CONSEQUENCES OF ANTI-AVOIDANCE PROVISIONS FOR BANKERS

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Thank you Mr Chairman. The last time that I accepted an invitation to follow Neil Forsyth, I found the experience quite exhausting. That occasion, he may recall, was in Canberra when he invited me to follow him in a jog around Lake Burley Griffin, which I understand was at that time (and perhaps still is) to him an essential prerequisite of preparation for any appearance before the High Court. If I should run out of steam this afternoon, it will be because Neil has set quite a cracking pace, and has certainly covered a great deal of ground.

The title of this session, as he has indicated to you, lends itself essentially to two approaches. One is the very strict or literalist approach (to taxation matters, at least) which used to be favoured by the High Court in what some have called the "Barwick era". The other is the more liberal, "purposive" approach which is currently favoured by the court, which is my choice.

If I were to take the literal approach I would be obliged to confine myself to s.260 and Part IVA, they being the main, if not the only (strictly speaking) anti-avoidance provisions in the Act.

In referring to Part IVA in his synopsis (and briefly in his address to you) Mr Forsyth mentioned the irony that the famous, or infamous, s.260 which it replaced has had its ups and downs. It was thought to have been, in effect, buried by the High Court, and Part IVA was introduced to replace it. But later it emerged, Lazarus-like, to show that this replacement had been perhaps unnecessary, and indeed, that perhaps s.260 as currently interpreted, in the surprising number of cases that still come forward on s.260, has more bite than Part IVA.

Talking of the resurrection, I happened to be at the graveside when it occurred, having been counsel for two of the three doctors, in the cases which went before the High Court and where the High Court effectively announced that s.260 was, after all, not dead and buried as had been supposed, but very much alive. That simply reinforces the lesson - if reinforcement were needed

- that the law is not static, and that a watchful eye is needed to be kept, not only on statutes relevant to your particular area of interest, but also on court decisions and judicial trends in respect of the interpretation of statutes; although I must say that in the Gulland, Watson and Pincus cases of which I speak (see 85 ATC 4765) it was perhaps not so much a "trend" that emerged, but rather a fairly sharp swerve, leaving a few cases such as Cridland's Case (1977) 140 CLR 330, and others heavily relied upon in argument by the taxpayers (for the assertion that s.260 did not apply) not dead and buried but very much in, as it were, a cul de sac.

Bankers are affected, like any other taxpayer, by the anti-avoidance provisions if applied to transactions in which they are directly concerned. But, that aside, the interests of bankers may clearly be both directly and indirectly affected, by the effect on their customers of such provisions, as their operation may adversely affect the customers' ability to repay borrowings, as well as the securities given for those borrowings.

Artificial or sham transactions which do not pass the so-called "smell test" that Neil Forsyth has mentioned in his synopsis, may often require for their implementation the co-operation, and indeed assistance, of a banker. One of the most common instances, of which we would all be aware, are "round robins". For example, with the decreased corporate tax which has just been announced, taxpayers may decide to use "smart lawyers and accountants to cook up some scheme" to quote Mr Hawke's words of yesterday, which may be of doubtful validity. If the participants in such a scheme were to seek the assistance of a banker by using a bank cheque, for example, or seeking to have the issue of a bank cheque, the funds for which were to be provided by the last cheque and perhaps a chain of several cheques and exchanges of cheques, that last cheque in turn being dependent for its backing on the receipt of funds generated by the issue of the bank cheque in the exchange, then there may be dangers for the bank. I expect that most bankers, if not all, would at this stage be mindful of those dangers. One is that the issue of a bank cheque may be viewed as a temporary overdraft (a "daylight facility" as it is sometimes called) notwithstanding that the cheques may be exchanged in this round robin or series of exchanges, over a table at settlement and simultaneously. And regardless of the actual order, what is more, it may still be so regarded despite the actual order of posting to the various accounts involved. If the customer concerned in such a transaction were to be made bankrupt, or in the case of a company, put into liquidation, then clearly there is a risk that the repayment of the temporary overdraft, which might be seen to occur if the matter went before the court, would be construed as a preference. And when a tax avoidance arrangement is involved, then the possibility of the participant being made bankrupt, or put into liquidation, by the Commissioner certainly cannot be lightly dismissed.

An even greater danger, perhaps, is the possibility that the particular transaction, the artificial transaction, may not simply be an attempt to avoid tax, but also to ensure or secure that tax could not be collected if tax were to be assessed. For example, it may involve, as just one of many possibilities, the remitting of funds to an overseas tax haven as part of such an arrangement. The Crimes (Taxation Offences) Act makes it an offence for a person to enter into an arrangement or transaction for purposes which include the purpose of securing that a company or trustee will be unable, or will be likely to be unable, having regard to its other debts, to pay sales tax or income tax payable by that company or trustee, either presently or in the future. The accepted view of that (and incidentally I understand in talking to Mr Mills that there has been little prosecution activity in this area) is that the "purpose" required by this particular provision is a subjective one. However, if the result of a transaction were in fact to be an inability on the part of the company or trustee to pay, then the "subjective" purpose is likely to be inferred (as that is the only way one could approach it), from that fact alone. Moreover, the term "likely to be unable" adds a degree of uncertainty, suggesting that it may be sufficient if the purpose (or a purpose) were to be that the company or trustee would probably be unable to pay as distinct from would be unable to pay.

How does this affect a banker? Given the aiding and abetting provisions of this Act there must be a real concern for bankers, as of course, for lawyers and accountants who may be giving advice in this area. But even if the banker's advice as such were not sought, objectively viewed it may be that the banker's assistance whether by facilitating round robins or otherwise, in enabling the transaction to take place would be viewed as aiding and abetting. I strongly doubt whether in such a case a policy of "official blindness" (and Neil Forsyth has already mentioned this question of whether one enquires or does not enquire or is "put on enquiry") would in any way assist a banker. That is to say, if the objective facts in a particular transaction were that it had as its actual result, or even as its likely result, the inability of the company or trustee in question to pay tax, for the bank to have abstained from enquiry into the matter, where those objective facts suggested that to be the purpose, is unlikely to exculpate the bank from "aiding and abetting".

Section 7 of the Act refers to knowledge or belief that the arrangement or transaction will, or will be likely to, secure that a company or trustee will be unable to pay its tax. Sedulous refraining from inquiry where the facts may call, or even scream out, for inquiry may of itself in such a case give rise to an inference as to the knowledge or at least the belief of the banker. Of course, it is all very much a question of degree, and I am not for a moment suggesting that a banker is going to be held guilty of aiding and abetting every time that a transaction takes place involving a customer of the bank, which has the consequence that the customer is thereafter unable to pay its tax. The question in such cases will be whether the facts to some extent speak for themselves, so that knowledge or belief as to the purpose or the intended result might be inferred.

In the event that the customer actually states that the purpose of the proposed transaction is to ensure that if the Commissioner seeks to recover tax, the money will not be there, the banker obviously has but one course to follow - and that is to refuse to assist. Such a possibility (that is of the customer actually stating that purpose) is not as fanciful as it may sound. All kinds of transactions spring to mind. Take, for example, a case where a customer has an overdraft secured on his own, and perhaps his family's, assets, but is operating a company and/or a trust that could be made available as security for the overdraft but presently are not. Suppose the customer were to go to his banker and ask the bank to agree to a re-arrangement of the security, so as to free up the personal security presently charged to the bank, and to replace it with assets of the company or the trust, telling the banker (as the banker would usually inquire) that the reason for this is that he wants to be sure that if the Commissioner issues an assessment, he will not be able to "get at" the assets of the company because those assets will be charged to the bank. That is one possibility, as it seems to me, where the banker by agreeing to that "transaction" (re-arranging securities for an overdraft) could be guilty of aiding and abetting if the result were that the Commissioner could not get at those assets of the company for the purpose of satisfying an assessment.

Section 218 of the Income Tax Assessment Act is, in a sense, also an anti-avoidance provision: it assists the Commissioner in recovering tax. It is one of the many tools or methods of recovery open to the Commissioner. Mr Gough, in his paper this morning on automatic crystallisation, touched on this subject.

Section 218, and its counterpart in the Sales Tax Assessment Act, s.38, are provisions which permit the Commissioner, in short, to serve notice on any person from whom money is due or accruing or from whom money may become due or accrue etc. to a taxpayer or who holds or may subsequently hold money for or on account of the taxpayer and so on, and require that person to pay the money in his hands, or when it comes into his hands, to the Commissioner to the extent necessary to satisfy the taxpayer's assessment debt to the Commissioner. So, if A owes B a debt, and B receives an assessment for income tax or sales tax, the Commissioner may serve a s.218 or s.38 notice on A, requiring him to pay the debt directly to the Commissioner.

The section was considered by the High Court in <u>Clyne's Case</u> (1981) 150 CLR 1, in one of the many jousts between the late Dr Peter Clyne and the Commissioner. Five years later in <u>Norgard</u> v. <u>The Commissioner of Taxation</u> 86 ATC 4947, its mirror image, s.38 of the Sales Tax Act, was considered by the Full Court of the Supreme Court of Western Australia, with regard to its effect on a debenture given in favour of the Rural & Industries Bank of Western Australia over a taxpayer company's assets, the taxpayer being LAI (for short). The charge which was contained in the debenture was expressed to be a specific charge as regards certain specified assets (which included the present and future book debts of LAI). The debenture was to secure LAI's fluctuating overdraft with the bank, which was quite considerable, and it contained an automatic crystallisation clause of the type referred to by Mr Gough this morning, expressed to operate in a number of defined events including the appointment of a receiver.

The Commissioner issued quite massive sales tax assessments to LAI, totalling in excess of $17,000,000 based on his disallowance of what he considered to be an artificial tax avoidance scheme entered into by LAI. There were objections lodged by LAI to those assessments. The Commissioner, within two months, disallowed the objections and simultaneously issued notices to all of the debtors of LAI (of whom there were many and amounting to a very large amount) as well as sending such a notice to the bank. On the day following its receipt of the notice, the bank made demand on LAI for the amount of its debt, which was secured by the debenture; and within five minutes of the demand not being met the bank appointed a receiver and manager.

Timing was crucial and was seen to be so. The bank-appointed receivers and managers immediately sent notices to the various debtors, requiring payment of their debts to be made to the receivers, so the debtors, no doubt somewhat bemused, received notices from the Commissioner to pay him, followed in short order by notices from the receivers, requiring the debts to be made payable to them. A sensible arrangement was then reached between the receivers and the Commissioner, whereby the book debts, the total amount of them, were collected and held in a fund to abide the court's determination of the dispute between the Commissioner and the bank's receivers as to entitlement.

Despite the wording of the debenture, which as I mentioned referred to a specific charge over certain assets including book debts, the court held that the charge in respect of the book debts was not a fixed charge, but a floating charge, although Chief Justice Burt acknowledged the possibility, nonetheless, of the creation of a fixed or specific equitable charge on future book debts. The floating charge over the debts only became fixed or crystallised upon appointment of the receivers, as a result of the automatic crystallisation clause. In saying that, the Chief Justice noted the wide range of other events specified in the crystallisation clause which, according to the clause, could result in crystallisation, and raised a query (without pursuing it) whether all of those events would necessarily result in crystallisation, something which in some instances at least he thought would be, as he put it, both odd and inconvenient commercially. However it was not necessary for him to decide that point.

The appointment of the receiver (the only act of crystallisation considered) clearly did crystallise the charge. That meant that the Commissioner was entitled to payment of those debts where the debtors had received notice before the appointment of the receiver was made by the bank in priority to the bank; but in respect of those debts where the debtors had received notice after the time of appointment of the receiver, the Commissioner was not entitled to those debts, or he was only entitled to them subject to the bank's charge. Since the appointment was made, as noted in the judgment, at 11.35 a.m. on the day following the sending of the notices by the Commissioner, the result of that approach was an anxious check being made in respect of each town or suburb where various debtors lived, to determine at what time in the ordinary course of post their notices would have been served upon them, in the many cases where it was not possible, by enquiry from the debtors themselves, to find out when the notices had actually been received. The result of that, in turn, was a division being made between the bank (or the receivers acting for the bank) and the Commissioner, according to when, in the ordinary course of post, the Commissioner's notices would have been served on the debtors - a result which you may well also think to be rather odd as well as inconvenient commercially.

That decision was given in December 1986 and the High Court subsequently refused special leave, saying that the decision was consistent with the views it expressed in Clyne's Case, albeit obiter. In the following year, in May 1987, the Tricontinental decision, to which Mr Gough referred this morning, was given, being a decision of the Full Court of the Supreme Court of Queensland. The same approach, essentially, was taken by that court in respect of an interpretation of s.218 and notices given in relation to debts which were the subject of a floating charge to Tricontinental.

The views expressed by the court were that, prior to crystallisation (which meant prior to the appointment of receivers) the debenture holder had no proprietary interest even in equity, nor an equity entitling the debenture holder to possession.

What are the practical implications of all this for bankers? One suggestion was made this morning by Mr Gough. That was that the automatic crystallisation clause, when being drafted, be extended to cover such events as the chargor not filing its tax returns or not paying assessed tax. That may be helpful, depending upon the circumstances, but it is a solution which cannot necessarily be regarded as certain in view of the marked reluctance of the courts (as witness what the Chief Justice Sir Francis Burt said in Norgard's Case) to treat all events specified in an automatic crystallisation clause as necessarily resulting in crystallisation: that is not to say that the courts will not do so - but there is certainly some doubt on the matter.

As Mr Keane, I think, commented this morning when speaking to Mr Gough's paper, it would appear that the decision in New Zealand, Re Manurewa Transport is the only decision which actually supports an expansive view of automatic crystallisation clauses, in the sense of relying upon something other than the appointment of a receiver and manager. Furthermore, the two suggestions that I have mentioned, although obviously not intended to be exhaustive, would not cover the eventuality of the Commissioner issuing, as he did in the Tricontinental Case, notices under s.218 simultaneously with the assessments. Perhaps (on the assumption that automatic crystallisation clauses may be upheld by a court taking an expansive view) a provision which stated that an event giving rise to crystallisation would include the entry into of a tax avoidance scheme by the taxpayer or the customer, might assist - although one doubts whether many customers, or bankers for that matter, would be much enthused about such a provision; or perhaps if the Commissioner should post a notice pursuant to s.218 or s.38 - the service of the notice, not the posting of it, being what is said to result in the Commissioner's "statutory charge" (as it was put in Clyne's Case) over the debts. Even that could be overcome by the Commissioner not posting, but simply delivering, such notices personally. So care would need to be taken.

In my outline I have referred to some tax rulings in relation to s.218. There were three in succession. The first of those was calculated to cause confusion and doubt amongst those practising in the conveyancing area, because effectively it said that if there was a sale of property, and the Commissioner got wind of the sale and the vendor of the property happened to owe the Commissioner tax, then it would be open to the Commissioner to give a s.218 notice to the purchaser, requiring the purchaser to pay the total amount of the purchase price to the Commissioner and not to the vendor or a discharging mortgagee. Of course the effect of that would be that the sale could not go ahead; so that ruling was tempered by two subsequent rulings, the last being Ruling 2313, the effect of which is that the Commissioner agrees that a purchaser who receives such a notice is not bound to pay the money to the Commissioner and indeed, may pay it to a mortgagee, in discharge of any encumbrance that exists on the clear title that he, the purchaser, has bargained to get. So we seem to be in a state of at least semi-ease in that regard, although there is potential, I think, for further difficulty if the Commissioner were to rely heavily on s.218 notices in relation to conveyancing transactions in the future.

Since time is running out, may I just mention two further matters. One is the question of stamp duty. Income tax and sales tax are not the only areas that should be considered. There are provisions in various State Acts which may impose charges in respect of stamp duty, and bankers should be aware, in considering loan securities, of the possibility that such charges for stamp duty (which in some cases may be very great indeed) may be sufficient to defeat, or may defeat by reason of a statutory charge, the banker's own securities to the extent of the stamp duty charges.

I conclude by noting that tax avoidance has for some considerable time now been the subject of great debate in Parliament. I understand that, not long ago, one parliamentarian rose to complain indignantly that he had heard that a number of professionals (and I do not know whether bankers were included amongst them) were avoiding tax by not working as hard as they used to and hence deriving less assessable income. He suggested that legislation be passed, deeming such persons to be working full time unless they had a good commercial reason for not doing so! I hasten to say that, as far as I am aware, his proposal is not the subject of any pending Bill.