THE DISCRETION IN PART IVA OF THE *INCOME TAX ASSESSMENT ACT 1936*: WHY THE DEVIL IS IN THE LACK OF DETAIL: PART TWO

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I INTRODUCTION

This paper is the second instalment of a two-part series reviewing the discretion in s 177F of Part IVA of the *Income Tax Assessment Act 1936* (Cth) (*ITAA 1936*). The first part of this paper argued that the nature and scope of the discretion in s 177F is uncertain and therefore presents an area of the *ITAA 1936* that is fertile for legislative amendment or administrative clarification. Specifically, the first part of the paper argued that the uncertainty surrounding what factors should be taken into account in choosing to *not* exercise the discretion contained in s 177F (where the preconditions are satisfied) conflicts with several important tenets of revenue legislation, namely, compliance with the rule of law, simplicity, certainty and administrative equity.[1]

This paper will analyse and discuss the alternatives to utilising the currently unstructured discretion in Part IVA. It will discuss mechanisms for managing the discretion and will explore different options for clarifying the factors that are relevant to a decision to not exercise the discretion in s 177F (where the preconditions are satisfied).

Firstly, this paper will argue that despite the shortcomings of the discretion in Part IVA, the existence of discretion in s 177F is desirable as a means of mitigating the harsh effects that would occur if the part applied automatically upon the establishment of the preconditions. Therefore, it is argued that the discretion must be managed or fettered rather than eliminated entirely. Notably, in addressing this point the paper does not discuss the broader argument of whether specific anti-avoidance rules should be utilised instead of general anti-avoidance rules as this is dealt with extensively elsewhere in the literature on Part IVA.[2] Therefore, it is a central assumption of this paper that a general anti-avoidance rule is an important and essential feature of the *ITAA 1936* and *Income Tax Assessment Act 1997* (Cth) (*ITAA 1997*).

Despite advocating the retention of a discretion in Part IVA, this paper suggests that the factors that influence an exercise of the discretion *not to apply* Part IVA in s 177F should be clarified in order to enhance taxpayer certainty, minimise compliance costs and help to achieve administrative consistency and equity. This paper considers which of the factors discussed in part one as being potentially relevant to an exercise of the discretion in s 177F *to not apply* Part IVA are suitable for legislative or administrative clarification. Once this is established, the paper analyses the method of clarification that should be adopted.

Following this analysis this paper will draw some conclusions.

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1 Nicole Wilson-Rogers and Dale Pinto, 'Reviewing the Discretion in Part IVA of the *Income Tax Assessment Act 1936:* Why the Devil is in the Lack of Detail: Part One' (2009) *Journal of Applied Law and Policy* 66, 79.

2 See for example Judith Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle' (2004) 4 *British Tax Review* 332-57.
Notably, the recent Commonwealth of Australia, The Treasury, 'Review of Discretions in the Income Tax Law' (Discussion Paper, June 2007) <http://www.treasury.gov.au/contentitem.asp?ContentID=1265&NavId=037> at 2 September 2010 acknowledged the need for a discretionary general anti-avoidance rule to ensure the Australian Taxation Office has the power to protect the revenue and felt an objective test should not be substituted for the broad discretion currently provided.

II SHOULD THE DISCRETION BE RETAINED?

Despite shortcomings relating to the uncertainty as to the nature and the scope of the discretion in s 177F, it is submitted that the discretion should be retained. Whilst Part IVA is an ever-present threat to tax planning or structuring activities, the discretion in s 177F represents an important mitigation tool that can be used to ensure the section does not apply in unintended circumstances. If the application of Part IVA was mandatory or self-executing upon the establishment of the preconditions the section could apply in many unintended circumstances. This is because the preconditions are so broad that they could potentially apply to many accepted and currently used structuring devices. For example, in relation to the use of a Phillips Trust or Everett Assignment[3] a persuasive argument could be sustained that the preconditions of a scheme, tax benefit and dominant purpose in s 177D are satisfied. If the operation of Part IVA was mandatory these types of arrangements would be impugned. However, the discretion in s 177F gives the Commissioner flexibility to choose *not* to apply Part IVA to those types of structures. Thus, in this regard the existence of discretion in s 177F helps to maintain the necessary flexibility in the section that has a potentially potent and extensive scope to annihilate legitimate tax planning structures and devices. Commentators directly acknowledge the existence and importance of the existence of discretion in moderating the application of Part IVA:

> The language used in the provisions is extremely wide. However, since the practical application of Pt IVA depends on the Commissioner making a determination in accordance with the powers conferred under s 177F, it is reasonable to expect that the ATO will only exercise these powers where it considers that a scheme is blatant, artificial or contrived, although it is somewhat uncertain which schemes would be treated as falling within that description.[4]

Another reason for retaining the discretion in Part IVA is that it enables the Part to be utilised only as a provision of last resort rather than in the front-line of statutory defences, in accordance with how the legislature originally contemplated the operation and function of Part IVA.[5]

III SHOULD THE DISCRETION BE FETTERED?

Whilst it is acknowledged that the existence of discretion in Part IVA is necessary, this article suggests that the nature and scope of the discretion in s 177F is uncertain. This uncertainty stems from the discretion in s 177F being completely unfettered and therefore represents an area of the legislation that is ripe for legislative amendment or administrative clarification.

The literature suggests that the Australian Taxation Office (ATO) envisages a favourable exercise of the discretion in Part IVA to be exceptional.[6] In this regard, as stated in part one of this paper, the ATO observes:

> It is to be expected, having regard to the policy underlying Part IVA, that the favourable exercise of the discretion would be confined to exceptional cases. For where a tax benefit has been obtained in connection with a scheme to which Part IVA applies it would seem to

3 Wilson-Rogers and Pinto above n 1, 79.
4 CCH, *Australian Master Tax Guide* (47th ed, 2010) 1525.
5 For example see the comments of Michael D'Ascenzo, the then Second Commissioner of Taxation, *The Odyssey Continues: Part IVA post Peabody* (Presentation to Allens Arthur Robinson, 13 June 2003) Australian Taxation Office <http://www.ato.gov.au/corporate/content.asp?doc=/content/38749.htm> at 22 October 2010.
6 Australian Taxation Office, *Part IVA of the Income Tax Assessment ACT 1936: commentary on key issues* <http://www.ato.gov.au/corporate/content.asp?doc=/content/75159.htm&page=1> at 19 December 2009.

> follow that the revenue will have been disadvantaged and action cancelling the tax benefit will generally be warranted.[7]

The significance of this statement appears to be two-fold. Firstly, the statement appears to be a clear acknowledgment that a discretion exists in s 177F.[8] Secondly, if the exercise of the discretion is thought to be exceptional this may make it an easier process to provide further clarity around the factors that would be taken into account in choosing not to exercise the discretion, as the identification of those factors would be relatively stable. Therefore any clarification of these factors would not be subject to constant amendment or change.

Furthermore, whilst it may be exceptional that the Commissioner would favourably exercise the discretion not to apply Part IVA, it is nonetheless important that these circumstances be clarified, in the interests of maintaining and enhancing taxpayer certainty. It is suggested that no further clarity is needed of those circumstances when the Commissioner would choose *to* exercise the discretion to apply Part IVA, as this is already covered extensively in various ATO pronouncements[9] including Taxpayer Alerts,[10] Taxation Determinations,[11] Rulings,[12] Practice Statements[13] and the case law.[14]

Rather, clarification is needed on those factors that would influence a favourable exercise of the discretion *not to apply Part IVA* pursuant to s 177F when the preconditions were satisfied, as this is an area where no administrative or legislative guidance currently exists.

The Review of Discretions Discussion Paper (the Discussion Paper)[15] acknowledged the need for a discretionary general anti-avoidance rule to ensure the ATO has the power to protect the revenue. Specifically the discussion paper argued that in the case of Part IVA an objective test should not be substituted for the broad discretion currently provided under the *ITAA 1936*. However, in the context of other discretions contained in the *ITAA 1997* and *ITAA 1936* the Discussion Paper recommended that in most cases the discretion should be replaced with specific criteria or objective tests.[16] The reasoning behind such recommendations was to provide taxpayers with a greater degree of certainty, particularly in the context of a self-assessment system. It is suggested that an ancillary benefit of these recommendations may also be to create a more certain right of objection or appeal for taxpayers and to enhance consistent administration of the *ITAA 1936* or *ITAA 1997* by different ATO officials or delegates.

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7 Ibid.

8 This argument was canvassed in detail in part one of the paper and will accordingly not be repeated here. See Wilson-Rogers and Pinto, above n 1.

9 For a comprehensive list of the Commissioner's view on where Pt IVA will apply see CCH, above n 4, 1532-33.

10 See for example, Australian Taxation Office, 'Application of Part IVA of the Income Tax Assessment Act 1936 to 'wash sale' arrangements'(18 April 2008) *Taxpayer Alert 2008/7;* Australian Taxation Office, 'Salary Deferral arrangements'(25 June 2008) *Taxpayer Alert 2008/14* at <http://ato.gov.au/atp/pathway.asp?pc=001/008/001> at 20 October 2010.

11 See for example Australian Taxation Office, 'Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to an employee savings plan as described in Taxpayer Alert TA 2008/13?' (31 March 2010) *TD 2010/10*; Australian Taxation Office, 'Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to a salary deferral arrangement as described in Taxpayer Alert TA 2008/14?' (31 March 2010) *TD 2010/11.*

12 See for example Taxation Ruling TR 2005/19 on scrip for scrip roll-over arrangements –and Part IVA, Taxation Ruling IT 2051 on leveraged leases, Taxation Ruling IT 2169 on equity leases, Taxation Ruling IT 2513 on the application of Part IVA to margin lending arrangements.

13 See for example Australian Tax Office Practice Statement Law Administration, PS LA 2005/24 'Application of General Anti-Avoidance Rules'.

14 See for example the cases of *Peabody v FCT* (1994) 181 CLR 359; *FCT v Spotless Services Ltd* (1996) 186 CLR 404, *Hart v FCT* (2004) 217 CLR 216.

15 Treasury, above n 2.

16 This course of action had its genesis in the Commonwealth of Australia, The Treasury, *Information Paper regarding Improvements to Self Assessment – Priority Tasks* (20 August 1991).

Although the logic and principles canvassed by the Discussion Paper [17] were stated not to apply to general anti-avoidance rules arguably they could be partially extended to a review of the discretion in s 177F. Signposts indicating what factors will be taken into account in exercising the discretion in s 177F would help to partially achieve some of the overall aims of the Discussion Paper (enhancing taxpayer certainty) whilst maintaining the need for flexibility in the context of general anti-avoidance rules.

Another advantage of clarifying the factors that influence a favourable exercise of the discretion would be to settle the controversial argument as to whether s 177F contains a discretion at all. As discussed in part one, several commentators have queried the existence of a discretion in s 177F.[18] A recent reflection of this view was proffered by Justice Pagone in his book *Tax Avoidance in Australia*. Pagone argued that the better view is that the application of Part IVA (where the preconditions are satisfied) is not discretionary at all:

> The more natural reading of the words in s 177F(1) is that the discretion conferred on the Commissioner is a discretion about the amount of the tax benefit to be cancelled and not about whether a tax benefit should be cancelled... There is furthermore, no basis to be found in s 177F to decide when the Commissioner should not exercise the power once satisfied that Part IVA applies by reference to the s 177D(b) factors. A construction that Part IVA authorises the Commissioner to suspend or dispense with the operation of its terms should not be adopted lightly. [19]

Whilst it was argued to the contrary in part one that there is in fact a discretion in Part IVA,[20] it is clear that the mere existence of a discretion in s 177F is contentious. Therefore, another advantage of providing greater clarity around factors that influence an exercise of discretion to not apply Part IVA is that this would resolve the question of whether a discretion in fact exists at all in s 177F.

Clarification of the factors that influence a favourable exercise of the discretion in s 177F would arguably also assist the ATO in a more consistent and equitable decision-making process in respect of the application of Part IVA. Furthermore, the establishment of relevant factors that can be considered by the Commissioner when deciding not to exercise the discretion to apply Part IVA would also create a more stable ground for judicial review of a decision by the taxpayer.

IV FACTORS TO BE INCLUDED IN A CLARIFICATION

This paper has argued that it is necessary to retain the discretion but that the factors that influence a favourable exercise of the discretion should be clarified. However, before the manner of clarification is discussed, it is necessary to identify and determine *which of the factors* discussed in part one should be included. Whilst part one canvassed a number of factors that could potentially be relevant to an exercise of the discretion in s 177F, it is argued in this paper that it is only appropriate or possible to clarify some of them via legislative amendment or administrative guidance. The factors listed in part one of the paper that could result in a favourable exercise of the discretion in s 177F included:

- where appropriate relief may not be available under the compensating adjustment provisions and the application of Part IVA could result in the same income being taxed twice,[21]

17 Treasury, above n 2.
18 Wilson-Rogers and Pinto, above n 1, 70-5.
19 G T Pagone, *Tax Avoidance in Australia* (2010) 126-7.
20 Wilson-Rogers and Pinto, above n 1, 70-5.
21 Australian Taxation Office, *Part IVA of the Income Tax Assessment ACT 1936 commentary on key issues* (14 November 1995) <http://www.ato.gov.au/print.asp?doc=/content/75159.htm> at 14 December 2009.

- where conduct was entered into that was encouraged by the policy or provisions of the *ITAA 1936* and *ITAA 1997*, having regard to the subject, scope and purpose of these Acts (for example the concessional superannuation rules or a decision to consolidate);
- where the conduct should be allowed for public policy reasons;
- where the conduct could be classified as an 'ordinary family or business transaction';
- where the application of Part IVA would not increase the tax paid by the taxpayer (for example where the taxpayer was bankrupt);
- ensuring the maintenance of equity between taxpayers, so that Part IVA is applied consistently to arrangements that materialize in the same economic result (despite the use of divergent tax structures); or
- for the purpose of maintaining political and economic norms. [22]

Whilst it was argued that all of these factors could potentially result in a favourable exercise of the discretion in Part IVA, it is argued that not all of them should be subject to or are suitable for administrative or judicial clarification. This is because some of the factors are too amorphous to be codified in a manner that would have any discernible impact on taxpayer certainty. In this regard a statement in the decision of *Merkur Island Corporation v Laughton*[23] is a reminder that some concepts/policies are not suitable for legislative or administrative clarification. The Court stated:

> Ministers when formulating a policy should at all times be asking themselves and asking parliamentary counsel: 'Is this concept too refined to be expressed in basic English? If so is there some way in which we can modify the policy so it can be expressed?'. [24]

A review of the list provided above illustrates that some of the stated reasons are not readily translated into coherent legislation or in a way that would enhance taxpayer certainty. For example, it is arguable that factors such as public policy, equity, political and economic norms are not matters that are readily capable of transcription into clear, concrete and reviewable legislation or administrative guidance. Another factor that it is argued may not be suitable for legislative or administrative guidance is where the application of Part IVA would not increase the tax paid by the taxpayer. It is thought that this factor should not be clarified because, as discussed in part one, the Commissioner in these circumstances may still choose to apply Part IVA in order to secure any payment that may become available and therefore it is not clear whether such a factor would truly influence the Commissioner not to exercise his discretion in Part IVA.

It is suggested that three reasons for not exercising the discretion to apply Part IVA (where the preconditions are satisfied) are suitable for clarification.

- Where the tax benefit resulted from a structure that is identified to fall within the definition of an ordinary family or business transaction. Part one suggested that an examination of extrinsic materials such as the Explanatory Memorandum and acknowledgments by the administration suggests that this is highly likely to be a reason why the Commissioner may not exercise his discretion to apply Part IVA for example, in the case of a trust structure for a family business in aid of income splitting.[25]
- However, a significant difficulty with prescribing this type of factor is that it may be difficult to define an ordinary family or business transaction. This is because

22 Wilson-Rogers and Pinto, above n 1, 76-80.
23 [1983] 1 All ER 334.
24 Ibid 351.
25 Wilson-Rogers and Pinto, above n 1, 78-9.

what is 'normal and ordinary' is inherently subjective.[26] Regardless, given that this is likely to be one of the dominant reasons why the discretion to apply Part IVA would not be exercised, arguably it should be clarified as a factor that impacts the discretion in s 177F. In fact such clarification may act as the impetus for further constructive discussion around the meaning of this term and therefore the overall intended operation of Part IVA.

- Given the potential width of this condition it may be necessary to create an additional framework regarding the definition of what constitutes an ordinary family or business transaction in order to stop any fallacious or unintended challenges to the section based on this factor.
- The conduct or scheme entered into is something which should be allowed, having regard to the policy or tax concessions encouraged by the *ITAA 1936* and *ITAA 1997*, for example utilising the concessional superannuation rules, research and development tax incentives or choosing to consolidate. Arguably, where the Act encourages a type of conduct or activity this would appear to be a compelling reason for not exercising the discretion in s 177F. The structure of the *ITAA 1936* and *ITAA 1997* would make no sense if tax concessions were given to taxpayers at one level and taken away at another.
- Where appropriate relief may not be available under the compensating adjustment provisions and the application of Part IVA may result in the same income being taxed twice.[27] This is an easily discernible and concrete factor that may influence the exercise of the discretion and therefore appears to be eligible for clarification.

However, it is suggested that whatever mechanism of clarification is adopted any list of factors clarifying the circumstances when s 177F will be exercised must be *inclusive and not exhaustive*. This would ensure that the Commissioner retains sufficient scope and flexibility to consider additional factors (including those above that were argued to be unsuitable for legislative or administrative clarification) when exercising the discretion. Furthermore, if the list is inclusive rather than exhaustive, the factors would act as signposts or indicators of the types of situations in which the Commissioner would exercise the discretion rather than acting as a limitation. The construction of an inclusive (rather than exhaustive) list goes some way to addressing the issues outlined by Black (as cited in part one of this paper) regarding any attempt to manage the discretion. Black stated:

> The assumption...that discretion can be 'managed' both to confine its exercise to certain actors and to limit the way that those actors use the discretion given, is ... ambitious if not misguided.[28]

V MECHANISMS OF CLARIFICATION

This paper suggests that there are two main forums by which the three factors outlined above could be clarified to create additional certainty for taxpayers. The first method could take the form of statutory amendment to s 177F. Statutory amendment could be undertaken in different ways. One method would be to circumscribe the discretion in a similar manner to the way that the operation of s 177D is fettered by the eight factors listed in part one.[29] Factors could be drafted and inserted into s 177F. Alternatively, the factors could be

26 See R W Parsons, *Income Taxation in Australia Principles of Income , Deductibility and Tax Accounting* (1985) 84, 16.38. Professor Parsons states: 'In any case what is artificial at one time may become normal when it is generally practised.'

27 <http://www.ato.gov.au/print.asp?doc=/content/75159.htm> at 14 December 2009.

28 Julia Black, 'Managing Discretion' (Paper presented at the ALRC Conference Penalties: Policy, Principles and Practice in Government Regulation, Sydney, 7-9 June 2001) <http://www.lse.ac.uk/collections/law/staff%20publications%20full%20text/black/alrc%20managing%20discretion.pdf> at 15 June 2009.

29 Wilson-Rogers and Pinto above n 1, 67.

included as regulations. A further option for legislative amendment would be to insert an objects statement or statement of principles into Part IVA that would have the effect of guiding an exercise of the discretion by outlining the overall policy of the part.

The second method of amendment would be to use administrative guidance to clarify the factors that would influence the discretion in s 177F and this could take the form of a binding public ruling, practice statement or an ATO Interpretive Decision.

A *Statutory Amendment*

In terms of the forms of statutory amendment it is suggested there are three alternate methods: amendment of s 177F, the insertion of a section to allow the factors to be prescribed by regulations or the insertion of a statement of principles at the beginning of Part IVA.

As discussed above, it is argued that any statutory amendment to Part IVA, should be *inclusive not exhaustive* to ensure that an exercise of the discretion in s 177F is not confined to the matters listed in the section. A statement of the factors should function as signposts or indicators of the factors that should be considered in exercising the discretion. However, it is not envisaged that this list is exhaustive.

The advantage of utilising statutory amendment to clarify the relevant factors is that it arguably provides greater certainty and transparency by ensuring that the factors would be located in the body of the legislation and this would also comply with the principles of the rule of law. Furthermore, any clarification in this manner would be subject to parliamentary scrutiny.

However, this method of amendment would be more administratively burdensome and time consuming than utilising administrative guidance (given the need for the amendment to be navigated through Parliament). The time involved in amending the legislation may not however be such an issue, as it has been suggested by some ATO literature that a positive exercise of the discretion would be 'exceptional' and therefore, it is likely that such a section would not need frequent amendment.[30]

Parliamentary scrutiny of any clarification is also highly desirable because as stated by Justice Pagone:

> A construction that Part IVA authorizes the Commissioner to suspend or dispense with the operation of its terms should not be adopted lightly.[31]

Therefore, given the importance of the clarification, it is a matter of sufficient gravity that requires parliamentary scrutiny rather than administrative guidance.

1 Amending s 177F by circumscribing the factors that should be considered

One mechanism of legislative amendment would be to fetter the discretion in s 177F by circumscribing the factors that should be considered in exercising the discretion.

S 177F could be amended by the insertion of an additional section (for example s 177F(1A) to clarify the factors. An example of how the section may be drafted is as follows.

In exercising the discretion in s 177F (1) the Commissioner *should have* regard to the following factors:

1. Whether the scheme is an ordinary family or business dealing;
2. Whether the conduct was something which as a matter of policy was encouraged by the Act;
3. Where appropriate relief may not be available under the compensating adjustment provisions and the application of Part IVA may result in the same income being taxed twice; and
4. Any other factor that is relevant to an exercise of the discretion.

30 Australian Taxation Office, above n 6.

31 Pagone, above n 19, 127.

In relation to the first two factors the meaning of the term 'ordinary family or business dealing' or conduct which as a matter of policy was encouraged by the Act may in turn require further clarification. Such additional clarification could take place by regulation – for example prescribing the meaning of this term or by providing administrative guidance on the meaning of the term (for example by practice statement or ruling). Alternatively, the term could be left undefined and subject to interpretation by the Courts. It is suggested that the circumstances where the third factor (listed above) may apply are sufficiently ascertainable without a further framework needed to provide administrative guidance.

If this mechanism of clarification was adopted, it may also be considered that factors that are not relevant for exercising the discretion in s 177F should be clarified. For example, there may be a statement to the effect that factors (for example subjective purpose) specifically excluded from being examined in s 177D should not be considered.

2 Regulations

Rather than to specifically state the factors by amending s 177F, an alternative method would be to list the factors via the regulations.

Pursuant to s 266 of the *ITAA 1936* and s 909-1 of the *ITAA 1997* the Governor General has a broad power to make regulations. Regulations assist in providing some of the detail that is necessary for effectively administering the legislation. As stated by Woellner et al in *Australian Taxation Law*:

> Regulations provide the practical detail needed to render the broader legislative provisions operational and prescribe the forms and procedures.[32]

Arguably, a prescription by regulation of some of the factors that the Commissioner would take into account in exercising his discretion in Part IVA would be matters that are convenient to be prescribed for carrying out or giving effect to the Act.

Initially a legislative amendment would be required to insert a subsection into s 177F that the Commissioner may have regard to any 'prescribed' factors in exercising the discretion in s 177F. The factors would then need to be enacted as regulations.

The benefits of including the factors by way of regulation, rather than as a separate legislative enactment to Part IVA, is that it provides a far more timely and flexible means of amending the factors that can be taken into account when exercising the discretion in s 177F. However, a statement of the factors in the regulations would still provide an additional level of certainty to taxpayers or their advisers. Where (and if) new factors arose they could be inserted via the regulations without the need to undergo the onerous parliamentary processes (apart from scrutiny by the Joint Committee on Delegated Legislation).

3 Statement of Principles

Another form of statutory amendment would be to make Part IVA subject to a statement of principles clarifying the circumstances to which Part IVA was intended to operate.

This would introduce a statement of the policy of Part IVA into the legislation and would inform taxpayers when the discretion to apply the section is likely to be exercised. The advantage of inserting a statement of principles is that it would not need to be as formal or legalistic as an amendment of the text of the section. Adoption of a statement of principles or an objects statement utilising a principles based approach to drafting accords with Recommendation 112 of the Henry Review which states:

> The government should commit to a principles based approach to tax law design as a way of addressing the growth and complexity of tax legislation and as a way of helping those laws to be interpreted consistently with the policy objectives.[33]

32 Robin Woellner et al, *Australian Taxation Law* (20th ed, 2010) 56.

Furthermore, such a statement would help Part IVA to be interpreted in a manner consistent with its policy objectives by explicitly stating these principles in the body of the legislation.

Recommendation 6.1 of the Review of Business Taxation (RBT) also suggested that Part IVA was intended to contain an objects clause. The RBT suggested that the objects clause should require that the application of Part IVA be consistent with, and support, the structure and underlying policy reflected in objects clauses in other parts of the income tax law. The RBT states:

> The objects clause of the GAAR[34] should clarify that the general anti-avoidance powers are to be exercised in a manner consistent with, and supportive of, the tax policy principles embodied in other provisions in the tax law. It should also make clear that the GAAR will not apply to the mere use in a straight-forward and ordinary manner of structural features of the law to best advantage -- for example, the use of an election or an entity structure (as opposed to the use of such features as part of a wider tax avoidance arrangement) does not in itself bear the stamp of avoidance. [35]

As noted in the RBT this type of policy statement would confirm the circumstances in which Part IVA was intended to apply and would help to reduce negative perceptions that valid business practices could be caught by the application of Part IVA:

> Such a statement of policy should confirm the circumstances in which the GAAR could be applied and reduce the perception that valid business practices could unintentionally be subject to the application of the GAAR.[36]

Whilst the insertion of a principles statement is not strictly fettering the operation of the discretion, in practice it would help to circumvent the operation of the discretion by stating the activities to which Part IVA was intended to apply.

It is suggested that the statement of principles should be broader than that suggested by the RBT and may take the following form:

> The general anti-avoidance powers in Part IVA are to be exercised in a manner consistent with, and supportive of, the tax policy principles embodied in other provisions in the tax. As a guide Part IVA will not be applied to the mere use of straight-forward and ordinary structural features of the *ITAA 1936* and *ITAA 1997* or transactions that are ordinary family or business dealings. Furthermore, Part IVA will not be utilised where the same income may be taxed twice and relief is not available under the compensating adjustment provisions.

B Clarification by way of Administrative Guidance

The second mechanism of clarifying the factors that may be taken into account in relation to a favourable exercise of the discretion in s 177F is to utilise ATO administrative guidance. This may take the form of a ruling, practice statement or ATO Interpretative Decision.

The administrative guidance could detail the factors that the Commissioner would take into account in determining whether to make a favourable exercise of the discretion in s 177F and is a more flexible and timely instrument than the primary legislation or regulations with which to amend the factors. Therefore amendment could more readily reflect the dynamic and changing circumstances within which the ATO operates.

By utilising administrative guidance it may be possible to make the statement of factors less legalistic and potentially more user/taxpayer friendly. Recommendation 2.8 of the

33 Ken Henry et al, *Australia's Future Tax System – Report to the Treasurer* (2009) Part One, Overview, Recommendation 112.

34 GAAR refers to a general anti-avoidance rule.

35 Commonwealth Treasury, *Review of Business Taxation* (1999) 241 <http://www.rbt.treasury.gov.au/> at 19 December 2009.

36 Ibid.

Report on Aspects of Income Tax Self Assessment,[37] states that ATO advice or guidance should be written in plain language, with a minimum of qualifying statements, so that it is accessible to the general public.

However, some judges, for example Justice French, have warned against utilising rulings (a form of administrative guidance) to act as a quasi legislative instrument or de facto law:

> The word 'ruling' has an obvious capacity to mislead. It is capable of conveying the impression that rulings published by the Commissioner have legal force. Insofar as it relates to the interpretation of the law, a ruling has no greater status than an administrative opinion. In so far as it relates to the way in which a discretion conferred by law would be exercised, it has no greater status than an administrative policy. There is a risk of an unwarranted elevation of rulings, by virtue of their terminology to a kind of 'de facto law'.[38]

Whilst confined to the use of rulings, arguably, the statements of Justice French could apply to any form of administrative guidance adopted. The utilisation of administrative guidance to clarify the factors would entail the guidance functioning as a form of de facto law without parliamentary scrutiny. Indeed, this is recognised in *Australian Taxation Law* where it is stated:

> In many situations ATO interpretations or actions create informal 'law' in that practitioners and their clients accept ATO practices or rulings without formal challenge, and structure their affairs accordingly. [39]

The obvious difficulty therefore with utilising administrative guidance to clarify the application of Part IVA is that whilst legislative amendments have the scrutiny of the Parliament, rulings are entirely outside of the Parliament's domain and only indicate the Commissioner's opinion on the matter. A matter illuminating the factors that the Commissioner should consider when deciding he should not exercise his discretion in relation to Part IVA is therefore arguably a matter for the legislature and not the administrator. Scolaro states:

> Rulings are issued by the Commissioner and given his primary role as tax collector his rulings are inherently biased. This element of bias is problematic because rulings are customarily followed by taxpayers and therefore, in practice they tend to achieve a 'de facto' law status. As a result the opinion of the Commissioner is unfairly applied as if it were law.[40]

A further disadvantage of administrative guidance is that it does not provide taxpayers with a right of objection. But arguably a taxpayer could lodge an application for a private ruling (based on the administrative guidance) and when this is delivered against the taxpayer they could object against the private ruling.[41]

1 Public Ruling

One form of administrative clarification is a public ruling. Utilising the rulings system to mitigate any uncertainty inherent in the use of an unfettered discretion in the *ITAA 1997* or *ITAA 1936* was specifically mentioned in the Discussion Paper on the *Review of Aspects of Income Tax Self Assessment.*[42] The Discussion Paper noted:

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37 Commonwealth of Australia, The Treasury, *Report on Aspects of Income Tax Self Assessment* (2004) 14 (ROSA report)

38 Woellner et al, above n 32, 1928 [30 472].

39 Ibid 54 [1 490].

40 Diana Scolaro, 'Tax Rulings: Opinion or Law? The need for an Independent "Rule-Maker"' (2006) 16 *Revenue Law Journal* 109,110.

41 Woellner et al, above n 32, 1934 [30474].

42 Commonwealth of Australia, The Treasury, *Review of Aspects of Income Tax Self Assessment* (Discussion Paper, 2004) 77 <http://selfassessment.treasury.gov.au/content/_download/discussionpaper/pdf/full.pdf> at 4 August 2010.

> One factor that reduces this impact (uncertainty) is that the Tax Office makes public rulings about how it will exercise a discretion and taxpayers can request private rulings on their particular circumstances.[43]

The advantage of rulings over a practice statement is that a ruling can be binding on the ATO and therefore can act as a de facto type of legal guidance. Certainly rulings are currently utilised as an important tool by tax practitioners for interpreting the tax legislation. [44] *Australian Taxation Law* states:

> ATO rulings are in an unusual situation, because since 1 July 1992 relevant ATO rulings are binding on the ATO in the sense that a taxpayer relying upon an appropriate and relevant ruling is protected by statute from penalty or other adverse action by the ATO. Thus under the 'self assessment' system these rulings have moved closer to formal law[45]

2 Practice Statement

Another form of administrative clarification is by practice statement. Law Administration Practice Statement 1998/1[46] explains the nature and purpose of a Practice Statement:

> Law Administration Practice Statements (LAPS) provide direction and assistance to staff on the approaches to be taken in performing duties involving the application of the laws administered by the Commissioner - usually referred to as 'technical' work. LAPS can supplement public rulings and are not intended to provide interpretative advice, but technical issues may be discussed in LAPS in the course of providing directions to staff.[47]

A detailed Practice Statement PS LA 2005/24 already exists on the practice adopted by the ATO in ascertaining various elements of Part IVA. PS LA 2008/3[48] provides at paragraph 116:

> Tax Officers must consider the application of the relevant general anti-avoidance rules in accordance with Law Administration Practice Statement PS LA 2005/24 General Anti-Avoidance Rules. This instruction applies irrespective of whether a private ruling application expressly seeks a ruling on the applicability of the general anti avoidance rule.[49]

Wilson-Rogers has argued elsewhere that a significant deficiency in PS LA 2005/24 was the fact that there was no reference to the circumstances where the Commissioner would choose *not* to exercise his discretion where the preconditions were satisfied.[50] Therefore, if it was decided that clarification was to be implemented by way of practice statement. PS LA 2005/24 could be amended to clarify the factors that could be taken into account in exercising the discretion in s 177F. A significant advantage of this method of clarification is that as this practice statement is already in existence, it has a profile, and is likely to already be a source utilised by practitioners as an indication of how Part IVA will be administered.

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43 Ibid.

44 Auditor General (Australia National Audit Office) 'The Australian Taxation Office Administration of Taxation Rulings' (Audit Report Number 3 of 2001/02, Commonwealth of Australia, Canberra, 2001) [3.53].

45 Woellner et al, above n 32, 54 [1 490].

46 Practice Statement Law Administration PS LA 1998/1, 'Law Administration Practice Statements' <http://law.ato.gov.au/atolaw/view.htm?locid='PSR/PS19981/NAT/ATO'&PiT=99991231235958> at 5 August 2010.

47 See para 1.

48 Practice Statement Law Administration PS LA 2008/3, 'Provision of advice and guidance by the Tax Office'.

49 Ibid.

50 Nicole Wilson-Rogers, 'Coming Out of the Dark? Uncertainties that Remain in Respect of Part IVA: How Does Recent Tax Office Guidance Help?' (2008) 4 *eJournal of Tax Research* 25, 44.

3 ATO Interpretative Decisions

A further type of administrative guidance that could be utilised to clarify the factors would be an ATO Interpretative Decision. PS LA 2008/3 defines the nature and scope of an ATO Interpretative Decision:

> An ATO ID is an edited and summarized decision on an interpretive matter that is indicative of how a provision of the law might be applied. ATO ID's do not provide advice to taxpayers and are not rulings under s 105-60 or under Part 5-5 therefore the tax that would otherwise be payable under the law remains payable. ATO IDs represent a precedential ATO view that tax officers must apply in resolving interpretative issues or, if they consider the application of the precedent will result in an incorrect decision or unintended outcome, escalate the matter for review.

The now withdrawn ATO ID 2001/619 is an example of an interpretive decision that addressed matters the Commissioner would take into account in exercising a discretion. Whilst the discretion in question was to extend time under the small business capital gains tax rollover it does indicate that ATO ID's can be utilised to clarify this type of matter.[51]

VI CONCLUSION

The first part of this paper argued that s 177F contains a discretion, however, it was argued that the nature and scope of the discretion in s 177F is uncertain. In particular it was noted that it is difficult to identify and predict those factors that are relevant to a decision of the Commissioner to *not* exercise the discretion in s 177F where the preconditions were satisfied. It was further submitted that the inherent uncertainty regarding the nature and scope of the discretion in s 177F compromised many important tenets of taxation legislation including certainty, equity and adherence to the principles of the rule of law. Given these shortcomings, the second part of this paper has argued that in order to partially mitigate this uncertainty, signposts or clarification should be given of some of the factors to be considered by the Commissioner in determining *not to apply Part IVA* under s 177F where the preconditions are satisfied. [52]

Three factors were suggested as being relevant to a favourable exercise of the discretion in s 177F and suitable for clarification:

1. Considering whether the scheme fell into the definition of an 'ordinary family or business dealing';
2. Ascertaining if the conduct or scheme was of a kind that as a matter of policy should be allowed having regard to the structure of the *ITAA 1936* and *1997*; and
3. Considering if the application of Part IVA would result in the double taxation of an amount and the compensating adjustment provisions were not available to be applied to mitigate the effects of this double taxation.

Two potential methods of clarification of the factors were suggested: statutory amendment or administrative guidance.

As discussed above, each method has its advantages or disadvantages. However, perhaps the most significant variables in determining the method to be chosen are the degree of flexibility required, the timeliness by which any amendment would need to be effected and whether clarification is thought to be a matter for the legislature or the administrator. The view of the ATO appears to be that a favourable exercise of the discretion not to apply Part IVA (where the preconditions are satisfied) would be

51 ATO ID 2001/619 (Withdrawn) 'Income Tax Capital gains tax: Small business roll-over: extension of time to acquire replacement asset' <http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID2001619%2F00001%22> at 20 October 2010.

52 It was argued that there is already significant information regarding when the Commissioner will exercise his discretion in the form of ATO rulings, practice statements and guidelines.

exceptional and therefore speed of amendment or the need for flexibility may not be determinative. Arguably, however, the need to clarify the factors is pivotal to deliver taxpayer certainty and to provide taxpayers with a stable or certain basis for judicial review.

Therefore, it is suggested that legislative amendment of Part IVA may be the most suitable method of clarification. A compelling argument can be made that, given the importance of clarifying these factors to create further certainty for taxpayers, this should be a matter dealt with by the legislature and not placed in the hands of the administrator, who may have an inherently revenue oriented bias. Given the recent recommendations of the Henry Review and earlier recommendations of the RBT it is further suggested that the adoption of a statement of principles may be the most beneficial mechanism of amendment.

However, whilst the forum and nature of amendment or clarification remains open to debate, the unequivocal conclusion that does emerge from this paper is that the factors that influence an exercise of the discretion in s 177F not to apply Part IVA require further clarification.