The Tax Institute

The Tax Summit

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Session 19.3: Part IVA and evidence

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Contents

1. Overview

With a recent flurry of court cases on Part IVA, and more likely on the horizon, what is clear from these cases is the importance of evidence. This session will explore expert advice as to what the courts are looking for in the context of evidence and Part IVA and the impact of the strength (or otherwise) of the evidence on a Part IVA position.

1 The topic of this session is the importance of evidence in a dispute involving Part IVA of the *Income Tax Assessment Act 1936* (Cth).

2 But first, some history. In a 2023 paper published in the Australian Tax Review, the late Richard Edmonds SC, former Justice Edmonds of the Federal Court of Australia, observed that the High Court has not had occasion to hear a Part IVA case since its decision in *Mills v Federal Commissioner of Taxation* (2012) 250 CLR 171 over 10 years ago, and before that one has to go back a further eight years to its decision in *Commissioner of Taxation (Cth) v Hart* (2004) 217 CLR 216.[1] Former Justice Edmonds also suggested that the history of Part IVA can be divided into four approximate decades, the most recent epoch being that from 10 February 2012 to the time of his writing. Whether 2024 and the years that are to follow will represent a continuation or a new epoch is not an uninteresting question.

3 The 2023 the Full Court of the Federal Court of Australia handed down its judgment in *Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* (2023) 115 ATR 316; [2023] FCAFC 3. Hespe J delivered the leading judgment and Perry J and Derrington J each agreed, with no supplement or derogation. In 2024, the Full Court constituted by Besanko, Colvin and Hespe JJ handed down a unanimous judgment in *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* (2024) 302 FCR 52; [2024] FCAFC 28 and then another Full Court constituted by Perram, Colvin and Jackman JJ delivered judgment in *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1; [2024] FCAFC 86 (Perram and Jackman JJ allowing the appeal and Colvin J dissenting).

4 *PepsiCo* is liable to excite as it represents the first occasion on which the operation of the diverted profits tax under s 177J of Pt IVA has been considered. It may also be fair to observe that in both *Guardian* and *Minerva*, the Full Court restated rather uncontroversial principles as to Part IVA. And the first instance decisions in *Mylan*

[1] The Hon Richard Edmonds AM SC, “Part IVA: A Reflective Discourse” (2023) 52 AT Rev 97

Australia Holding Pty Ltd v Commissioner of Taxation (No 2) [2024] FCA 253 (8 March 2024, Button J), *Merchant v Commissioner of Taxation* [2024] FCA 498 (14 May 2024, Thawley J) and *Ierna v Commissioner of Taxation* [2024] FCA 592 (6 June 2024, Logan J) may well be simply a flurry of application of settled principles to novel facts.

2. Summary

5 The issues discussed in this paper include:

a. A refresher on the principles that apply to determining the tax benefit and the dominant purpose.

b. Some lessons that can be gathered from the recent cases about how a taxpayer may mount a successful challenge to the tax benefit or counterfactual element of Part IVA.

c. Some lessons that can be gathered from the recent cases about how a taxpayer may mount a successful challenge to the dominant purpose element of Part IVA.

d. The longevity of a Part IVA audit and how that impacts the availability of evidence.

6 Some key takeaway points are:

a. Consider both the express assumptions as well as the *implied* assumptions your case, or your expert evidence, depends on.

b. It has been said that "a prediction that has a different commercial outcome from the scheme entered into and carried out is not readily accepted as reliable" and "the taxpayer's rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme". But I would argue that these statements should be considered more in the nature of "lore" rather than "law". It is possible to show that the taxpayer would have desired a different commercial outcome from the scheme entered into and carried out if they were unable to enter into or carry out the scheme. It is possible that the taxpayer's rejection of an alternative at the relevant time for being second best is actually good evidence that the taxpayer would have adopted that alternative had they not entered into or carried out the scheme.

c. The longevity of Part IVA audits could have the effect that relevant documents may be lost to the passage of time. Perhaps we can only remind our clients about the advantage to them to contemporaneously record the steps leading up to their transaction structuring and retain those documents.

3. Refresher on the principles

7 Part IVA turns on 3 key factual issues; (1) the scheme, (2) the counterfactual, (3) dominant purpose.

3.1 The scheme

8 Modern Part IVA cases rarely turn on a dispute about the proper articulation of the scheme.

9 The definition of “scheme” encompasses not only a series of steps which together can be said to constitute a “scheme” or a “plan” but also (by its reference to “action” in the singular) the taking of but one step. There is no requirement that a scheme have some commercial or other coherence: *Commissioner of Taxation (Cth) v Hart* (2004) 217 CLR 216 at 238 [47] per Gummow and Hayne JJ. It is a common occurrence that the Commissioner will articulate more than one scheme, typically referred to as the “wider” scheme and the “narrower” scheme. And the taxpayer has practically no input into the scheme definition.

10 However, that does not mean that the articulation of the scheme is uninteresting.

11 First, whilst a wider or narrower approach may be taken to the identification of a scheme, it cannot be an approach which divorces the scheme from the tax benefit: *Hart* at 226 [9] per Gleeson CJ and McHugh J. Although it might be regarded as a rather uncommon situation for the taxpayer and the Commissioner to find that the scheme (or schemes) articulated by the Commissioner does not contain a tax benefit. So perhaps this point has little practical consequence.

12 Second, the dominant purpose analysis turns on the attribution of an imputed purpose to a person, or one of the persons, who entered into or carried out the scheme or any part of the scheme having regard to the 8 exhaustive factors in s 177D(2). The point to be made is that the objective purpose that may be attributed to a person will be informed by how the Commissioner articulates the scheme. And, in this context, it is worth noting the suggestion by Hely J in the Full Federal Court that the more the scheme can be confined to the essential elements by which the tax benefit is obtained, the more likely it will be that the conclusion will be drawn that the dominant

purpose for a person entering into a scheme so defined was to obtain a tax benefit.[2] Whilst on appeal in the High Court, Gummow and Hayne JJ questioned whether or not Hely J's observations may be a universally true proposition[3] it is likely to at least reflect practical reality for the ordinary case.

3.2 The tax benefit

3.2.1 Generally

13 Section 177F enables the Commissioner to cancel a tax benefit which has been obtained in connection with a scheme.

14 The various tax benefits that may be liable to cancellation are described in s 177F. The most common are s 177F(1)(a) ("an amount not being included in the assessable income of the taxpayer…") and s 177F(1)(b) ("a deduction being allowable to the taxpayer…").

15 Set out more fulsomely, s 177F(1)(a) provides:

> (1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:
>
> (a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out; or

16 And s 177F(1)(b) provides:

> (1) Subject to this section, a reference in this Part to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:
>
> …
>
> (b) a deduction being allowable to the taxpayer in relation to a year of income where the whole or a part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in

[2] *Hart v Commissioner of Taxation* (2002) 121 FCR 206 at 231[85].
[3] *Hart* at 240 [54].

relation to that year of income if the scheme had not been entered into or carried out; or

17 The reference to "would have been" and "would not have been" "if the scheme had not been entered into or carried out" is a reference to what is commonly referred to as the counterfactual or the alternative postulate. The tax benefit is therefore measured by reference to what circumstances would have instead resulted had the taxpayer not entered into or carried out the scheme.

3.2.2 Old Part IVA, New Part IVA and the taking into account of tax consequences of the counterfactual

18 The principles applicable for constructing the counterfactual, and therefore identifying the tax benefit, depends on whether the scheme was entered into or carried out before or after 15 November 2012.[4]

19 "Old Part IVA" governs in relation to schemes entered into or carried out before 15 November 2012. Under old Part IVA the Australian tax cost of the implementation of a transaction was an objective consideration to be taken into account in determining the reasonableness and reliability of the alternate postulate. The tax consequences of implementing the alternate postulate might objectively be shown to be such that the potential cost could call into question the reliability of the prediction that the alternative was reasonable: *RCI Pty Ltd v Federal Commissioner of Taxation* (2011) 84 ATR 785 at 844 [136] and 846-848 [141]-[150] per Edmonds, Gilmour and Logan JJ; *Commissioner of Taxation (Cth) v Peabody* (1994) 181 CLR 359 at 385-6 per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ; see also *Federal Commissioner of Taxation v Guardian AIT Pty Ltd* [2023] FCAFC 3 at 353 [168] per Hespe J.

20 "New Part IVA" governs in relation to schemes entered into or carried out after 15 November 2012. Section 177CB was introduced to reverse the effect of the decision in *RCI* as follows:

> (1) This section applies to deciding, under section 177C, whether any of the following (***tax effects***) would have occurred, or might reasonably be expected to have occurred, if a scheme had not been entered into or carried out:

[4] *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth), sch 3, item 10.

> …
>
> (2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).
>
> (3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.
>
> (4) In determining for the purposes of subsection (3) whether a postulate is such a reasonable alternative:
>
> (a) have particular regard to:
>
> (i) the substance of the scheme; and
>
> (ii) any result or consequence for the taxpayer that is or would be achieved by the scheme (other than a result in relation to the operation of this Act); but
>
> (b) disregard any result in relation to the operation of this Act that would be achieved by the postulate for any person (whether or not a party to the scheme).

21 Section 177CB(4)(b) requires therefore that the tax consequences of implementing the alternate postulate be disregarded in assessing whether the alternative postulate is a reasonable alternative to entering into or carrying out the scheme.

3.2.3 Other principles applicable to identifying the tax benefit

22 The question of whether or not a taxpayer obtained a tax benefit in relation to a scheme is one of fact, to be determined objectively: *Peabody* at 382 per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ; *Hart* at 232-3 [37] per Gummow and Hayne JJ; *RCI* at 842 [127] per Edmonds, Gilmour and Logan JJ; *Federal Commissioner of Taxation v Lenzo* (2008) 167 FCR 255 at 227 [119] per Sackville J citing *FCT v Mochkin* (2003) 127 FCR 185 at 194 [26] per Sackville J; *FCT v AXA Asia Pacific Holdings Ltd* (2010) 189 FCR 204 at 237 [126] per Edmonds and Gordon JJ; *Commissioner of Taxation v Ashwick (Qld) No 127 Pty Ltd* (2011) 192 FCR 325 at 371 [153(2)] per Edmonds J.

23 Section 177C requires the Court to predict the events that would have or might reasonably have expected to have taken place in the absence of the scheme:

Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd (2010) 186 FCR 410 at 422 [47] per Dowsett and Gordon JJ; *AXA* at 238 [131] per Edmonds and Gordon JJ. A reasonable expectation requires something more than a mere possibility: *Peabody* at 385-6 per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ; *Lenzo* at 278 [122] per Sackville J.

24 It has been suggested that evidence given by a taxpayer that they would not have undertaken a particular activity, or adopted a particular course, in lieu of the scheme is unlikely to be sufficient to discharge the onus unless it is supported by objective indicia to be gleaned from the context and matrix of underlying or “foundation” facts: *RCI* at 844 [134] per Edmonds, Gilmour and Logan JJ. This doubt as to the probative value of evidence of the taxpayer’s subjective intention appears to echo the caution expressed by Fullagar J in *Pascoe v Commissioner of Taxation* (1956) 30 ALJR 402 at 403 that statements of purpose, object or state of mind must be ‘tested most closely, and received with the greatest caution’.[5] Relevantly, in *McCutcheon v Federal Commissioner of Taxation* (2008) 168 FCR 149, Greenwood J suggested (at 163-4 [37]-[39]) that a deponent in seeking to demonstrate (and discharge the onus of proof) that an assessment is excessive having regard to a prediction as to whether an amount might reasonably have been included in the assessable income of the taxpayer, can not simply give evidence that the answer is to be found in the deponent speculating as to what he or she would or would not have done in the absence of the scheme (citing *WD & HO Wills (Australia) Pty Ltd v FCT* (1996) 65 FCR 298).

25 The taxpayer’s rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme: *Ashwick* at 372-3 [153(12)] per Edmonds J. We return to this proposition later.

26 Finally, the alternative postulate must not itself be a scheme to which Part IVA applies: *Hart v Commissioner of Taxation* (2018) 261 FCR 406 at 445-446 [94]-[96] per Robertson, Wigney and Steward JJ; *Futuris Corporation Ltd v Federal Commissioner of Taxation* (2010) 80 ATR 330 at 356 [113] per Besanko J. I prefer not to see this as a freestanding proposition about what is or is not a permissible counterfactual. Rather the conceptual basis of this point is probably that if a taxpayer were to erect a counterfactual would qualify as a scheme to which Part IVA applies,

[5] See also more recently *Konebada Pty Ltd ATF the William Lewski Family Trust v Commissioner of Taxation* [2023] FCA 257 at [30] per Hespe J (appeal dismissed: *Konebada Pty Ltd ATF the William Lewski Family Trust v Commissioner of Taxation* [2024] FCAFC 42).

then it “might reasonably be expected” (to use the language in s 177C) that the Commissioner would make a determination pursuant to s 177F to cancel that tax benefit with the result that a comparison of the scheme to the counterfactual would produce a tax benefit because the tax consequence of the counterfactual being compared is modified by the surrogate application of Part IVA.

4. Challenging the counterfactual

Showing that the Commissioner's counterfactual is unreasonable does not necessarily discharge the onus of proof

27 The taxpayer bears the onus of proving that an assessment is excessive: s 14ZZO(b) of the *Taxation Administration Act 1953* (Cth). It follows that it is the taxpayer who bears the onus to establish that amended assessment issued by the Commissioner in purported cancellation of the tax benefit is excessive, including by establishing that there is no tax benefit or by establishing that it is less than that determined by the Commissioner: *Trail Bros* at 420 [35]-[36] per Dowsett and Gordon JJ, Edmonds J agreeing at 426 [62]; *AXA* at 238 [134] per Edmonds and Gordon JJ, Dowsett J agreeing at 206 [1].

28 However, merely showing that the Commissioner's counterfactual is unreasonable will not necessarily follow that he has established that the assessment is excessive.

29 In *RCI* at 843 [130], the Full Court (Edmonds, Gilmour and Logan JJ) in a joint judgment explained:

> Even if a taxpayer establishes that the Commissioner's counterfactual is unreasonable, it will not necessarily follow that he has established that the assessment is excessive. That is because the issue is not whether the Commissioner puts forward a reasonable counterfactual or not; it is a question of the court determining objectively, and on all of the evidence, including inferences open on the evidence, as well as the apparent logic of events, what would have or might reasonably be expected to have occurred if the scheme had not been entered into. Thus, even if a taxpayer establishes that the Commissioner's counterfactual is unreasonable, that will not discharge the onus the taxpayer carries if the court determines that the taxpayer would have or might reasonably be expected to have done something which gave rise to the same tax benefit.

30 Equally, their Honours also emphasised at 843 [131] that a tax benefit is not proven merely because Commissioner's counterfactual is demonstrated to be reasonable because even if the Commissioner's counterfactual is demonstrated to be reasonable the Court may still find, on all the evidence, inferences and logic referred to, that if the scheme had not been entered into the taxpayer would have or might reasonably be expected to have done something which did not give rise to a tax benefit, or which

gave rise to a tax benefit less than that thrown up by the Commissioner's counterfactual.

31 And so there are examples where the taxpayer does not erect an alternative counterfactual. *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* (2024) 302 FCR 52 is a recent example of that: see 61 [48]. And so is *Merchant v Commissioner of Taxation* [2024] FCA 498: see [243]-[244].

4.1 It remains possible however in reconstruction cases to show that all counterfactuals are unreasonable (a lesson from PepsiCo)

32 Although showing that the Commissioner's counterfactual is unreasonable does not necessarily discharge the onus of proof, *PepsiCo Inc v Federal Commissioner of Taxation* (2024) 303 FCR 1; [2024] FCAFC 86 is a useful reminder that, in a case where the Commissioner relies on the "might reasonably be expected to have occurred" limb (s 177CB(3)), then it may still be possible for a taxpayer to discharge their onus of proof if by showing that there is no reasonable postulate for the purposes of s 177CB(3): 20 [68]. Although not expressly stated in *PepsiCo*, I would imagine that if the Commissioner relies on an "annihilation" counterfactual (s 177CB(2)) then it is not to the point that the "events or circumstances that actually happened or existed" sans the scheme would be unreasonable (for s 177CB(2), unlike s 177CB(3), is not conditioned on the remaining postulate being reasonable).

33 And in *PepsiCo*, the taxpayer was able to show that there was no reasonable postulate as an alternative to the scheme.

34 One of the issues in was whether or not PepsiCo, Inc ("PepsiCo") and Stokely-Van Camp, Inc ("SVC") should be liable to pay diverted profits tax in respect of what the Commissioner contended was an embedded royalty payable by a local distributor (the "Bottler") to a PepsiCo/SVC subsidiary (the Seller), which was said to be embedded in prices paid by the Bottler for drinks concentrate purchased from the Seller. The payments made by the Bottler to the Seller for drinks concentrates were contemplated to be made under exclusive bottling agreements between, inter alia, PepsiCo/SVC and the Bottler described in the judgment as "EBAs". The EBAs determined the price at which the concentrates were to be purchased but they did not make any provision

for the payment by the Bottler of a royalty for its use of PepsiCo's trade marks or other intellectual property.

35 At the risk of oversimplification, the Commissioner's case was to assert that the economic substance of the arrangement was one in which the Bottler acquired both goods, drinks concentrate, and rights in the nature of licences to use intellectual property, for the payment of an undivided lump sum: 7 [14]. As the Commissioner submitted, if there were no embedded royalty, then it would entail that the right granted to the Bottler to use the relevant trade marks and intellectual property would have been given in effect for nothing: 7 [15].

36 The Court rejected the Commissioner's submission that the rights granted to the Bottler to use the relevant trade marks and intellectual property were given in effect for nothing: 7-8 [17]. Also at the risk of oversimplification, part of the non cash bargain was that the Bottler had obligations to distribute PepsiCo and SVC's beverages in Australia in a manner that enhanced the goodwill of the PepsiCo and SVC brand: 8 [19].

37 The Commissioner's primary case was that the embedded royalty was liable to royalty withholding tax, in the ordinary manner, pursuant to s 128B(2B) but if the result of the arrangement between PepsiCo/SVC and the Bottler was to avoid the payment of a royalty from the Bottler to PepsiCo/SVC then the diverted profits tax regime in Part IVA should apply.

38 It is a convenient time to make an observation here about the expert evidence in *PepsiCo* (and Perram and Jackman JJ's observations about the state of the evidence – or the inadequacies with the Commissioner's evidence – generally). Each party led valuation evidence about the price of the hypothetical royalty that might have been charged between PepsiCo/SVC and the Bottler: 15 [49]. But Perram and Jackman JJ, without being unkind, expressed some doubt about the relevance of that evidence. As their Honours observed at 15 [50], the experts were instructed to assume that the concentrate price included a royalty component but there was no evidence before the Court that this assumption was correct. That would make the evidence, plainly, irrelevant. The Honour's observed at 15 [50] that evidence of that kind, that the concentrate price included a royalty component, would have required a detailed analysis of the economics of the EBAs and its relationship with the concentrate price.

Their Honours explained that establishing that the licence of the intellectual property was valuable is only half of the necessary inquiry. The missing other half involves the concentrate price and all of the other burdens and benefits flowing from the EBAs: 15 [51].

39 And, for good measure, again at 22 [83]:

> We do not say that a case could not be imagined in which a concentrate price did, as a matter of commercial and economic substance, include a royalty. However, we do not see how this can be done without engaging in an analysis of the economics of the EBA. These economic questions are likely to be influenced not only by the value of the intellectual property involved but also by the other benefits and burdens flowing from the relevant EBA. As we have explained when dealing with the royalty withholding tax issue, it is not the case that PepsiCo derived no benefit from the grant of the licence to use the intellectual property. The determination of the extent of benefits of that kind is likely to involve at least an examination of the extent of the goodwill attaching to the relevant marks and PepsiCo's market share in Australia in relation to the brands in question. Given the complexity of the bargain expressed in the EBA, there may well be many other relevant considerations.

40 In hindsight, unremarkable and not unkind comments. If there were to be a novel lesson learned here, then it may be that one should be vigilant to ask not what are the express assumptions but also consider what *implied* assumptions your case, or your expert evidence, depends on.

41 Returning though to how the evidence affected the manner in which the Court assessed the counterfactual. The relevant tax benefit said to have been obtained was the one described in s 177CB(1)(bc): the taxpayer not being liable to pay withholding tax on an amount where the taxpayer either would have, or might reasonably be expected to have, been liable to pay withholding tax on the amount if the scheme had not been entered into or carried out. The Commissioner's 2 counterfactuals were that:

> (a) the relevant EBA would or might reasonably be expected to have expressed the payments to be made by [Bottler] to be for all of the property provided by (and promises made by) the PepsiCo Group entities (rather than for concentrate only); or
>
> (b) the relevant EBA would or might reasonably be expected to have expressly provided for the payments to be made by [Bottler] to include a royalty for the use of, or the right to use, the relevant trademarks and other intellectual property (whether or not the amount of the royalty was specified).

42 Perram and Jackson JJ's conclusion in relation to the reasonableness of the Commissioner's counterfactuals is expressed at 25 [98]-[99]. Simply if the scheme included elements from which it could be inferred as a matter of commercial and economic substance that the payments for concentrate included a royalty then it might well be obvious that in the absence of the scheme PepsiCo would have sought to recoup the value of that royalty. But where the evidence does not permit the conclusion to be drawn that the concentrate price included a royalty, the Commissioner's counterfactuals are not reasonable alternatives to the scheme. And while the taxpayer remained bound to prove that the assessments to diverted profits tax are excessive, meaning that it bore the burden not only of showing that the Commissioner's postulates are not reasonable alternatives but also that there are no reasonable alternative postulates, Perram and Jackson JJ found at 25 [100] that the only postulates which can bring the payments to tax are ones in which the Bottler's payments for concentrate can be seen as being made in part for the grant of intellectual property rights. But the evidence did not permit the drawing of that conclusion.

43 But the more common method of challenging the tax benefit element of Part IVA is to show that, had the scheme not been entered or carried out, the taxpayer would have embarked on a course of events that would have nonetheless not resulted in the derivation of assessable income, or resulted in being allowed a deduction or some other outcome consistent with avoiding the tax consequences which the Commissioner seeks to visit upon the taxpayer by the making of a s 177F determination. It is to those methods that we now turn.

4.2 Guardian: a case study

The facts

44 In *Guardian*, the taxpayer was successful at first instance in respect of both the s 177C and s 177D questions.

45 The substance of the Commissioner's complaint in *Guardian* was that a non resident natural person, Mr Springer, was able to obtain the benefit of unfranked income of a trust (AIT) at a 30% corporate tax rate instead of at a 45% marginal tax rate applicable to non residents.

46 The gist of the scheme entered into was: (1) the trustee ("GAIT") distribute trust income to a corporate beneficiary ("AITCS"), (2) AITCS, as a beneficiary not under any legal disability with a present entitlement to the income of the trust estate, pay income tax at the corporate rate pursuant to s 97 of the *Income Tax Assessment Act 1936* (Cth), (3) GAIT distribute 30% of the trust income to AITCS to enable AITCS to pay its income tax, (4) AITCS declare a fully franked dividend equal to the balance of the unpaid present entitlement, (5) GAIT and AITCS set off AITCS's debt to GAIT (the dividend) and GAIT's debt to AITCS (the balance of the unpaid present entitlement), (6) in the next year, GAIT distribute the franked dividends, streamed, to Mr Springer a non resident beneficiary, (7) as the dividend is fully franked, the 30% corporate tax is the final tax paid and no further withholding tax or income tax is payable by Mr Springer.

47 The Commissioner assessed Mr Springer on the basis that had the scheme not been entered into or carried out, Mr Springer would or might reasonably be expected to have had included in his assessable income the net income of AIT that had otherwise been included in AITCS's assessable income. And Mr Springer would have been liable to tax at the 45% marginal rate. In other words, the tax benefit was the amount of assessable income diverted from Mr Springer to AITCS.

48 At first instance, Mr Springer satisfied the court that the Commissioner's counterfactual was "against all reason": see *Guardian* at 347 [140]. The primary judge found that had the scheme not been entered into or carried out, AITCS would have received and retained its trust distribution in cash or if the present entitlement was to remain unpaid, AITCS would have entered into a Division 7A compliant loan agreement with GAIT. The Division 7A issue arose because of an interpretation of Taxation Ruling 2010/3 which risked unpaid present entitlements owing by a trustee to a corporate beneficiary being subject to Division 7A: see *Guardian* at 327 [48]. It would seem that Taxation Ruling 2010/3 was a wonderfully productive ruling for Part IVA, for it also occasioned the scheme the subject of *Ierna v Commissioner of Taxation* [2024] FCA 592.

49 The Commissioner succeeded in overturning the primary judge's findings in respect of s 177C on appeal.

50 As Hespe J observed at 351 [157], Mr Springer bore the onus of satisfying the Court of what might reasonably be expected to have occurred in the absence of the scheme. This required Mr Springer to satisfy the Court that, in the absence of the scheme, he would not have received a direct distribution of unfranked income from the AIT, and what might reasonably be expected to have occurred instead.

Lessons from Guardian

51 For present purposes, there are at least 3 matters worth discussing.

52 First, Hespe J observed that to the extent that Mr Springer's counterfactual relied on a Division 7A loan from AITCS to GAIT, that would have seen AITCS retain an asset (in the form of the Division 7A loan) under the counterfactual whereas under the scheme Mr Springer directly owned the asset (the franked dividends): *Guardian* at 352 [163]. Her Honour referred to evidence given by Mr Springer that he was uncomfortable with money being in a bank account over which Mr Springer did not then have control: *Guardian* at 352 [163]. Hespe J then made an observation at 352 [163] that:

> A prediction that has a different commercial outcome from the scheme entered into and carried out is not readily accepted as reliable.

53 Second, Hespe J noted that "the very commercial outcome which would result from an investment or loan agreement by AITCS was in fact rejected by Mr Springer when he proposed the payment of a dividend by AITCS" and that "the taxpayer's rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme", citing *Ashwick* at 372–3 [153(12)] per Edmonds J: *Guardian* at 352 [164].

54 For what it is worth, s 177CB(4)(a) notwithstanding, I would regard both the proposition that "a prediction that has a different commercial outcome from the scheme entered into and carried out is not readily accepted as reliable" and "the taxpayer's rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme" as "lore" rather than "law".

55 Perram and Jackson JJ's reasoning process in *Pepsico* made express reference to the 2 limbs in 177CB(4)(a) and their method of assessing the reasonableness of the counterfactual was rather "s 177CB(4)(a) heavy": 20-23 [71]-[89]. But s 177CB(4)(a)

requires one to "have particular regard to" the substance of the scheme and any result or consequence for the taxpayer that is or would be achieved by the scheme. Whilst giving effect to the natural connotation of the words "have particular regard to" suggests that greater weight (of an unquantified magnitude) might be given to the express factors, the statute does not make them determinative.

56 So my point is that I would regard the propositions that "a prediction that has a different commercial outcome from the scheme entered into and carried out is not readily accepted as reliable" and "the taxpayer's rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme" as observations as to frequently reliable assumptions about human decision making. But they will not always be assumptions that hold true.

57 For example, I would argue that the adage "a prediction that has a different commercial outcome from the scheme entered into and carried out is not readily accepted as reliable" would usually only hold true if the taxpayer had a single commercial outcome. To give an arbitrary example, a minority shareholder may either wish to execute a takeover of the company or be bought out and the in the abstract, to sell the whole of one's shares in a company or to buy the whole company might be considered apparently inconsistent commercial objectives. But it is also not beyond the realm of possibility that a shareholder may either want to control the whole company or else liquidate their investment and move on. Perhaps one could suggest that selling a minority interest or successfully executing a takeover are actually consistent commercial outcomes when expressed with a higher degree of abstraction – the maximisation of value from your shareholding in the subject company.

58 So returning to the topic of this session, it may be worth asking whether your alternative counterfactual achieves the same or a different commercial outcome, and if a different commercial outcome, what basis is there to explain why that alternative commercial outcome was one which is consistent with a commercial outcome expressed with a higher degree of abstraction or otherwise was seriously in contemplation at the time.

59 And as to the proposition "the taxpayer's rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme", we will return to that when we come to discuss *Mylan*.

60 Third, Mr Springer sought to lead evidence from his accountant to the effect that that a competent adviser would not advise that the AIT *unfranked* income be distributed to Mr Springer: *Guardian* at 353 [167]. This was because whilst Mr Springer was a non-resident, that income would have been taxed at the highest marginal tax rate, whereas franked income would be received by Mr Springer without additional Australian tax payable.

61 Such an argument in relation to schemes entered into or carried out after 15 November 2012 would be foreclosed by s 177CB. As Hespe J explained at 354 [174], by reason of s 177CB(4)(b), it was not open to the primary judge to have regard to the higher Australian income tax cost that would have applied had the income been distributed directly to Mr Springer in determining what might reasonably be expected to have happened had the 2013 related scheme not been entered into or carried out.

62 Of course, s 177CB(4)(b) in its literal expression requires that the court or tribunal engaging in the fact finding mission "disregard any result in relation to the operation of [the 1936 Act and 1997 Act]". So a taxpayer could not argue that they would not have entered into or carried out the counterfactual advanced by the Commissioner by reason of adverse tax outcomes (thus prohibiting the argument in *RCI*). But it would seem that it would not be open to a court or tribunal to take into account any result in relation to the operation of the taxation law indirectly either. What I mean by indirectly might be illustrated better with a hypothetical. Suppose the taxpayer could procure a finding that they would have unquestionably followed the recommendation of their accountant or lawyer. And the accountant or lawyer then gives evidence that had the taxpayer elected not to enter into or carry out the scheme, then they would have recommended an alternative scheme and said nothing more about the reasons why. In those circumstances, the taxpayer is not leading evidence about the Australian tax cost of their counterfactual in support of the contention that their counterfactual is a more reasonable alternative to the scheme. It is peculiar that s 177CB(4)(b) read literally might mean that the "admissibility" of evidence given by an accountant or lawyer advising the taxpayer about the alternative recommendation would turn on whether the accountant or lawyer expressed their reasons for their recommendation.[6]

[6] Arguably the evidence is not admissible for the purposes of s 55 of the *Evidence Act 1995* (Cth) because the evidence must be disregarded for the sole purpose for which was sought to be led.

4.3 Mylan: a case study

Summary

63 *Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 2)* [2024] FCA 253 is an example of where the taxpayer was able to show an alternative counterfactual to the Commissioner's which would have produced a smaller tax benefit (although the precise amount of the tax benefit was not required to be worked out by reason of the taxpayer's success in relation to dominant purpose).

64 Relevantly, in a deduction case, if it may be predicted that, had the scheme not been entered into, the taxpayer would have done something which would have given rise to an allowable deduction in an equivalent amount, and if that prediction is sufficiently reliable to be regarded as reasonable, there will be no tax benefit: *CPH Property Pty Ltd v FCT* (1998) 88 FCR 21 at 42.

65 This was the principle that *Mylan* sought to invoke; that had it not obtained the interest deductions under the scheme, it would have obtained interest deductions of at least the same amount under the alternative postulate.

4.3.1 The facts in Mylan

66 *Mylan* concerned deductions arising out intercompany debt funding in connection with the acquisition by Mylan Inc and its subsidiaries ("Mylan Group") of the generics pharmaceuticals business owned by Merck KgaA on 2 October 2007.

67 Immediately prior to the acquisition, the generics pharmaceuticals business carried on by Merck KgaA in Australia was conducted by a locally incorporated company, Alphapharm Pty Ltd ("Alphapharm"). Alphapharm was held by an intermediate Merck KgaA subsidiary known as "MGGBV". The transaction involved Mylan Inc and a Luxembourg subsidiary of Mylan Inc known as "Lux 5" borrowing a significant amount of money to effect the acquisition under a facility known as the "SCA".

68 It was in this context that the Mylan Group came to incorporate local intermediate holding companies, Mylan Australia Pty Ltd ("MAPL") and Mylan Australia Holdings Pty Ltd ("MAHPL").

69 MAPL would come to acquire Alphapharm by supplying to MGGBV a promissory note known as “PN Lux 1” equal to the value of Alphapharm. MAPL acquired PN Lux 1 from a Mylan Group entity known as “Lux 1”. To acquire PN Lux 1, MAPL issued to Lux 1, 2 intercompany notes known as PN A1 and PN A2. PN A1 was set at 25% of the value of Alphapharm and PN A2 was set at 75% of the value of Alphapharm. PN A1 was retired shortly after 2 October 2007 and only PN A2 survived as MAPL’s remaining debt obligation. The overall effect of the transaction was that MAPL borrowed 75% of the value of Alphapharm to acquire Alphapharm. The PN A2 bore interest, subsequently fixed at 10.15 per cent per annum for 7 years. This aspect of the acquisition, permitting the spin off of Alphapharm to MAPL (and the spin off of Merck KgaA’s local Canadian and French subsidiaries) before the acquisition by the Mylan Group of the balance of the Merck KgaA target companies, arose out of an amendment to the share purchase agreement originally struck between Mylan Inc and Merck KgaA. However, the overall purchase price to Merck KgaA remained the same. The purchase price was able to remain the same because the value of MGGBV stayed the same even after it sold Alphapharm, because MGGBV held PN Lux 1. Instead of Mylan Inc indirectly acquiring Alphapharm by acquiring MGGBV, Mylan Inc acquired MGGBV which held PN Lux 1.

70 In the events that occurred, MAHPL was entitled to deductions for interest incurred by MAPL in respect of PN A2. Mylan Inc was entitled to deductions for interest in the US incurred on the SCA. MAPL’s interest obligations were capitalised on PN A2 with the effect that, in the events that occurred, there was no payment of interest by cash by MAPL to the intercompany lender and no repatriation of cash into the US.

71 The Commissioner’s contention was recorded in *Mylan* at [444] as follows:

> The point that the Commissioner sought to make was that the change in the structure of the Acquisition facilitated the creation of intercompany financing arrangements that (on his view) duplicated a portion of the external debt with internal debt. In short, the point was that Mylan was still paying the same price to Merck and it (and Lux 5) were still borrowing the same amount from the external lenders under the SCA, but, instead of a portion of the external debt being borne by MAPL (and so reducing the amount of external debt borne by Mylan and Lux 5), that external debt remained unchanged and an *additional* intercompany debt was created. The Commissioner emphasised that this arrangement did not result in any additional cash resources being made available.

72 And further, as recorded in *Mylan* at [465], it was common ground that the quantum of debt that Mylan planned for MAPL to assume in connection with the acquisition of Alphapharm corresponded with the thin capitalisation limits then in place in Australia.

73 And because of Mylan Inc's anticipated US tax profile following the acquisition, it was not expected to be able to obtain a credit in the US for taxes paid in Australia because it would have been in "overall foreign loss" ("OFL") position under the Internal Revenue Code. Every dollar of Australian tax paid is one dollar more in the overall US and Australian tax paid by Mylan Inc on Alphapharm's profits and every dollar of Australian tax paid is one dollar saved on Mylan Inc's overall US and Australian tax paid on Alphapharm's profits. Mylan Inc's tax profile was found to "independently … support a commercial decision to have MAPL take on more, rather than less, debt" in Australia: *Mylan* at [467].

4.3.2 The dispute about the tax benefit in Mylan

74 As recorded in *Mylan* at [223], the Commissioner's primary counterfactual in *Mylan* posited that:

> (a) there would have been no incorporation of new Australian entities MAHPL and MAPL;
>
> (b) there would have been no amendment to the original SPA to nominate or substitute MAPL as purchaser of the shares in Alphapharm from MGGBV;
>
> (c) Alphapharm would have joined the Mylan group as a result of the acquisition of MGGBV for cash consideration payable by Lux 2; and
>
> (d) there would have been no issuance of PN Lux 1, PN A1, PN A2 and PN A4.

75 The reference to "PN A4" is a reference to an intercompany note which refinanced PN A2.

76 Effectively, the Commissioner's primary counterfactual in *Mylan* was to cancel the whole of the interest deductions on the intercompany debt borrowed by MAPL to acquire Alphapharm.

77 In the alternative the Commissioner pleaded 2 alternative counterfactuals, referred to as the secondary and tertiary counterfactuals. They are described in *Mylan* at [225]-

[226]. The substance of the secondary and tertiary counterfactuals were that, instead of MAPL borrowing 75% of the value of Alphapharm and financing the balance of the acquisition with equity, MAPL would borrow a lesser amount such that the debt to equity ratio of the financing was less than 3:1. This would have the effect that the tax benefit would be a part of the interest deductions that had been claimed by MAHPL on the intercompany debt borrowed by MAPL to acquire Alphapharm.

78 The taxpayer also erected 2 counterfactuals, recorded in *Mylan* at [227]:

> (a) Counterfactual A — that MAPL might be expected to have funded the acquisition of Alphapharm using 25% equity injected by its parent and 75% debt borrowed from Mylan (or a US subsidiary, rather than Lux 1) on the same, or similar, terms as those set out in PN A2.
>
> (b) Counterfactual B — that MAPL might be expected to have funded the acquisition of Alphapharm using 25% equity injected by its parent and 75% debt borrowed from an external lender or lenders.

79 In other words, one element of the taxpayer's challenge to the Commissioner's amended assessment was to attempt to show that had the scheme not been entered into, the taxpayer would have done something which would have given rise to an allowable deduction in an equivalent amount.

80 Perhaps a demonstration *par excellence* of the proposition that the question of whether or not a taxpayer obtained a tax benefit in relation to a scheme is one of fact, to be determined objectively and that s 177C requires the Court to predict the events that would have or might reasonably have expected to have taken place in the absence of the scheme, Button J held at [297] that it was open to the court to consider counterfactuals that depart from the precise bounds of the counterfactuals put up by the parties and at [394] articulated a "preferred counterfactual" that was a variant on the MAHPL's counterfactual B and the Commissioner's tertiary counterfactual.

81 The key elements of Button J's "preferred counterfactual" was an external borrowing of AUD 785,329,802.60 (the AUD equivalent of 75% of the provisional estimated value of Alphapharm at time of the transaction), guaranteed by Mylan Inc (and so at an interest rate referable to Mylan Inc's credit rating from time to time), but at floating rates instead of a fixed rate at 10.15 per cent per annum for 7 years. In light of Button J's conclusion as to dominant purpose, it was not necessary for the Court or for the parties to work out the quantum of the tax benefit by comparing the interest

deductions actually obtained under the scheme and the interest deductions that would have been allowable under the preferred counterfactual. But it would have been reasonable to expect that under the preferred counterfactual, the size of the tax benefit would have been smaller than the tax benefit cancelled by the Commissioner, being in large part the additional interest attributable to the differential between a fixed rate at 10.15 per cent per annum for 7 years and the prevailing floating rate.

4.3.3 Lessons from Mylan

82 There are probably four lessons worth noting from *Mylan*.

83 First, the volume of evidence adduced by the taxpayer in order to support its counterfactual. Recall that in *Guardian* the taxpayer was able to rely in large part on affidavit evidence from Mr Springer and his accountant, the taxpayer in *Mylan* tendered a substantial number of documents at trial. The impression from reading *Mylan* at [52] to *Mylan* at [175] was that the taxpayer adduced evidence which could tend to establish the step by step decision making process of the Mylan Group from the first making of its bid for Merck KgaA's generics pharmaceuticals business on 6 March 2007 to the close of the transaction on 2 October 2007. And then it also led evidence as to post acquisition steps, at least until 31 December 2008 (see *Mylan* at [176] to *Mylan* at [209]). And this voluminous lay evidence was supported by expert evidence including in the disciplines of US tax law (*Mylan* at [18]), financial markets and corporate treasury (*Mylan* at [20]).

84 That is an unsurprising decision for the taxpayer to have made. Recall that its forensic challenge was to satisfy the court that had it not entered into or carried out the scheme, it would have nonetheless entered into or carried out some other transaction structure which would have resulted in the taxpayer incurring the same interest expense.

85 In the course of its lay evidence, the taxpayer in *Mylan* sought to lay before the court all the "foundational facts" which would set the commercial objectives, and the parameters in which those objectives could be met, so that the Court could put itself in the taxpayer's position and effectively construct the most likely "second best" option.

86 But in assisting the Court step into the Mylan Group's shoes, it was also necessary for the taxpayer to lead expert evidence to assist the Court in understanding the various

consequences of the choices that were presented to the Court, as to debt versus equity, gearing ratios, fixed and floating interest rates, swaps and other hedging instruments and the like.

87 Thus the taxpayer also led evidence from a US tax expert to explain, for example, the operation of the “OFL” rules which would have resulted in the inability to credit taxes paid in Australia and double taxation for the Mylan Group in the US: *Mylan* at [556]. Which formed part of the taxpayer’s case as to why it could be expected that there would be local country borrowing and local country borrowing at the gearing ratio under the scheme and in the counterfactual. And the taxpayer’s evidence from their financial markets expert and corporate treasury expert substantiated the premise that alternative funding sources, as a feature of the taxpayer’s counterfactual, were available to the taxpayer in the ordinary course of business and so would have been available under the alternative postulate.

88 Second, the “preferred counterfactual” found by Button J was a variant of an external borrowing option that had been considered and rejected by the Mylan Group. *Mylan* is an illustration that the proposition which fell from Edmonds J in *Ashwick* at 372-3 [153(12)], that the taxpayer’s rejection of an alternative at the relevant time is important evidence in determining what would have occurred in the absence of the scheme, does not always apply to disqualify a rejected counterfactual. Arguably it was precisely because an external borrowing option had been available, but rejected for being suboptimal, that it made it more likely that had the scheme not been entered into or carried out, the taxpayer would have adopted the “second best” option. Thus when considering how *Ashwick* applies to any particular case, one should also ask the reason why a particular alternative had been rejected. Evidence of rejection for being inconsistent with the taxpayer’s objectives and evidence of rejection for being suboptimal compared to the scheme that had been entered into or carried out, carries with it very different evidentiary consequences.

89 Third, *Mylan* may demonstrate the degree of the particularity that might be required from a counterfactual deduction case. Whereas in an income tax benefit case, the taxpayer’s counterfactual is usually that they would have taken alternative steps and not derived the income in any event, in a counterfactual deduction case, it is likely that the taxpayer will not satisfy the burden of proving their assessment is excessive without being able to show the amount of the counterfactual deduction.

90 In *Mylan* at [303] Button J identified 5 factual matters that required resolution in order to determine the amount of the tax benefit (or that there had not been any tax benefit). Although those paragraphs should not be treated as setting out any principle of law, I would venture the following observations:

a. As to [303(a)], it appears fair to conclude that a taxpayer could not show that, had the scheme not been entered into or carried out, it would have borrowed money under some alternative scheme, if the taxpayer could not proffer a lender or at least a market in which the taxpayer could have borrowed money,

b. As to [303(b)], the taxpayer should be able to be specific about the principal amount of the counterfactual loan to enable calculation of the counterfactual interest over the relevant period,

c. As to [303(c)], the taxpayer should be able to be specific about the interest rate for the counterfactual loan to enable calculation of the counterfactual interest over the relevant period,

d. As to [303(d)] and [303(e)], the taxpayer has the onus of proving any other term material to working out the calculation of the counterfactual interest over the relevant period.

91 Fourth, *Mylan* is a reminder that although the question of whether or not a taxpayer obtained a tax benefit in relation to a scheme is one of fact, to be determined objectively, it is permissible, subject now to s 177CB(4), to take into account the subjective intentions, indeed, idiosyncrasies of the taxpayer. Much was made by the Commissioner in his argument about dominant purpose that the taxpayer geared up to the maximum permitted under the thin capitalisation safe harbour ratios: see *Mylan* at [313]. But that same evidence supported the taxpayer's case that in any other counterfactual borrowing, they would have still borrowed up to the thin capitalisation safe harbour ratio: see *Mylan* at [312]. There is now an interesting question as to whether s 177CB(4)(b) now requires that no tax related objective is now permitted to be taken into account in determining the most likely counterfactual.

4.4 A quick point about Ierna

92 Perhaps I am giving insufficient respect to *Ierna v Commissioner of Taxation* [2024] FCA 592 by mentioning it in summary form, but it should be noted that s 177CB(4)(b) worked to the Commissioner's disadvantage because the negative tax consequence arising from the taxpayer's loss of pre-CGT status in certain units in a unit trust was disregarded when determining whether the taxpayer's alternative postulate, which would have involved the disposal of pre-CGT assets, was a reasonable one. See *Ierna* at [229]-[230].

5. A general statement of the principles in relation to the dominant purpose analysis

93 Section 177D(1) requires an assessment of dominant purpose as follows:

> This Part applies to a scheme if it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of:
>
> (a) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit in connection with the scheme; or
>
> (b) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit in connection with the scheme;
>
> whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers.

94 Section 177D(2) stipulates the 8 exhaustive factors that are required to be taken into account when making an assessment as to the dominant purpose that could be imputed to a person who entered into or carried out a scheme or part of the scheme:

> (2) For the purpose of subsection (1), have regard to the following matters:
>
> (b) the manner in which the scheme was entered into or carried out;
>
> (b) the form and substance of the scheme;
>
> (c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
>
> (d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
>
> (e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
>
> (f) any change in the financial position of any person who has, or 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;
>
> (g) 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;

(h) 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).

95 It is said that the s 177D inquiry is to be answered by having regard to the eight matters set out in that section and that those matters are posited as objective facts: *Peabody* at 382 per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ.

96 Section 177D does not permit any inquiry into the subjective motives or state of mind of any person. The s 177D inquiry is not concerned with the actual purpose of a party to a scheme. It requires a conclusion to be drawn about an objectively ascertained intention: *Commissioner of Taxation v News Australia Holdings Pty Ltd* (2010) 89 ATR 461 at 472 [30] per Stone, Jessup and Jagot JJ.

97 In considering the s 177D matters, it may be appropriate and necessary to have regard to the possibilities that existed outside of the scheme entered into or carried out. The various alternatives that were in fact considered may cast light on the conclusion to be drawn from the application of a particular s 177D matter: *Hart* at 244 [69] per Gummow and Hayne JJ; *Spotless Services Ltd v Federal Commissioner of Taxation* (1996) 186 CLR 404 at 422 per Brennan CJ, Dawson, Toohey, Gaudron, Gummow and Kirby JJ; *Federal Commissioner of Taxation v Macquarie Bank Ltd* (2013) 210 FCR 164 at 223-4 [210]-[211] per Middleton and Robertson JJ. Although not expressly articulated any of the 8 enumerated factors (perhaps it is implied in “manner”), that would seem to be an obvious matter to take into account. Arguably, if there were no other possibilities for the taxpayer but to enter into or carry out the scheme in order to achieve an objective other than obtaining a tax benefit, it could be hardly said that the scheme had been entered into or carried out for the dominant purpose of obtaining the tax benefit.

98 The eight matters listed in s 177D(2) is not required to be analysed individually provided they are taken into account; a “global assessment of purpose” is permissible: *Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235 at 263 [94] per Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ.

6. Recent developments in the case law on dominant purpose

Guadian: a case study

99 There are 2 interesting points to take about dominant purpose from *Guardian*.

100 The first was the observation at 356 [188] by Hespe J that there is a danger in using hindsight to reach a conclusion about purpose that is not objectively apparent when the circumstances are considered as an evolving chronology. Perhaps it is fair to generalise the statement even further that there is a danger in using hindsight to reach a conclusion about dominant purpose. We will return to this hindsight issue in *Mylan*.

101 The second is how this hindsight issue produced a result in which the Court found that the scheme which had been entered into or carried out in the 2012 year had not been entered into or carried out by the taxpayer for the dominant purpose of obtaining a tax benefit, but a materially identical scheme which had been entered into or carried out in the 2013 year was one which had been entered into or carried out by the taxpayer for the dominant purpose of obtaining a tax benefit.

102 My gloss on this part of the judgment, at 356-357 [189]-[192] is that the explanation for why AITCS declared a dividend which became payable to GAIT (being the critical step of turning unfranked trust income into franked dividends that could be streamed to Mr Springer) was because Mr Springer had by some point before 30 June 2012 decided that he was no longer comfortable with accumulating a cash balance in AITCS's bank account (over which he had no control) and wished to distribute that cash to himself. Thus the declaration of a dividend was a natural method of lawfully drawing the cash balance from AITCS's bank account back to the trust, which could then distribute that trust income to him. But that same excuse could not explain why GAIT appointed trust income to AITCS and AITCS declared a dividend back to GAIT. Having expressed his discomfort with accumulating a cash balance in AITCS's bank account, there was no reason, other than a tax reason, why trust income should first be appointed to AITCS before it found its way into Mr Springer's hands.

103 Often s 177D(2)(a) (manner and form) invites considerable focus. That is unsurprising because often the other factors do not invite extensive evidence. For example, s 177D(2)(h) which calls for consideration of the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer can be dealt with by mere recital that the participants to the scheme are related parties or unrelated parties.

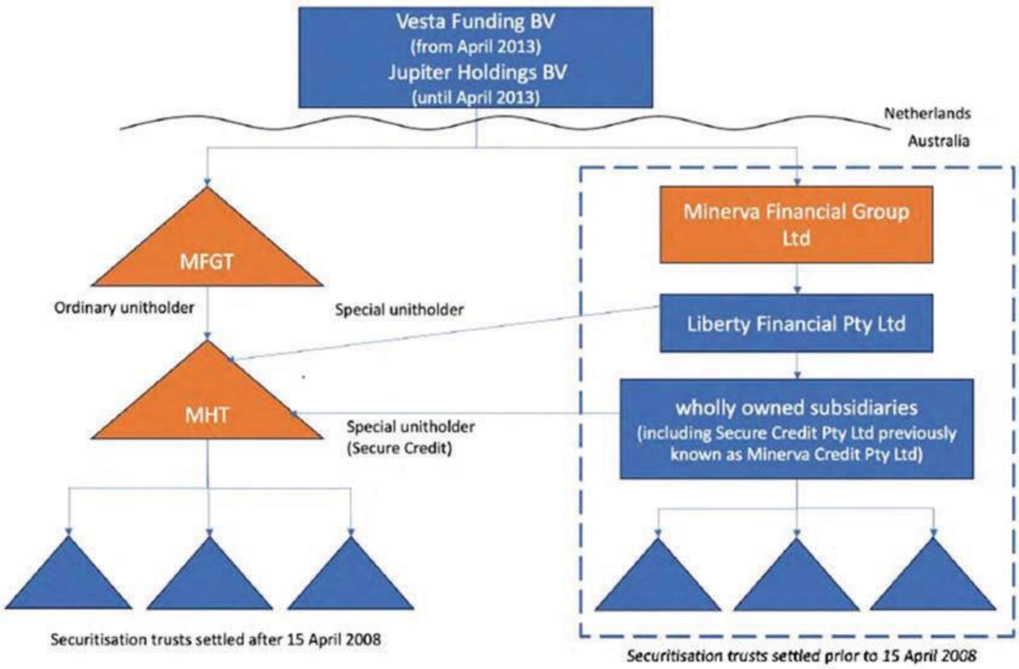
104 Returning to the theme about impact of the strength (or otherwise) of the evidence on a Part IVA position, *Guardian* illustrates the utility of simply leading evidence about the whole of the facts and circumstances leading up to the entering and carrying out of the scheme because that may permit a finding that the scheme had been entered into or carried out to solve some pre-existing non tax problem. Although that is probably not necessarily a point that needs to be separately borne in the mind because it goes part and parcel with preparing the highest and best evidence in a counterfactual case.

6.1 Minerva: a case study

105 *Minerva Financial Group Pty Ltd v Federal Commissioner of Taxation* (2024) 302 FCR 52; [2024] FCAFC 28 contains the latest restatement at an intermediate appellate level as to the principles that apply to the finding as to dominant purpose in Part IVA. There is a restatement of 12 principles set out at 65-67 [60].

106 In colloquial terms, *Minerva* concerned an allegation by the Commissioner that the taxpayer entered into a Part IVA scheme which had the effect of diverting Australian source income from an Australian resident subsidiary taxpayer, Liberty Financial Pty Ltd (“Liberty Financial”), to foreign resident tax advantaged entities Jupiter Holdings BV and Vesta Funding BV (together, “Jupiter/ Vesta”). That had the result that income which would have otherwise been liable to tax at the 30% corporate rate to an Australian resident company had been liable to tax only at the 10% withholding tax rate: *Minerva* at 57 [29].

107 A structure diagram of the corporate group after a restructure is set out below (taken from *Minerva* at 56 [18]):



108 By way of background, the taxpayer was a member of the Liberty Group of companies and trusts that provided non-bank financial services. As explained in *Minerva* at 54 [6], as a "non-bank" provider of financial services, the Liberty group obtained its funds to make loans by securitising its loan receivables and related securities. The securitisation process involved the establishment of special purpose securitisation trusts. The trustee of the securitisation trusts issued notes to third party noteholders and units to a related entity in the form of a residual income unit ("RIU") and a residual capital unit ("RCU"). The holder of the RIU was entitled to receive the balance of the income of the securitisation trust remaining after interest was paid to the noteholders (and other expenses paid) and the holder of the RCU was entitled to receive the balance of any capital of the securitisation trust after the repayment of principal to the noteholders and any other financiers.

109 Prior to 2007 Liberty Financial was the holder of RIUs and RCUs in the Liberty Group. That is, prior to 2007, Liberty Financial was the beneficial owner of the economic profits made by the Liberty Group's financial services business in Australia.

110 In 2007, in anticipation of an initial public offering, the Liberty Group commenced a restructure: *Minerva* at 55 [9]. As part of this restructure:

a. A unit trust, the Minerva Financial Group Trust ("MFGT"), was established with units held by Minerva Financial Group Ltd ("Minerva Financial"). These units were eventually transferred to Jupiter/Vesta.

b. Another unit trust, the Minerva Holding Trust ("MHT"), was established. MFGT held ordinary units in MHT. MHT's other unitholders (referred to as "special unitholders") were Liberty Financial and Minerva Credit Pty Ltd. Minerva Financial was the trustee of the MHT.

c. MHT became the holder of RIUs and RCUs in new securitisation trusts settled by the Liberty Group.

111 As a result of the restructure the economic profits of the new securitisation trusts would, absent the exercise of discretion by Minerva Financial was the trustee of the MHT to distribute profits to the special unitholders, flow to the MFGT which would then flow to Jupiter/Vesta. If Minerva Financial as the trustee of the MHT determined instead to distribute profits to the special unitholders, that would approximate the pre restructure outcome where Liberty Financial would have received the economic profits of the Liberty Group's financial services business in Australia.

112 The Commissioner relied on 3 schemes on appeal (which can be described as the "second scheme", "third scheme" and "fourth scheme", the "first scheme" was not pressed). The second scheme comprised of the steps that (1) resulted in Jupiter becoming entitled to all of the units in MFGT, (2) the non-exercise of the discretion of the trustee of MHT to make distributions to the special unitholders and (3) the lending by MHT of the amounts it received as distributions on the RIUs to Liberty Financial. The third scheme comprised of the comprised of (1) the choice by Minerva Financial as trustee of MHT to not exercise its discretion to distribute any more than a nominal amount of MHT's distributable income to the special unitholders and the lending by MHT of the amounts it received as distributions on the RIUs to Liberty Financial. The fourth scheme consisted only of Minerva Financial's non-exercise of discretion as the trustee of MHT to make distributions to the special unitholders.

113 It is pertinent first to observe that the primary judge found, and the Commissioner did not challenge on appeal, that the restructure was undertaken for the dominant purpose of facilitating an initial public offering of stapled securities: *Minerva* at 70 [82].

114 Picking up the discussion about s 177D(2)(a) manner and form, *Minerva* again emphasises the utility of leading evidence about the whole of the facts and circumstances leading up to the entering and carrying out of the scheme in order to facilitate a finding that the scheme had been entered into or carried out to solve some pre-existing non tax problem. It is difficult to avoid the impression that once it was found that the restructure was undertaken for the dominant purpose of facilitating an initial public offering of stapled securities, the complaints by the Commissioner that trust discretions had not been exercised to restore the tax outcome to the pre-restructure position had lost some force. That may have been the impression sought to be subtly conveyed in *Minerva* at 70 [80]:

> The contextual matters relied upon by the Commissioner essentially seek to draw upon a diversion from the pre-restructure course of conduct to assert that the manner in which the schemes were carried out supported a conclusion that a party carried out each of the schemes for the dominant purpose of enabling the taxpayer to obtain a tax benefit.

115 And less subtly again at 71 [85]:

> As has been explained, to conclude that a party entered into or carried out a scheme for the requisite dominant purpose, it is not sufficient to show that the taxpayer would have paid more tax if something different had been done. The trustee paid distributions in accordance with the terms of issue of the ordinary notes and the trust constitution. None of the contextual matters relied upon by the Commissioner cast any different light on the manner in which the scheme was entered into.

116 Other than counselling the utility of the leading evidence about the whole of the facts and circumstances leading up to the entering and carrying out of the scheme for the purposes of revealing the pre-existing non tax problem that the scheme was intended to solve, *Minerva* also illustrates the assistance that can be provided by a witness with a corporate finance or corporate governance discipline. We will return to that in *Mylan* save to observe in summary form that evidence about centralisation of treasury and cash management (see *Minerva* at 72 [89]) has the capacity to defuse allegations by the Commissioner about circularity of cash flows.

6.2 Mylan: a case study

117 I might suggest 3 things to take from *Mylan* about dominant purpose.

118 The first is a bit of a subtle one. Whilst any rational and well resourced taxpayer would run an alternative counterfactual case (where available) in tandem with a dominant purpose case, *Mylan* presents a reminder that even if the alternative counterfactual case does not reduce the tax benefit to NIL, a lower tax benefit may indirectly show that the whole of the assessment is excessive because it casts doubt that the dominant purpose of entering into or carrying out that scheme was to obtain *that* tax benefit.

119 In *Mylan* at [453] Button J set out the reminder:

> In this regard, it is important not to lose sight of the tax benefit in question. The tax benefit is the difference between the tax deductions claimed under the schemes and the tax deductions that would have been (or would reasonably be expected to have been) allowable on the preferred counterfactual. It is the assumption of debt by MAPL that results in *some* tax deductions being allowed for interest on borrowings.

120 My gloss is that there is a good reason why s 177C precedes s 177D. It is only after having worked out the most probable counterfactual that one can ask whether a person entered into or carried out the scheme in order to get *that* tax benefit. And where the tax benefit under the taxpayer's counterfactual is substantially lower than the one advanced by the Commissioner, the question is whether the scheme had been entered into or carried out for the dominant purpose of obtaining that incremental benefit.

121 The second is an observation about a less subtle point, which is the use to which the large volume of expert evidence had been put by both sides in the case. The taxpayer and the Commissioner each had a United States tax law expert. The taxpayer and the Commissioner each had a capital markets expert. And the taxpayer also had an expert with a corporate treasury discipline.

122 At a high level of abstraction, the taxpayer's dominant purpose case in *Mylan* was simple. Recall that the Commissioner alleged that the scheme had been entered into or carried out for the dominant purpose of creating deductible interest in Australia payable to an intermediate holding company in Bermuda (in circumstances where otherwise the Australian subsidiaries would have been wholly equity funded). The

taxpayer's case was that the intercompany debt instruments facilitated repatriation of cash from Australia to the Mylan Group in the United States, which was necessary to enable the United States borrowers to service the extraordinary amount of debt borrowed to finance the acquisition of Merck KgaA's generics pharmaceuticals business owned.

123 Fairly, the Court found that the Mylan Group expected to rely on cash generated by the newly acquired Australian subsidiary to service the significant external debt borrowed by Mylan Inc and Lux 5 to acquire the Merck KgaA generic pharmaceuticals business: *Mylan* at [265], [288], [438]. Extensive evidence was led by the taxpayer about the benefits of debt over equity: *Mylan* at [254]-[255]. This evidence enabled the Court to find that an internal borrowing would have been simpler than an external borrowing and an intra-group borrowing would inherently be more flexible than an external borrowing: *Mylan* at [326]. The Court also found that repatriation of cash by means of dividends alone, by contrast with repatriation facilitated by intra-group financing, would have been more complex (requiring resolutions at each stage up the corporate chain, and possibly also constrained by limits on when and how often dividends could be paid, or restrictions relating to the payment of dividends from profits): *Mylan* at [438].

124 Evidence of this nature has the capacity to diffuse what Gordon J described in *Noza Holdings Pty Ltd v Federal Commissioner of Taxation* (2011) 82 ATR 338 at [315] as intercompany arrangements which could "excite the closest attention to the possible application of Pt IVA".

125 Thus the conclusion arrived at by Button J in *Mylan* at [446].

126 I suggested earlier that we would return also to the (impermissible) use of hindsight to inform the dominant purpose analysis. The way that this issue presented itself in *Mylan* was that PN A2 had originally been struck as a floating rate debt instrument but it was subsequently and retrospectively amended to bear a fixed rate. It is not necessary to discuss the retrospectivity element in any great detail because the Court found that the retrospective decision to fix the interest rate had been committed to near contemporaneously (*Mylan* at [492]). But expert evidence had been led as to why no adverse inference can be drawn from the mere decision to elect fixed rates over floating rates. See *Mylan* at [376] and [479]. The point recorded in *Mylan* at

[376] was an endorsement of a “fixed-floating equivalence”, by which the deep and liquid swap market ensures that, on a particular day, there is no arbitrage opportunity in the market by picking fixed over floating, or vice versa. And the reasoning in *Mylan* at [479] reveals the utility of expert evidence in proving corporate governance principles, including, for example, how fixed rate intercompany loans facilitate the management of interest rate risk centrally at a group treasury level (a matter which would otherwise not be expected to be within the scope of permissible judicial notice pursuant to s 144 of the *Evidence Act 1995* (Cth)). I mention this first as a species of the rejection of hindsight reasoning and second to illustrate the potential utility of expert evidence.

127 Another purpose for which expert evidence was led was about the operation of the “overall foreign loss” (“OFL”) rules in the Internal Revenue Code of the United States. The point being made by the taxpayer, by the use of expert evidence, was that had they not entered into or carried out the scheme, they would have suffered double taxation. The issue was described in *Mylan* at [158] as follows:

> Mylan also had (and expected that it would continue to have) an “Overall Foreign Loss” (OFL) in the US. An OFL is a US tax law concept that limits the availability of foreign tax credits (FTCs) to be applied against taxable US income. At the time of the Acquisition, Mylan was in an unfavourable OFL position which was expected to limit its ability to claim FTCs in future taxable years. The effect of this was that dividends or other payments from the earnings of the acquired subsidiaries for the benefit of the US parent were expected to be subject to US tax at the rate of 35% with no, or no full, credit for foreign taxes paid.

128 The substance of the evidence given by the taxpayer’s US law expert was set out in table form in *Mylan* at [291]. The table sets out the overall tax burden on the Mylan Group with increasing interest expenses. So that I do not set out the whole table, a functional description is as follows. There are 3 capital structure alternatives in 2 universes. The 2 universes are a “with no OFL” universe and a “with OFL” universe.

129 In alternative 1 with NIL interest expense, there is 30 cents in the dollar of Australian corporate income tax. In alternative 2 with interest at 50% of EBIT, there is 15 cents in the dollar of Australian corporate income tax and 5 cents in the dollar of Australian withholding tax totalling 20 cents in the dollar of Australian taxes. In alternative 3

there is 7.5 cents in the dollar of Australian corporate income tax and 7.5 cents in the dollar of Australian withholding tax totalling 15 cents in the dollar of Australian taxes.

130 In the "with no OFL" situation, the "Permitted Foreign Tax Credits" amount is equal to the total amount of Australian tax paid. That is, all Australian taxes paid is fully creditable and the "Total U.S. and Foreign Taxes Paid" is equal to the US corporate tax rate at 35 cents in the dollar.

	Alternative 1 (100% equity funded)	**Alternative 2** (Partially equity and partially debt from U.S. CFC – Int Exp is 50% of EBIT	**Alternative 3** (Partially equity and partially debt from U.S. CFC – Int Exp is 75% of EBIT
With No OFL			
Permitted Foreign Tax Credits	30	20	15
Residual U.S. Tax Benefit (Liability)	(5)	(15)	(20)
Total U.S. and Foreign Taxes Paid	(35)	(35)	(35)
After Tax Earnings of Mylan	65	65	65

131 If Mylan Inc is in OFL situation then no foreign taxes are creditable. Therefore Mylan Inc pays 35 cents in the dollar to the US Government and no taxes paid to the Australian Government is creditable meaning that the Mylan Group's overall tax burden is the amount of the US tax paid and the amount of Australian tax paid.

	Alternative 1 (100% equity funded)	**Alternative 2** (Partially equity and partially debt from U.S. CFC – Int Exp is 50% of EBIT	**Alternative 3** (Partially equity and partially debt from U.S. CFC – Int Exp is 75% of EBIT
With OFL			
Permitted Foreign Tax Credits	–	–	–
Residual U.S. Tax Liability	(35)	(35)	(35)
Total U.S. and Foreign Taxes Paid	(65)	(55)	(50)
After Tax Earnings of Mylan	35	45	50

132 The Commissioner’s submissions were recorded in *Mylan* at [559] as follows:

> Against that background, the Commissioner accepted that it was economically rational for Mylan to seek to reduce its overall tax burden (given the inability to claim FTCs) but submitted that “[t]he reduction of Australian tax [by incorporating MAPL and having it borrow funds] was a response to Mylan being in an OFL position, which created the motivation to reduce non-US tax on foreign source income repatriated to Mylan”. In effect, the Commissioner’s submission was that the purpose of entry into the schemes was to address the consequences of Mylan’s OFL position by reducing the amount of tax paid in Australia (the rationale being, the less tax paid, the less the impact of an inability to claim FTCs).

133 That submission was rejected (see *Mylan* at [560]-[561]). It may be a controversial point as to whether a scheme which had been entered into or carried out for the dominant purpose of compensating a United States resident taxpayer for not being able to access foreign tax credits by paying less tax in Australia (and therefore reducing the amount of uncredited foreign taxes paid) could be characterised as a scheme that had been entered into or carried out for the dominant purpose of obtaining a tax benefit (in Australia). But it is a thought experiment that has either already been asked and answered or one which awaits a future case. And it would be interesting to consider how this argument may be run in a future case. Suppose that the foreign resident investor were in a jurisdiction which did not offer any unilateral relief in respect of double taxation. Such a taxpayer would be analogous to the “with OFL” situation in *Mylan* because the residence jurisdiction does not allow a credit for taxes to the Australian Government paid by their Australian resident subsidiary. How would such an argument be evaluated then?

134 Finally, I will briefly mention what may or may not be another controversial point, and that is the Commissioner’s submission recorded in *Mylan* at [466] that the Mylan Group’s “tracking of the thin capitalisation limits” indicated that MAPL took on a level of debt that was not driven by business considerations but driven by a desire to be loaded up with the maximum possible debt in order to obtain deductions in Australia. The taxpayer’s success in that regard might well be attributable to the evidence recorded in *Mylan* at [460]-[462]. Those paragraphs commence with Button J’s observation that:

> There was ample evidence to support MAHPL's contention that Mylan's target level of debt related to the Acquisition was approximately 75%.

135 And concluded with:

> The 3:1 gearing ratio that Mylan implemented for MAPL was also supported by the expert evidence of Mr Stack and Mr Ali that the funding structure, and the level of debt, were not excessive from a group treasury perspective, and constituted a reasonable funding mix that was broadly consistent with Mylan's anticipated funding mix for the Acquisition as a whole, reflecting Mylan's overall risk appetite.

136 At least on the facts of that case, the taxpayer had a basis to submit that there was a sound independent basis for gearing the Australian subsidiaries with 75% debt, which coincided with Australia's thin capitalisation safe harbour ratio at that time.

6.3 Merchant: a case study

137 I mention only briefly *Merchant v Commissioner of Taxation* [2024] FCA 498 to make a point about the weight that is given to contemporaneous documents in the s 177D(2)(a) analysis and to segue into a concluding point.

138 I had suggested earlier that of the 8 factors in s 177D(2) it tends to be subpara (a) that is given focus. And, I think is fair to suggest, it is in relation to manner and form that the taxpayer has the greatest capacity to lead evidence in support of their case (although there will always be exceptions; I can see an appropriate case in which expert evidence might illuminate, for example, form and substance).

139 The facts and outcome in *Merchant* can be shortly described. Mr Merchant founded Billabong Limited ("BBG"). Mr Merchant indirectly held a significant number of shares in BBG through the Merchant Family Trust ("MFT"). The MFT also held shares in Plantic Technologies Ltd ("Plantic"). Mr Merchant wished to divest MFT's investment in Plantic but the MFT was likely to realise a significant capital gain from a disposal of its Plantic shares. The Commissioner alleged that Mr Merchant entered into and carried out a scheme whereby the MFT sold its high cost base shares in BBG to the Gordon Merchant Superannuation Fund ("GMSF") to crystallise a capital loss which would then shelter the MFT's capital gains on the disposal of its shares in Plantic. Thawley J found that it would be concluded that the dominant purpose of Mr Merchant, MFT and GMSF was to obtain a tax benefit in the form of the capital losses on the sale of the BBG shares from the MFT to the GMSF (see *Merchant* at

[405]). Thawley J rejected the taxpayer's contention that the dominant purpose of the sale of BBG shares from MFT to GMSF was to provide funding to the MFT and found that, at best, such a purpose was a subsidiary purpose: *Merchant* at [407].

140 Thawley J set out the material findings of fact in *Merchant* at [406]-[407]. And as far as there may be useful metaphors in helping construct a case, I note Thawley J's reference to "the genesis of the BBG Share Sale…" in in *Merchant* at [407]. That is often a weighty factor in the s 177D(2)(a) analysis and the s 177D(2) analysis overall. It did not assist Mr Merchant that the contemporaneous evidence appeared to support findings that "it was EY that raised the idea of the MFT selling high cost BBG shares to GMSF in the context of the sale of Plantic": *Merchant* at [357]. It did not assist Mr Merchant that, although he had raised the possibility of releasing cash to the MFT by selling its BBG shares in December 2011 and July 2012, he had abandoned those plans without explanation (whether in affidavit or in the contemporaneous documents): *Merchant* at [358]. See also *Merchant* at [189]. Perhaps evidence had been lost to the passage of time, for the sale of the BBG shares occurred on 4 September 2014 (*Merchant* at [186]) and the matter first came on for hearing on 15 March 2024. This case is therefore presents a rather unexceptional illustration about the importance of contemporaneous documents to reveal the (tax or non tax) genesis of the scheme.

141 This segues into my final point.

7. The longevity of Part IVA audits

142 The last point that is worth making is to make an observation about the longevity of some Part IVA audits. Such an observation relates to the theme in that, in most cases, the passage of time is apt to affect the quality of any lay evidence available to the taxpayer.

143 I mentioned already the amount of time that had passed between the scheme in *Merchant* (4 September 2014) and the first hearing of the matter on 15 March 2024.

144 I also observed above that *Mylan* was an "Old Part IVA" case. By way of reminder, the transaction involved Mylan Inc's acquisition of Merck KgaA's generic pharmaceuticals business on 2 October 2007.[7] The Commissioner's investigation commenced in November 2009 and progressed to an audit in early August 2012.[8] Assessments were issued on 27 April 2021 for a 10 year period and a further assessment was issued on 28 February 2022 for a further year.[9]

145 In this case, the time between the first execution of the scheme, the tax benefit, assessment, objection, Part IVC appeal and final hearing was more than 16 years (between 2 October 2007 and final hearing on 9 October 2023).

146 Litigators frequently keep a reference to what fell from McLelland CJ in Eq in *Watson v Foxman* (1995) 49 NSWLR 315 at 319 in their toolbox. There his Honour observed:

> human memory of what was said in a conversation is fallible for a variety of reasons, and ordinarily the degree of fallibility increases with the passage of time, particularly where disputes or litigation intervene, and the processes of memory are overlaid, often subconsciously, by perceptions or self-interest as well as conscious consideration of what should have been said or could have been said. All too often what is actually remembered is little more than an impression from which plausible details are then, again often subconsciously, constructed. All this is a matter of ordinary human experience.

147 Perhaps that is another reason why evidence given by a taxpayer that they would not have undertaken a particular activity, or adopted a particular course, in lieu of the scheme is unlikely to be sufficient to discharge the onus unless it is supported by objective indicia to be gleaned from the context and matrix of underlying or

[7] Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 2) [2024] FCA 253 at 42
[8] *Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 1)* [2023] FCA 672 at [8]
[9] *Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 1)* [2023] FCA 672 at [9]

"foundation" facts: *RCI* at 844 [134] per Edmonds, Gilmour and Logan JJ. They may tend to use hindsight reasoning to rationalise what they would have done, or they may be more willing to hypothesise a decision attended with greater commercial risk than which they prospectively may have avoided.

148 But the risks attendant on relying on statements by a taxpayer as to what they would have done, without corroborating contemporaneous documents traverse no new ground.

149 But what happens when the passage of time results in the loss of documents?

150 In *Buzadzic v Commissioner of Taxation* [2024] FCAFC 50 Bromwich, Abraham and McEvoy JJ recorded a submission going to this point as follows:

> 25 Secondly, the record keeping and retention requirements imposed upon taxpayers accompanied the move to self-assessment of income tax many decades ago, such that receipts no longer had to be provided with income tax returns. Mr Buzadzic's argument, especially orally, was to the effect that, where the Commissioner is making an assessment relating to tax for an earlier period, and the person is no longer required under the tax legislation to retain records for that period, "*the burden of proof on the balance of probabilities needs to be adjusted to take into account that that record does not exist*". Mr Buzadzic's oral submissions seemed to argue that it was somehow not fair, or inconsistent with the retention periods in the relevant legislation, to require him to produce records for a period outside those retention periods in order to discharge the onus by establishing that certain impugned sums of money were not income. No proper basis was identified for why the requirement to retain such records for substantiation purposes would give rise to a relaxation of the quality of evidence necessary to discharge the onus of proving that an assessment is excessive, and what the correct assessed sum should be.
>
> 26 Of course, if a taxpayer were able to prove that records had been kept, but not retained after a retention period, so were not available to support the argument that a particular expense had been incurred, that might, in some cases, be a reason for the Tribunal to accept other evidence to the same effect in order to discharge the onus, as the Tribunal's reasons reproduced above tend to indicate. But that would be a matter for ordinary fact finding, bearing no resemblance to this case. That is simply a reflection of the fact that whether the onus is satisfied will depend on the circumstances of the case. Rather, Mr Buzadzic's argument seemed to be no more than that the passing of the point of time at which records were required to be retained meant that secondary accounting records should be accepted at face value. That proposition cannot be accepted, especially in light of the Tribunal's reasoning on this topic.

151 Of course, to the extent that documents can be retained, then there is no substitute for the tender of a contemporaneous document.

152 But what *Buzadzic* might facilitate is a court or tribunal being more willing to make findings of facts as to the probable contents of documents by drawing inferences from secondary evidence.

153 To give an arbitrary example, if a document recording commercial objectives and the relative weighing of commercial factors leading to the making of a commercial decision were created, but lost by the passage of time, that may well be a prime candidate for a relevant court or tribunal to accept secondary or indirect evidence about the contents of that document. But a taxpayer only gets there if they can prove that such a document had once existed.

154 Which is a rather indirect way for me to come to the main point. There is no substitute for the tender of a contemporaneous document and a contemporaneous document cannot come into existence without it being created. In *Mylan*, the great volume of contemporaneous business records supplied ample foundation for the Court to construct a counterfactual that was largely consistent with the taxpayer’s case having regard to the taxpayer’s contemporaneous commercial objectives and the parameters in which those decisions were required to be made. And so whether or not *Buzadzic* grants some reprieve for taxpayers who have lost documents to the passage of time, it is still recommended to make and maintain a record of the decision making process.

155 I appreciate that most of our clients are in the business of doing business and not in the business of documenting their business. But hopefully at least a well advised client may be reminded to record their commercial objectives, their priorities, or the reasons for rejecting certain options. That will avoid misunderstandings in the future about whether the taxpayer should be believed when erecting a counterfactual with a different commercial consequence (or which achieves a different commercial objective) to the scheme, or whether the taxpayer should be believed when the counterfactual is one which they rejected for being second best. And this will assist taxpayers in better revealing the genesis of the scheme (or, alternatively described, the non tax problem which the scheme was designed to solve), which tends to be a weighty consideration in whether it would be objectively concluded that the taxpayer (or another person) entered into or carried out the scheme for the dominant purpose of obtaining a tax benefit.

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