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SESSION 10:

Part IVA and Restructures

Presenter

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2018 National Resources Tax Conference



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Part IVA and Restructures

ITAA includes anti-avoidance, and general provisions:

- General provisions not construed so as to deter tax avoidance (due to the existence of anti-avoidance provisions).
- Specific anti-avoidance provisions operate where the GAAR does not.
- Should non-infringement of the specific provisions infringe the GAAR?

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Restructuring and Part IVA

- Perfectly legitimate tax planning to avoid triggering specific anti-avoidance rules.
- Anti-Hybrid Bill Explanatory Memorandum [1.20] – [1.21]:
 - “[M]any taxpayers will restructure ... restructures which remove a hybrid mismatch could result in:
 - ...
 - retaining a deduction with a greater amount being included in a foreign income tax base ...
 - These alternative arrangements would satisfy the objective of the hybrid mismatch rules”

Can Part IVA where specific anti-avoidance rules don't?

- Part IVA – can it impose the tax you don't have to pay, because you're restructuring to ensure you're not committing tax mischief within the specific provisions???
- Yes, because:
 - 177B(1):
 - “Nothing in the following limit the provisions of this Part:
 - (a) the provisions of this Act (other than this Part)...”; and
 - Part IVA is to be construed and applied according to its terms (*Spotless*, 186 CLR 404 at 414).



Part IVA Recap

- Applies to “schemes” where under s 177D:
 - tax benefit in connection with the scheme;
 - requisite purpose conclusion is reached having regard to the eight factors in s 177D(2).
- Tax benefit – 177C
 - For this seminar, focus is on a deduction being allowable where whole or part would not have been or might reasonably have been expected not to have been allowable.
- Cancellation – 177F.



Tax benefit: s 177C

- Tax benefit defined in s 177C, informed by 177CB:
 - Annihilation approach – in considering what would have occurred, ignore the whole of the scheme: s 177CB(2);
 - Reconstruction approach – in considering what might reasonably have been expected, consider a reasonable alternative postulate but disregard results in relation to the income tax legislation – s 177CB(3).
 - Consider the exclusion under s 177C(2):
 - Ignore if due to declaration, agreement, election etc expressly provided by the Act; and
 - The scheme was not entered into or carried out by any person to enable the choice etc.



Purpose of tax avoidance: s 177D

- Purpose of a person entering into or carrying out the scheme, having regard to the 8 factors identified in s 177D(2).

- Alternative potential transactions may be relevant to purpose:

- *FCT v Hart* 217 CLR 216 at 243:

“To draw a conclusion about purpose from the eight matters identified in s 177D(b) will require consideration of what other possibilities existed. To say, as Hill J did, that ‘the manner in which the scheme was entered into or carried out is certainly explicable only by taxation consequences’ assumes that there were other ways in which the borrowing of moneys ... might have been effected”



Hybrid arrangements

- Differences in domestic tax regimes can allow arbitrage for multinational groups, driving down overall global tax rate.
- For example: instrument treated as debt in Australia, may be treated as equity overseas with receipts either non-taxable or taxable later than the entitlement to a deduction arises in Australia (Examples 2 and 3 in the paper).
- Deduction being available in 2 places (Example 1 in the paper).



Legislative response

- Cannot cover anti-hybrid measures comprehensively here, but some simple deduction examples are in the technical paper:
 - Example 1 – denial of deduction in Australia where deduction also available in foreign country;
 - Examples 2 and 3 – deferral of deduction in Australia until corresponding income is assessed overseas;
 - Example 4 – potential denial of deduction in Australia where foreign tax rate 10% or less.
- Other integrity rules e.g. thin-cap. See example 5.



PCG 2018/D4, released 21 June 2018

- ATO to be commended for considering the issue of restructures and Part IVA.
- PCG 2018/D4 however misidentifies relevant criteria.
- PCG 2018/D4 also contains no analysis about how Part IVA might be applied in scenarios that the Commissioner does not consider to be low-risk.



177D -v- PCG 2018/D4 low risk factors

Section 177D factors

- the manner in which the scheme was entered into or carried out;
- the form and substance of the scheme;
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- the result in relation to the operation of the Act that, but for Part IVA, would be achieved by the scheme;
- any change in the financial position of the relevant taxpayer that resulted, will result, or may reasonably be expected to result from the scheme;

2018/D4 low risk factors

- There is no change to the jurisdictions of the entities involved under the replacement arrangement.
- The original arrangement makes commercial sense for the parties involved (in that prior to the restructure it would not have attracted the application of Part IVA of the ITAA 1936).
- The replacement arrangement makes commercial sense for the parties involved.
- The restructure and replacement arrangement are effected in a straightforward way having regard to the circumstances.



177D -v- PCG 2018/D4 low risk factors

Section 177D

- any change in the financial position of any person who has, or who has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f) of the scheme having been entered into or carried out; and
- the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

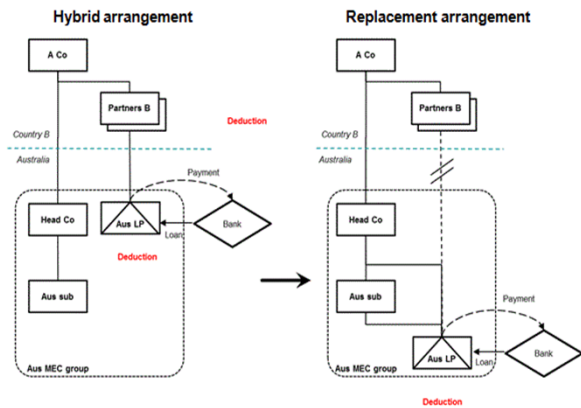
2018/D4 low risk factors

- The restructure and replacement arrangement are implemented on arm's length terms.
- The replacement arrangement is otherwise tax effective. That is, disregarding the potential application of Part IVA of the ITAA 1936, the replacement arrangement preserves a tax benefit. Whether a tax benefit actually exists under a replacement arrangement depends on whether an amount remains deductible or non-included.



Example 1 – taken from PCG 2018/D4

- Prior - double deduction in Australia and overseas; Country B regards Aus LP as a “look through” entity and gives the non-resident partners a deduction for their share of the bank interest.
- Post restructure, deduction in Australia; no deduction overseas.
- At a global level, the group’s effective tax rate goes up. However, what the scheme achieves is the preservation of a deduction in Australia that otherwise would be lost.



Example 1 – low risk (cont)

- Better analysis than the PCG 2018/D4 approach is:
 - Apply the criteria in s 177D(2) to determine whether there was a dominant purpose of obtaining the tax benefit, i.e. the deduction in Australia. If this is low risk, why?
 - These factors are suggested to be of significance:
 - The manner in which the scheme was entered into or carried out (s 177D(a)).
 - Any change in the financial position of any person who has, or has had, any connection ... with the relevant taxpayer ... (177D(2)(f)).
 - Any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f) (177D(2)(g)).



Example 1 – low risk (cont)

- Various alternative ways of obtaining bank finance are available to groups such as this. Unlike *Hart*, the manner in which the scheme was entered into or carried out is not explicable only by tax consequences.
- The consequence for the taxpayer is that finance from a third party bank continues to be extended to fund the group's Australian operations and a deduction for finance costs, which ordinarily are allowed, is preserved.
- The Australian assets are now wholly owned by Australian residents, and only the Australian entities get a deduction.
- An observation from several Part IVA cases is that the s 177D purpose can easily be reached if the arrangement made no sense, absent the tax outcome e.g. *Spotless*, *Hart*, *Citibank*, *BATAS*.



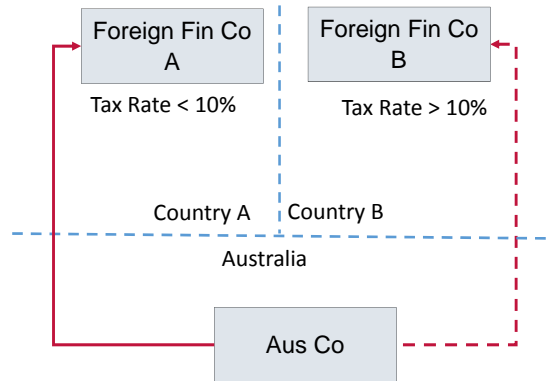
Example 1 – low risk (cont)

- The consequence for the taxpayer's ultimate parent company is that its global tax rate goes up.
 - Losing a deduction overseas arguably sheds little light on whether there was a purpose of obtaining a deduction in Australia???
 - This either tends against a dominant purpose of obtaining the tax deduction in Australia, or is neutral.
 - There is a change in jurisdiction in the members of the LP – which the ATO says is not a feature of “low risk” arrangements. However the deduction, financing and operations are all now only in Australia.



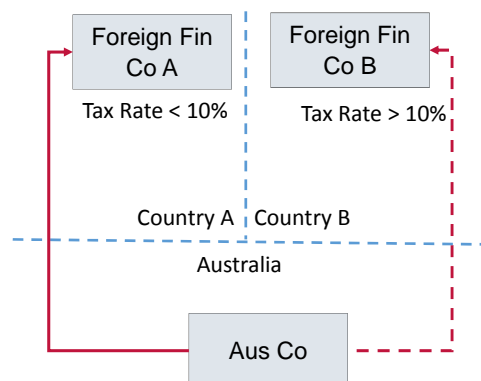
Example 4 – refinancing an existing loan

- Existing loan from Foreign Fin Co A is replaced with a new loan from Foreign Fin Co B.
- Lender jurisdiction is now >10% tax but less than the Australian rate.
- Assume all companies are ultimately owned by the same parent co.
- Assume the original loan would trigger the s 832-725 integrity rule, because:
 - Purpose of enabling a deduction for the payment; and
 - Purpose of enabling foreign income tax at 10% or less.



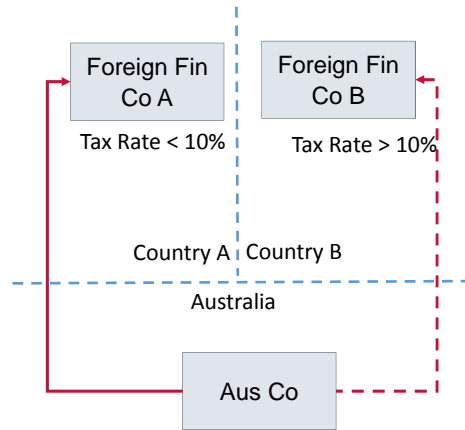
Example 4 – does Part IVA Apply?

- There is a change of jurisdictions, so the Commissioner would not conclude that this is low risk.
- There is a tax benefit, assuming s 832-725 would deny the pre-existing deduction.
- 177D – turns on particular facts in every case.
- Manner of entering into or carrying out the scheme – assume alternatives are available, e.g. for Aus Co to be funded by Australian financiers. An equivalent deduction in Australia would be available under the alternatives – therefore this tends against a purpose of obtaining a tax benefit.



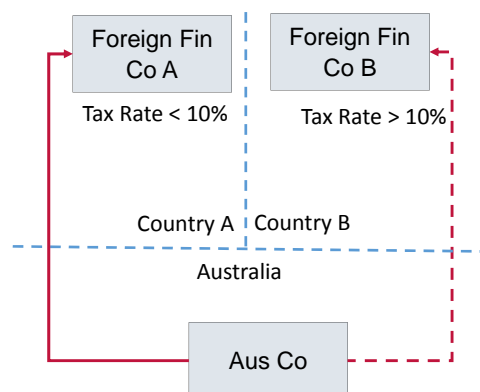
Example 4 – does Part IVA Apply?

- Manner of entering into or carrying out the scheme (cont):
 - Assume refinancing done as a global restructure, Fin Co B raises funds from external parties and lends to multiple subsidiaries across the worldwide group on arm's length terms. This would tend against a purpose of obtaining a tax benefit.
- Result in relation to the Act, BUT FOR Part IVA, that the scheme achieves (s 177(2)(d)):
 - AusCo would get a deduction for financing costs, which ordinarily are deductible;
 - AusCo avoids triggering the anti-hybrid integrity rule in s 832-725. Should restructuring to avoid committing tax mischief trigger Part IVA? Restructuring recognised as legitimate.
 - Balancing these considerations means this factor is neutral or tends against a purpose of obtaining a tax benefit.



Example 4 – does Part IVA Apply?

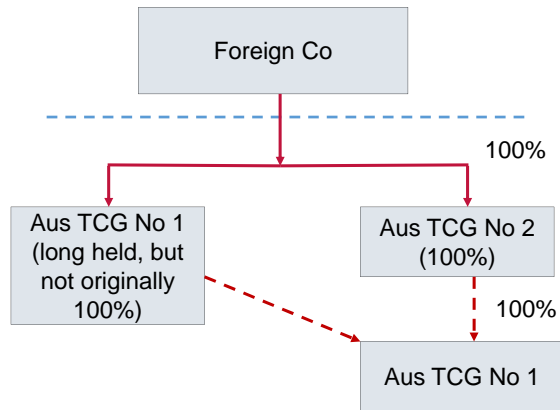
- Change to financial position and other consequences (s 177D(2)(f) and (g)):
 - Aus Co obtains finance.
 - Fin Co B derives income.
 - If Fin Co B can pay exempt dividends to the ultimate parent, does this suggest a purpose of obtaining a tax benefit in Australia? Probably not.
- Analogy to sale and leaseback cases – showing that the after tax cost of funding is lower than the cost of funding operations by another method, does not of itself show a purpose of obtaining a tax benefit. This may be different in non-inclusion of income cases, as *Spotless* shows.





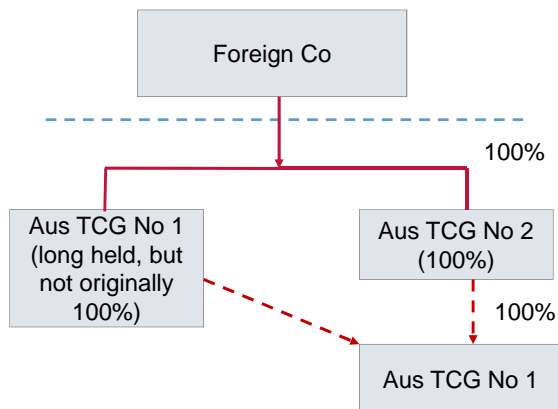
Example 5 – simplifying holding structure

- TCG No 1 has assets and tax losses; TCG No 2 has taxable income and thin-cap issues.
- TCG No 2 acquires TCG No 1 and TCG No 1 ceases to exist.
- On integration of the groups, TCG1 losses are available (subject to SBT) and all assets of the combined groups are able to be counted for thin-cap purposes.



Example 5 – is there a tax benefit?

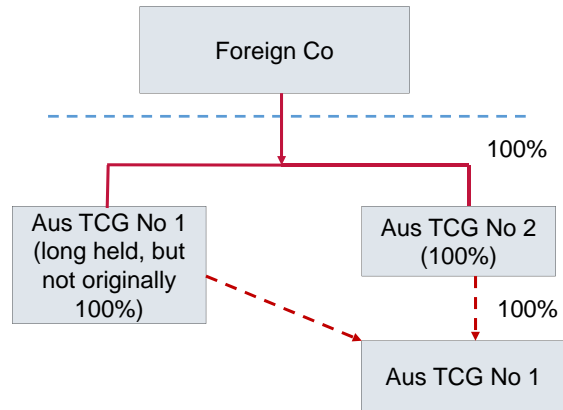
- Tax benefit? Potential ability to use carried forward losses, and potential for increased deductions without infringing thin-cap limits, are “attributable to the making of a ... choice ... expressly provided for by this Act” – see s 177C(2)(b)(i). Choices are to consolidate; and to claim deductions for carried forward losses.
- Was the scheme entered into or carried out by a person for the purpose of creating the circumstance to enable the choices to be made? See s 177C(2)(b)(ii).
- Commercial and compliance benefits from a single group structure in Australia? One tax return; potential corporate efficiencies.
- Importance of record keeping and documentation.





Example 5 – assessment of purpose

- Assessment of purpose under s 177D may be different from that under s 177C. Specific identified factors required to be considered.
- Each factor needs to be considered. Not possible to do so in this seminar. Many facts would be relevant.
- It is worth noting though that some of the Part IVA cases that have involved restructures, where the taxpayers failed, have involved transactions that made no sense absent the tax benefits; or where the commercial advantage was in fact obtaining the tax benefit (*BATAS*; *Citigroup*; *Spotless*).
- Streamlining management structures and reducing compliance burdens if proven by evidence, would not allow that conclusion here.



Thank you

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