expressed by a different Federal Court in *Metal Manufactures Ltd v FC of T*.³⁵ Again the issue concerned a sale and leaseback arrangement involving an inflated sale price. Not only did the Court hold that the sale of the fixture and subsequent leaseback were effective, it held that Part IVA did not apply. The rationale was that the primary purpose of the arrangement was to secure medium term finance and the associated tax benefits were only a secondary purpose. Some rationale for the inflated sale price was also discernable, the price being based on a going concern valuation. The decision included very little analysis, particularly of the primary/secondary purpose distinction, and *Eastern Nitrogen* was not even referred to in the context of Part IVA. Not surprisingly both decisions have proceeded on appeal.

With the exception of the *Metal Manufactures* decision and its difficult primary/secondary purpose distinction, the early indications are, therefore, that *Spotless* will not be read down. However, the tension remains intense and building. In particular, the application of Part IVA in the context of tax concessions will inevitably lead to friction that will have to be oiled.³⁶ The looseness in the definition of "scheme" and the demise of any commercial purpose exception obviates the criterion that the tax avoidance

purpose be "dominant". The endorsement of a creative application of the reasonable hypothesis test ensures that the identification of a tax benefit will almost always be achievable. It could be suggested that the ATO has effectively been granted a general discretionary power and the rule of law is in disarray.

4. PROPOSALS FOR REFORM AND VIEWS OF OTHER COMMENTATORS

In this environment it is surprising that the government has announced measures to strengthen the application of Part IVA.³⁷ The proposals include:

- (i) improvements" to the reasonable hypothesis test to provide legislative guidance to taxpayers and remove the ability to argue that the reasonable alternative to the scheme under challenge was to do nothing;³⁸
- (ii) expansion of the concept of tax benefit to include the generation of rebates, credits or losses;
- (iii) authorisation of the ATO to issue a single determination in respect of a scheme; and
- (iv) that there be an annual review of the application of Part IVA by a board comprising government and external representatives.³⁹

A precedent for the first proposal is provided by s 165-10(3) of *A New Tax System (Goods & Services Tax) Act 1999* that provides that a "GST benefit" exists even if there is no economic alternative to the activities engaged in. Thus, under that legislation it is not possible to argue that but for the scheme there would have been no

³⁵ 99 ATC 5229 ("*Metal Manufactures*").

³⁶ See R Vann and Allerdice, above n 22, 370.

³⁷ See the Treasurer, *Press Release No 74* (11 November 1999), Attachment D. In response to Opposition concerns that the reduction in the tax rate on capital gains would result in schemes to convert income into capital, the government has also enacted changes to the definition of tax benefit to make it clear that such schemes are caught. Enacted as s 177C (4) by the *New Business Tax System (Integrity and Other Measures) Act 1999*. Both the ATO and the Tax Institute of Australia are reported as having stated that these changes add nothing and just clarify the existing law; F Buffini and P Cleary, "Changes to Tax Avoidance Law Branded Unenforceable" *Australian Financial Review* (1 December 1999) 6.

³⁸ Discussed by Harris, above n 17, 135.

³⁹ Funding for a Board of Taxation was a feature of the 9 May 2000 Federal Budget.

transaction at all because the scheme was the only economic way of implementing the transaction.⁴⁰

The second proposal tackles a widely appreciated limitation in Part IVA. In fact, piecemeal amendments over the years have sought to remedy this deficiency on a case by case basis.⁴¹

The third proposal is directed at mass marketed tax shelter arrangements. It will be interesting to see how the proposal works in practice. It is difficult to envisage how Part IVA can apply to a taxpayer in the absence of a consideration of their individual circumstances. In fact, a reference to these circumstances would appear to be the express mandate contained in s 177D(b).

These proposals had their germination in the Ralph Review.⁴² Unfortunately, the government has been silent as to its acceptance of the main proposals for the reform of Part IVA proposed in that report. These were that:

- (i) Part IVA contain an objects clause requiring its application be consistent with and support the structure and underlying policy reflected in objects clauses in other parts of the income tax laws; and
- (ii) structural reform of the tax laws be the primary mechanism for combating tax avoidance and that Part IVA have, essentially, an interim application.

The Ralph Review rejected the need for substituting a principal effect test for the dominant purpose approach. The GST legislation makes reference to such a test and an appreciation that the dominant purpose approach in Part IVA was flawed might yet result in government support for it to be replaced with a principal effect test.⁴³

There is little discussion in the report of the proposal that Part IVA contain a statement that it is to be applied in a purposive manner other than the comment that this should reduce the perception that valid commercial transactions could be subject to the application of the Part. However, the proposal has its foundation in sentiments that have been expressed by a number of commentators who elaborate on the supporting arguments.

For example, in a paper written prior to the High Court decision in *Spotless*, Orow argues that the dominant purpose test in Part IVA is flawed because a tax avoidance purpose is a commercial purpose. Put differently, Part IVA requires an unsustainable distinction between a taxpayer's immediate and ultimate purposes. Either Part IVA required a general exemption stating specific purposes that are acceptable or, preferably, it should be amended to focus on Parliament's purpose rather than that of the taxpayer.⁴⁴

Subsequently, he prophesies that, unless amended, Part IVA will go the same way as s 260 as judges predominantly apply the rule of precedent in the search for consistency which will ultimately result in the reading down of the Part.

⁴⁰ It has been suggested that the changes to the reasonable hypothesis test should take into account that the "do nothing" option is acceptable in many internal re-organisations: R Conwell, "The Ralph Report. Protecting the Income Tax Base" (1999) 34 *Taxation in Australia* 246, 247.

⁴¹ Harris, above n 17, 136-138.

⁴² (<http://www.rbt.treasury.gov.au/publications/paper4/index.htm>).

⁴³ Division 165 of *A New Tax System (Goods and Services Tax) Act 1999* contains a GAAR, modeled on Part IVA, but which focuses on the principal effect of an arrangement as an alternative to the dominant purpose. The Explanatory Memorandum does not explain the rationale for this addition.

⁴⁴ NF Orow, "Towards a Conceptually Coherent Theory of Tax Avoidance - Parts 1 and 2" (1995) 1 *New Zealand Law of Taxation Law and Policy*, 288 and 307. Orow nevertheless accepts that a taxpayer's purpose may have some secondary relevance, 317-318.

This process will occur over time during which the interpretation of the provision will wax and wane with the politics of the High Court.⁴⁵

McLeod advances a similar proposal. He agrees that tax avoidance is best tackled by restructuring the tax system to remove opportunities for avoidance and by increasing the cost of avoidance. Because it is not sensible to suggest that all tax incentives be removed from the system, the anti-avoidance provision ought to recognise the legitimacy of tax induced behaviour. Thus, he suggests that the GAAR contain both a dominant purpose test and an exemption provision where the "avoidance" was consistent with Parliament's purpose. To facilitate the identification of Parliament's purpose it should be specifically stated in the legislation and access to parliamentary debates and reports should be permitted.⁴⁶

Thus, these commentators would support the Ralph Review proposal of introducing a purposive element to restore some integrity to Part IVA. Sole reference to a taxpayer's purpose is simply inappropriate as not all tax motivated transactions are illegitimate.

Even the strongest advocates for Part IVA suggest that more certainty is required in the form of further definition of the core principles in the Part.⁴⁷ Grbich appears particularly concerned that technical legal arguments may emasculate the operation of the Part. His view would appear to be

that the only limitations on the application of the Part are that it is restricted to "artificial", "unusual", "not normal" or "unnatural" arrangements, terms that he variously uses throughout his paper. However, it is suggested that, as with the notion of elaborateness, these expressions are inadequate in providing any guidance on the application of Part IVA.⁴⁸ With respect, it is inappropriate for the ATO or the judiciary to rule upon commercial normality. Furthermore, the proposition of legitimacy by popular vote cannot be supported. The notion that an arrangement is normal because everyone else is doing it was soundly rejected in the first pronouncement on Part IVA, *Case W58*.⁴⁹

5. OVERSEAS EXPERIENCES

In the pursuit of evidence as to the best approach to a GAAR, it is appropriate to review experiences in selected overseas common law jurisdictions.

Certainly, tax avoidance and the tensions generated by GAAR are not uniquely an Australian problem. Arnold and Wilson canvass the universal nature of the problem although warning of the dangers of transposing solutions because of differences in the tax systems of the various countries. Nevertheless, the authors conclude that Canada, Australian and New Zealand have all enacted broad statutory rules rather than embracing judicial anti-avoidance doctrines.⁵⁰

⁴⁵ NF Orow, "The Future of Australia's General Anti-Avoidance Provision" (1995) 1 *New Zealand Journal of Taxation Law and Policy* 225. Recently, Orow has taken his argument that Part IVA is flawed further suggesting that it discloses no clear principle and is uncertain in operation. In fact, he argues that it has no operation if the other tax provisions are interpreted according to their policy and purpose. Failing the criteria of a good tax system, the Part ought to be repealed and the government should require that tax legislation be interpreted according to its policy and purpose with this being clearly stated: NF Orow, "Part IVA - Seriously Flawed in Principle" (1998) 1 *Journal of Australian Taxation* 57.

⁴⁶ RA McLeod, "An Economic Approach to Taxation Avoidance" (1996) 2 *New Zealand Journal of Taxation Law and Policy* 171. McLeod suggests that the government should focus on tax avoidance at the sharp end rather than at the margin as otherwise there is a risk of generating substantial transaction costs for taxpayers and impeding economically desirable behaviour. The government needs to appreciate that it will never obliterate all tax avoidance.

⁴⁷ Grbich, above n 20, 117.

⁴⁸ The use of "artificiality" as a test is rejected in BJ Arnold and JR Wilson, "The General Anti-Avoidance Rule – Parts 1, 2 and 3" (1988) 36 *Canadian Tax Journal* 831, 1123 and 1369 and also in BJ Arnold, "The Canadian General Anti-Avoidance Rule" [1995] *British Tax Review* 541, 545-546. Gammie also rejects artificiality and complexity as criteria by which to identify tax avoidance: M Gammie, "Tax Avoidance and the Rule of Law: The Experience of the UK" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 199-200.

⁴⁹ 89 ATC 524. The matter was heard by Hartigan J and so has judicial status.

⁵⁰ BJ Arnold and JR Wilson, "The General Anti-Avoidance Rule - Part 1" (1998) 36 *Canadian Tax Journal* 831, 872.

5.1 Singapore and Hong Kong

To this list we should add Hong Kong and Singapore. Both jurisdictions have traditionally relied on a provision that provides a power to disregard artificial or fictitious transactions. This provision had been applied to shams and commercially unrealistic transactions.

In 1984, Hong Kong introduced s 61A of the *Inland Revenue Ordinance* to compliment the existing provision.⁵¹ Section 61A replicates Part IVA.⁵² However, the Inland Revenue Department has ruled that the section has no application to normal commercial transactions and, furthermore, the tax purpose must be dominant over all other purposes combined for the provision to apply.⁵³

In contrast, in 1988 Singapore replaced its existing provision with a GAAR based on the Australian s 260 but with its application expressly excluded from bona fide commercial transactions.⁵⁴ The Singapore Inland Revenue Service ("IRS") argues that the section does not contain sweeping and catch all clauses like other countries such as Hong Kong although this is difficult to accept from a reading of the provision. Additionally, the IRS has undertaken not to apply it where advantage is being taken of tax incentives. Rather, the section is apparently directed at artificial arrangements or where various intermediaries or transactions have been interposed to avoid tax.⁵⁵

The adoption in these two countries of the current and former Australian GAARs respect-

ively could be taken as an endorsement of these provisions. However, it is significant that in each jurisdiction a commercial justification exception applies in contrast to the direction now being taken in Australia. As discussed earlier, the problems with such a rule motivated the High Court's rejection of it in *Spotless*.

5.2 South Africa

A broad statutory GAAR also exists in South Africa. Section 103(1) of the *Income Tax Act 1962* imposes a GAAR that contains both an objective and subjective test. That is, an avoidance transaction will be ineffective where it was not objectively employed for bona fide business purposes and was entered into for the main purpose of obtaining a tax benefit.

The bona fide business purposes limb had been inserted in 1996 to replace a test that focussed on whether the arrangement was abnormal. However, this test had been weakened by the fact that some avoidance transactions had become so common in the business community that they could not be regarded as abnormal.⁵⁶

Unfortunately, the section has been interpreted as focussing on both the subjective and objective purposes of the taxpayer, not Parliament, and the problems with the provision are well documented. It appears to confuse purpose and motive and is arguably flawed in requiring the assessment of bona fide transactions from the perspective of typical business behaviour.⁵⁷

⁵¹ Section 61.

⁵² Section 61A was recently considered in *C of IR v Yick Fung Estates Ltd* (1998) 4 HKC 700 where it was held to apply to a unilateral arrangement where only one of the factors to be referred to in order to ascertain whether the dominant purpose of the scheme was to obtain a tax benefit suggested this conclusion. The section was held to impose a purely objective test and to override the other provisions of the Ordinance as a matter of statutory interpretation. In contrast, in Australia the factors to which Part IVA directs attention in order to ascertain the objective purpose are sufficiently broad to encompass the subjective purposes of the taxpayer and other parties. See Watts, above n 24, 307-310 and Grbich, above n 20, 91. Contrast Carbone, above n 26, 450.

⁵³ Departmental Interpretation and Practice Note 15 (revised), paras 19 and 23-26.

⁵⁴ *Income Tax Act*, s 33.

⁵⁵ Letter dated 20 January 1988 to the Registrar of the Singapore Society of Accountants.

⁵⁶ See RC Williams, "The 1996 Amendments to the General Anti-Tax Avoidance Section of the Income Tax Act" (1997) 114 *South African Law Journal* 675. This reinforces my earlier comments as to the appropriateness of normality as a test of unacceptable behaviour.

⁵⁷ See Williams, *ibid* 682. He advocates that the focus should be on the objective purpose test only.

The limitations of the provision may have been the catalyst for a recent acknowledgment by the South African judiciary of a substance over form principle.⁵⁸

5.3 United Kingdom

In the United Kingdom, which has traditionally relied on judicial anti-avoidance doctrines, the 1997 Budget contained a bombshell that the government was considering introducing a GAAR for direct taxes that would apply to companies only. The Consultative Document⁵⁹ was met with condemnation by the profession.⁶⁰ This Consultative Document proposed a substantial move away from literalism to a purposive approach to interpretation. Essentially tax avoidance was to be widely defined with exceptions for "acceptable tax planning" and "protected transactions". The former was to be a transaction that took advantage of a concession contained in the legislation whilst the latter was to be a transaction which was either reasonably to be regarded as encouraged by the legislation or not otherwise in conflict with its purpose.⁶¹

Arguments against this proposal inevitably included that it would potentially apply to overall

commercial transactions, undermine certainty, erode the rule of law and effect an inappropriate transfer of power to the Inland Revenue.⁶² Also, interestingly, one commentator has argued that in assessing tax avoidance, attention should focus not on the purpose of the legislator but rather on that of the taxpayer, primarily because parliamentary purpose is often too hard to ascertain. In effect, the courts would be required to ascertain what Parliament *would* have intended. This would result in an arbitrary and inconsistent application of the rule.⁶³ In any event, what is unacceptable tax avoidance is ultimately a subjective decision so it should be left to the courts to determine in accordance with the social and political mores of the time.⁶⁴

The notion that the Inland Revenue could substitute a normal transaction for the tax driven transaction also drew criticism on the basis of how normality was to be ascertained.

Ultimately, these criticisms carried the day and the government announced in the 9 March 1999 Budget that it had decided not to proceed with a GAAR and rather would persevere with more targeted legislation.⁶⁵

⁵⁸ See *Erf 3183 / I Lady Smith (Pty) Ltd and another v C of IR* 1996 (3) SA 942 (A); 58 SATC 229, discussed in L Olivier, "The Substance Over Form Doctrine Applied to Tax Avoidance Schemes" (1998) *The South African Law Journal* 646.

⁵⁹ *A General Anti-Avoidance Rule for Direct Taxes: Consultative Document*, Financial Secretary to the Treasurer, HMSO 1998. Also see *Tax Avoidance*, Tax Law Review Committee, 1997. The non-Government Tax Law Review Committee ("TLRC") had recommended the adoption of a statutory GAAR provided that it was sensibly targeted and contained appropriate safeguards. Whilst this would not remove the need for structural reform to prevent avoidance, to the extent that the GAAR would support a purposive approach to interpretation and be coupled with an advance clearance procedure and public guidance, it was viewed as an improvement on the existing United Kingdom judicial anti-avoidance doctrines. Discussed in H McKay, "Tax Law Review Committee Report on Tax Avoidance" [1988] *British Tax Review* 86.

⁶⁰ For example see H Appleton, "Background to the GAAR: Ramsay and McGuickian" (1998) 476 *The Tax Journal* 5; O Ralph, "GAAR: Empty Threat or Deal Stopper?" (1998) 9 *International Tax Review* 13; PS Vaines, "Taxing Matters" (1999) 149 *The Practitioner* 256; E Troup, "The Consultative Document on a General Anti-Avoidance Rule for the United Kingdom – A View from a Practising Lawyer" [1999] *British Tax Review* 5; P Gillett, "The Consultative Document on a General Anti-Avoidance Rule for Direct Taxes – A View from Business" [1999] *British Tax Review* 1. Also see C Masters, "Is There a Need for General Anti-Avoidance Legislation in the United Kingdom?" [1994] *British Tax Review* 647 whose analysis is roundly criticized in BJ Arnold. "The Canadian General Anti-Avoidance Rule" [1995] *British Tax Review* 541.

⁶¹ This is to be contrasted with the TLRC proposal that focussed on the intention of parliament. For a comparison of the TLRC proposal and that contained in the Consultative Document, see M Parry-Wingfield, "A GAAR Too Far?" [1998] *The Tax Journal* (9 November) 7.

⁶² Ralph compares GAARs elsewhere in the world for the purpose of illustrating how they generate uncertainty. Whilst this can be alleviated by a well-run advance rulings procedure, typically rulings take too long, require too much detail and are invalid if any details of the transaction are changed. Notably, the Australian advance ruling system is viewed as one of the worst in the world: O Ralph, "GAAR: Empty Threat or Deal Stopper?" (1998) 9 *International Tax Review* 13.

⁶³ E Troup, "The Consultative Document on a General Anti-Avoidance Rule for the United Kingdom – A View from a Practising Lawyer" [1999] *British Tax Review* 5.

⁶⁴ P Gillett, "The Consultative Document on a General Anti-Avoidance Rule for Direct Taxes – A View from Business" [1999] *British Tax Review* 1.

⁶⁵ R Downhill, "Budget Analysis" (1999) 96 *Law Society's Gazette* 24.

There is a clear similarity between the United Kingdom proposal and the Canadian provision discussed below.

5.4 New Zealand

The New Zealand GAAR⁶⁶ borrows heavily from the former Australian GAAR, s 260.

The leading decision on its interpretation is the Privy Council decision in *Challenge Corporation Ltd v C of IR*⁶⁷. In striking down a transaction utilising the group loss provisions in an unintended fashion, the Privy Council distinguished between tax mitigation and tax avoidance. Tax mitigation is legitimate and occurs where a taxpayer obtains a tax advantage by reducing their income or by incurring expenditure in circumstances where the legislation offers a reduction in tax liability. On the other hand, tax avoidance is where a tax liability is reduced without an attendant economic loss or expenditure.

Neither of these concepts had been addressed in argument⁶⁸ and the distinction has not found favour with the New Zealand Court of Appeal. Rather, the predication test evolving from *Newton v FC of T*⁶⁹ was applied in *Hadlee and Sydney Bridge Nominees Ltd v C of IR*⁷⁰ and more recently in *Miller v C of IR*.⁷¹ Thus, in contrast to Australia, a commercial transactions exception applies.

There has also been some debate within the judiciary as to whether the choice doctrine applies to the New Zealand GAAR. The Court of Appeal in *Miller* was not prepared to apply the choice

doctrine considering itself bound by *Challenge* where the Privy Council stated that the doctrine had no application in the context of the loss grouping provisions, the same regime at issue in *Miller*. On the other hand, at first instance, Baragwanath J, endorsed the choice doctrine with the rider that the GAAR would only override a choice specifically envisaged by the legislation where there was some "impropriety". No criteria was put forward to assist in applying this impropriety test although reference was made to "normal business techniques".⁷² As argued earlier, this notion of "normality" does not advance the analysis.

It remains unclear whether the judicial anti-avoidance doctrines established in the United Kingdom can have an application in New Zealand. It has been suggested that *Challenge* was implicitly based on these principles.⁷³ Nevertheless, the New Zealand courts would appear to have rejected any substance over form common law principle.⁷⁴

In the 1990 Report of the Consultative Committee on the Taxation of Income from Capital⁷⁵ ("Valabh Committee"), changes were recommended to the New Zealand GAAR loosely based on Part IVA. There would be a two tiered approach, the first based on the "dominant objective" of the taxpayer to obtain a "tax objective". However, pursuant to the second tier principle, this would only be impeachable where the objective was inconsistent with the scheme and purpose of the legislation. To determine this, reference was to be made to the how detailed the substantive provisions relating to the transaction

⁶⁶ *Income Tax Act 1994*, ss BG1, GB1, GZ1 and OBI.

⁶⁷ [1986] 2 NZLR 555 ("*Challenge*").

⁶⁸ *New Zealand Income Tax Law and Practice*, CCH Loose Leaf Service, paras 537-800.

⁶⁹ (1958) 98 CLR 1.

⁷⁰ (1991) 13 NZTC 8,116. In this case the Court of Appeal was substantially motivated by the unfairness for other taxpayers if the taxpayer was able to obtain a tax advantage in the manner at issue. The GAAR was not considered by the Privy Council in dismissing the appeal: (1993) 15 NZTC 10,106.

⁷¹ (1997) 18 NZTC 13,001; (1998) 18 NZTC 13,961 ("*Miller*").

⁷² (1997) 18 NZTC 13,001, 13,031. Discussed in CM Ohms, "Aspects of Anti-avoidance Law and Policy in Two Commonwealth Jurisdictions", *1999 Annual Australasian Tax Teachers Conference*. Confirmed by His Honour in *KJ Cummings Ltd v CIR* (1998) 18 NZTC 13,537, 13,549 and *Wither v CIR* (1998) 18 NZTC 13,606, 13,608.

⁷³ CCH Tax Editors, *1999 New Zealand Master Tax Guide*, paras 33-120 and 33-130.

⁷⁴ *Ibid*, paras 33-050 and 33-090.

⁷⁵ Consultative Committee on the Taxation of Income from Capital, *Final Report* (October 1992) and see *Key Reforms to the Scheme of Tax Legislation, Discussion Paper* (October 1991).

were, whether any specific anti-avoidance provisions existed but were not applicable, whether the matter involved a tax incentive provision and the purpose of the relevant substantive provisions having regard to government consultative documents, reports, committee findings and parliamentary speeches.

The suggestion was that the more detailed the legislation addressing the arrangement and/or if it were an incentive provision, then the less likely that the GAAR would operate. The rationale was that this would support the view that the arrangement was contemplated by Parliament.

Additionally, in ascertaining the taxpayer's objective, reference was to be made to matters such as the substance of the arrangement, the manner in which it was carried out, the existence of any artificiality and whether the arrangement was consistent with that expected to be carried out on an arm's length basis.

These proposals are yet to be acted upon. In a recent government sponsored report on tax compliance by a "Committee of Experts",⁷⁶ the Valabh recommendations were rejected. In particular, the Committee was concerned that the proposals would reduce the flexibility and objective nature of the GAAR. Rather, the Committee recommended further structural changes to the tax laws to broaden the base and lower the tax rates. Some clarifying amendments to the existing GAAR were proposed however including a provision to the effect that the New Zealand courts were not precluded from applying judicial anti-avoidance rules.⁷⁷ Additionally, the Committee recommended that the Internal Revenue Department withdraw its 1990 Policy Statement on the application of the GAAR and

apply the provision less conservatively.⁷⁸

It is difficult to understand the basis of the concerns as to flexibility and objectiveness. In any event, the New Zealand tax legislation mandates in s AA3(1) that a purposive approach to interpretation is to be adopted and, in that context, the Valabh GAAR recommendations might be viewed as less pressing. As will be seen, there is a clear similarity between these proposals and the Canadian approach.

It is the history of tax avoidance and the government response in Canada that provides the most significance for Australia. Whilst similar in some respects to Part IVA, the focus of the Canadian GAAR on Parliament's purpose has been the centrepiece of that provision. As observed above, proposals advocated for the United Kingdom and New Zealand also provide support for this approach⁷⁹ and there have been calls for Australia to embrace a similar regime. It is useful to consider the Canadian developments for the purpose of assessing the desirability of these proposals for Australia.

5.5 Developments in Canada

5.5.1 Arnold and Wilson

Any consideration of the Canadian GAAR must commence with a reference to the pivotal 3 part analysis by Arnold and Wilson in 1988.⁸⁰ In these articles, Arnold and Wilson examine the history behind, and the likely future of, the Canadian GAAR which became effective on 13 September 1988.

The authors explain that prior to its introduction there were a number of ineffective anti-avoidance provisions. Furthermore, the

⁷⁶ Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance (December 1998).

⁷⁷ Paragraphs 6.18-6.53.

⁷⁸ Paragraphs 6.54-6.101 and 13.42-13.53.

⁷⁹ For a discussion of the Swedish experience where the GAAR also mandates reference to whether the purpose of the legislation has been violated, see L Muten, "The Swedish Experiment with a General Anti-avoidance Rule" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997). In contrast to the Canadian approach reference to the legislative purpose is a substantive element of the provision rather than a defence (similar to the Valabh recommendation). The other elements of the Swedish rule are the securing of a tax advantage that in the circumstances was the main reason for the action taken.

⁸⁰ BJ Arnold and JR Wilson, "The General Anti-Avoidance Rule- Parts 1, 2 and 3" (1988) 36 *Canadian Tax Journal* 831, 1123 and 1369. The views expressed in these articles are neatly summarized in BJ Arnold, "The Canadian General Anti-Avoidance Rule" [1995] *British Tax Review* 541.

Supreme Court of Canada had, in its decision in *Stuart Investments Ltd v The Queen*,⁸¹ rejected the adoption of a judicial business purpose test, although it did endorse a purposive approach to interpreting statutory provisions.

Also, during the early 1980s, Revenue Canada had, in response to pressure from a conservative government and the creation of a taxpayer Charter of Rights, softened its stance on tax avoidance with the result that it became wide-spread and seriously impacted on fiscal policy. This led to a heated debate resulting in the enactment of s 245 of the *Income Tax Act*, the Canadian GAAR.

The section authorises Revenue Canada to reconstruct an "avoidance transaction" in such a manner as is reasonable in order to deny a "tax benefit". "Avoidance transaction" is defined as any transaction that would result in a tax benefit other than where it was undertaken for bona fide purposes. However, a transaction will not be an avoidance transaction where it would not result in the misuse of the provisions of the Act, or an abuse of the Act as a whole ("misuse/abuse limb"). "Tax benefit" is defined broadly to include reductions in, avoidance or deferral of tax or an increase in a refund.

Arguments against the introduction of this rule included that it was unnecessary, unconstitutional, a violation of the rule of law, that it would give too much administrative discretion to Revenue Canada and that the uncertainty it would generate would impede legitimate commercial transactions. The proposal was subjected to considerable parliamentary scrutiny resulting in substantial changes from the original draft. Of note was the deletion of an express authorisation of the courts to refer to the explanatory notes relating to the rule.

In rejecting these arguments against the GAAR, Arnold and Wilson suggest principles to

be applied in assessing the rule. These include that the rule:

- (i) be sufficiently broad to deal with all types of illegitimate tax avoidance;
- (ii) distinguish between legitimate and illegitimate tax avoidance;
- (iii) focus on the results of transactions rather than the taxpayer's purpose. However, if a purpose test is used it should be objective;
- (iv) minimise uncertainty; and
- (v) be a provision of last resort.

The authors acknowledge that it is very difficult to enunciate criteria for distinguishing between legitimate and illegitimate tax avoidance. They dismiss the concept of artificiality as the arbitrator as being too ambiguous and rather prefer that the distinction be based on the purpose of the transaction. However, such an approach requires a narrowing of or exclusions to the GAAR to protect transactions that are consistent with the policy of the Act but lack a non-tax purpose.

Applying these criteria to the Canadian GAAR, the authors conclude that the bona fide purpose test should be based on the objective commercial results of what the taxpayer did rather than on the taxpayer's state of mind.⁸² The authors canvass the possible exclusions noting that the Canadian GAAR creates a general exception for transactions within the policy of the legislation that lack a bona fide purpose (the misuse/abuse limb). This is discussed in detail below.

The authors also acknowledge that one of the most difficult issues with a GAAR is its relationship with specific provisions. They suggest that rather than a fixed rule as to which

⁸¹ [1984] CTC 294; 84 DTC 6305.

⁸² Dodge argues that because the purpose behind a provision is sometimes difficult or impossible to assess, this is why the misuse/abuse limb could not practically constitute the basis of the GAAR and why the primary test is the bona fide purpose test; DA Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36 *Canadian Tax Journal* 1.

should prevail the courts must adopt a case by case approach.

As to the need to minimise uncertainty, this can be achieved through the use of explanatory notes and administrative pronouncements. To ensure consistency, the application of the GAAR should be restricted to high-level decision-makers within the taxing authority.⁸³

The misuse/abuse limb is identified as the central element of the Canadian GAAR. Arnold and Wilson suggest that this limb could be interpreted as either a rule of construction, a substantive exemption or an exemption for transactions that are non-abusive.

That is, the possible approach of the courts is to:

- (i) apply the GAAR as a bona fide purpose test using the misuse/abuse limb to resolve difficult cases where it is unclear whether the rule should take precedence over more specific provisions of the Act. That is, use this limb as a rule of construction;
- (ii) use this limb as a substantial exception such that the purposive approach to the interpretation of the tax laws would be maintained. That is, the rule would be viewed as a codification of *Stuart*. However this may render the GAAR meaningless because under the purposive approach to statutory interpretation the provisions of the Act must be applied in accordance with their object and spirit and, accordingly, upon any subsequent application of the GAAR the transaction at

issue could never constitute a misuse or abuse; or

- (iii) apply the rule as an unprincipled test based upon economic reality.

The authors see the second option as the most likely.⁸⁴ Nevertheless, to avoid any doubt they would prefer that this limb be replaced with a statement of purpose such as "this section is intended to counter abusive tax avoidance".⁸⁵ This statement would be a signal to the courts that their responsibility was to distinguish between illegitimate tax avoidance within the broad limits of the bona fide purpose test.

Ultimately, the authors take the view that the GAAR is likely to have less impact on commercial life and tax planning than many had predicted. If anything, the strength of the rule is that it will likely embolden Revenue Canada to be more aggressive in assessing and litigating tax avoidance and cause tax planners to be more cautious. This is borne out by the discussion in Part 3 of their analysis where they identify that Revenue Canada has not been consistent in its pronouncements of the application of the provision and rather appears to be applying a "smell" test. Thus, they conclude that it is impossible to enunciate any general principles that may be used in predicting how the rule will be applied.

One of the issues only given a passing consideration by Arnold and Wilson is the requirement for Revenue Canada to apply a reasonableness test in identifying the most likely alternative transaction and, hence, the tax benefit.

⁸³ Revenue Canada has issued a number of information circulars providing examples of where the GAAR will or will not apply. See Revenue Canada, *Taxation, Information Circular 88-2* (21 October 1988) and *Supplement 1* (13 July 1990). Applications of the rule are reviewed by Head Office and a "GAAR Committee" comprising senior government officials.

⁸⁴ These interpretive difficulties have enticed one commentator to argue that the Canadian GAAR is void for vagueness; J Nitikman, "Is GAAR void for vagueness" (1989) 37 *Canadian Tax Journal* 1409. He also refers to the inability of taxpayers to calculate their potential liability under the GAAR in advance and the lack of a standard by which to judge the existence and quantum of a tax benefit. Also see HJ Kellough in "A Review and Analysis of the Re-Drafted General Anti-Avoidance Rule" (1988) 36 *Canadian Tax Journal* 23 who argues that the GAAR generates uncertainty and is unnecessary in any event. Contrast DA Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36 *Canadian Tax Journal* 1 where it is argued that rather than creating more uncertainty the GAAR has the opposite effect by fostering a purposive approach to interpretation. Arnold expects that the void for vagueness argument will be rejected by the courts: BJ Arnold, "The Canadian General Anti-Avoidance Rule" in GS Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), 221. As is discussed below, the judiciary to date has supported this view.

⁸⁵ They acknowledge that this approach had been adopted in an earlier draft of the legislation. Above n 80, 1147 and 1170. It is consistent with the Ralph Review recommendation.

Other commentators have recognised the difficulties here where there are a number of alternatives that the taxpayer may have selected given that no selection criteria are specified in the legislation. The issue is typically whether the most tax ineffective option is to be selected or whether tax considerations may be taken into account when identifying the most likely alternative?⁸⁶

5.5.2 GAAR Decisions

It is interesting to examine subsequent developments with the GAAR since its introduction in the light of this analysis.

Firstly, it has been observed that whilst the GAAR was intended to replace the judicial doctrines, both Revenue Canada and the judiciary have continued to apply these and use the GAAR only as a last resort.⁸⁷ Similarly, whilst the GAAR was supposed to obviate the need for specific anti-avoidance rules these have also continued to be enacted and enforced.⁸⁸

To date there have been eight GAAR decisions.⁸⁹ The first dealt with the equivalent provision in the GST legislation. At issue was a blatant tax avoidance scheme and it has been suggested that the sole significance of the

decision is a warning to tax advisers that a literal interpretation of the tax laws is no longer the norm.⁹⁰

The first income tax cases dealing with the GAAR were *McNicol v The Queen*⁹¹ and *RMM Canadian Enterprises Inc v The Queen*⁹² which both involved dividend stripping, the latter with an international aspect. Whilst some have not been surprised at the application of GAAR to what they describe as blatant tax avoidance,⁹³ most commentators rejected the decisions as an inappropriate application of substance over form. The transactions were viewed as having an overall commercial purpose. There were simply two ways to achieve this purpose, one which was more tax effective. Thus, the essence of the criticism was that the courts had applied the reasonable hypothesis test inappropriately by identifying the less tax effective alternative as the standard by which to achieve the commercial purpose.⁹⁴

In particular, one commentator has criticised *McNicol* as furthering non-neutralities in the tax system because the taxpayer was simply seeking to achieve the same tax result from disposing of assets in a company as if it held the assets directly. Accordingly, it was suggested that the transaction could not be viewed as an abuse or misuse of the tax provisions.⁹⁵

⁸⁶ For example see PW Hogg and J McGee, *Principles of Canadian Income Tax Law* (2nd ed, 1997) 484.

⁸⁷ JA Nitikman, "Preparing for NAFTA: Canadian Judicial Anti-avoidance Doctrines Part I" (1993) 19 *The International Tax Journal* 1.

⁸⁸ HJ Kellough QC, "Tax Avoidance: 1945-1995" (1995) 43 *Canadian Tax Journal* 1819.

⁸⁹ For a discussion of the more recent decisions see AH Kingissepp, "Canada: GAAR Update" [1999] *Journal of International Taxation* 38. Statistics on the number of decisions that have been referred to the GAAR Committee indicate that as at the end of 1998, 15 cases had been heard or were pending: "GAAR Statistics", (1998) *Tax Topics* (November 5) (1391) 1 and also see T Hickey, "The Goods on GAAR" (1996) 129 *Magazine for Canada's Chartered Accountants* 26. This article illustrates the considerable detail in the public arena providing guidance on the application of the GAAR.

⁹⁰ *Michelin Tyres (Canada) Ltd v MNR* [1995] CITT, No 20 ("*Michelin Tyres*") discussed in V Krishna, "First GAAR Case an Easy Win for Revenue" (1995) 6 *Canadian Current Tax* 1; 1995 CCT LEXIS 35.

⁹¹ 97 DTC 111 ("*McNicol*"). Followed in *OSFC Holdings Ltd v The Queen* (25 June 1999) Ottawa 97-225 (IT)G (TCC) (unreported), where the Tax Court adopted a purposive analysis in applying the GAAR to a scheme to access tax losses and endorsed substance over form.

⁹² 97 DTC 302.

⁹³ R Jarman, "Have GAAR's Teeth been Blunted?" [1999] *Dominion Tax Cases Newsletter* (3) (8 February).

⁹⁴ T Korovalis, "What has the Tax Court of Canada Added to the GAAR Analysis?" (1997) *The International Tax Review* 54; N Boidman, "First Court Decision on Canada's Statutory Business Purpose Test: *McNicol v The Queen*" (1997) 26 *Tax Management International Journal* 135; AH Kingissepp, "Canadian Tax Court decides First Case under General Anti-Avoidance Rule" (1997) 8 *Journal of International Taxation* 126; N Boidman, "Canada's Anti-Avoidance Rule Applied to US Disposition of Canadian Subsidiary" (1997) 26 *Tax Management International Journal* 478.

⁹⁵ Kingissepp, above n 94.

Another view has been expressed that *McNicol* was flawed in allowing the arrangement under a specific anti-avoidance provision yet holding that the GAAR applied. It was argued that a transaction cannot be a misuse or abuse of the provisions of the Act if it is consistent with the specific anti-avoidance provisions.⁹⁶

Thus, these two commentators would appear to view the case as authority for, respectively, the second (purposive based exemption) and first (rule of construction) possible interpretations of the misuse/abuse limb of the GAAR as identified by Arnold and Wilson.

On the other hand, Roxam endorses these decisions but accepts that the courts are applying an economic substance approach consistent with Arnold and Wilson's third possible scenario. Nevertheless, Roxam believes that the purposive approach to statutory interpretation endorsed by the GAAR assists in rendering the tax laws more principled and the cases demonstrate that the judiciary can provide guidance and general principles.⁹⁷ Admittedly this conclusion is based on a comparison with the United Kingdom position where the anomalous distinction between acceptable tax mitigation and unacceptable tax avoidance has generated considerable uncertainty.

The GAAR has been held not to be applicable in a number of decisions. In *Huskey Oil Ltd v The Queen*,⁹⁸ the GAAR was not applicable on the basis that the transaction was motivated by bona fide purposes. It has been suggested that the facts of this case lie at the other end of the spectrum to those in *Michelin Tyres* and *McNicol*.⁹⁹

The same comment can be made in relation to

*Jabs Construction Ltd v The Queen*¹⁰⁰ where again a purposive analysis was adopted with the conclusion that the provisions were being used for the very purpose for which they were designed. The Court stated that the transaction was the last one that it would have considered subject to the GAAR and emphasised that the GAAR was not to be used routinely as it was an extreme sanction.

Other cases have considered the constitutional validity of the GAAR. In *Nadeau v the Queen*,¹⁰¹ the Tax Court rejected an argument that there had been an arbitrary application of GAAR and the taxpayers' Charter of Rights had been violated. At issue was a surplus stripping arrangement that clearly had no purpose other than tax avoidance.

A similar conclusion on the provision's constitutional validity was reached in *Blair T Longley v The Queen*.¹⁰² The Tax Court also held that the provision was not void for vagueness or contrary to the rule of law as it had a limited application and, in fact, no application where the substantive provisions in question were clear and unambiguous.¹⁰³

5.5.3 Commentators on the GAAR

Apart from specific comments on the recent GAAR decisions, some commentators have taken the opportunity to refocus on the desirability of the GAAR or possible changes to it.

Krishna acknowledges the difficulties in identifying the object and policy of the tax laws as there can be competing policies. In particular, it is difficult for the GAAR to be applied in circumstances such as where there is a differentiation in the manner of taxation of different sources of income.¹⁰⁴ Specifically in

⁹⁶ Boidman, above n 94, 135 and 478.

⁹⁷ I Roxam, "General Anti-Avoidance in Action - News from Canada" [1998] *British Tax Review* 140.

⁹⁸ 99 DTC 308.

⁹⁹ Jarman, above n 93.

¹⁰⁰ (24 June 1999) Vancouver 98-827 (IT)G (TCC) (unreported).

¹⁰¹ 99 DTC 324.

¹⁰² (30 June 1999) Victoria 90/1523 (BCSC) (unreported).

¹⁰³ Also see *Owen Holdings Ltd v The Queen*; discussed in G Richards, "Tax Litigation - Disclosure of Rulings" (1997) 7 *Canadian Current Tax* 81.

¹⁰⁴ V Krishna, "Purposive Interpretation as a Weapon Against Tax Avoidance" (1997) 8 *Canadian Current Tax* 9. Thus, he advocates structural reform to tackle avoidance.

relation to *McNicol*, given the capital gains exemption in the legislation, whilst the taxpayers did not promote the underlying rationale of this exemption, it was unlikely that they abused the policy of the Act by taking advantage of it. This was particularly the case given that the transaction did not breach the specific anti-avoidance provision built into the exemption.

Furthermore, he queries whether a taxpayer's motive should be relevant at all and rather proposes that the GAAR be amended to just contain the misuse/abuse limb thereby mandating a purposive interpretation of the tax laws. This should be complimented with a requirement that Parliament state the purposes of tax provisions.¹⁰⁵

Crerar attempts to predict how the courts will interpret the GAAR from here. He suggests that the alternatives are a continuation of the purposive approach, which will rationalise and purify the Canadian tax system or, alternatively, the GAAR will be interpreted as a vague anomaly and eventually discarded. The decisions to date suggest the former approach, however, the uncertainty and vagueness associated with the GAAR may be its downfall.¹⁰⁶

5.5.4 Recent Non-GAAR Supreme Court Decisions

Finally, in order to attempt to prophesise how the Supreme Court will interpret the GAAR it is appropriate to reflect on recent decisions by the Court dealing with pre-GAAR arrangements. The cases would suggest that the Supreme Court has taken a legalistic approach to tax avoidance in contrast to the Federal Court of Appeal. In fact, as at 1998, the statistics indicated that whilst 80% of the tax appeals to the Federal Court of Appeal have been decided against the taxpayer, the Supreme Court has overruled the Court of Appeal in 13 of the last 15 appeals.¹⁰⁷

The leading Supreme Court decision in this regard is probably *Neuman v The Queen*¹⁰⁸ The endorsement by the Supreme Court of a blatant income splitting arrangement has been viewed as an indicator of its likely approach to the GAAR.¹⁰⁹

Since *Neuman*, a number of subsequent Supreme Court decisions have endorsed this approach.¹¹⁰ These cases illustrate that the Supreme Court is concerned that the purposive approach to statutory interpretation creates

¹⁰⁵ V Krishna, *ibid*, endorses the purposive approach over the approach that has been adopted in the United Kingdom.

¹⁰⁶ D Crerar, "Interpretations of GAAR: Before and Beyond *McNicol* and RMM" (1997) 23 *Queen's Law Journal* 231, 250. Crerar acknowledges that uncertainty has its benefits both offensively and defensively.

¹⁰⁷ D Lewis, "Godzilla v Neuman" (1998) 46 *Corporate Brief* 1.

¹⁰⁸ DTC 6297 ("*Neuman*").

¹⁰⁹ R Jarman, "Is the Supreme Court Decision in the Neuman Case really the Great Victory for Tax Planners that Some Have Claimed it to be?" (1998) 9 *Dominion Tax Cases Newsletter* 1. Also see D Lewis, above n 107; Zawada-Craig, "Hello Neuman [*Neuman v Minister of National Revenue*]" (1998) 19 *Saskatchewan Business* 33; K Selzac, "Supreme Court of Canada Re-affirms Use of Holding Company and Dividends as Income Splitting Technique" (1999) 10 *The Journal of International Taxation* 58.

¹¹⁰ *Duha Printers (Western) Ltd v The Queen* 98 DTC 6334 discussed in CLT Falk, "Tax Planning Alive and Well in Canada" (1998) 18 *Tax Topics* (1371) 1. *Continental Bank Leasing Corporation v The Queen* 98 DTC 6505 discussed in R Wertscheck, "Continental Bank Victorious" (1998) *Tax Topics* 1385, 1. See also the earlier Supreme Court decisions in *Antoska v The Queen* 94 DTC 6314, *Friesen v The Queen* 95 DTC 5551, *Mara Properties Ltd v The Queen* 96 DTC 6309 and *Hickman Motors Ltd v The Queen* 97 DTC 5363. The Tax Court is following suit. See *Bigras v The Queen* 98 DTC 1988 discussed in R Jarman, "Are Pre-September 1988, Section 245 Avoidance Cases of Any Significance?" (1998) 16 *Dominion Tax Cases Newsletter* (November 9) 1 and *Hollinger Inc v The Queen* 98 DTC 1913 discussed in J Morand (1998) *Tax Topics* 1394, 1.

uncertainty and is to be avoided. Furthermore, the existence of a tax avoidance purpose is not necessarily fatal. Thus, a checkered future for the GAAR is likely.¹¹¹ This view is supported by at least one commentator who refers to these decisions for the proposition that the Court may confine the application of GAAR to clearly abusive transactions lacking any business purpose.¹¹²

The tension between the Canadian courts continues to be played out in the litigation in *Shell Canada Ltd v MNR*¹¹³ The case concerns a complex, but not abnormal, financing arrangement that was clearly structured around tax considerations. The Tax Court, whilst acknowledging the difficulty of reconciling the Court of Appeal and Supreme Court decisions, had emphasised the primary financing purpose of the transaction.¹¹⁴ The Federal Court of Appeal applied a business purpose test and overruled the Tax Court.

Krishna cites this decision as an inappropriate application of the purposive approach because the taxpayer was simply taking advantage of how the tax laws apply differently to different sources of income and so was acting consistent with the purpose of the legislation. He sees the decision as generating uncertainty and demonstrating both the difficulty of identifying the purpose of legislation and also identifying the purpose of a taxpayer where both immediate and overriding purposes exist.¹¹⁵

The circumstances have now been set up for the Supreme Court to reconsider its approach to tax avoidance.¹¹⁶

6. CONCLUSION

Cooper eloquently states the paradox of a GAAR. Given that there is no agreement on precisely what is tax avoidance, how is a provision to be drafted to address it? Presumably, it is precisely because the drafter cannot foresee an avoidance possibility, that the drafter cannot write a precise rule to deal with it; but in effort to deal with the unforeseen and the unforeseeable possibility, the drafter does draft a rule – a GAAR.¹¹⁷

The flaws in Part IVA have been exposed by the High Court of Australia decision in *Spotless*. It is fallacious to distinguish between commercial and tax purposes. Similarly it is fallacious to distinguish between overriding and immediate purposes. Part IVA is destined to either be unworkable due to the uncertainty generated by its broad terms or to face extinction at the hands of a reforming judiciary.

Rather, the arbitrator of unacceptable tax avoidance should be Parliament itself. The GAAR should direct the courts to identify the purpose of Parliament's legislation. Parliament should be required to particularise this purpose when enacting legislation and the ATO authorised and encouraged to make pronouncements on the

¹¹¹ Surprisingly, Revenue Canada has indicated that it does not believe that the GAAR would apply to the income splitting arrangement in *Neuman*, although it might have an application to the circumstances of *Continental Bank* and would definitely apply to the loss utilisation scheme in *Duha Printers*: S Peart, "The Impact of Certain Tax Cases" (1998) *Tax Topics* 1392, 1.

¹¹² DR MacIntosh, "Canadian Tax Wrap Up", (1999) 10 *The Journal of International Taxation* 43, 48. MacIntosh provides evidence that Revenue Canada is seeking to recharacterise transactions for the purposes of GAAR, not according to what the taxpayer would have done absent the arrangement, but rather on the basis of what it considers to be an economically equivalent transaction. Thus, it is possible that GAAR assessments may produce tax beyond that resulting from any transaction that the taxpayer would contemplate.

¹¹³ 98 DTC 6177 (FCA).

¹¹⁴ It has been suggested that this would also save the transaction from attack by the GAAR: RB Thomas, "Tax Avoidance with a Little Help from Downunder" (1997) 45 *Canadian Tax Journal* 295.

¹¹⁵ V Krishna, "The Illusive Interest Deduction" (1998) 8 *Canadian Current Tax* 89.

¹¹⁶ The Court of Appeal followed its decision in *Shell Canada in Canadian Pacific Ltd v The Queen* 99 DTC 5132; affirming the Tax Court: 98 DTC 2021. Leave to appeal to the Supreme Court was granted to Canadian Pacific on February 9, 1999.

¹¹⁷ Above n 2, 26-27

application of Part IVA, both at a private and public level. These pronouncements should be monitored by a Part IVA committee comprising representatives of the various stakeholders.

Ironically, some of the difficulties arising from the current GAAR arise out of a failure to adopt a purposive approach to *its* interpretation. The departure from both the Second Reading Speech and the Explanatory Memorandum in relation to the meaning of "dominant" and the application of the provision to business and family dealings resulted from adopting the literal rule of interpretation. Arguably, a purposive approach would have given weight to this extrinsic material.

Support for an approach to applying a GAAR that focuses on the purpose of Parliament, at least by way of an exclusionary limb, is contained in the now shelved United Kingdom proposals for a statutory GAAR and the New Zealand Valabh Committee recommendations.

The approach proposed above would also substantially replicate developments in Canada where the misuse/abuse limb has been recognised by commentators and the judiciary as mandating a purposive interpretation.¹¹⁸ Whilst it must be conceded that the Canadian Supreme Court may render the GAAR impotent in that country, the Australian High Court as currently constituted is unlikely to adopt a similar approach. In any event, there are lessons to be learnt from the drafting of the Canadian provision that might limit this possibility.¹¹⁹

In particular, the Canadian GAAR replicates a troublesome feature of the Australian GAAR with its reference to the purpose of the taxpayer. From the perspective of ascertaining liability under the substantive provisions (in contrast to the penalty

provisions), it should not matter whether a taxpayer intentionally enters into a scheme for the purpose of avoiding tax, or enters the scheme ignorant of this purpose but nevertheless happy in the result. Furthermore, the notion of a tarnished purpose raises the prospect of a bona fide purpose, expressly in Canada and implicitly in Australia. It is a short step to the awkward proposition that whilst a commercial purpose is bona fide, the minimisation of tax is not a bona fide commercial purpose.

Fortunately, whilst the Canadian GAAR contains this reference to whether a taxpayer has a bona fide purpose, both Revenue Canada, in its pronouncements, and the judiciary have treated the misuse/abuse limb as the critical issue rather than the purpose test. This has resulted in the second possible judicial approach to the GAAR alluded to by Arnold and Wilson being generally adopted, namely that the rule mandates a purposive interpretation. A similar approach for Australia is suggested.

Thus, the purpose of the legislator should be the sole focus. Admittedly, as some of the Canadian decisions illustrate, difficulties arise where Parliament's purpose cannot be identified from the legislation or extrinsic material. With the general availability of objects clauses and less reluctance by the judiciary to refer to extrinsic material these difficulties can be minimised. Parliament must be implored to elaborate on the purpose of tax legislation it enacts.

The simplification project in Australia¹²⁰ endorsed the use of objects clauses in tax legislation and these were gradually being inserted. It would appear that the legislation arising from the Ralph Review will continue this trend. Unfortunately, the proposal to insert an objects clause in Part IVA apparently endorsing a

¹¹⁸ It is notable that one commentator has argued that Part IVA fails the criteria of a good tax system - NF Orow, "Part IVA - Seriously Flawed in Principle" (1998) 1 *Journal of Australian Taxation* 57 - whereas another has argued that the Canadian GAAR furthers these criteria - D Crerar, "Interpretations of GAAR: Before and Beyond McNicol and RMM" (1997) 23 *Queen's Law Journal* 231. Ultimately it may depend on what criteria are focussed on.

¹¹⁹ In particular, the message contained in the provision must be clear and left unfettered by complexities and obscure wording. This aspect is to be explored by the writer in a subsequent article.

¹²⁰ And the United Kingdom and New Zealand.

purposive interpretation of the tax laws, whilst well intentioned, may be a retrograde step. It is unlikely that the judiciary will give much weight to an objects clause subsequently included with a provision that exhibits little regard to the terms of the provision or relevant extrinsic material. Such an approach of attempting to amend legislation by the inclusion of objects clauses may simply result in such clauses being read down or ignored and a corruption of the whole process.¹²¹ With this caveat, such clauses should be widely employed.

It is possible that a purposive approach has the potential to create uncertainty and may offend the notion that the taxpayer should be able to rely on the express words of the legislation. This could be recognised by Parliament in the need to particularise the intention behind legislation clearly, in the creation of an independent board to review the manner in which the GAAR is applied by the ATO, in encouraging both the ATO and the judiciary to settle tax disputes on a compromise basis rather than all or nothing and in the operation of the ruling, penalty and interest regimes. This could even extend to the imposition of negative penalties where a court concludes that Parliament and/or the ATO has not sufficiently responded to the need to clarify the law. In this way taxpayers might be compensated for the costs incurred as a result of uncertainty.

Finally, the Canadian, United Kingdom, New Zealand and Ralph Review approaches all mandate a purposive interpretation as an exclusionary element of the GAAR. However the Canadian experience would suggest that whether the purposive principle is a substantive element of the GAAR or an exception to its application, Parliament's purpose will, in practice, be the critical consideration.

The suggestion then is that the purposive rule be the sole element of the GAAR as other elements such as bona fide purpose, dominant purpose or principal effect¹²² merely confuse the essential issue. Therefore an alternative to a GAAR that promotes a purposive interpretation of the tax laws could be a general rule that tax laws be interpreted in a purposive manner.¹²³ The adoption of such an approach and its implications for legislative drafting is the subject of a separate article by the author. Suffice to state for current purposes, there is a judicial trend in the United Kingdom, Canada, New Zealand and Australia away from the literal rule of interpretation to a purposive approach. Furthermore, Canada, New Zealand and Australia all have provisions in their Acts Interpretation legislation mandating a purposive approach. It is surprising that in Australia and New Zealand at least, scant regard has been paid to these provisions by the courts.

¹²¹ This issue is to be explored further in a subsequent article.

¹²² As was observed above, the Ralph Review rejected this test. It has been criticised as being too broad and inappropriate - K Schurgott, "Prepayment and anti-avoidance measures" (2000) 34 *Taxation in Australia* 489, 494. See also P McCouat, *GST Survival Guide* (1999) 206. Generally, see G Hill, "GST Anti Avoidance – Division 165" (1999) 5 *Journal of Australian Taxation* 295. It has been suggested that it would result in prepayment and trading stock elections being impugned. I Crisp, "The New Business Tax System: Life after Ralph" (2000) 34 *Taxation in Australia* 411, 412. To the extent that a principal effect test redirects the focus from the taxpayer's purpose, it could be supported if it were coupled with an instruction to interpret the legislation in a purposive manner. In such a case, it is suggested that the concerns noted above would not be realised although it must be doubted what the test would add.

¹²³ If a purposive approach is to be adopted generally then arguably a GAAR based on this approach becomes unnecessary. See Waincymer, above n 2, 254.

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