STANDARD INTERPRETATION GUIDELINE 2018-03

INCOME TAX – ANTI-AVOIDANCE Section 102

This Standard Interpretation Guideline ("SIG") sets out Fiji Revenue and Customs Service's ("FRCS") policy and operational practice in relation to section 102 of the *Income Tax Act 2015*.

It is issued with the authority of the Chief Executive Officer of FRCS.

All legislative references in this SIG are to the *Income Tax Act 2015* (unless otherwise stated).

This SIG is in effect from 22 June 2018 and may need to be reviewed in the event of any relevant legislative amendments.

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EXECUTIVE SUMMARY

1. Taxes are imposed by Parliament in accordance with its intention as noted in the relevant tax legislation. However, legislation cannot fully capture Parliament's intention. It is incumbent on taxpayers to not only comply with the black letter of the law, but also with the spirit and intent of the relevant tax legislation.

2. Section 102 is a general anti-avoidance rule ("GAAR"). GAARs exists to ensure that the schemes designed to undermine the intention of tax laws are combatted and any tax benefits obtained from such schemes are nullified. As such, section 102 is the CEO's primary mechanism for targeting tax avoidance.

3. In broad terms, section 102 extent counteracts tax schemes that comply with the black-letter (literal) interpretation of tax laws, **but nevertheless defeats the spirit and intent of the relevant tax laws**. Further, the aim of the tax scheme is to pay less tax than if the scheme **had not been entered into**.

4. Tax avoidance is conceptually different from tax evasion and the difference are in terms of legality; Tax avoidance is legally exploiting the tax system to reduce current or future tax liabilities by means not intended by Parliament; whereas tax evasion consists of illegal practices by taxpayers to **knowingly** not file returns and/or pay tax.

5. Tax avoidance is like the civil matter of breach of contract. Usually, the party breaching the contract has to pay compensation and damages. However, there are no criminal offences committed by the party breaching the contract.

6. Tax evasion, on the other hand, **is** a criminal offence. It is analogous to the criminal offence of theft – with FRCS/Government being the victim and the taxpayer being the thief. In broad terms, it involves a taxpayer who knows that s/he has a tax obligation (such as file a return and/or pay tax) yet deliberately does not fulfill his/her obligation.

7. It is very important to note that the CEO will not be required to invoke section 102 in cases involving "shams". A "sham" is basically where parties have entered into arrangements without really intending to create legal relations. Hence, the arrangements they enter into are for "show" only to make third parties (including FRCS) believe that legal relations have been created.

8. The objective of "shams" is, sometimes, to create an impression under which tax position for a taxpayer is more favorable. However, at no stage do any of the parties ever intend to pursue obligations under the arrangements. In simple terms, the arrangements are "fictitious" and have no legal effect.

9. Because the "sham" involves fictitious arrangements, they cannot achieve any of the desired tax avoidance objectives because no legal arrangements were created in the first place. Consequently, the CEO does not need to invoke section 102. He can simply set the tax adjustments based on what the true legal arrangement is.

10. A decision by CEO to invoke section 102 will not be made lightly. It will usually be made after careful objective analysis and full understanding of the facts involved, by reference to documentary and other evidence available.

11. The next step would be, to apply the facts to the following requirements for section 102:

    a. The facts must show that a "scheme" has been entered into;

    b. The "scheme" results in "tax benefits"; and

    c. The sole "purpose" of the scheme is tax avoidance. If a scheme has more than one purpose, **then** one of the purposes is tax avoidance

12. In terms of identifying a "scheme", it includes a course of action, agreement, promise, plan or understanding. These can be expressed or implied. The definition also covers schemes that are not enforceable at law. Hence the definition of "scheme" is not limited to legally enforceable "formal" transaction; it also covers situations where two persons agree to something orally. These parameters indicate that the definition is very wide.

13. The next step is to identify "tax benefits" that arise as a result of the scheme identified in the first step. The definition of "tax benefit" includes, among other things, a reduction or postponement of a liability to pay tax, an entitlement to a refund or an increase in a tax credit.

14. In broad terms, the identification of a tax benefit involves analysing a hypothetical scenario. This involves the following steps:

    - Ascertaining what the tax position (amount of tax paid, etc.) of a taxpayer **would have been** if the scheme had not been entered into. Say we ascertain that but for the scheme, Taxpayer A would have paid $100,000 income tax for a particular year.

    - Comparing the tax position under the hypothetical situation with the actual tax position under the scheme. If Taxpayer A paid $20,000 as a result of the scheme, we have consequently identified $80,000 tax benefit.

15. The next step is to identify the "purpose" of the scheme which is tax avoidance. If the scheme has more than one purpose, whether one of the purposes is tax avoidance (as long as that purpose is not tax avoidance).

16. The first thing to note about the "purpose" test is that; it is the "purpose" or effect **of the arrangement** that is relevant. Further, "purpose" is not the same as the intentions of the parties who entered into such arrangement. Consequently, the test is objective and not subjective in nature.

17. Most overseas case laws on "purpose" have stated that "purpose" in this context means "the effect which it is sought to achieve — the end in view".

18. Factors that FRCS will look for in identifying tax avoidance purpose in a scheme include: artificiality, contrivance, lack of commercial reality and lack of economic benefits obtained for prices supposedly paid.

19. In some cases, a scheme will have more than one purpose, one of which is tax avoidance. Section 102 will not be applicable in situations where the tax avoidance purpose is "merely incidental".

20. The term "merely incidental" has been interpreted in a number of New Zealand case law and this would provide guidance in Fiji's context.

21. Once it is established that the requirements in section 102 are met, the CEO is entitled to use the reconstruction provision to readjust the taxpayer's tax position and recover the tax lost as a result of the tax avoidance scheme.

22. The reconstruction provision allows CEO to make estimates of what a taxpayer's tax position would have been if he or she had not entered into the tax avoidance scheme.

23. The CEO makes adjustments following three stages; that is, negate any tax avoidance purposes or effects that have not been counteracted by the annihilation, reinstate legitimate tax outcomes voided by the arrangement and make appropriate consequential adjustments.

INTRODUCTION

24. Section 102 is the general anti-avoidance law for income tax law purposes. It exists to ensure schemes that are designed to exploit perceived "loopholes" do not succeed in avoiding tax payable by taxpayer.

25. The need for a general anti avoidance law arises because tax laws simply cannot specify the exact tax consequences of the uncountable number of schemes that can be entered into. Instead tax law drafters do their best to specify as broadly what schemes and transactions that Parliament intended tax to apply to at the time it passed the relevant tax law.

26. Because tax laws cannot capture every scheme and scenario that may exist, it opens taxpayers to enter into schemes that are designed to avoid tax – these schemes technically comply with the wording of the tax acts but are clearly contrary to the intention of Parliament. General anti-avoidance rules such as section 102 are designed to fill this gap and make these schemes taxable in accordance with the intention of Parliament.

27. Tax avoidance is bad for Fiji because it reduces the tax revenue available for schools, hospitals, roads and other social need. It is also very unfair because taxpayers that do not engage in tax avoidance have to pay a higher burden of taxation as opposed to tax avoiders.

28. Fiji tax legislation is not alone in having general anti-avoidance provision – Australia and New Zealand have had general anti avoidance rules in their respective tax acts for decades.

29. If section 102 is successfully invoked by FRCS, then the CEO has wide reconstruction powers under section 102(1) to eliminate any tax benefits obtained by a tax avoider taxpayer.

30. It should also be noted at the outset that tax **avoidance** is a completely separate concept from tax **evasion** (which can amount to a criminal offence). Tax avoidance is not a criminal offence. This is further discussed later in this SIG.

PROPER APPLICATION OF SECTION 102

31. FRCS acknowledges that section 102 is a powerful tool that can have significant and far reaching consequences for taxpayers. It is also acknowledged that section 102 is not to be used in routine cases purely because tax officials do not like an outcome in a particular tax audit.

32. In broad terms, it is to be invoked by the CEO only after all the relevant facts have been collected by FRCS officers and the facts have been carefully analysed.

33. The process for the invoking of section 102 by FRCS is elaborated further in this SIG. However, three factors have to be emphasized at the start:

    - The application of section 102 is purely based on **objective** analysis. In broad terms, we need to ask "What would a reasonable person conclude as to why a particular arrangement has been entered into?". The test is not **subjective** in nature.

    - Section 102 requires FRCS to analyse the **purpose** of an arrangement, not the **intention** of the parties who entered into the arrangement. As an analogy, consider why roads are constructed. We note the purpose of having roads, because roads (being inanimate objects) cannot have intentions. Hence the arrangement is like a road – we should ask what is the purpose of having a particular road (i.e. to get from point A to point B), but the intention of the road builders is irrelevant.

    - Consequently, section 102 is not a test of a taxpayer's motives and intentions and FRCS will take all care to avoid any implication that a decision to invoke section 102 is a judgment on a taxpayer's ethics and/or morality.

LEGISLATIVE ANALYSIS

34. The substantial part of section 102 came into force with effect from 1 January 2016. It was introduced as part of the re-written Income Tax Act 2015.

35. Section 102 was modified in the Income Tax (Budget Amendment) Act 2017, which came into effect from 1 August 2017.

36. In the following part of this SIG, we will explain why the changes were required to the previous version of section 102.

37. The previous version of section 102 (part of which relates to general anti-avoidance) stated:

> **"102 (**1) Notwithstanding this Act, if the CEO is satisfied that –
> (a) a tax avoidance scheme has been entered into or carried out;
> (b) a person has obtained a tax benefit in connection with the tax avoidance scheme; and
> (c) having regard to the substance of the tax avoidance scheme; it would be concluded that a person or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in paragraph (b) to obtain a tax benefit,
>
> the CEO may determine the tax liability of the person who obtained the tax benefit as if the tax avoidance scheme had not been entered into or carried out and can make compensating adjustments to the tax liability of any other person affected by the tax avoidance scheme.
>
> (3) If a determination or adjustment is made under this section, the CEO must issue an assessment giving effect to the determination or adjustment.
>
> (4) A determination or adjustment under this section must be made within 7 years from the last day of the tax year to which the determination of adjustment relates."

38. The relevant definitions were contained in subsection (5):

> "(5) In this section-
> "scheme" includes a course of action and an agreement, arrangement, promise, plan, proposal, or undertaking, whether express or implied and whether or not enforceable;
>
> "tax avoidance scheme" means any scheme if one of the main purposes of a person in entering into the scheme is the avoidance or reduction of any person's liability to tax under this Act;
>
> "tax benefit" means-
> (a) a reduction in a liability to pay tax;
> (b) a postponement of a liability to pay tax;
> (c) an entitlement to a refund;
> (d) an increase in a tax credit;
> (e) any other advantage arising because of a delay in payment of tax; or
> (f) anything that causes gross income to be exempt income, a capital gain to be an exempt capital gain, or a fringe benefit to be an exempt fringe benefit;"

39. The previous version of the legislation was problematic for two major reasons:

40. **Structural inconsistency:** The previous legislation had two "purpose" tests - section 102(1) required "sole or dominant purpose" and this had to be contrasted with the definition of "tax avoidance scheme" in section 120(5) which referred to "one of the main purposes".

- The phrase "dominant purpose" becomes relevant where a taxpayer enters into an arrangement with two or more purposes – for example, a large corporate does a restructuring of business affairs for commercial reasons and the arrangement also yields tax benefits for the taxpayer.

- The phrase "main purpose" is similarly relevant in cases of multiple purposes for entering into an arrangement. In commercial terms, the words "dominant" and "main" have different meanings. Therefore, the tests in sections 102(1)(c) and in the definition of "tax avoidance scheme" in section 102(5) are theoretically different.

- Consequently, it could be argued that section 102 has two "threshold" purpose tests for FRCS to satisfy, whereas internationally (Australia and New Zealand) only one purpose test is contained in their respective general anti-avoidance rules. This reflects the reality that general anti avoidance rules require and function best, with one purpose test only.

41. **Requirement to have "dominant" purpose in the first place**: The word "dominant" connotes that the tax avoidance purposes has to be more than 50% in order for the CEO to invoke section 102. That is, the tax avoidance purpose must "overwhelm all others".

    This is unusual in an international context because it causes distortions. Consider the following example:

    Two large companies engaged in the same type of business enter into a business reorganization at the same time. Company A does the restructuring **solely** for tax avoidance purposes and is clearly caught under section 102.

    Company B does the restructuring for tax avoidance **and** commercial financing reasons. Both purposes are of equal importance (50% each). Here the tax avoidance purpose cannot be said to be "dominant" since there is another purpose of equal importance. Consequently, the CEO would not have been able to invoke section 102 against Company B since the "dominant purpose" test has not been satisfied.

42. This outcome is arguably unfair since both are tax avoiders – yet only Company A has to pay further tax and Company B gets off free.

43. The international benchmark is that the general anti-avoidance rules are applicable where the sole purpose is tax avoidance or where tax avoidance is one of the purposes (as long as that purpose is not "merely incidental").

44. Two changes were made as part of the Income Tax (Budget Amendment) Act 2017:

    - As noted above, there were previously two "purpose tests" – in section 102(1)(c) and in the definition of "tax avoidance scheme" in section 102(5). The test in section 102(1)(c) was completely removed.

    - The purpose test is now instead contained in the new definition of "tax avoidance scheme" in section 102(5) and removes the requirement for a "main" or "dominant" tax avoidance purpose. Section 102 will be invoked as long as one of the purposes is "tax avoidance", and as long as that purpose is not "merely incidental".

45. The new section 102(1) states:

> **"102** (1) Notwithstanding this Act, if the CEO is satisfied that –
>
> (a) a tax avoidance scheme has been entered into or carried out; and
> (b) a person has obtained a tax benefit in connection with the tax avoidance scheme,
>
> the CEO may determine the tax liability of the person who obtained the tax benefit as if the tax avoidance scheme had not been entered into or carried out and can make compensating adjustments to the tax liability of any other person affected by the tax avoidance scheme."

46. The definition of "tax avoidance scheme" in section 102(5) will state:

> "tax avoidance scheme" means any scheme, whether entered into by a person affected by the scheme or by another person, that directly or indirectly –
>
> (a) has tax avoidance as its purpose or effect; or
> (b) has tax avoidance as one of its purposes or effects, if the tax avoidance purpose or effect is not merely incidental."

47. This approach is consistent with the development of anti-avoidance provisions in Australia and New Zealand where the requirement for "dominant" purpose has been eliminated.

48. This SIG has been issued to provide guidelines on the amended (and currently applicable) section 102 (with the amendments noted above).

Tax Havens

49. Section 102 also contains the following subsection in relation to tax havens:

> "(2) When a resident person has entered into a transaction that directly or indirectly has the effect that income is foreign-source income derived through a non-resident entity that is connected to a tax haven, the CEO may adjust the income and foreign tax credit position of the resident person to reverse the tax effect of the transaction."

50. The term "tax haven" is defined in subsection (5) as follows:

> "tax haven" means a foreign country or part of a foreign country that has-
>
> (a) effective tax rates significantly lower than those of Fiji; or
>
> (b) laws providing for the secrecy of financial or corporate information that facilitate the concealment of the identity of the real owner of any income or asset."

51. This SIG only applies to the general anti-avoidance aspects of section 102. Consequently, the parts of section 102 relating to tax havens is not covered in this SIG. It is envisaged that a separate SIG will be issued on this topic in due course.

Elements Required for Section 102 To Apply

52. The elements required for the CEO to invoke the amended section 102 are as follows:

- Tax avoidance rules are not required if the transactions are a sham. If they are a sham, they are automatically void for tax purposes;

- Tax avoidance is conceptually distinct from tax evasion. Care should be taken to ensure that the two are not confused;

- There must be a "scheme" as defined in section 102(5) entered into by a taxpayer;

- That scheme must have led to at least one person obtaining a "tax benefit" as also defined in section 102(5); and

- Based on an objective analysis of the arrangement itself (*inter alia* its features, characteristics, effects) it can be concluded that at least one of the purposes of the arrangement is tax avoidance (as long as that purpose is not "merely incidental").

Sham

53. A sham is a transaction set up to conceal the true intention of the parties. It is inherently ineffective at law so it does not require provisions such as section 102 to strike it down.

54. The classic definition of a sham was given in the UK case *Snook* v *London & West Riding Investments Ltd* [1967] 1 All ER 518. In this case Diplock LJ defined a "sham" in the following terms ([1967] 1 All ER at 528):

> "I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the Court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities … that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a 'shammer' affect the rights of a party whom he deceived."

55. In the *Mills* v *Dowdall* [1983] NZLR 154, Richardson J described the concept of sham as a situation in which the "essential genuineness of the transaction is challenged". His Honour held that a sham would exist in two situations:

- where the documents do not reflect the true agreement between the parties; and

- where the documents are *bona fide* in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered.

56. Authority for the proposition that it is not necessary for section 102 to strike down a sham may be found in *Jacques* v *FC of T* (1924) 34 CLR 328. In that case, Isaacs J said (at 358):

> "… a sham transaction is inherently worthless and needs no enactment to nullify it."

57. A similar view was subsequently taken in *Hancock* v *FC of T* (1961) 12 ATD 312 at 328 and *Newton* v *FC of T* (1958) 11 ATD 187 at 225.

58. This approach is consistent with the protective nature of section 102. The role of the section is to ensure the operation of other provisions of the Act as Parliament intended they should apply. In the case of a worthless sham, there is no other provision that the sham would otherwise circumvent.

Tax Avoidance Vs Tax Evasion

59. **Tax avoidance** is legally and conceptually different from **tax evasion**. As a starting point, tax evasion is a criminal offence whereas tax avoidance is not.

60. The distinction between tax avoidance and tax evasion is best explained by the following analogy:

    - Person A is an acquaintance of Person B.
    - Person A has entered into a business contract with Person C.
    - Person B uses his closeness with Person A to steal $10,000.
    - Person C breaches the contract and causes a $10,000 loss to Person A.

61. Both Persons B and C have caused the **same** amount of loss to Person A ($10,000) and both will have to pay that amount to Person A.

62. However, only Person C will have further consequences because he has committed a criminal offence (theft). He is potentially liable for a fine and/or a jail term.

63. On the other hand, the dispute between Person A and C will be deemed to be a purely civil matter (non-criminal law). Person C may have to pay monetary damages in addition to the $10,000, he has to pay Person A - but there will be no criminal law implications for Person C.

64. In a tax context:

    - Person A is FRCS.

- Person B is a tax evader (criminal offence) because he clearly has a tax liability of $10,000 but deliberately and knowingly does not pay to FRCS. He has essentially "stolen" from FRCS.

- Person C is a tax avoider. He has structured his tax affairs in such a way to exploit the provisions in the Income Tax Act so that he does not have to pay $10,000 tax – that he would have had to pay if he had not done the scheming. While he is in technical compliance with the Income Tax Act, he has nevertheless breached Parliament's "spirit and intent" that nobody should be able to avoid tax by scheming their way around the provisions of the Income Tax Act.

This is why Parliament has enacted section 102. It is designed to recover tax that would otherwise be lost to ingenious scheming by taxpayers and their tax advisers. These taxpayers have "breached their contract" with the Parliament of Fiji that everyone should have to pay their fair share of taxes.

65. Both tax evasion and tax avoidance are very powerful tools available to the CEO. Consequently, the first step in the analysis is to establish that tax avoidance is the appropriate cause of action in the first place.

Scheme

66. The term "scheme" is defined in section 102(5) as:

> "includes a course of action and an agreement, arrangement, promise, plan, proposal, or undertaking, whether express or implied and whether or not enforceable"

67. This definition is broadly in accordance with the Australian definition of "scheme" and the New Zealand definition of "arrangement" in the respective income tax legislation.

68. The Australia definition of "scheme" is defined in section 177A of the *Income Tax Assessment Act 1936 (Cth)* which states:

> **"scheme** means:
>
> (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
>
> (b) any scheme, plan, proposal, action, course of action or course of conduct."

69. The New Zealand definition of "arrangement" is defined in section YA 1 of *Income Tax Act 2007* as:

> "means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect."

70. The similarity of the Fiji definition of "scheme" with the Australian and New Zealand means that a lot of case laws from those countries can be used to provide practical guidance on what constitutes a "scheme".

71. The first thing to note about the definition is that, it is very wide in application. In *Federal Commissioner of Taxation v Hart* [2004] HCA 26; 217 CLR 216, Callinan J noted [at 89]:

> "The use of singular, narrow words, proposal, action or course of action in s117A(1)(b) in juxtaposition with, for example, agreement or arrangement in s177A(1)(a) indicates that something done which is less than the whole of an arrangement or agreement may be capable of itself being a scheme. This view is I think … consistent with, and a true reflection of the statutory language …"

72. A similar point was made by Richardson P in *CIR v BNZ Investments* [2002] 1 NZLR 450 (CA) in relation to the breadth of the New Zealand definition of "arrangement":

> "[45] The words contract, agreement, plan and understanding appear to be in descending order of formality. A contract is more formal than an agreement, and in ordinary usage is usually written while an agreement is generally more formal than a plan, and a plan more formal or more structured than an understanding. And it is accepted in the definition of arrangement that the contract, agreement, plan or understanding need not be enforceable."

73. Richardson P also cited with approval the Australian High Court case of *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548 that a "scheme" extended beyond contracts and agreements "so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect".

74. In this respect these judicial pronouncements are similar to those made in the cornerstone case of *Newton v Commissioner of Taxation* [1958] AC 450 (PC) (at 465):

> "[the then Australian definition of "scheme] is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may not be enforceable at law."

75. The key point for the definition of "scheme" in Fiji is that "scheme" is not limited to legally enforceable "formal" transactions – it can arise even, for example, where two persons orally agree to something.

76. There are also some practical issues:

- Can unilateral actions constitute a "scheme"?
- Extent of consensus/understanding required to be party to an "arrangement"
- Can the definition of "scheme" include the failure to do something?
- Extraterritorial limitations

Unilateral actions as "schemes"

77. The words "scheme", "agreement" and undertaking are contained in the definition. These words (on their ordinary meaning) would indicate that the concept of "scheme" requires the involvement

of at least two persons in order for a "scheme" to exist. Specifically, the issue arises as to whether a scheme can exist with unitary actions.

78. The definition of "scheme" in section 102 includes a "course of action", which can be undertaken by a person acting alone.

79. Further, the definition includes a "plan". A plan does not necessarily which means the definition will also apply to a person acting alone to give effect to a plan.

80. In *Russell v Commissioner of Inland Revenue* (2012) 25 NZTC 20-120, the Court of Appeal assumed a one-person plan could be an "arrangement", upholding the view of Wylie J in the court below:

> "[54] We agree with the Judge that if a consensus is needed, the appellant provided any necessary consensus for the purposes of the overall plan. The appellant orchestrated the whole arrangement. However, we note that the statutory definition of "arrangement" does not require such consensus: a plan will suffice. Here the overall plan was that created, designed and executed by the appellant."

81. Consequently, a "scheme" can arise even where a single person is acting by himself or herself.

Extent of consensus/understanding required to be party to an "arrangement"

82. In most cases, it is anticipated that taxpayers will know, and agree with, all of the relevant steps/transactions carried out by another person that is part of the same "tax avoidance scheme". Consequently, that taxpayer will be considered to be party to an "arrangement" that consists all those transactions.

83. A taxpayer will also be deemed to be part of a scheme where the taxpayer is aware of the **steps/transactions**, but unaware that the **outcome** of the scheme is tax avoidance. The same will apply where the taxpayer genuinely or reasonably believed that the transactions did not constitute tax avoidance. The New Zealand case *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433 confirmed this point.

84. But what about situations where the taxpayer is not aware of (and therefore did not agree to) some of all of the steps/transactions carried out by another person and which constitute tax avoidance?

85. In such situations, taxpayers may argue that it is unfair if they are included in a scheme that they were not even fully aware what the steps/transactions were.

86. This point was also examined by the Privy Council in the *Peterson* case. Lord Millet stated:

> "Their Lordships do not consider that the "arrangement" requires a consensus or meeting of minds; the taxpayer need not be a party to "the arrangement" and in their view he need not be privy to its details either."

87. FRCS considers that a similar position should apply in a Fiji context. While at first it may seem unfair that taxpayers will be "caught" by schemes that they are not even fully aware of, the rationality of the position can be explained as follows:

88. A significant number of tax audits conducted by FRCS finds tax shortfalls (ie. taxpayer underpaid taxes). A large number of these taxpayers would have made the mistakes because they were unaware of what their obligations were and/or unaware of key aspects of the transactions they had entered. But are they absolved of their tax obligations merely because they were unaware that they needed to pay tax? Definitely not – they have to pay further tax whether or not they were aware their tax returns were wrong.

89. This taxation is not imposed on what a taxpayer believes his or her liability to be. If this was indeed the case, then taxation would collapse because everyone would "believe" they have zero tax to pay.

90. Instead, taxation is imposed on an objective analysis of the facts and transactions entered into by a taxpayer. Their level of belief or knowledge may be relevant to how much (if any) penalties they need to pay, but not to the question of tax liability in the first place.

Can "scheme" include failure to do something?

91. The definition of "scheme" in section 102 is broad enough to include the failure to do something.

92. In the Australian case of *Corporate Initiatives Pty Ltd v Commissioner of Taxation* 2005 ATC 4392 the Court held:

> "Part of the statutory definition of 'scheme' is 'any … course of action or course of conduct'. This conveys the notion of a series of interrelated acts by a person or persons over a period of time. **The non-doing of an act can form part of such a course**, as for example where it is said that a student regularly fails to hand in essays."

Tax Benefit

93. The second element that has to be proven in order to invoke section 102 is that a taxpayer (or taxpayers) must have obtained a "tax benefit", which is defined in section 102(5) as follows:

> "**tax benefit** means:
> (a) a reduction in a liability to pay tax;
> (b) a postponement of a liability to pay tax;
> (c) an entitlement to a refund;
> (d) an increase in a tax credit;
> (e) any other advantage arising because of a delay in payment of tax; or
> (f) anything that causes gross income to be exempt income, a capital gain to be an exempt capital gain, or a fringe benefit to be an exempt fringe benefit..."

94. The New Zealand equivalent is called "tax avoidance" and is contained in section YA 1 of the *Income Tax Act 2007*, which states:

> "**tax avoidance** includes-
> (a) directly or indirectly altering the incidence of any income tax:
> (b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:
> (c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax."

95. The Australian equivalent is contained in section 177C and 177CB.

96. The definition in section 177CB is considered to be the prevalent definition. The key part of this section states:

> **"177CB The bases for identifying tax benefits**
>
> (1) This section applies in deciding under section 177C, whether any of the following (*tax affects*) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:
>
> (a) an amount being included in the assessable income of the taxpayer;
>
> (b) the whole or a part of a deduction not being allowable to the taxpayer;
>
> (c) the whole or a part of a capital loss not being incurred by the taxpayer;
>
> (d) the whole or a part of a foreign income tax offset not being allowable to the taxpayer;
>
> (e) the taxpayer being liable to pay withholding tax on an amount."

97. FRCS considers that while the wording of the Fiji definition of "tax benefit" is somewhat different from the Australian and New Zealand equivalents, the essential enquiry is the same under all three versions.

98. Section 102 applies where tax has actually been "avoided" as a result of a scheme. If a taxpayer enters into a scheme, but that scheme does not actually lead to any tax being avoided, then section 102 cannot be invoked. It would be pointless to do so since section 102 seeks to recoup lost tax due to tax avoidance.

99. So exactly when can we say that tax has been avoided? This is done by doing a comparison between:
    - What amount was paid by the taxpayer in his/her tax returns as a result of entering into the tax avoidance scheme, and

    - Identifying the amount of tax that would have been paid if the taxpayer had not entered into the tax avoidance scheme. This enquiry is variously known as the "alternative postulate" or the "counter factual".

100. The determination of whether there is a tax benefit involves a comparison between the actual tax position and that which would or might reasonably be expected to have been the position if the scheme had not been entered into. It was held in *FC of T v Peabody* (1994) 181 CLR 359, 385; 94 ATC 4663, 4671 that:

> "A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable."

101. So, for example, if a taxpayer pays only $10,000 income tax for the 2017 tax year as a result of entering into a scheme but would have paid $50,000 if it had not entered into the scheme, then clearly $40,000 tax has been as a result of entering into the scheme. This is the amount of the "tax benefit" because it is a "reduction in a liability to pay tax" (as per paragraph (a) of the definition of "tax benefit").

102. All three versions (Fiji, Australia, New Zealand) require a comparison between the actual tax position (as per the scheme entered into) and "what would have been" paid if the scheme had not been entered into.

103. Practical difficulties can sometimes occur in ascertaining what a taxpayer's tax position would have been if he or she had not entered into the scheme. At a practical level, this involves ascertaining a "hypothetical" situation and set of facts that would have happened if the taxpayer had not entered into the scheme.

Purpose or Effect of Scheme

104. In the definition of "tax avoidance arrangement", an arrangement must have a single "purpose or effect", or one "purpose or effect" which is more than incidental, of tax avoidance.

105. The Fiji purpose test is similar to New Zealand – hence New Zealand case law is particularly helpful in the Fiji context.

106. Although the position was slightly uncertain following the approach taken by the Privy Council in *C of IR* v *Challenge Corporation* Ltd (1986) 8 NZTC 5,219, it is submitted that the term "purpose or effect" refers to the object or goal of the arrangement. This interpretation was adopted in relation to the former general anti-avoidance section in New Zealand s 108 of the Land and Income Tax Act 1954 and the former equivalent section in Australia, s 260.

107. In *Newton* v *FC of T* (1958) 11 ATD 442 (in relation to s 260) the Privy Council interpreted (at p 445) "purpose or effect" to mean "the effect which it is sought to achieve — the end in view".

108. Similarly, in *Tayles* v *C of IR* (1982) 5 NZTC 61,311 (in relation to the New Zealand equivalent of section 102) the Court of Appeal held (at p 61,318):

> "The issue before the Board of Review, the High Court and this court involved an enquiry into the purpose or effect of the arrangement admittedly made. Whatever difference of meaning there may be in dictionary terms between the words "purpose" or "effect", posed as they seem to be as alternatives in sec 108, they usually have been looked on in the cases as a composite term. "The word 'purpose' means not motive but the effect which it is sought to achieve — the end in view. The word 'effect' means accomplished or achieved. The whole set of words denotes concerted action to an end — the end of avoiding tax." *Newton* v. *F.C. of T.*at p. 465. And "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 …" *Ashton* v *C of IR* at p 61,034."

109. In *FC of T* v *Gulland* 85 ATC 4765 Dawson J observed that ordinarily the terms of "purpose" and "effect" do not require separate consideration because the effect of an arrangement will coincide with its purpose (p 4,793).

110. In *Ben Nevis Forestry Ventures Ltd* v *C of IR* (2009) 24 NZTC 23,188 a minority judgment of the Supreme Court (Anderson J and Elias CJ) cited the comment above from *Tayles* with approval. After noting that the composite term "purpose or effect" cannot be collapsed into "effect", their Honours stated:

> "[8] … Sir Anthony Mason, sitting in the Hong Kong Court of Final Appeal [*Shiu Wing Ltd* v *Commr of Estate Duty* [2000] HKCFA 96 at para 78], has also said of the application of tax legislation purposively construed to a transaction or arrangement that it is concerned with "the aim or end in view"."

111. In this case it is not necessary to revisit that approach. Applying it, "effect" is part of a composite term so that the general anti-avoidance provision is concerned with arrangements having the "intended effect" or object of altering the incidence of tax. That is not to say that purpose is to be equated with the motive of the taxpayer or the motives of the architects of the arrangement. It is well established that motive is not determinative, although it may be evidence which sheds light on a purpose of tax avoidance and so is not wholly irrelevant.

112. In *Glenharrow Holdings Ltd* v *C of IR* (2009) 24 NZTC 23,236 the Supreme Court cited the dictum in *Newton* with approval. Blanchard J was emphatic that the general anti-avoidance provision was concerned with the purpose of the arrangement, not the purpose of the parties. His Honour stated that the purpose of the arrangement may be deduced entirely from the arrangement and its effect.

113. In *Ben Nevis*, the Supreme Court noted that an arrangement structured in a contrived or artificial way was among the indicia for a tax avoidance arrangement ([108]). Even before *Ben Nevis*, artificiality (and contrivance) had often been referred to by New Zealand courts, but without any detailed analysis of what those terms meant; see *Loader v C of IR* (1974) 1 NZTC 61,132 (SC).

114. The better view is that artificiality in a transaction may strongly imply the existence of tax avoidance but not necessarily in every situation. For example, Cooke J, in *C of IR* v *Challenge Corporation*

Ltd (1986) 8 NZTC 5,001 (CA) at 5,012 stated "The transactions are so artificial that one would very readily characterize them as tax avoidance", but ultimately ruled in favour of the taxpayer company.

Merely Incidental

115. If the sole purpose or effect of a taxpayer in entering into a scheme is tax avoidance, then the scheme will be sufficient for section 102 to be invoked since the requirement in section 102(1)(a) will be satisfied.

116. However, as discussed above, some schemes may have more than one purposes and one of them includes tax avoidance.

117. For example, a taxpayer may enter into a scheme because the bank wants the taxpayer to undertake a restructuring before more money is lent. Tax avoidance is also one of the purposes of the scheme. If the tax avoidance purpose is "merely incidental" to the bank's reconstruction provision, then section 102 cannot be invoked.

118. When identifying purposes and effects of a scheme in order to apply the merely incidental test, the purposes or effects must be objectively ascertainable from the arrangement. The reason for this is that section 102 applies to the scheme itself (as opposed to the motives or intentions of the parties to the scheme).

119. The next issue is how is how "incidental" is to be interpreted. The word is defined in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) to mean: **incidental. *adj* 1** occurring as a minor accompaniment; occurring by chance in connection with something else. **2 (incidental to)** liable to happen as a consequence of. **n** an incidental detail, expense, event, etc.

120. Consequently, there are two interpretations that can be given to the word "incidental" in the context of section 102. The first is that, a tax avoidance purpose or effect will be deemed to be "incidental" if it is relatively minor or small compared to the other purpose(s) of the scheme.

121. The second interpretation is that; a purpose or effect is "incidental" if it follows on from another (non-tax avoidance) purpose or effect.

122. FRCS considers that the second interpretation is the correct one. In the New Zealand case of *Challenge Corporation Ltd v CIR* [1986] 2 NZLR 513, the Court of Appeal examined this issue in detail. the Woodhouse P stated:

> "Does it have the rather exiguous meaning and effect of excusing only "the casual" or "the minor" or "the inconsequential" tax avoidance purposes? If so, many "ordinary" dealings would probably be caught by [the New Zealand equivalent of section 102] because inevitably the associated tax purpose could seem stronger than that. And the problem would be magnified if as well the assessment had to include estimates of the taxpayer's motives. However, I do not think the phrase "merely incidental" does have such a limited effect and in accord with *Newton v Commissioner of Taxation* [1958] AC 450 I am satisfied as well that the issue as to whether or not a tax saving purpose or effect is "merely incidental" to another

purpose is something to be decided not subjectively in terms of motive but objectively by reference to the arrangement itself.
As a matter of construction I think the phrase "merely incidental purpose or effect" in the context of [the New Zealand equivalent of section 102] points to something which is necessarily linked and without contrivance to some other purpose or effect so that it can be regarded as a natural concomitant."

123. These statements by Woodhouse P were cited with approval by Harrison J in *Westpac Banking Corporation v CIR* (2009) 24 NZTC 23,834. His Honour stated:

> "... A tax avoidance purpose or effect must be more than merely incidental to any other purpose or effect, such as ordinary business or family dealings, to constitute statutory avoidance. Inclusion of an adjectival phrase such as "not merely" is unusual in a statute; and its presence is not without difficulty in the context of tax legislation.
>
> However, when used in conjunction with the word "incidental", I think the phrase "not merely" is designed to emphasize that a tax avoidance purpose, if found, will offend [the New Zealand equivalent of section 102] unless it naturally attaches or is subordinate or subsidiary to a concurrent legitimate purpose or effect, whether of a commercial or family nature. Identification of a business purpose will not immunise a transaction from scrutiny where tax avoidance can be viewed as "a significant or actuating purpose which has been pursued as a goal in itself; see *Tayles* per McMullin J at NZTC 61,318; NZLR 736. Conversely, a transaction will not offend where tax avoidance naturally attaches to that other acceptable purpose or effect."

124. Justice Harrison also highlighted the fact that a purpose or effect that is "merely incidental" cannot be a goal in itself:

> "The tax avoidance purpose here could never be regarded "as a natural concomitant" of a dominant commercial purpose. Deployment of the deductibility provisions to reduce the bank's liability to income forecast in the following year in accordance with its tax shelter or capacity calculation became a discrete and real end or objective on its own. I find that Westpac's use or its tax shelter was a significant or actuating purpose which was pursued as a goal in itself in each transaction. As a matter of fact, and degree, Westpac's tax avoidance purpose was more than merely incidental to any legitimate commercial purpose."

125. In summary, FRCS considers from the decided authority and legislative background, that "merely incidental" in this context means that the tax avoidance purpose must merely follow as a natural concomitant of the arrangement being structured in the particular way to achieve a non-tax avoidance purpose or purposes.

Reconstruction

126. Once it has been established that FRCS is entitled to invoke section 102, the next step would be to determine how much extra tax the taxpayer(s) have to pay (or less entitlements of losses etc.).

127. Section 102 essentially states that if the substantive provisions of section 102 have been satisfied, then the CEO is entitled to:

> "… determine the tax liability of the person who obtained the tax benefit as if the tax avoidance scheme had not been entered into or carried out and can make compensating adjustments to the tax liability of any other person affected by the tax avoidance scheme."

128. This is known as the "reconstruction provision". It basically allows the CEO to make estimate of what a taxpayer's tax position would have been if he or she had not entered into the tax avoidance scheme. Essentially, it allows the CEO to recover the tax lost as a result of the tax avoidance scheme.

129. The first point to note is that the reconstruction provision of section 102 is that, it applies to the whole of the tax avoidance scheme. It does not allow for apportionment. If, for example, the tax lost as a result of a scheme is $100,000, then the taxpayer is not entitled to argue that the CEO's recovery entitled is less than that amount.

130. FRCS considers that the broad nature of the power under the reconstruction provision allows the CEO to make adjustments to do any of the following:
    - negate any tax avoidance purposes or effects that have not been counteracted;
    - reinstate legitimate tax outcomes voided by the tax avoidance scheme; and
    - make consequential adjustments.

131. The effect of the above is that the CEO recovers increasing tax payables (or decreases losses available etc.) based on a hypothetical set of facts.

132. This hypothetical is the CEO's best estimate of the amount of tax that would have been paid if no scheme had been entered into. So for example, if a taxpayer would have paid $100,000 but does pay $40,000 as a result of a tax avoidance scheme, section 102 allows the CEO to issue assessments for a further $60,000 (plus penalties etc. that may be applicable).

Practical Guidance

133. Due to the complexity of the law involved, we are unable to give short examples of what is (or is not) tax avoidance. However, for practical guidance, FRCS suggests that taxpayers and their advisers should consider analysing real cases from Australian and New Zealand for practical application of the new section 102.