Episode 137: Summary

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The legal podcast

Episode name: Getting Down to Brass Tax: Understanding Asset Protection vs. Tax Avoidance

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What area(s) of law does this episode consider?

Tax avoidance; tax minimisation; tax evasion; asset protection advice.

Why is this topic relevant?

Working side-by-side with a client's tax and/or financial adviser on a new deal or a new venture is remarkably common, and often, everyone's responsibilities seem nicely partitioned - you'll do the asset protection advice, and the tax advisor will look after the tax effectiveness and efficiency of the structure - but those lines can be blurred.

When might it be ethically incumbent on a lawyer to give advice on the tax consequences of a structure recommended for asset protection purposes? When might the tax adviser's 'law-heavy' advice venture into unqualified legal practice? Our conversation today will touch on these blurred lines, and how important it is to have an effective interdisciplinary approach to advising clients when it comes to asset protection.

The introduction of the general anti-avoidance rules (GAAR) in Part IVA of the *Income Tax Assessment Act 1936* (Cth) adds a layer of complexity for lawyers providing asset protection related advice. These rules were designed to prevent schemes that exploit tax loopholes, but they also create a fine line which legal advisors must navigate to ensure that their clients' asset protection strategies do not inadvertently trigger tax avoidance provisions. This issue is especially relevant in the corporate and commercial law sectors, where asset protection is often intertwined with tax planning.

What legislation is considered in this episode?

Income Tax Assessment Act 1936 (Cth) ('1936 Act')

Criminal Code Act 1995 (Cth)

Tax Agent Services Act 2009 (Cth) ('TASA')

What cases are considered in this episode?

Inland Revenue Commissioners v Duke of Westminster [1936] AC 1

- The Duke of Westminster lawfully minimised his tax burden by restructuring payments to his gardener through a covenant, making them tax-deductible. The court upheld this arrangement, affirming that taxpayers may legally structure their affairs to reduce taxes within the law's limits. Despite objections from tax authorities, Lord Tomlin ruled that the Duke's actions were legal, distinguishing lawful tax avoidance from tax evasion.

Newton v Federal Commissioner of Taxation [1958] UKPCHCA 1

- The Privy Council introduced the concept of “ordinary family or commercial dealing” to differentiate lawful transactions from tax avoidance under Australia’s section 260 of the 1936 Act. Lord Denning emphasised examining a transaction's effect to determine if it was aimed solely at tax avoidance. This principle, influencing the current anti-avoidance provisions, recognises legitimate dealings that do not trigger tax avoidance laws.

Hart v Commissioner of Taxation [2018] FCAFC 61

- Mr. Hart’s law firm income had been distributed through a scheme to reduce tax. Justice Bromwich initially ruled that Part IVA clearly applied, with a 50% penalty under section 226 of the 1936 Act, and the Full Federal Court upheld this, finding no error in Bromwich’s reasoning. Mr. Hart’s inability to present a credible counterfactual led to the High Court denying special leave to hear the appeal.

Federal Commissioner of Taxation v Spotless Services Ltd [1996] HCA 34

- The High Court explored whether Part IVA of the 1936 Act could apply to a commercial scheme aimed at maximising tax benefits. For Part IVA to apply, a scheme must involve a “tax benefit” and be undertaken with a dominant purpose of securing that benefit. While legitimate commercial arrangements remain outside Part IVA’s scope, the Court clarified that tax-driven strategies - even if commercially advantageous - may fall within its anti-avoidance provisions.

Federal Commissioner of Taxation v Peabody [1994] HCA 43

- In 1985, Terrence Peabody devised a complex financial arrangement involving his company, TEP Holdings, to buy out partner Mr. Kleinschmidt’s share in Pozzolanic, using creative financing and share restructuring to increase ownership and avoid taxes, ultimately valuing the company at $30 million, with his wife Mrs. Peabody later taxed $888,005 on trust income. The High Court found that the Commissioner’s discretion under section 177F(1) of the 1936 Act to cancel tax benefits is limited to those connected to schemes under Part IVA. The High Court upheld the Federal Court’s decision, finding that Mr. Peabody's actions were commercially motivated, not aimed at providing Mrs. Peabody with a tax benefit, concluding she did not receive a tax benefit related to a Part IVA scheme.

Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52

- In 1999, Alphapharm imported flu vaccines via a sub-distribution agreement with Ebos, which contracted Toll for logistics without direct dealings with

Alphapharm. After state health authorities rejected shipments due to improper temperature control, Alphapharm and Ebos sued Toll for negligence. The High Court ruled that Richard Thomson acted as Alphapharm's agent, allowing Toll to enforce an exclusion clause in its contract, leading to a judgment in favour of Toll.

Australia and New Zealand Savings Bank Ltd v Commissioner of Taxation [1993] FCA 393

- In 1986, a partnership agreement between banks led to investments in a unit trust, with funds sourced from a non-recourse loan. The partnership incurred interest charges and claimed losses, which were partially allowed by the Commissioner, leading to court proceedings over deductions and assessable income calculations for tax purposes. The court found that the nature of a transaction should be analysed based on the legal rights conferred. In the absence of claims that the transaction is a sham or the application of anti avoidance measures under Part IVA, then the court has to focus on the formal aspects of the transaction.

Minerva Financial Group Pty Ltd v Commissioner of Taxation [2024] FCAFC 28

- Minerva Financial Group reorganised in 2007 into a trust and corporate silo structure, distributing income to non-resident unit-holders to minimise withholding tax liabilities between 2012 and 2015. The Full Federal Court unanimously ruled that Minerva did not enter into any schemes with the dominant purpose of obtaining a tax benefit, thus rejecting the Commissioner's claims. This case reinforces that obtaining a tax benefit alone does not equate to tax avoidance under Part IVA.

Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 2) [2024] FCA 253

- In 2007, Mylan agreed to acquire Merck's global generics business, establishing Mylan Australia and Alphapharm, funded by intercompany debt consistent with Australia's thin capitalisation limits. The Federal Court ruled in favour of the taxpayer, concluding that Part IVA did not apply to Mylan's loan arrangement, as MAHPL lacked the dominant purpose of obtaining a tax benefit through its structured borrowing and debt consolidation strategies. The Court also rejected the Commissioner's counterfactual and double deduction claims.

What are the main points?

- Asset protection is a broad field encompassing strategies to minimise risks in commercial and family dealings. It is cross-disciplinary practice that includes

tax advice and management, which is not inherently legal but overlaps with legal measures in business and family matters.

- There is confusion surrounding the definitions of tax planning, minimisation, avoidance, and evasion. The key distinction between tax evasion and the other practices is legality, with evasion involving criminal offences, while planning and minimisation are associated with strategies that are legal.
- The GAAR and recent decisions of the Federal Court have reiterated that the test for determining tax liability is objective, and a taxpayer's subjective intentions are deemed irrelevant under Part IVA.
- Two fundamental inquiries need to be made in relation to Part IVA. The first is determining if there has been a tax benefit, followed by an assessment using the factors in section 177D of the 1936 Act.
- There is a distinction between the "but for" test and the alternate postulate test in analysing tax benefits.
- The distinction between asset protection and tax avoidance is often blurred, particularly for businesses that use company and trust structures.
- Accountants, particularly those who are registered tax agents, are authorised under the TASA to provide tax-related legal advice, but their scope is limited and does not extend to complex legal matters that are not considered tax-related.

What are the practical takeaways?

- Some lawful tax minimisation strategies include using companies or trust structures to reduce tax liabilities. For example, a sole trader paying high marginal tax rates may benefit from incorporating their business. Another strategy involves setting up a trust with a corporate trustee to allocate income to beneficiaries at the trustee's discretion.
- Lawyers providing asset protection advice without considering the tax implications for their clients may place themselves at risk of negligence claims.
- Employers may prefer candidates with a Masters degree, especially in technical fields like tax and corporations. Joining relevant professional associations, such as the Tax Institute, can provide valuable resources and networking opportunities in specialised areas like tax law.

Show notes

Mathew Leighton-Daly, 'Asset protection and tax avoidance' (2024) 58(11) Taxation in Australia 615

Bloom, D. (2016) ‘Tax Avoidance - A View from the Dark Side’, *Melbourne University Law Review*

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