Part IVA has new teeth

Changes announced

The Government will extend the operation of the general anti-avoidance provisions of Part IVA. The difficulty for taxpayers is that retrospective amendments will likely be introduced in the spring sitting of Parliament, leaving significant uncertainty regarding the nature and extent of changes. The amendments are expected to apply to transactions after 1 March 2012.

What is Part IVA?

Part IVA was originally intended to counter blatant, artificial and contrived tax avoidance schemes that otherwise comply with the technical requirements of the tax law. However, Part IVA is definitely not limited to “tax schemes”. The legislation was very broadly drafted and it has become clear over time that Part IVA can potentially apply to a variety of otherwise commercial transactions or business restructures undertaken in accordance with the tax law, provided the arrangement or specific steps in the arrangement are predominantly intended to achieve a tax saving.

Consequence of Part IVA

Taxpayers face cancellation of any tax saving, severe penalties and interest if Part IVA is applied.

The critical issues

Broadly, there are two critical aspects to the current operation of Part IVA:

1. The identification of a tax benefit resulting from the transaction or arrangement (this aspect will change - see below); and

2. Determining whether the dominant purpose of undertaking the transaction or arrangement (or part of the arrangement) was to achieve the tax benefit. The dominant purpose must be determined objectively based on the evidence and having regard to eight specific factors identified in the tax legislation.

As a general statement, Part IVA should not apply to a transaction (or part of a transaction) that is predominantly motivated by commercial objectives. It is important that each step in a transaction or arrangement is commercially explained.
Why has the Government announced changes to Part IVA?

In recent court decisions involving significant corporate restructures, taxpayers have successfully argued that there was no tax benefit despite the fact that specific steps in the restructures were clearly intended to significantly reduce tax. In order to quantify a tax benefit, it is necessary to compare the tax result under the arrangement to the tax liability that would likely have resulted if the arrangement had not been undertaken. In these recent cases, the taxpayers presented evidence that they would not have undertaken any transaction that resulted in a significant tax liability, and therefore would either have done the transaction in a different tax-effective way or alternatively done nothing at all.

By contrast, the ATO argued that the taxpayers would have incurred substantial tax liabilities or even double taxation in the absence of the scheme. The Courts’ acceptance that there was no tax benefit in these cases has troubled the ATO and triggered the Government’s announcement to amend Part IVA.

The scope of the changes

The full extent of the amendments is unknown at this stage and will be subject to consultation. However, it is clear that the amendments will seek to overcome the current debate about “tax benefits”. Importantly, this will shift the focus of Part IVA back to the purpose or intent of the taxpayer in entering the arrangement.

The practical implications

No-one is obliged to arrange their affairs or make choices that result in the absolute maximum tax liability or double taxation. A business or investor may legitimately take advantage of a variety of options, tax concessions and rollovers to achieve commercial outcomes and alleviate the tax cost in accordance with the tax law. However, if saving tax is your dominant reason for doing something then Part IVA could potentially apply to remove the tax benefit and impose severe penalties.

Part IVA is essentially used as a tool for the ATO to challenge transactions or arrangements that are entered into for the dominant purpose of obtaining a tax benefit. Part IVA applies to transactions that would otherwise fully comply with the tax law. Consequently, prevailing ATO attitudes and the potential implications of Part IVA (if any) are relevant considerations for any significant transaction, business restructure or asset sale.

Clearly Part IVA will be strengthened in response to the recent case law, and the ATO will have greater capacity to quantify a tax benefit or saving. In practice, this may be based on the ATO’s subjective view of what the taxpayer should have done and consequently how much tax should have resulted.

The key issue then becomes “dominant purpose”. In essence, why did the taxpayer undertake the transaction and the various steps involved? In light of this, it is critical to adequately identify and document the commercial drivers for any significant transaction, business restructure or arrangement.

Want to know more?

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