ESTATE PLANS AND ARRANGEMENTS TO AVOID INCOME TAX.

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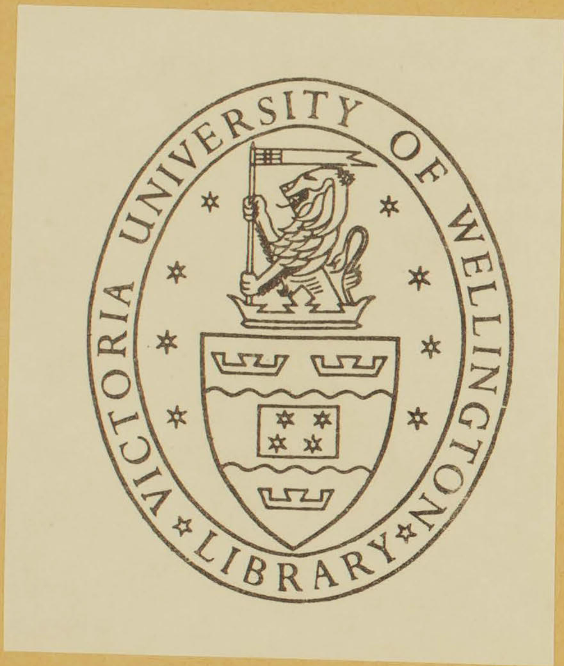
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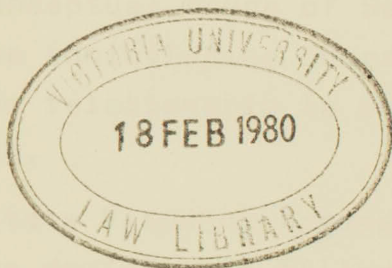
JOHN GORDON BASSETT

ESTATE PLANS AND ARRANGEMENTS TO AVOID INCOME TAX

SUBMITTED FOR THE DEGREE OF MASTER OF LAWS OF THE VICTORIA UNIVERSITY OF WELLINGTON

OCTOBER 1977



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ESTATE PLANS AND ARRANGEMENTS TO AVOID INCOME TAX

PART I INTRODUCTION

A. THE PROBLEM DEFINED

One of the problems foremost in the mind of an estate planner will be the implications that any prospective scheme will bear on the liability to income tax. Whilst the cardinal objective may be the desire to minimise estate duty,[1] that course of action involving the least, periodic contribution to the fisc may also be expected to be an important determinant factor. The question that then arises is the extent to which the latter consideration may be permitted to influence the course of action taken to fulfil the former objective? Hanging over the intended estate plan, somewhat like the sword of Damocles, is section 99 of the Income Tax Act 1976. This provision, a generic anti-avoidance measure, denies fiscal efficacy to every arrangement that has the purpose or effect of the avoidance of income tax. Hence the issue this paper will deal with will be to examine the circumstances in which a taxpayer may rely on the argument of innocence that he was merely implementing an estate plan, when the fall of that sword is imminent and he is called upon to refute an application of section 99. And, for the sake of brevity, this contention that the alleged arrangement to avoid income tax was but an exercise in estate planning will throughout this paper be referred to as "the estate planning argument".

B. OUTLINE OF THE MATERIAL TO BE SURVEYED

With the law on section 99 having been built up almost entirely by judicial precedent, the approach of this paper will be to undertake a case-by-case analysis of the material jurisprudence in order that some resolution of the issue may be postulated.

[1] as charged by section 3 of the Estate and Gift Duties Act 1968

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Reference will in the first instance be made to local case law on the subject. The next Part will examine the treatment accorded the problem in relation to Australia's legislative analogue, the essence of which will be to draw out the sharply contrasting approach there taken despite the similar ancestry of the two provisions.[1] The third Part will raise some of the possible arguments that may be made by the hapless estate planner intent upon preventing that sword of Damocles decipitating his estate plan.

C. <u>REFERENCES</u>

All of the material New Zealand case law to date has arisen from a consideration of the legislative forebear to section 99, being section 108 of the Land and Income Tax Act 1954.[2] Whilst the new section has considerably expanded upon the terms of its predecessor, the basic thrust common to both sections - to negate the fiscal effect of tax avoidance arrangements - is still the same. Hence the principles established under the former provision[3] may under our doctrine of precedent be applied when resolving issues that arise under its legislative successor. To avoid possible confusion amongst the sections of the respective Tax Acts, <u>all</u> references in this paper will be to the provisions of the 1976 Act. Furthermore, the various provisions studied together with the relevant case law decided thereunder, are set out in the Appendix to this paper. Hence any reference to this paper will be to the citation as referred to in the Appendix.

[1] which is traced through by North P. in <u>Elmiger</u> at pages 176-7 and the Privy Council in <u>Mangin</u> at pages 594-5 and 600.

[2] repealed by section 436 of the Income Tax Act 1976, which statute applies in respect of the tax on income derived in the income year commencing 1st April 1977. See s.1(2) of the 1976 Act.

[3] alluded to at page 5 below.

PART II NEW ZEALAND

A. JUDICIAL APPROACHES TO TAX AVOIDANCE

Learned members of the judiciary have from time to time stated their view as to the proper approach to be taken by the Court to problems of tax avoidance. Some of these various comments were alluded to by Woodhouse J. in Elmiger,[1] in a judgment which, though one of our earliest, still stands as one of the most lucid expositions on the question of the proper approach to be taken to problems arising under section 99. His Honour noted the conflict between the view expressed by Lord Tomlin in Duke of Westminster[2] - that every person is entitled to organise his affairs so as to pay less tax than he otherwise might - and the point made by Viscount Simon L.C. in Latilla[3] that to allow him to do so is to increase pro tanto the burden of tax on the other, more law abiding citizenry. Matters have not rested at that point however, for Lord Reid took up the question in Greenberg, to make the telling observation that:

> "We seem to have travelled a long way from the general and salutary rule that the subject is not be taxed except by plain words. But I must recognise that plain words are seldom adequate to anticipate and forestall the multiplicity of ingenious schemes which are constantly being devised to evade taxation. Parliament is very properly determined to prevent this kind of tax evasion and, if the courts find it impossible to give very wide meanings to general phrases, the only alternative may be for Parliament to do as some other countries have done, and introduce legislation of a more sweeping character which will put the ordinary well-intentioned person at much greater risk than is created by a wide interpretation of such provisions as those which we are now considering."[4]

[1] at pages 686-688

[2] at page 19

[3] at page 266. A contention found to be unconvincing, on the ground that, in any event, governments are inclined to overtax. See Vineberg, at pages 31-32.

[4] at page 149. A view endorsed by Lord Wilberforce in Joiner, at page 1055

However the last word on the subject was written by Lord Simon of Glaisdale,[1] who argued for the Courts to apply a strict interpretation to taxing statutes on the basis that whilst -

> "It may seem hard that a cunningly advised taxpayer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens. But for the courts to try to stretch the law to meet hard cases .... is not merely to make bad law but to run the risk of subverting the rule of law itself."

It is against a background of these competing values that our Courts approach problems of tax avoidance under section 99. The exercise in essence reduces itself to endeavouring to accord to the subject the freedom to organise his affairs as he sees fit, yet without jeopardising the interests of the fisc. In the estate planning context, the striking of this balance becomes a particularly delicate question, for to allow the subject too much liberty when planning for both these fiscal burdens is to concede him the best of both worlds.

B. THE SCOPE OF SECTION 99

The other matter of general background that sets the scene for a discussion of the estate planning argument is the judicial perception of the place of section 99 in the scheme of the Income Tax Act. The decision in McKay is one of the leading cases in point, where the Court of Appeal was called upon to examine the relationship between sections 96 and 99. The particular issue before the Court was whether an assignment of income for a term longer than "the prescribed period" (and hence deemed to no longer be income of the assignor) may yet by an application of section 99 become income assessable to the assignor? The Court unanimously answered this question in the affirmative, the view of their Honour's being most clearly expressed in Speight J's observation that -

[1] in Ransom v Higgs at p.949

> "I agree with the President that if the assignment is not within section 96 the matter is at large and falls for decision on the same principles as any other arrangement which is tested against section 99."[1]

It would seem then that our Courts are willing to accord a wide potential to section 99, not being prepared to read in the limitation that it is subject to the other provisions of the Act. It may be added that in Wisheart, the other important case on this point, the Court of Appeal applied the same reasoning in relation to the general deductions section.[2] However the subsequent remarks by the Privy Council in Europa (No.2) would seem to cast doubt on the position taken by the Court in Wisheart. This conflict is more fully discussed at Part IV B, below.

C. THE ESTATE PLANNING ARGUMENT

1. Introduction

The genesis of much of our law on section 99 is traceable to the landmark decision of the Privy Council in Newton. The Board there undertook a thorough review of the law that had developed under the Australian section 260, and then went on to state the principles to be applied under the section; the quintessence of which was that -

> "In order to bring the arrangement within the section you must be able to predicate - by looking at the overt acts by which it was implemented - that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknolwedge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section."[3]

[1] at page 604

[2] being section 104

[3] at page 764. The refinements that were subsequently added to the principles established in Newton were summarised by our Court of Appeal in Ashton, at page 328.

This predication test marks out the correct approach to be followed in an administration of the section, and which our Courts have found to comprise two aspects. The first is essentially an evidentiary one, and delineates the proper subject matter to be scrutinised in order that the test may be discharged. The second aspect is the substantive one, as to whether an examination of the appropriate material discloses a transaction of the type within the ambit of the section. The estate planning argument in relation to both these aspects has attracted some judicial commentary, so this Part of the paper naturally divides itself into a discussion of these two matters. That will leave as the remaining substantive matter to consider, the question of the potential range of application that section 99 bears in the estate planning context.

2. The Correct Source of the Estate Planning Argument

The case of Ashton provides the appropriate starting point under this head. The facts here were that a firm of accountants, upon a change of partners, rearranged their practice so that the commission earned from hire purchase agreements actioned in their office came to be income of the family trusts of the firm's principals. One of the prime movers of the arrangement testified that the reorganisation was inspired by the desire to secure for the respective families a source of income in the event of the demise of that partner.

Wilson J. at first instance was prepared to accept this modified form of the estate planning argument, which in his Honour's view showed the matter to be "a very prudent and reasonable arrangement."[1] So the arrangement was held to be a case of ordinary family dealing. The Court of Appeal however was not inclined to such a benevolent construction of the facts, finding the arrangement "highly artificial".[2] Their Honours' went on to hold that the evidence explaining why the arrangement

[1] at page 310

[2] at page 328

was adopted was irrelevant, for this merely disclosed what the taxpayer's motive was. And yet motive, on authority of Newton, is an irrelevant consideration. This reasoning the Privy Council endorsed, their Lordships holding that the problem of ascertaining an arrangement's purpose or effect must be approached on the basis that -

> "If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability to pay income tax."[1]

It followed, as their Lordships went on to emphasise, that the material purpose or effect could be determined "only" by reference to the arrangement itself and not by reference to the parties subsequent conduct.[2] The Board's firmness in this respect contrasts with the approach heretofore taken in the authorities, where no such strict limitation had been placed on the range of material that may be reviewed. In McKay for example, the Court took into account as "background"[3] two earlier, similar transactions as materially assisting in indicating the purpose or effect of the transaction presently under review. Moreover and particularly in the estate planning context, it can be imagined that this insistence on examining only the arrangement itself may lead to harsh results. There is perhaps no better way to demonstrate sincerity to the estate planning purpose than to subsequently act in fulfillment of it.[4] Yet it would hardly be sensible or fair not to give due weight to subsequent history in these circumstances. However as to the other relevant point taken by the Board - of equating the estate planning

[1] at page 722

[2] at page 722

[3] at page 598

[4] it will be seen that in one case later events influenced a Court's conclusion. See at page 12 below. The problems inherent in the approach mandated by the Board are discussed at pages 9-10 below.

argument with the irrelevant matter of motive - it would seem that this reasoning is not of wide import. For it is established that when the argument is adduced from the correct context, it may yet be vindicated. This is evident from the next case to be considered.

In Loader the taxpayer had for several years carried on in his own behalf a successful earthmoving contractors business. But now, determined to reorganise his affairs, the taxpayer first established a family trust and incorporated a company (the shareholding in which was held by two family trusts, each of which benefited the family of the taxpayer and that of his financial adviser). The taxpayer next sold most of his plant and equipment to the family trust and the rest to the company. In each case, the purchase price was interest-free and repayable on demand. The family trust then bailed its assets to the company, who then employed the taxpayer to utilise them in the same enterprise that he had previously conducted. Mr Justice Cooke found, for business and familial reasons, that the taxpayer would have adopted this "wholesale reorganisation"[1] of his affairs regardless of the taxation advantages obtained.[2] Therefore, his Honour concluded, a sole or principal purpose of the arrangement was not to escape liability to income tax and thus the section did not apply.

Mr Justice Cooke found himself able to introduce the estate planning argument so as to entertain the taxpayer's contention based upon it by the means that -

> "The documents themselves naturally suggest that the principal purposes were the twin advantages of incorporation and of providing some capital and income security for members of the objector's family by permanently transferring assets for their benefit."[3]

[1] at page 479

[2] at page 477

[3] at page 447, emphasis added

From that premise, it was but a short step to conclude that -

> "From the documents it may be inferred that estate duty and tax savings may well haveeach beem included in the purposes of the arrangement."[1]

The reasoning applied by Mr Justice Cooke may be stated to be that the estate planning argument may be relied upon when it speaks from the terms of the arrangement, for the argument will thus demonstrate what the material purpose or effect of the arrangement was. Nor will oral testimony in support of the argument be completely ignored, because it may "fortify"[2] the conclusion reached by a scrutiny of the arrangement itself. However, his Honour's view contrasts with the view taken by the Privy Council in Ashton, where testimony of a similar nature was excluded on the ground that it was within the irrelevant category of "motive". On this state of the authorities, some criticisms readily come to mind.

Firstly, there is the failure to elucidate the notion of "motive" in order that it may be distinguished from the concept of "purpose". It is for example difficult to grasp the reasoning that holds that to provide some "capital and income for members of the objector's family"[3] is a matter of purpose, whilst the fulfillment of the "wish to provide for the welfare of their families"[4] is a case of motive. Secondly, the suspicion lingers that, at least in the type of situation dealt with by Mr Justice Cooke, the Court is doing a little more than using the extraneous evidence to "fortify" a conclusion reached by an examination of the arrangement itself. Here the estate planning argument is only implicitly suggested by the terms of the arrangement, so it is difficult to see how a Court can accurately surmise that this was the relevant purpose or effect without actually embracing the independent evidence which explains that that was the case.

[1] at page 477,

[2] at page 477

[3] Loader at page 477

[4] Ashton at page 327, in the Court of Appeal

Thirdly, it is perhaps too subjective an approach to hold that "only" the arrangement itself be examined by the Court. It has just been noted that the estate planning argument will often only be impliedly suggested upon a scrutiny of the arrangement. This gives rise to the danger that on the same set of facts, different Courts may come to the opposite conclusions because to one Court the argument may not speak forecefully enough from the arrangement itself.[1] For each of these reasons, it may be expected that the question of the precise relevance of evidence extraneous to the arrangement itself will sometime receive further judicial scrutiny. Meantime, the common sense approach followed by Mr Justice Cooke may be acknowledged - that where the estate planning argument speaks from the arrangement itself, this will transform the taxpayer's erstwhile "motive" into a "purpose or effect" of the arrangement.

3. The Merits of the Estate Planning Argument

Once the estate planning argument has been adduced from the proper source, the task remaining is to convince the Court of the cogency of the argument. In terms of the predication test,[2] the estate planning argument was made under the aspect of contending that the arrangement was but an instance of "an ordinary family dealing without necessarily being labelled as a means to avoid tax."[3] Upon application of the predication test, no dispute would arise in the case where the estate planning argument is found to amount to the arrangement's only purpose or effect. However in the situation where it may also be inferred that the desire to avoid income tax was one of the purposes of the arrangement too, original questions arise. In this situation,

[1] as indeed occurred in the Ashton proceedings, as between the first two Courts.

[2] cited at page 5 above.

[3] Newton at page 764. The position obtaining under the new section is stated at page 14 below.

the balancing of the competing values spoken of earlier[1] - between the sovereignty of the individual and the need to safeguard the interests of the fisc - is thrown into sharp relief and thus the Court is called upon to determine which value shall prevail. Precisely this situation arose in the recent case of Tayles, which decision may now be referred to so as to elicit how the judicial mind perceives of the force of the estate planning argument.

In Tayles, the transactions under review concerned, like Loader, a thorough-going exercise in estate planning, carried out by two brothers in relation to each of their farming enterprises.[2] The essence of the scheme was to create and utilise the media of a unit partnership, in which the taxpayer and a recently formed family trust joined to carry on the farming business. The capital of the partnership, divided into three classes, comprised a total of 50,600 units, of which the taxpayer held all but 2,000.[3] The actual farm property, although it remained registered in his name, was declared to be held in trust for the benefit of the partnership, which was declared to be for a period of 23 years unless sooner determined.[4] The taxpayer then proceeded to gift $2,000 and bail his livestock and equipment to the family trust, which then comprised the trust's contribution to the partnership. It only remained to employ the taxpayer as a salaried manager of the farming enterprise. By these means, the scheme rather artfully comprised all the essential ingredients of a desirable estate plan. The taxpayer had a secure and

1 at pages 3-4 above

2 the plans in both cases were identical apart from minor adjustments to suit the individual case. So reference to one plan may for convenience be taken as also encompassing reference to the other.

3 his 100 A units gave him ultimate control of the partnership, whilst his 48,500 B units (which figure represented the equity he had held in the farm) secured the right to a 5% fixed cumulative preferential dividend. The units held by the family trust enabled it to enjoy the surplus income and receive the surplus capital after repayment of all other units on a winding-up.

4 which the taxpayer, with the specified proportions of unit holdings, could have achieved at any time.

hopefully adequate source of income,[1] yet with his equity in the venture frozen in such a way that it could be readily diminished by a progressive gifting programme. Unfortunately for the taxpayer, the scheme was not viewed in the ensuing proceedings in such a kindly light.

The Taxation Board of Review was unimpressed with counsel's contention that this admittedly novel scheme bore all the hallmarks of a traditional estate plan and so ought to be treated as such. To the contrary, the Board of Review thought that the scheme was a "highly artifical structure"[2] imposed on this farming venture, making no practical difference in the manner of the way the farm was operated. Secondly, the Board of Review was inclined to doubt the taxpayer's sincerity to the avowed purpose, for the Members noted that not only was the taxpayer largely ignorant of the "mechanics"[3] of the scheme, but also no change in the unit holding had occurred in the succeeding nine years. It was for these two reasons that the Board of Review concluded that the section applied.

On appeal to the Supreme Court, Mr Justice Jeffries agreed with that conclusion. The principal feature of the plan which persuaded his Honour to this view was the use of the 5% cum. pref. dividend. Jeffries J. thought that this was "an artificial device so that a superflow of income was received by the trust."[4] Hence it could "be predicated that the manner in which the scheme was implemented was to avoid tax, at least as one central purpose." For much the same reason, Jeffries J. then went on to hold that this acknowledged exercise in estate planning could not be accepted as a matter of ordinary family dealing. The essence of his Honour's reasoning was to start from the premise that -

[1] from his salary, the bailment agreement, and the 5% cum. pref dividend.

[2] at page 522

[3] at page 523

[4] at page 677

> "The vagueness of the term ordinary business or family dealing cannot be used as a cover for all or any type of transaction within a family."[1]

With that point made, there will only be an ordinary family dealing where there is merely some -

> "elements of generosity, risk and eased application of current commercial practices .... (but not where there is) abandonment of commercial practice, apparent mercantile foolishness or marked artificiality."[2]

With this test in mind, his Honour concluded -

> "What persuades me the scheme is caught by the section is that both the appellants have passed to the partnerships the single asset of each which is of overwhelming importance as the income earning asset, and at the same time accepted, or probably themselves fixed, a device to the scheme to limit the flow of income in return for the use of that asset."[3]

It is apparent that in fulfillment of the balancing exercise that the Court was called upon to discharge, a position in favour of protecting the interests of the Revenue was adopted. For the stand taken by the Court was that whilst it may perhaps be a matter of ordinary family dealing to reorganise one's affairs in fulfillment of an estate plan, this may not be achieved without violating section 99 if an income tax saving device is expressly embodied as part of that rearrangement. It may be expected that much the same position will continue to prevail under the present section. Subsection (2)(a) applies the section to the case where the (only) purpose or effect of the arrangement is tax avoidance. Subsection (2)(b) catches the arrangement that has at least two purposes or effects - one of which is tax avoidance - regardless of whether one of those purposes or effects

[1] at page 678

[2] at page 678

[3] at page 678

is a matter of ordinary family dealing. Thus the position established by subsection (2) is that where the estate plan (as a matter of ordinary family dealing) is the <u>only</u> purpose or effect, the section will not apply. Whereas, if that estate plan as a matter of ordinary family dealing be a purpose or effect that co-exists along with the more than "merely incidental" purpose or effect of tax avoidance, paragraph (b) applies the section. In this regard, the position now coincides with what was said to be in one of the earliest cases on the section.[1] In <u>Elmiger</u>, Woodhouse J. had stated the proposition that -

> "it is my opinion that the family or business dealings will be caught by section 99 despite their characterisation as such, if there is associated with them the additional purpose or effect of tax relief (in the sense contemplated by the section) pursued as a goal in itself and not arising as a natural incident of some other purpose."[2]

In terms of that test, <u>Tayles</u> may be cited as authority for the proposition that relief from tax will be regarded as "pursued as a goal in itself" in the case where a tax saving feature is expressly embodied as some part of the arrangement itself. For of the arrangement reviewed in that case, the use of the 5% cum. pref. dividend ineluctably suggests the desire to diminish the tax burden by limiting income. <u>Loader</u> by way of contrast may be cited as an example of where - there being no tax saving feature an overt part of the arrangement - the avoidance of tax was "a natural incident of some other purpose" because the estate plan would have been adopted regardless of its income tax advantages. As to the more factual aspect as to whether any particular arrangement is within either limb of the test formulated by Woodhouse J., this will be taken up and more fully considered on the discussion of onus of proof, at Part IV A, below. Meantime, the outstanding issue of principle - being the potential scope of section 99 in the estate planning context - remains to be referred to.

[1] his Honour there was following <u>Newton</u> and the "one purpose" test. However in <u>Mangin</u> the requisite purpose test was modified to a "sole or principal purpose"; only to be changed back to a "one purpose" test by <u>Ashton</u>; to be altered to a "main or one of the main purposes" in <u>Europa (No.2)</u>

[2] at page 694

4. The Scope of Section 99 in the Estate Planning Context

Once again the case of Tayles is an important precedent, because the decision of Mr Justice Jeffries on the facts of that case can be seen to raise original questions as to the possible limits to the range of section 99; a vital question in the estate planning context. The suggestion has been made that the decision in Tayles "represents a considerable extension of the ambit of the section".[1] This view is based on the contention that, for an arrangement to escape application of section 99, "the Courts have required the trusts to gain an enduring benefit."[2] It is pointed out that most of the cases, from Elmiger, Mangin and Udy through to Gerard and Ashton, are characterised by "short term transfers of high income producing assets or quickly wasting assets."[3] Tayles on the other hand is said to be different, because the farm would eventually pass to the taxpayer's family. Ergo an "enduring benefit" had been obtained. On this analysis, it may be observed, the decision in Tayles can be seen to strike at one of the essential characteristics of any estate plan and hold that satisfaction of this element was not enough to defeat an application of section. Inherent in any estate plan, regardless of form, is that some "enduring benefit" move tothe disponor's family. Hence, although Tayles occurred in the context of a reorganisation of an entrepreneurial activity, does Mr Harley's analysis suggest that the case has wider ramifications for areas outside its particular context? The answer to this question is plainly a matter of vital concern to estate planners.

Before testing this contention by means of eliciting from the jurisprudence the pivotal feature which will move the judicial mind to apply the section, some comments may first be made on the coherence of the argument itself. In the first instance, it is unfortunate that the commentator did not intimate precisely what he had in mind when speaking of the notion of an "enduring benefit".

[1] Harley at page 141

[2] at page 143

[3] at page 143

Does it connote merely the right to a source of income or something more in the form of the acquisition of a permanent asset or an interest therein? In Loader for example, whilst the family trust obtained equity in the new family company, its source of income was dependant upon the continued personal exertions of the taxpayer. Which is exactly the situation that prevails in the classic paddock situation. Only in the former case was the arrangement upheld, yet it would be difficult to hold that the "enduring benefit" in the form of a source of income was different in kind in the two situations.

A second problem is encountered when it is maintained that application of the section depends upon the nature of the assets transferred. Such a view would not for example sustain the different results that were reached in the similar cases of Grierson and Wisheart. Each case concerned the endeavour by an engineering and legal firm respectively to utilise a service company to provide inter alia office equipment to the respective practices. Yet in Grierson the Court upheld the arrangement.[1]

Thirdly it may be asked where the Courts have expressly "required" an "enduring benefit" to pass in order to defeat invocation of the section? There is for example only some olden dicta by the High Court of Australia,[2] that the section could not invalidate an actual disposition of income-producing property, made to reduce the burden of taxation. The nearest our Court of Appeal has come to making the stipulation argued for is to merely state that the section could not avoid "transactions consisting simply of absolute present gifts of capital."[3] Perhaps the position closest to requiring an "enduring benefit" is that taken by the Inland Revenue Department itself. In "Incidence of Taxation" for example,[4] where the Department sets out the guidelines

[1] for reasons explained at page 38 below

[2] Purcell, at page 473

[3] McKay, at page 601

[4] particularly at pages 6 to 12

followed in administering the section, the emphasis for an unimpeachable arrangement is upon those transactions that create real and enduring obligations and benefits and which involve permanent transfers without reservations or reversions. In short "an enduring benefit". However it is apparent that the Courts do not analyse problems arising under the section on the basis of the view argued for by Mr Harley or indeed that taken by the Department itself.

The case law suggests that the fundamental basis upon which application proceeds is that overriding importance is to be attached to the impact - or lack thereof - that the arrangement has on the affairs of the taxpayer. Right from the earliest cases, the Court found it significant that "there was no change in the practial operation of the partnership business" or that "the appellants continued their business to all intents and purposes as before."[1] Instead, the only change was found to be an "accounting or procedural"[2] one that enabled income to be "hived off",[3] "siphoned off"[4] or "diverted".[5] Hence the approach taken in the authorities is that when a survey of the particular facts discloses that the "economic incidence"[6] of the disponer's tax burden is all that has been affected by the arrangement, then the Court will move to invoke section 99 - unless the taxpayer is able to adduce sound reasons which demonstrate that the arrangement was either necessary or desirable.[7]

[1] Elmiger at pages 179 (North P.) and 188 (McCarthy J.) respectively. For reiteration of the same notion, see for example Marx at pages 192 and 213, Udy at page 17, Ridley Motors at pages 51-52, Wells at page 144, Mangin at page 234, Wisheart at page 321, McDonald at page 133, and Halliwell at page 2

[2] Marx at page 213, per McCarthy J.

[3] Udy at page 17

[4] Ridley Motors at page 52

[5] O'Kane Construction at page 57

[6] Mangin at page 596

[7] as the taxpayer was able to do in Grierson for example, for the reasons noted at page 38 below.

Plainly this analysis does not postulate the absence of an "enduring benefit" as the pivotal notion upon which application of the section proceeds. Rather it is in the notion that the arrangement merely alters the disponer's tax burden without any noticeable change in the conduct of his affairs that the Courts find an unacceptable degree of artificiality in the impugned arrangement. Inexorably then, the Court moves to draw the inference that the proscribed purpose or effect was in mind. If this line of reasoning be the fundamental basis upon which the Courts move to apply the section, then to attach importance to the notion of "enduring benefit" as argued for by Mr Harley (and indeed followed by the Department itself) is to misconceive the potential scope of the section. Moreover, it may further be pointed out that the analysis suggested by the authorities does not mean, as some commentators[1] have suggested, that the Courts "read down" the word "effect" in the phrase "purpose or effect", for quite clearly the view just argued for holds that much importance is also attached to this aspect. It only remains to add that this analysis would not support the view that Tayles "represents a considerable extension of the ambit of the section"[2] novelty of the particular circumstances excepted.[3]

However to discount the importance of "an enduring benefit" is not to make a case for despair amongst estate planners. It may be observed that the estate planning argument has arisen in the context of a reorganisation of a taxpayer's entrepreneurial activity. In this type of situation, the Court may naturally incline to be suspicious of the argument, for the commercial context may well suggest that the desire to reduce income tax could have also been a strong motivating force.[4] Beyond that type of situation, where for example a person proceeds to divest himself of his

[1] Dalton at page 104, Richardson at page 565

[2] as noted at page 15 above

[3] indeed, it was pointed out at page 12 above, that one of the reasons expressly relied on by one of the courts in the Tayles proceedings was the view just argued for

[4] for reasons that are more fully developed at Part IV A, below

equity, is a shadow area; one not touched on in depth by any wide-ranging judicial discussion. It has already been noted[1] that our Court of Appeal has stated in passing that to "simply" dispose of property is not within the subject matter dealt with by the section. That view may be endorsed, on the basis of the predication test that is administered under the section. To "simply" dispose of property would not enable it to be predicated that the transaction was "implemented in that particular way so as to avoid tax."[2] Some authority in support of this view may be drawn from the judgment of Wild C.J. in Wisheart, where his Honour applied the predication test[3] to meet the contention that to dispose of the insurance agency was an ordinary family dealing.[4] This suggests that the converse conclusion would be open in the more innocent situation presently in mind. It is on this line of reasoning that it may be speculated that if the Department should seek to reverse its present policy and apply the section to this shadow area, it would probably be unsuccessful.

The discussion of our jurisprudence has taken us to the point of perceiving that section 99 is on its face a far-reaching provision. The only limitation that it would seem to be subject to is an administrative one whereby the section is only applied in a commercial context where a purpose or effect of tax avoidance is thought by the Revenue to be present. Just what a taxpayer must do in this situation to defeat invocation of the section is a matter taken up at Part IV A below. At this juncture, the appropriate course is to turn to the Australian situation in order that it may be illustrated the disparate approach there taken, despite the close similarity between the two sections.

[1] at page 16 above

[2] Newton at page 764

[3] at page 442

[4] although his Honour was overruled on appeal on the ground that an insurance agency was not an asset that could be "transferred", this does not detract from the reasoning applied by the Chief Justice.

PART III AUSTRALIA

A. THE CONCEPTUAL SCOPE OF SECTION 260

In any endeavour to apply section 260 of the Income Tax Assessment Act 1936-1977, the Federal Commissioner of Taxation faces the task of satisfying two conceptual limitations that the section is subject to. One of these limitations has been found to be inherent in the terms of the section itself, whilst the other is said to flow from the judicial perception of the place that the section occupies in the scheme of the Act. These restrictions are of course independant of the further consideration as to whether the particular fact situation under review is of the type nominally within the terms of the section as it has been interpreted in the cases.[1] Hence the discussion in this Part of the paper broadly divides itself into an examination of these three matters.

1. The Annihilating Character of Section 260

The High Court in Clarke[2] first drew attention to the point that section 260 merely "annihilates", for income tax purposes, every arrangement that purports to avoid liability to income tax. The significance of this limitation lies in the point that, even if the section may be applied to such an arrangement and the matters thereby voided are disregarded, an appropriate set of facts must still remain which support the Commissioner's assessment. Otherwise the assessment must fall because the section does not authorise the assumption of hypothetical facts.[3] This point may be illustrated by reference to what is one of the most controversial cases decided under section 260, being the

[1] the approach taken in this jurisdiction is to also apply the principles laid down in Newton. For a lucid discussion of their interpretation by the Australian courts, see Dalton; especially at pages 96-109.

[2] at page 127

[3] Spry at page 90

decision of the Full High Court in Cecil Bros.[1] The taxpayer there was footwear merchant, whose impugned arrangement was to simply interpose a family trust between itself and its usual wholesale outlet. By this means, the taxpayer paid $39,554 more for its trading stock than if it had dealt directly with the wholesaler. Perhaps not unnaturally, the Commissioner sought to reduce by that amount the taxpayer's claim for a deduction on account of purchases of trading stock. The view taken by the Full High Court as to the problems attendant upon annihilation was expressed by Menzies J. in the following terms -

> "I do not think that section (260) authorises the Commissioner to substitute a different price for that actually paid in accordance with those (trading stock) contracts. Indeed section 260 does not authorise the Commissioner to do anything; it avoids as against the Commissioner arrangements, etc., as specified and so leaves him to assess taxable income and tax on the facts as they appear when the avoided arrangements, etc., are disregarded. Here it is not revealed that the taxpayer company's real outgoings for its supplies were $39,554 less than it paid or that the additional $39,554 was not paid or was a gift to (the family company). To arrive at any such conclusion would, I think be an unauthorised reconstruction of what occurred....."[2]

The significance of this limitation of the section will vary from case to case, yet it does indicate that there is some truth in the observation by Mr Justice Mahoney, that section 260 "operates after the manner of a blunt axe".[3]

[1] that controversy, arising on another aspect of the case, is expanded upon at Part IV B, below.

[2] at page 441

[3] Polden & Wilson at page 157, a case where although the section applied, the Commissioner's assessment failed because of annihilation problems.

2. The Relationship to Other Sections of the Act

The nature of the second limitation was summed up by Sir Garfield Barwick when his Honour observed -

> "there will be no relevant alteration of the incidence of tax if the transaction being the actual transaction between the parties, conforms to and satisfies a provision of the Act even if it has taken the form in which it was entered into by the parties in order to obtain the benefit of that provision of the Act."[1]

The principle expressed by his Honour is compendiously known as "the choice doctrine", whose origin is usually traced back to another controversial decision of the High Court; being the case of W.P. Keighery Pty Ltd.[2] The reasoning underlying the doctrine may be found in the following observation of Gibbs J., who recently had occasion to make some general comments about the office of section 260. Thus his Honour wrote -

> "the presence of section 260 makes it impossible to place upon other provisions of the Act a qualification which they do not express, for the purpose of inhibiting tax avoidance. In other words it is not permissible to make an implication which does what section 260 fails to do in preventing the avoidance of tax. If it is suggested that a taxpayer has engaged in a device to secure a fiscal advantage, and the relevant provisions of the Act do not expressly deal with the matter, the case depends entirely on section 260."[3]

[1] Mullens at page 509

[2] but see Dalton at page 113 for the suggestion that germination of the doctrine may be traced back further, to the dicta expressed in Purcell, and which was alluded to at page 16 above.

[3] Patcorp at page 429

The jurisprudence subsequent to the propoundment of the choice doctrine in Keighery has been marked by a gradual extension of the parameters of that doctrine. Although this is not to say that all subsequent developments have been entirely in the direction of an expansion of the doctrine. Mr Justice Mahoney for example has developed the exception that the Act offers no relevant "choice" in respect of its "machinery" provisions.[1] Be this as it may, the latest word from the High Court is to not only reaffirm the doctrine, but also to take it to its ultimate logical conclusion. Thus in Slutzkin, Aickin J. observed -

> "To adopt a course which produces a result outside the scope of the Act is not to alter the incidence of tax, or to defeat any liability to tax or to prevent the operation of the Act, notwithstanding that such a course is adopted with full knowledge of the provisions of the Act and with a conscious intention that the proceeds should not fall within the operation of the Act."[2]

It would seem then that the Act also offers a "choice" whether or not a proposed transaction should be brought within the terms of the Act, so that to decline to do so is not to violate section 260. The authority of these remarks may perhaps be questioned, for not only do they rest uneasily against the view of Mr Justice Gibbs just quoted, but also they would seem to be opposed to the following comment of Mr Justice Walsh, who, also speaking for two other members of the High Court, wrote -

> "If a taxpayer makes a decision to arrange matters so that income from his property follows one of the courses so described and reaches him with the character of capital, in my opinion he is not thereby exercising a right of choice between alternatives which the Act lays open to him."[3]

[1] see Cridland, particularly at page 221

[2] at page 144

[3] Ellers Motors, at page 55

However, irrespective of this conflict of precedent, it would seem that the High Court currently takes a very narrow view of the scope of section 260.[1] It would seem moreover that the Federal Commissioner now recognises that section 260 is no longer an effective weapon to defeat measures of tax avoidance and has switched the battle to another front. Thus the recent passage of section 31C,[2] the intended amendment to section 103A(2)(d)(vi)[3] and the proposed introduction of measures of tax avoidance[4] would seem to foreshadow a campaign that relies upon legislating for specific tax avoidance problems rather than utilising the all-embracing approach followed under section 260.

B. THE ESTATE PLANNING ARGUMENT

Having traced through the increasingly narrow conceptual range of section 260, it should perhaps not be surprising to find such a development paralleled by a trend of restrictive application in those areas where - nominally at least - the section may be applied. This development will become evident by an examination of the precedents reviewing income splitting arrangements that bear estate planning implications.

1. The decision in Millard

This case concerned the manoeuvre whereby the taxpayer, a registered bookmaker, sold his business to a newly incorporated family company. Thereafter the taxpayer purported to carry on as agent for the company exactly the same business as previously.

[1] see for example the insistence by Barwick C.J., that before section 260 can be applied, there must be an antecedant transaction that is recast into its present form in order to avoid tax. Stated in Mullens at pages 507 and 510. The parallel between this view and what his Honour argued when appearing as Counsel in Newton has been noted. See Gzell at page 46.

[2] which authorises the Commissioner to apportion purchases of trading stock to reflect its true price where the parties in question are not dealing at arms-length. In essence, the Cecil Bros. type of situation.

[3] to further restrict the ability of an erstwhile private company attaining "public" status merely for tax purposes. In essence, the Keighery, Casuarina type of situation.

[4] Budget Speech 1977-78, at page 22.

Perhaps because the taxpayer took the unwise course of acknowledging that his actuating purpose was to "pay less tax and end up with more capital",[1] Taylor J. had little difficulty in holding that the section applied.

2. The decision in Hollyock

A similar conclusion was reached in the case of a sale by a chemist of a one-half share in his pharmacy business to his wife. Much of the judgment of Mr Justice Gibbs is burdened with a discussion of the different "purpose" tests of Newton and Mangin,[2] in the course of which his Honour makes out a forceful case for adoption of the former standard. In any event though, Gibbs J. was satisfied that along with the desire to avoid death duty, the avoidance of income tax was an essential purpose. Ergo the section applied.[3]

These early decisions plainly marked a willingness on the part of the Australian Courts to be sympathetic to the Commissioner's endeavours to utilise section 260 to strike down income splitting arrangements carried out in a family context. However subsequent precedents reveal a current of authority pulling in the opposite direction, which thereby accords a substantial measure of legitimacy to the estate planning argument.

3. The decision in Peacock

Here Mr Justice Nettleford sitting in the Supreme Court of Tasmania considered the case of where a registered surveyor admitted his wife as a full partner in his practice. However it was not until some fourteen years later that the Commissioner sought to challenge the arrangement, by assessing, at that point,

[1] at page 342

[2] mentioned at Fn 1, at page 14 above

[3] see at page 607

the income derived from the practice to the husband. In his denial of the Commissioner's assessment, the taxpayer acknowledged that whilst possible tax savings were in mind, nonetheless, the sharing of the capital built up through the marriage for the purposes of estate duty savings and to ensure spousal independance and security were the main actuating reasons.[1] Such honesty had its reward, for Nettleford J. held that the facts disclosed an ordinary dealing without necessarily being labelled as a means to avoid tax.[2]

Perhaps the most interesting feature of this case is the broad view his Honour took of the concept of an "ordinary dealing" in order to arrive at what might at first blush seem a surprising result - that it is not "unusual" for a non-qualified person to be a principal in a professional practice. The premise underlying his Honour's reasoning was that he regarded the taxpayer's enterprise as not merely a professional practice involving the exercise of a special technical skill, but rather as a "business" whose range of activities necessarily comprehended more than purely professional work. It was that reasoning which enabled the Court to justify the otherwise surprising result. In this connection, it may be added that much the same view enabled his Honour to skirt the point made as to the possible illegality of the arrangement. Mr Justice Nettleford held, by a literalism, that as the taxpayer's wife in her participation of the work of the firm did not actually hold herself out as a surveyor, then equally she did not "practise" as one; in terms of the proscription contained in the relevant professional statute.[3] The judgment then makes it reasonably clear that the Court was inclined to a liberal view of matters of ordinary family dealing, which is to acknowledge the force of inter alia the estate planning argument.

[1] see at pages 678-9

[2] at pages 688-9

[3] see at page 686

4. The proceedings in Jones and Bayly

The decision in these two similar cases by the Chief Justice of South Australia sitting in that State's Supreme Court may be taken as further evidence of this trend of a tolerant approach. Each case concerned a pharmacy business, which in Bayly had been purchased by the taxpayer's wife whilst in Jones had been sold by the taxpayer to his wife. In both cases, the husband was thereafter employed, by his unqualified wife, as a salaried manager to conduct the pharmacy business.[1]

In their efforts to deny an application of section 260, the taxpayers in both cases were nothing if not resourceful in argument. The actuating reasons were said to be to secure some relief from the two fiscal burdens, together with the desire to obtain equality of ownership with the matrimonial assets.[2] Naturally this latter aspect received the most emphasis, and was said to spring from the wish to secure some measure of the limitation of liability should the business prove unsuccessful (neither business was carried on through the media of a company), as well as to organise their affairs to reflect the modern notion of a marriage as a partnership of equals in all respects. In Bayly, however, Chief Justice Bray did not feel compelled to make any findings on the cogency of the taxpayer's arguments, for his Honour thought that the Commissioner's assessment entailed some notional reconstruction.[3] Hence it fell on that ground.

In Jones though no such difficulty prevailed, so the Court had to deal squarely with the question as to whether the facts showed a case of ordinary family dealing. This the Court answered in the affirmative, despite the series of obstacles to be surmounted before that conclusion could be reached.

[1] it may be noted that in New Zealand this situation is to some extent regulated by section 97. The essence of that provision is to allow only "reasonable" remuneration or share of profits where a relative joins in the conduct of the taxpayer's business. Normally the material ruling rate is taken as the appropriate standard. In practice, the section is quite an effective measure to counter income splits in this type of situation.

[2] see Bayley at page 226 and Jones at page 232.

[3] see at page 227. Essentially the point was that "the facts which remain" upon voidance of the purchase by the wife would still not leave the husband as owner of the business in order that the income derived therefrom could be assessed to him.

The first point to arise was the significance sought to be attached to the casual, if not suspicious, manner by which the sale transaction was implemented. It transpired[1] that the price was satisfied out of the profits of the business - and only then upon the imminence of the current proceedings. His Honour met the point by holding that the parties seriously "intended" that a sale should be made, so that any irregularity in bringing it to fruition could be ignored.

The second matter dealt with by the Chief Justice was the question of illegality, as his Honour had found[3] that it was illegal for Mrs Jones to acquire and carry on this pharmacy business. His Honour met this obstacle by citing[4] the principle that income dishonestly earned was taxable just the same as honest gains and then illustrated the point by giving the specious analogy[5] that it would be ridiculous to no longer tax income earned by a licenced tradesman merely because he had not paid his annual licence fee. And secondly, which is perhaps the more telling point, Bray C.J. noted that any illegality in the mode of carrying on of the business could not be said to convert the income of the wife into that of the husband's.[6]

The next issue facing the Court was the contrary precedent

[1] see at page 232

[2] at page 234

[3] at page 234

[4] at this point, Bray C.J. adopted the discussion on the subject made in Bayly. See at pages 219-220.

[5] specious because it would only be truly in point if it were Mister Bayly who owned and carried on the business in the illegal manner suggested in the analogy.

[6] at page 220

of Hollyock, which dealt with[1] it may be recalled the very similar problem of a sale of a one-half interest in a pharmacy business by a husband to his wife. To distinguish that precedent, his Honour invoked the judgment of the Privy Council in Europa (No.2) as now stating the correct law on the point. Although Hollyock followed the "one purpose" test of Newton, his Honour felt that this had been superseded by the "main or one of the main purposes" test of Europa (No.2). But curiously enough, Bray C.J. did not mention the "one purpose" test reaffirmed in Ashton; which might have had some bearing on the choice of the relevant test to be adopted.[3] Be this as it may, the Chief Justice went on to find[4] that the main purpose of the present transaction was to secure the equalisation of the matrimonial assets, with the savings in income tax to be gained thereby only a minor and subsidiary purpose and effect.

The final noteworthy aspect of the judgment concerns the expansion by the Chief Justice upon the concept of an ordinary family dealing. Of that notion, Bray C.J. observed -

> "A redistribution of family assets including a family business, as between a husband and wife is a normal ordinary, everyday family transaction which would not normally attract section 260 where there is no professional element in the business. Farmers, shopkeepers, factory owners do it frequently."[5]

It would seem that his Honour was willing to extend the opportunity to engage in matrimonial asset sharing exercises regardless of its vocational context, without considering it necessary to make any such refinement as Nettléford J. did in Peacock. In so doing, it would seem that the following warning sounded by Menzies J. in Peate will no longer be heeded. There

1 see at page 25, above.

2 see at page 226 and page 238

3 for it would have meant two Privy Council and one High Court precedant following a "one purpose" test, as against the "principal" or "main" purposes tests of Mangin and Europa (No.2). Newton and Hollyock were ostensibly binding on the Court, whilst Mangin and Europa (No.2) technically were not.

4 at page 238

5 at page 238

his Honour had pointed out -

> "What, outside a profession might be regarded as an ordinary transaction may, within a profession have an altogether different appearance."[1]

So it is readily apparent that these three later cases illustrate that the present trend of authority in Australia is to elevate exercises in matrimonial asset sharing, almost as a matter of principle it would seem, into matters of ordinary family dealing and therefore beyond the range of section 260. With the estate planning argument but one facet of such transactions, it may be said that that argument has been judicially acknowledged as potent enough to materially assist in defeating an application of the section.

5. The Situation of Service Trusts or Companies

The use of service trusts or companies in the management or conduct of an enterprise is not a matter that has to date received extensive judicial scrutiny. However it would seem that in the meantime, the Federal Commissioner is taking a hard line and is refusing to acknowledge their efficacy for tax purposes.[2] The issue is currently being litigated, but unfortunately the results to hand do not offer a convincing resolution of the matter.

The case in point is the decision of Mr Justice Waddell in Phillips, when sitting in the Supreme Court of New South Wales. The matter that arose for consideration concerned the measures taken by a large accountancy firm, the essence of which was to establish a unit trust for the purpose of the trust then providing the various management and administrative services required by the firm. The Commissioner denied the partnership a deduction for all the amounts paid to the trust on account of the provision of

[1] at page 460. Cited with approval by Gibbs J. in Hollyock, at page 607.

[2] see Pose at page 15.

those services,[1] which action members of the firm challenged.

The approach taken by Waddell J. was, in essence, to back-in to the problem. The initial premise of his Honour's reasoning was to hold[2] that the decision of Cecil Bros. governed the present facts, then noting[3] that that decision had been approved by the Privy Council in Europa (No.1). Whilst this latter observation is undoubtedly correct, it is nonetheless clear from the judgment given by the Board that their Lordships approved of that decision in relation to problems arising from the deductions section of the Act.[4] Hence few legal scholars would be willing to adduce that approval as relevant to any discussion under section 260. That point aside, Waddell J. then made a lengthy citation from the judgment of Menzies J.,[5] when his Honour had discussed the difficulties that arose upon annihilation and which the Commissioner faced in endeavouring to support his assessment. Those remarks Waddell J. turned to apply to the instant facts. They showed, in his Honour's view, that the Commissioner's assessment entailed notional reconstruction, because it involved substituting the firm in the place of the trust in the various service contracts that had been made between the firm and the trust.[6] As a final comment, his Honour added[7] that in any event, the establishment of the unit trust (and the companies used to manage the trust) were not, as the Commissioner argued, capable of annihilation because a proscribed purpose could not be inferred from their mere establishment. Thus his Honour concluded an application of section 260 could not be sustained.

1 see at pages 346-347

2 at page 356

3 at page 357

4 Waddell J. ought instead have cited Europa (No.2), as mentioned at page 44 below.

5 part of which is quoted at page 21 above.

6 at pages 357-358

7 at page 358

Although not very clearly articulated, Mr Justice Waddell's view that the Commissioner's assessment entailed some reconstruction seemed to rest on the ground that the various substitutions his Honour mentioned would then lead to the situation of the firm being both parties to the several contracts and thus making, in effect, payments to itself. In which case, the claim for the respective deductions could be denied because there would have been no effective disbursement or outlay. However there was another line of reasoning open to the Court if the whole transaction had been approached in its chronological order.

The initial premise of this reasoning is the point that Waddell J. added almost as an afterthought and which concerns the ability to annihilate the unit trust and management companies. Millard has already been cited[1] as an example where the Court denied the existence of a company upon an application of the section. Furthermore, the decisions of the Privy Council in Mangin[2] and Ashton[3] may be cited as authority to similarly treat a Trust. Thus contrary to his Honour's view, it would seem to be a proposition firmly entrenched in the authorities that section 260 does authorise the Commissioner to ignore the existence of a trust or company when he comes to make his assessment. The position is usually said to be[4] that upon the avoidance of the trust or company and any agreement that they may have made in prosecution of the proscribed purpose, the status quo ante is notionally restored and the Commissioner is entitled to assess on the basis of the position that obtained prior to the making of the (now voided) arrangement.[5] It is manifest that the essence of

1 at page 24 above

2 see at page 597

3 see at page 724

4 see the summary given by Bray C.J. in Bayly at page 227

5 a similar situation arose in Wisheart in relation to the employment of office staff. As the agreement under which the law firm purported to pay for the staff provided by the service company was void, the firm lost the right to claim a deduction for the expenditure on account thereof. See North P. at page 322 and Turner J. at page 331

this line of reasoning is to merely strike down without any concommitant reconstruction and thus provides reason for holding that the Commissioner's assessment in Phillips was yet sustainable. It is to be hoped that when the Federal Court hears the appeal lodged in these proceedings, a more convincing exposition of the problem is offered.

6. Conclusion

The ability of this jurisdiction's all-embracing anti-avoidance provision to deny fiscal efficacy to any estate plan is restricted by two considerations. Firstly there are the two conceptual limitations that the provision is subject to, both of which are illustrated by the proceedings in Cecil Bros.[1] It may be added though that the extension by Phillips of the reconstruction limitation to the service trust type of situation is not of compelling authority, so that further judicial scrutiny of this aspect may be expected. Secondly and perhaps most importantly, is the current judicial willingness to hold that the exercises in matrimonial asset sharing - which expressly encompass the estate planning argument - are matters of ordinary family dealing and hence may be undertaken without fear of violating section 260. This willingness may be evidenced by the position that the authorities postulate - that it is not now "unusual" for a professionally qualified taxpayer to be either a partner with or in the employ of his unqualified spouse in the pursuit of his professional calling. Thus the power of the estate planning argument has in this jurisdiction been judicially acknowledged.

[1] the aspect relating to the choice doctrine is referred to at Part IV B below.

PART IV ARGUMENTS DENYING AN APPLICATION OF SECTION 99

The concept underlying the administration of section 99 is that the provision is said to be "self-executing"[1] and not dependant upon the exercise of a discretion by the Commissioner. Its application to an arrangement of the type within its terms thereby exposes a set of "taxable facts".[2] The Commissioner then sets in motion the process to make the appropriate assessment. Should the taxpayer wish to challenge the assessment duly issued, he can have the matter determined by way of proceedings on objection as provided for in Part III of the Act. Once before the selected forum,[3] the objector is only limited[4] by his imagination in the range of arguments he may adduce as denying vindication of the Commissioner's assessment. It is anticipated that those arguments may possibly be four in number, as follows.

A. NO PROSCRIBED PURPOSE OR EFFECT - ONUS OF PROOF

Quite clearly the most obvious contention that the objector will seek to make is the factual one that the only purpose or effect of the impugned arrangement was to implement an estate plan. Alternatively, in the case where the estate plan is implemented to also further some other purpose or effect, it will be contended that the avoidance of tax was "a merely incidental purpose or effect" and not one "pursued as a goal in itself ......

[1] Bailey at page 258, per Aickin J.

[2] Bailey at page 253, per Barwick C.J.

[3] which will be either the Taxation Review Authority or the Supreme Court

[4] provided that the arguments were stated in the grounds of objection: section 36(1) of the Inland Revenue Department Act 1974

(but) arising as a natural incident as some other purpose."[1] The thrust of the objector's argument will be to persuade the Court, as the taxpayer was able to do in Loader, that an examination of the impugned arrangement discloses that it was an estate plan which was for that reason compelling or desirable. Therefore it would have been adopted irrespective of its income tax ramifications. The cogency of this argument will of course depend upon the evidence before the Court in each case, yet it is nonetheless a vital exercise to elucidate the onus of proof set by the Court when determining such issues.

The initial point to make is that by statute the objector bears the onus of proof in these proceedings.[2] However there is surprisingly little discussion in the authorities as to what onerous implications - if any - that this may hold for an objector. There is for example only passing reference to the point in Wisheart[3] and Loader,[4] which seems to suggest that our Courts do not attach any particular significance to the statutory placement of the onus of proof. In this regard, the recent remarks of Bray C.J. in Jones have important implications for setting the onerous nature of the standard confronting any disputant estate planner.

It may be recalled that section 190 of the Assessment Act requires the taxpayer to show that the assessment is excessive in any proceedings challenging it. The effect of that section

[1] see the discussion at pages 13-14 above and the authorities there noted.

[2] see section 33(10) of the Income Tax Act 1976 and section 36 of the Inland Revenue Department Act 1974

[3] at page 339, per Haslam J.

[4] at page 475

was recently considered by the High Court in Gauci, in connection with the purposive of resale provisions of section 26(a).[1] Chief Justice Bray considered the test laid down by Sir Garfield Barwick in Gauci, and then extended that proposition to encompass arrangements reviewed under section 260. So we now find -

> "Section 190 does not require the taxpayer to show positively that the transactions cannot possibly be labelled as a means to avoid tax, or that they are only explicable by reference to ordinary business or family dealing."[2]

For the purposes of our jurisdiction, acceptance of this formulation would entail an important concession for an objector. For by the standard set, the objector would not need to "show positively" that his impugned arrangement "cannot possibly" have the proscribed purpose or effect. It may be anticipated that in those cases where the Court finds the objector's explanations to be not entirely cohesive, such a standard may be vital to the outcome. Because here, although the Court may not be completely persuaded to the objector's version of the actuating reasons, it may nonetheless still be sustained as it is not incumbent upon an objector to go further and positively demonstrate that the culpable purpose could not possibly have also been in mind. This subtle but perceptible easing of the burden of proof may thus aid an objector in his rebuttal of section 99. However present indications are that the lead shown by Chief Justice Bray would not be followed in this country.

In Williams Property Developments Ltd, Mr Justice Jeffries had occasion to review the subject of burden of proof in relation to the question of property acquired with the excisable purpose of resale.[3] His Honour's judgment traced through the view of Barwick C.J. as to the effect of section 190, firstly when a dissentient in Steinberg, and later when in a majority in Gauci.

[1] which correspond approximately with our section 65(2)(e)

[2] at page 237

[3] under section 91, in relation to the definition of "trading stock" as stated by that provision.

Although not noting any material differences between the respective legislative analogues, Jeffries J. expressly refused to follow the test proposed by Sir Garfield Barwick, finding that that test moved the emphasis of the burden of proof away from the plain wording of the statute.[1] Instead, Mr Justice Jeffries preferred the forceful reasoning of Mason J.,[2] who as a dissenter in Gauci, endeavoured to apply the view taken by the majority in Steinberg. That being the position, it may be expected that with this disapproval of the source of the remarks from which the test propounded in Jones, was drawn, any local court considering the problem of onus of proof under section 99 would probably decline to accept the test formulated by Chief Justice Bray in relation to section 260.

With the obligation to discharge the onus of proof now firmly in mind, the degree of severity of that task is the next matter that calls for scrutiny. The first point to note is that the standard against which an arrangement is tested under section 99 is an objective one.[3] The significance of this stipulation is that it is not enough for an objector to merely aver what his actuating purposes were. He must in addition convince the Court of their veracity. For a clear example of an application of this standard, reference may be made to the judgment of Casey J. in McDonald. There, the approach taken by his Honour was to critically examine[4] each of the explanations of the arrangement offered by the objector, and, finding them wanting, draw the inference of an excisable purpose.

The second aspect of the matter of onus of proof concerns the apparent rigorous standard that our Courts apply under section 99. For it is readily apparent that our jurisprudence on section 99 is permeated by the notion that some commercial or business

[1] at page 141

[2] which in essence was that section 190 did not place any onus on the Commissioner to show that the assessment was correctly made.

[3] Ashton at page 721

[4] see particularly at page 133

efficacy for the impugned arrangement is necessary before application of the section may be defeated.[1] This can be evidenced firstly by pointing out that it may be implied from the view argued for above[2] as to the primal basis upon which application of the section proceeds. In the notion that application of the section proceeds where the Court finds "no change" effected by the arrangement in the conduct of the taxpayer's affairs, it is implicit that some sound business motivation must then be adduced if invocation of the section is to be defeated. Otherwise that will leave as the only possible explanation of the arrangement, the fiscal purpose of the desire to relieve the burden of income tax. An instance of the line of reasoning in mind is afforded by the decision in Grierson. There the Court found that whilst the impact of the arrangement was only a "paper"[3] one, the arrangement could yet be sustained because it furthered the business purposes of -

> "facilitating changes in partnership personnel and to ensure better and more economical control and use of equipment"[4]

Secondly this point may be illustrated by noting some of the express references the Courts have from time to time made on the point. The view of the Courts of paddock trust arrangements was said to

[1] it may be noted that in the United States, a "business purpose" doctrine has permeated revenue law since the landmark decision in Gregory. Furthermore, recent indications in Canada are that the jurisprudence there is developing in a similar direction - see for example A.T. Leon - though not without its dissentients - see Massey Fergusson Ltd. The latter trend is discussed by the authors Matheson, Ware, and O'Keefe.

[2] particularly at pages 17-18

[3] at page 5

[4] at page 9

be that it "smacks of business unreality"[1] whilst the use of a service company by a law firm was said not to fall within "the ambit of current business dealing and conform with general legal practice in New Zealand".[2] Furthermore, the test propounded by Mr Justice Jeffries in Tayles[3] as to what constitutes an ordinary family dealing is as his Honour expressly acknowledges, only a slight relaxation of a commercial standard.

The third aspect of the onus of proof concerns the relevance to the estate planning context of the pivotal feature[4] upon which application of the section proceeds. It may perhaps be surmised that when a taxpayer reorganises his business affairs in fulfillment of an estate plan, the desire to retain control of affairs to much the same degree as previously will probably lead to little change, in practical terms, in the conduct of his affairs. Moreover, if other legal personalities (such as a family trust or company) are interposed in order to reduce the taxpayer's equity, this will compound the judicial suspicion naturally aroused by that other feature of the plan. Hence, in the estate planning situation - because it necessarily bears no commercial rationale - the Court may reflexively incline to perceive artificiality in the arrangement because all it may amount to is an "accounting or procedural" change whose only noticeable effect appears to be to diminish the burden of income tax.

To pass now from the general to the specific, the fourth matter to point out is that the estate planning argument will probably be discounted in the situation where it occurs in the context of the reorganisation of an enterprise that depends almost entirely upon the specialised, personal exertions of the taxpayer

[1] Mangin at page 597, the Board quoting from the judgment of Turner J. in the Court below

[2] Haslam J. in Wisheart, at page 339

[3] cited at page 13 above

[4] identified at pages 17-18 above

himself. The reasoning in such a case is that as the demise of the taxpayer would leave little or nothing to pass to his family, it is unlikely he would be planning for the posthumous conduct of his business. This point was made by the Court in both Wells[1] and McDonald,[2] concerning the reorganisation of the affairs of a chiropractor and commission agent respectively; allegedly for estate planning reasons.

The fifth point to make is that it may sometimes be inferred that in view of the different nature of the liabilities allegedly sought to be avoided, a taxpayer would be more likely to be concerned with the immediate and pressing desire to relieve the burden of income tax than he would be to diminish the remoter and more impersonal obligation of estate duty. In Ashton for example, the Court of Appeal alluded to this point, where McCarthy P. observed -

> "it must have been seen by the (taxpayers) that (the arrangement) was more likely to have effect upon charges received during their joint lives than upon those received after the death of one of them."[3]

In Ashton the importance of this consideration was to furnish a point of reinforcement to an already skeptical Court. The significance of this point may be expected to be to similarly influence the Court in those cases that also concern a thorough reorganisation of the taxpayer's business enterprise.

The cumulative effect of each of these points is to clearly demonstrate the rigorous nature of the onus of proof confronting any estate planner called upon to deny application of the section to his erstwhile estate plan. As a final illustration of the severe nature of the burden of proof, reference may once again be made to the decision of Mr Justice Jeffries in Tayles.

[1] at page 143

[2] at page 133

[3] at page 328

In that case, it may be recalled[1] that the most offensive aspect of the arrangement was the 5% cum. pref. dividend. To the casual observer this one feature would not seem to be particularly fundamental to the scheme as a whole to disclose that the avoidance of income tax was "one central purpose".[2] Thus to seize on this one minor aspect as revealing a culpable purpose is to apply a rigorous standard indeed. The final point to add is that the foregoing analysis of New Zealand's jurisprudence plainly indicates that the tolerant view currently taken in Australia[3] of arrangements with estate planning ingredients is not a view that may be expected to find favour with our Courts. Indeed the difference in standard between the two jurisdictions has been judicially acknowledged. In Halliwell, Casey J. noted[4] the "more liberal" view taken in Australia of matters of family dealings. Thus it may be said that the estate planner will only be able to discharge the heavy onus of proof he bears when he is able to completely satisfy the Court of his sincerity to only the avowed purpose of estate planning.

B. THAT THE ARRANGEMENT IS PROTECTED BY ANOTHER SECTION OF THE ACT

The essence of this argument is that compliance with the terms of some other section of the Act necessarily protects the arrangement from impeachment under section 99. This contention contrasts with the point drawn out above,[5] that despite fidelity to one provision of the Act, the problem is still "at large" and section 99 may yet be invoked. The decision of McKay in relation to section 96 was cited in support. However to further

1 pointed out at page 13 above

2 at page 677, emphasis added. Although it may be acknowledged that such a lack of proportion may well incline the Court of Appeal to take a contrary view of the case when the appeal lodged in the matter is heard.

3 noted above, particularly at pages 25-29

4 at page 17

5 at page 5

amplify what the Court of Appeal said in that case, it must be added that their Honour's were careful to make the reservation that "on its own"[1] observance with section 99 would not be a case for section 99. The position may now be stated to be that compliance with section 96 may normally be expected to be a case not within the scope of section 99, although this will not prevent the Court in a proper case moving to apply section 99.[2]

The most likely situation in which the present argument will occur is the case where an estate plan is challenged by the Commissioner by means of applying section 99 to disallow some claim for a deduction (under section 104) that implementation of the plan leads to. This contention in turn reduces itself to arguing for acceptance in our jurisdiction of the view expressed by Dixon C.J. in Cecil Bros., that -

> "I have great difficulty in seeing how (section 260) could apply to defeat or reduce any deduction otherwise truly allowable under section 51."[3]

From the volume of judicial comment that this opinion has attracted, it is evident that this view is perhaps one of the most contentious issues of law to arise under both sections 260 and 99. It is necessary now torefer to those comments in order that some resolution of the issue may be hypothesised.

(a) In Australia support for the proposition has been divided:

- in Cecil Bros. itself, whilst three other judges in the Full High Court - Kitto, Taylor and Windeyer J.J.[4] concurred in Sir Owen Dixon's judgment, both Owen[5] and Menzies[6] J.J. expressly disagreed with the Chief Justice's view.

[1] at page 605, per Speight J. See also Turner P., at page 600

[2] it may be pointed out that in the case where an estate plan leads to a violation of the terms of section 96, the estate planning argument would not be sufficient to defeat application of that section: James

[3] at page 438. Section 51 corresponds to our section 104

[4] see at pages 438 and 442

[5] sitting at first instance, see at page 436

[6] in the Full High Court, at page 439

- in Hooker-Rex McTiernan J.[1] suggested that any claim under section 51 was still subject to the "ordinary business dealing" test propounded under section 260.
- in Franklin's Selfservice Menzies J.[2] repeated the position his Honour had taken in Cecil Bros.
- in Patcorp Gibbs J., in stating[3] that it was unnecessary for the purposes of the present case to resolve this rift in judicial thinking, may perhaps be taken as thinking that the issue was open to further discussion.

(b) In New Zealand there has similarly been a diversity of judicial view as to the correctness of Sir Owen Dixon's opinion. The precedents in point:

- in Elmiger, Woodhouse J. discussed the issue and held that section 104 could not override the effect of section 99.[4] On appeal, the contention was abandoned.
- in Europa (No.1) both North P.[5] and Turner J.[6] concurred in Sir Owen Dixon's view. On appeal to the Privy Council, the majority of the Board refrained[7] from expressing an opinion of the applicability of section 99 as the case had already been decided under section 104. The minority of their Lordships however described the Commissioner's contention on section 99 as "hopeless"[8]. However it may be added that Pose[9] makes the point that their Lordships probably did not even have in mind the present question.

[1] at page 652
[2] at page 689
[3] at page 434
[4] at page 693
[5] at page 389
[6] at page 415
[7] at page 653
[8] at page 659
[9] at page 23

- in Mangin the Board proceeded to apply section 99 without any discussion of the possible obstacle posed by Cecil Bros. This step necessarily implies rejection of the primacy of section 104.
- in Wisheart both North P. and Turner J. seemed to recant of their former views when their Honours' unequivocally rejected the view of the majority in Cecil Bros[1] yet without referring to their earlier opinions.
- in Europa (No.2) McMullin J. thought it now "quite clear"[2] that section 99 may apply to defeat a claim for a deduction under section 104. McCarthy P. in the Court of Appeal[3] adopted the view expressed by the minority of the Board in Europa (No.1). The Privy Council held that allowance of the claim in full under section 104 would be "incompatible"[4] with the claim being liable to avoidance under section 99. Furthermore, their Lordships thought the present case was on all fours with Cecil Bros.
- in Halliwell Casey J. undertook what was a rather limited review of the problem and endeavoured to rationalise the authorities by holding that section 99 could only be applied where "the need for such expenditure has been contrived."[5]

It is on these lines that the differing views as to the relationship between section 104 and section 99 are drawn. In view of the diversity of opinion, it is perhaps a matter of conjecture which way the issue will ultimately be resolved. However the better view would seem to be that followed in the

[1] see at pages 323 and 328-30 respectively.

[2] at page 556

[3] at page 487

[4] at page 556

[5] at page 13

Elmiger, Wisheart and Mangin line of authority as being one consistent with the judicial perception of the scope of our section 99. It may be recalled that in McKay,[1] our Court of Appeal applied the notion that although an impugned transaction satisfied the terms of another section of the Act, the transaction was still "at large" and then had to face the additional obstacle of section 99. But in Australia on the other hand, a clear line of authority may be traced through from Keighery, Casuarina, Patcorp to Mullens; which holds that once particular section of the Act is satisfied, section 260 cannot be invoked. Hence the view expressed by Sir Owen Dixon in Cecil Bros. can be seen to be consistent with that line of authority, which contrasts with the broader conceptual scope given by our Courts to section 99. So it is on the basis of the differing judicial conceptions of the ambit of the respective provisions that it may be held that compliance with section 104 does not preclude the further inquiry as to whether section 99 has been violated.

It remains to deal with the contrary judicial opinion preventing acceptance of this conclusion. The first is the position taken by the Privy Council in Europa (No.2). However the way open to interpret the opinion of the Board is to hold that they were directed to the facts of that particular case. Hence the "incompatability" spoken of by the Board may be said to be occasioned by the present matter being a case of "expenditure genuinely made."[2] In which case that characteristic would make the transaction a matter of ordinary business dealing and therefore necessarily safe from impeachment under section 99.[3]

[1] see at page 5 above .

[2] the test given by the majority in Europa (No.1), at page 649

[3] which reasoning could also explain the view that Sir Owen Dixon expressed. If expenditure was "necessarily incurred in the production of assessable" income and hence was "properly deductible" under section 51, a fortiori it would be a matter of ordinary business dealing and hence not a case for section 260. But it must be acknowledged that the facts in Cecil Bros. do not readily lend themselves to this interpretation: it is difficult to conceive how the purchase of trading stock at a much inflated price could be described as "an ordinary business dealing without necessarily being labelled as a means to avoid tax."

This interpretation would seem to be consistent not only with the situation before the Board, but also one in line with the rather brief treatment of the whole problem by their Lordships. It may be expected - as was suggested by CaseyJ. in Halliwell[1] - that if the Privy Council was turning its mind to the broader question of the general relationship between sections 104 and 99, a more detailed exposition of the problem would have been undertaken.

The second precedent to deal with is the test formulated by Casey J. in Halliwell. Briefly the facts in that case concerned a classic income split arrangement: sale by a dentist to his family trust of the assets utilised in his practice, followed by their lease back. The problem though was complicated by the trust subsequently purchasing, for lease to the taxpayer, assets from independant sources for use in the practice. Mr Justice Casey went some way to accepting the majority view in Cecil Bros., when his Honour added to the relationship between the two sections the refinement that section 99 could only apply to defeat a claim under section 104 when "the need for such expenditure has been contrived."[2] Application of this test had the rather curious result that section 99 could only void the hire of those assets originally owned by the taxpayer.[3] Yet the terms of his Honour's judgment did not seek to draw any distinction between the "need" on account of which both categories of assets had been hired. This consideration would seem to suggest that the real basis upon which the different treatment of the two categories of assets rested was whether the assets had originally been owned by the taxpayer.

[1] at page 12

[2] at page 13

[3] the category of independant purchases could not be said to be "contrived" because the need to hire them was demanded by the business. So they may as well be hired from the family trust as anywhere. Unfortunately his Honour did not proceed to state why the same could not be said of the assets sold to the trust.

In any event, the obscurity of this part of his Honour's reasoning aside, it would seem, with all due respect, that the test laid down by Casey J. directs attention away from the vital inquiry mandated by the predication test when any matter is tested under section 99. It has already been noted[1] that the essence of the predication test is that -

> "you must be able to predicate - by looking at the overt acts by which it was implemented - that it was implemented in that particular way so as to avoid tax."[2]

The question required to be asked under this test is not, as Casey J. held, whether the need for an expenditure arising from an arrangement has been contrived so as to avoid tax. Rather the inquiry directed by the test formulated in Newton is to the manifestly separate notion as to whether a need that leads to some expenditure has been satisfied in a particular way as to disclose a culpable purpose or effect. It is the essence of the predication test that the vital inquiry is to examine the way in which an arrangement is implemented, with any examination of the antecedant matter of the need which that expenditure reflects not being to the point. On this analysis, Casey J. ought to have scrutinised the hire agreements in order to determine whether they disclosed a culpable purpose or effect, rather than turn his mind to "the need" which those agreements were the maturation of. The test propounded by Mr Justice Casey can be seen then to be inconsistent with the conventional approach mandated by the authorities, which thus deprives that test of any compelling force. In which case, the view argued for previously may yet be sustained and section 99 not be said to be necessarily subject to section 104.[3]

1 at page 5 above

2 Newton at page 764

3 the issue is further debated by Harley at page 229, where some sound, more technical reasons in support of this conclusion are advanced. Moreover if the suggestion made at fn 3 at page 45 above be correct, it would follow that Sir Owen Dixon's view would not be tenable in relation to the new section - at least in the case where the arrangement has two purposes or effects. At pages 13-14 above, it was pointed out that matters of ordinary business dealing are within the scope of the section, where one purpose is tax avoidance. In which case, the justification for deductibility would not also necessarily vindicate the matter under section 99.

C. THE NEW SOURCE ARGUMENT

The germination of this argument may be traced to one of the four, unsolicited general propositions that the Privy Council in Europa (No.2) laid down as applying to section 99. Thus the Board stated -

> "The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax."[1]

Unfortunately their Lordships did not proceed to elucidate what was in mind when pronouncing this enigmatic "new source" limitation to section 99. Some of the questions that readily spring to mind are precisely what is meant by a "source" of income? How drastic a change has to be made to existing revenue in order that subsequent income may be said to be "new"? An instance of the type of problems that may be encountered in application of this principle is offered by the recent proposal that preferential shareholders in Europa Oil (N.Z.) Ltd exchange their current holdings to a proportionate amount of convertible notes.[2] Whilst conceptually the nature of the "source" of income would be altered, can it be said that those persons now receive income from a "new" source? To date, differing judicial views have been expressed as to the meaning of the exception propounded by the Board. Firstly, Mr Justice Casey in Halliwell undertook a rather brief discussion of the question, and formulated the proposition that -

> "a new source of income (to which the arrangement under attach relates) depends on a common-sense appraisal of the physical source itself, as well as the taxpayer's interest in it, and of any other relevant circumstances."[3]

[1] at page 556

[2] National Business Review 14 September 1977, page 8

[3] at page 15

That being the case, his Honour went on to hold that the income derived from a professional practice upon its complete take-over by the taxpayer could not be said to be "new" because the taxpayer had previously been a (junior) partner in that practice. This view his Honour noted was consistent with the decision in Wisheart, where the impugned arrangement was implemented upon a change of partners. Yet no significance was attached to the impugned reorganisation as to suggest that it led to a transformation of income outside the scope of the section.

By way of contrast to Mr Justice Casey's view, reference may be made to the opinion expressed by Sir Garfield Barwick in Mullens.[1] One of the reasons for the insistence by his Honour for an antecedant transaction that is recast in a tax avoiding form before section 260 can apply, was that "by parity of reasoning" the new source of income limitation may extend to "a new basis for a deduction."[2] The view of his Honour would appear to give a very literal meaning to the principle and hold that without that earlier, analogous transaction, every reorganisation leads to a "new" source of income or a "new" right to a deduction, as the case may be. This view would plainly all but emasculate section 260. However it may be cogently argued that similar reasoning would not be applicable under section 99. Firstly the germination of his Honour's view has been traced back[3] to the contention made when appearing as counsel before the Board in Newton. Yet that argument was unambiguously rejected by the Board, it being held that the section did have prospective effect.[4] Secondly the decision of our Court of Appeal in Martin[5] may be cited as an instance where section 99 has been applied despite the absence of an antecedant transaction.

[1] noted at fn 1, at page 24 above

[2] see Mullens, at page 510

[3] also noted at fn 1, at page 24 above

[4] at page 763. A proposition affirmed in Mangin, at page 596

[5] in order to deny the benefit of carrying forward accumulated losses, as provided for under the former section 188

Present indications are that our Courts are inclined to treat the "new source" limitation cautiously, holding that some sort of radical transformation to existing revenue is necessary before the exception can be established.[1] In the estate planning context, that view would still leave room for contention in the situation where there is a reorganisation of affairs, so that existing income becomes sufficiently altered in character as to support the argument that it is now revenue derived from a "new source". It remains to be seen what guidelines future Courts establish as applying to the principle, though the view of Sir Garfield Barwick may be noted as offering an indication of the wide potential that the principle holds.

D. <u>RECONSTRUCTION PROBLEMS</u>

If each of the three arguments advanced above fail to persuade the Court to overrule the Commissioner's assessment, an objector may yet still escape an application of section 99 because of the inability to negate the effect of the culpable transaction. Subsection (3) authorises the Commissioner to make an adjustment of the assessable income of any person affected by a tax avoidance arrangement so as to counteract any tax advantage obtained thereby. In which case, subsection (4) deems the income assessed to such persons to be derived by that person and not any other person.[2] Of the problems that may arise under this aspect of the section, it has already been noted that -

> "the concept of a tax advantage does mean that the taxpayer can argue that if the arrangement had not been entered into he would not have derived as income sums which, under the arrangement, he appears to have avoided.[3]

[1] essentially the view argued for by the commentators. See for example Pose at page 26, Harley at page 227.

[2] which deeming provision, curiously enough, does not extend to transactions of a kind dealt with by subsection (5);

[3] Congreve at page 313

In other words, there will be no "tax advantage" because if the taxpayer had thought that the transaction under review was going to be struck down by an application of section 99, then he would not have entered into it. Ergo there has been no "advantage" obtained in his fiscal position. It would seem unlikely that a Court would accept such reasoning, at least as a general proposition, for to sustain it would plainly be to all but emasculate the section. Moreover, some support for this conclusion may be drawn from the speech of Lord Wilberforce in Parker. There his Lordship made some comments about the definition of "tax advantage" given by what is now the proviso to section 460(5) of the Income and Corporation Taxes Act 1970; in relation to transactions in securities. Of that statutory definition, his Lordship observed -

> "(the definition) presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that the way in which he received what it is sought to tax, prevents him from being taxed on it; and that the Revenue is in a position to reply that if he had received what it is sought to tax in another way he would have had to bear tax. In other words, there must be a contrast, as regards the 'receipts' between the actual case where these accrue, in a non-taxable way with a possible accruer in a taxable way, and, unless this contrast exists, the existence of the advantage is not established."[1]

[1] at page 415. And followed by the House in Cleary. These remarks may be said to be in point, for the terms of the definition upon which they are based are even more narrowly drawn than the matters alluded to in paragraphs (a) and (b) of subsection (3).

The essence of this definition then is that it postulates that there must be a contrast between the "actual" and the "possible" before there can be said to be a tax advantage. In which case, it would not be incumbent upon the Revenue to show that there was an imperative transaction carried out, in the most advantageous fiscal manner before there can be said to be a "tax advantage".

However this definition was stated in the relatively straight-forward context of where there is only the one transaction under review. Much more difficult questions arise when the conduct of a business is under review, for here the Court may be called upon to make suppositions in order that the requisite contrast may be drawn. The type of problems that may arise in this sort of situation are indicated by the facts in O'Kane Construction Ltd. Briefly the facts in that case were that the principal shareholder in the taxpayer established a family trust, to which he sold and took a lease back of the company's earthmoving equipment. The trust then bought a farm and, some eighteen months later, purchased a machine (identified as a "TD 25") for use in the business of both the taxpayer and on the farm. Henry J. held that whilst the initial sale and lease back transaction could be voided, the purchase of the TD 25 and its hire to the company could not be. One of the reasons why was because it transpired that there was a choice to either buy or hire a machine like the TD 25, so that it was an acceptable business transaction for the trust to choose to buy the machine.[1]

This decision then illustrates the point that the Commissioner may have difficulty supporting his assessment in cases where there is some change in the modus operandi of the taxpayer's business subsequent to implementation of the impugned arrangement. For in such a situation, the Court may be called upon to speculate or make very hypothetical assumptions as to the course of conduct that might have been followed if the arrangement had not been entered into. And this might draw the Court, no doubt reluctantly, into what one Judge rather colourfully termed "the world of fiscal fantasy".[2]

[1] see at page 57-8

[2] Wilson J. in Gerard at page 281

Thus the importance of any argument based upon a misconceived reconstruction may be expected to depend very much upon the timing of an application of section 99, as the decision in O'Kane Construction Ltd indicates that the fruits of a tax avoidance scheme may yet be still enjoyed where discretionary dealings subsequent to its implementation occur. This is because those later events do not in such a case readily enable a contrast to be drawn with the possible course of events if the arrangement had not been entered into in order that a "tax advantage" may be hypothesised.

E. SUMMARY

The erstwhile licence of a taxpayer to organise his affairs to pay less tax than he otherwise might throws into sharp relief the conflict between this sovereignty of the individual and the need to safeguard the interests of the fisc in cases where a taxpayer makes arrangements that purport to diminish both prospective fiscal burdens. In these cases, where the taxpayer may be seen to be arguing for the best of both worlds, it perhaps should not be surprising that the Courts are wary of the argument that asserts as a justification for a diminuation of the perennial burden, the desire to reduce the posthumous levy. This suspicion is manifested firstly in the insistence that the argument may be made only from the proper source - that it be disclosed by an examination of the terms of the plan itself. With that obstacle surmounted, the second problem is to persuade the Court of sincerity to the avowed purpose. The current state of our jurisprudence reveals that this will only be achieved when the saving in income tax is an unsolicited advantage and is seen not to be a feature expressly embodied in the plan itself. This situation contrasts with that obtaining in Australia, where the trend of present authority is to accord exercises in matrimonial asset sharing - which encompass estate planning objectives - a standing outside the range of that jurisdicition's legislative analogue. However, when an estate planner is called upon to deny an application of section 99, it is apparent that he faces a rigorous task in discharging the onus of proof that he bears. The emphasis in the authorities is to

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look for some business or commercial motivation that furnishes a rationale of the arrangement, yet in the estate planning context this is manifestly an onerous requirement to satisfy. Thus of the estate planning argument, the view is offered that our Courts do not view the contention as some sancrosanct or invoilable argument whose elucidation necessarily protects an estate plan from impeachment under section 99. Rather its adducement does not preclude the pragmatic approach of a careful scrutiny of the material facts in order to determine the veracity of the contention and an absence of the proscribed purpose or effect. Then and only then may an estate plan escape the thunder of section 99.

APPENDIX

PARTS I AND II

Section 99 of the Income Tax Act 1976:

(1) For the purposes of this section -

"Arrangement" means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:

"Liability" includes a potential or prospective liability in respect of future income:

"Tax avoidance" includes -

(a) Directly or indirectly altering the incidence of any income tax:

(b) Directly or indirectly relieving any person from liability to pay income tax:

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

(2) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly -

(a) Its purpose or effect is tax avoidance; or

(b) Where it has 2 or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings, -

whether or not any person affected by that arrangement is a party thereto.

(3) Where an arrangement is void in accordance with subsection (2) of this section, the assessable income and the non-assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement, and, without limiting the generality of the foregoing provisions of this subsection, the Commissioner may have regard to such income as, in his opinion, either -

(a) That person would have, or might be expected to have, or would in all likelihood have, derived if that arrangement had not been made or entered into; or

(b) That person would have derived if he had been entitled to the benefit of all income, or of such part thereof as the Commissioner considers proper, derived by any other person or persons as a result of that arrangement.

(4) Where any income is included in the assessable income or, as the case may be, in the non-assessable income of any person pursuant to subsection (3) of this section, then, for the purposes of this Act, that income shall be deemed to have been derived by that person and shall be deemed not to have been derived by any other person.

(5) Without limiting the generality of the foregoing provisions of this section, where, in any income year, any person sells or otherwise disposes of any shares in any company under an arrangement (being an arrangement of the kind referred to in subsection (2) of this section) under which that person receives, or is credited with, or there is dealt with on his behalf, any consideration (whether in money or money's worth) for that sale or other disposal, being consideration the whole or, as the case may be, a part of which, in the opinion of the Commissioner, represents, or is equivalent to, or is in substitution for, any amount which, if that arrangement had not been made or entered into, that person would have derived or would derive, or might be expected to have derived or to derive, or in all likelihood would have derived or would derive, as income by way of dividends in that income year, or in any subsequent years or otherwise howsoever, an amount equal to the value of that consideration or, as the case may be, of that part of that consideration shall be deemed to be a dividend derived by that person in that first-mentioned income year.

(6) Contains bridging provisions in respect of arrangements made or entered into before the section came into force, on the 1st day of October 1974.

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Elmiger v Commissioner of Inland Revenue (1967) N.Z.L.R. 161, C.A.

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(1973) 4 A.T.R. 48, S.C.

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PART III

Section 260 of the Income Tax Assessment Act 1936-1977

260. Every contract, agreement, or arrangement made or entered into, orally, or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -

(a) altering the incidence of any income tax;

(b) relieving any person from liability to pay any income tax or make any return;

(c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or

(d) preventing the operation of this Act in any respect,

be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

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Clarke v Federal Commissioner of Taxation (1932) 2 A.T.D. 121, H.C.A.

Cecil Bros Pty Ltd v Federal Commissioner of Taxation (1964) 111 C.L.R. 430, H.C.A.

Polden & Wilson Pty Ltd v Federal Commissioner of Taxation (1976) 6 A.T.R. 144, S.C. of N.S.W.

W.P. Keighery Pty Ltd v Federal Commissioner of Taxation (1957) 100 C.L.R. 66, H.C.A.

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Peate v Federal Commissioner of Taxation (1964) 111 C.L.R. 443, H.C.A.

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Dr I.C.F. Spry "Arrangements for the Avoidance of Taxation" The Law Book Company Limited, 1972

PART IV

Section 460(5) of the Income and Corporation Taxes Act 1970.

Provided that no adjustment made under subsection (3) above by reference to any transaction or transactions to counteract any tax advantage shall by virtue of this subsection be so made that a

person bears more tax than if the transaction or transactions had not had as a consequence that any relief or increased relief from, or repayment or increased repayment of, income tax, or any deduction in computing profits or gains, was obtained or obtainable, or that the way in which receipts accrued was such that the recipient did not pay or bear tax on them.

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Bailey v Federal Commissioner of Taxation (1977) 7 A.T.R. 251, H.C.A.

Gauci and Masi v Federal Commissioner of Taxation (1975) 5 A.T.R. 672, H.C.A.

Williams Property Developments Ltd v Commissioner of Inland Revenue (1977) 2 T.R.N.Z. 138 S.C.

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Massey-Fergusson Limited v The Queen (1977) C.T.C. 6, Fed C.A.

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