

Clash of the deeming provisions: pre–CGT concessions, tax consolidation and policy in the Federal Court

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Abstract

*The Federal Court of Australia in *Financial Synergy Holdings Pty Ltd v FCT* endeavoured to effectively reconcile complex and inconsistent deeming provisions in relation to capital gains tax (CGT) and tax consolidation. The interpretative approach that was adopted at first instance resolved the matter directly at hand, but also raised a number of problems that may not have been immediately apparent. In one view, these seemingly unforeseen complications would arise because of the special rules that govern tax consolidation, and might manifest themselves: (1) on the wholesale or*

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staggered disposal of membership interests in a subsidiary member by a consolidated group; and (2) in terms of the potentially narrow scope of the CGT concession created by the pre-CGT proportion provisions. This article therefore puts forward an alternative consideration of the interaction between the provisions at issue, an approach consistent with that adopted by the court on appeal and which addresses, to some extent, the problems that might be said to arise as a result of the approach that was accepted at trial.

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1. Introduction

The combined effect of the tax consolidation and capital gains tax (CGT) provisions appear to have eluded serious judicial scrutiny, at least until the relatively recent Federal Court judgments in *Financial Synergy Holdings Pty Ltd v FCT*.¹ The proper treatment of legislative provisions that appear to be in conflict can be a challenge that presents itself when it comes to the interpretation of statutes, and at issue in *Financial Synergy* was how potentially complex and inconsistent deeming provisions (provisions that are not unusual in modern tax and other legislation) should interact.

This article posits that the general reconciliation of the CGT and tax consolidation provisions that was provided by the court at first instance in *Financial Synergy* raises a number of problems that may not be immediately apparent. In one view, these seemingly unforeseen complications would arise because of the special rules that govern tax consolidation, and might manifest themselves: (1) on the wholesale or staggered disposal of membership interests in a subsidiary member by a consolidated group; and (2) in terms of the potentially narrow scope of the CGT concession created by the pre-CGT proportion provisions in the tax consolidation regime.

2. The material facts of Financial Synergy

In *Financial Synergy*, the taxpayer was engaged in the financial services industry and was the unitholder of a trust known as the Financial Synergy Unit Trust, a trust pursuant to which an actuarial business was conducted and which in its first incarnation was established by David Orford and William Szuch. The Commissioner accepted that 80% of the beneficial interest in the first incarnation of the trust was held by Mr Orford (as trustee of the Orford Family Trust)² and the remaining 20% by an entity controlled by Mr Szuch.³

The units that were created in the relevant trust were taken to have been issued to the former around June 1985 and to the latter around 1989.⁴ However, by 2007, all the units in the trust were held by the new trustee of the Orford Family Trust, Superannuation Systems (Aust) Pty Ltd. The units in the trust were then transferred to the taxpayer on 29 June 2007 in exchange for market value consideration of 30 million ordinary shares in the taxpayer paid to \$1 each, and Superannuation Systems as transferor of the units chose to obtain pre-CGT roll-over relief under Subdiv 122-A of the *Income*

1 [2015] FCA 53 (9 February 2015) (*Financial Synergy Trial*); [2016] FCAFC 31 (10 March 2016) (*Financial Synergy Appeal*) (generically, *Financial Synergy*).

2 *Financial Synergy Trial* at [8].

3 *Ibid.*

4 *Ibid.*

Tax Assessment Act 1997 (Cth) (ITAA97) in respect of the CGT event that happened upon the transfer of the units.⁵

On 1 July 2007, a consolidated group was formed with the taxpayer as the head company and with the unit trust comprising one of two or more consolidatable entities of the taxpayer as head company. Among other things, the formation of the group therefore required that the cost base of the units in the trust be ascertained in order to determine the relevant allocable cost amount for tax consolidation purposes.

3. All a matter of timing ...

The first step in working out the allocable cost amount for the purposes of s 705-60 ITAA97 is governed by s 705-65 ITAA97, which requires a determination of the cost base of the relevant CGT asset.⁶ Pursuant to s 110-25(2)(b) ITAA97, the first element of the cost base of the asset is taken to include:

“... the market value of any other property [namely, property other than money] you gave or were required to give, in respect of acquiring [the asset] (worked out as at the time of the acquisition).” (emphasis added)

As previously noted, the taxpayer actually obtained the relevant units in the trust on 29 June 2007. However, the transferor of the units chose to obtain pre-CGT roll-over relief under Subdiv 122-A in respect of the CGT event which occurred upon the transfer of its units to the taxpayer. Pertinently, s 122-70(3) ITAA97 provides that a company acquiring assets that are subject to such roll-over relief is taken to have acquired the relevant assets before 20 September 1985. The section states:

“If you [the transferor] acquired the asset before 20 September 1985, the [transferee] company is taken to have acquired it before that day.”

The pivotal issue highlighted in *Financial Synergy* was whether the relevant “time of the acquisition” by the taxpayer of the units in the Financial Synergy Unit Trust for the purposes of s 110-25(2)(b) was the date that the taxpayer *actually* acquired the units from the transferor, or the date that it was *deemed* to have acquired the units under s 122-70(3).⁷ Not surprisingly, the difference in the outcome between the application of these two approaches was material, being the difference between

5 Leaving aside the potential application of CGT event K6, the taxpayer could have chosen to disregard the roll-over and lose the pre-CGT status of the units but obtain (for the purposes of step 1) a market value cost base.

6 The term “cost base” as it appears in s 705-65(1) is defined by Div 995 ITAA97, which in turn takes the meaning of the term as given by Subdiv 110-A ITAA97. The general rules in relation to the cost base are set out in s 110-25 of Subdiv 110-A.

7 *Financial Synergy Appeal* at [1].

around \$1,600,000 (the approximate value of the actuarial business carried out pursuant to the trust prior to 20 September 1985) and \$30,000,000 (ie the 30 million ordinary shares in the taxpayer paid to \$1 each that were issued to the transferor in consideration for the units).⁸

4. The approach at first instance and on appeal

4.1 *Justice Pagone at trial*

Broadly, the trial judge concluded that s 122-70(3) operated in law to deem the units in the trust to have been acquired before 20 September 1985,⁹ and that the cost base of the units consequently should be determined at this time for the purposes of determining an allocable cost amount. Essentially, Pagone J reasoned that, whatever the (limited) purpose of s 122-70(3) might be:

- the ordinary and natural meaning of the phrase “as at the time of the acquisition” in s 110-25(2)(b) could encompass the time of “actual” acquisition and also the time of “deemed” acquisition under the Div 122 ITAA97 roll-over; and
- rejecting the submissions of the taxpayer, that there was no compelling reason to exclude the determination of the cost base of a CGT asset pursuant to s 110-25(2)(b) from the application of the express deeming provision in s 122-70(3). For instance, Pagone J observed that the provisions that govern the time of acquisition of CGT assets in Div 109 ITAA97 contemplate that an asset may be treated as having been acquired at some time other than its actual time of acquisition.¹⁰ By way of example, item 8 in the table in s 109-55 ITAA97 deals with the preservation of the pre-CGT status of a pre-CGT asset for a taxpayer obtaining a “same-asset roll-over” and also refers to the roll-over under Div 122.

Importantly, Pagone J held that setting the “time of the acquisition” in s 110-25(2)(b) as the time of the “deemed” acquisition under Div 122 would be consistent with the policy underlying the roll-over relief in Div 122 in respect of pre-CGT assets, namely to ensure “both that any capital gain arising from the CGT event would be disregarded and that any pre-CGT status of the asset would be preserved in the hands of the company acquiring the asset”.¹¹ His Honour also noted that the purpose of

8 Ibid at [2].

9 *Financial Synergy Trial* at [11], [18].

10 Ibid at [14].

11 Ibid at [11], although his Honour did not expressly refer to any of the extrinsic material which potentially could be considered under s 15AB(2) of the *Acts Interpretation Act 1901* (Cth) in reaching this view, or state why the factors set out in s 15AB(3) precluded consideration of this material under the circumstances of the case. A view of the proper role of policy in the interpretation of taxation legislation is set out in M Robertson, “The dangers of the ATO’s ‘policy intent’ approach to the construction of tax Acts” (2014) 43 *Australian Tax Review* 22.

s 110-25(2)(b) is to determine the value of property that is given for the acquisition of a CGT asset, and that the “time of acquisition” element of the section therefore serves the purpose of setting the relevant time at which the market value of the property in question is to be worked out.

Justice Pagone surmised that:¹²

“in this case (if not also in all cases), the CGT status of the units in question depends only upon their time of acquisition. ... It is, accordingly, a false dichotomy in this case to draw a distinction between the date of acquisition of assets and their CGT status. ... It would, furthermore, be curious if the taxpayer ... would be placed by the legislature in the position of being able to obtain a market value cost base for assets which have preserved their pre-CGT status yet also enjoy such benefits as are conferred by s 705-125 in working out the pre-CGT factor for assets of a joining entity. Section 705-125 is found in the consolidation regime and recognises the pre-CGT status of the membership interests of joining entities by allocating a pre-CGT factor *to the assets* of the joining entity.” (emphasis added)

4.2 *The Full Federal Court*

The decision at trial was overturned on appeal on somewhat limited grounds of statutory interpretation in a succinct judgment by Middleton, Logan and Davies JJ,¹³ with all three justices reaching the opposite conclusion to that of Pagone J. The plurality of Middleton and Davies JJ held that, as a matter of construction, the effect of s 110-25(2) (the roll-over deeming provision) did not qualify the operation of s 122-70(3) (the time of acquisition provision).¹⁴ Justice Logan helpfully accepted that the former section could be described as a “quantitative valuation provision”, and the latter characterised as a “qualitative provision”.¹⁵ In deciding in the way that it did, the Full Court of the Federal Court also implicitly yet effectively avoided a number of policy anomalies that would have manifested themselves in relation to the operation of the CGT and consolidation provisions under the approach adopted by Pagone J.

5. Tensions

The interpretative approach adopted at first instance in *Financial Synergy* arguably brings to the fore tensions in terms of how the cost base and pre-CGT roll-over provisions considered above are to interact with the overarching contextual “single entity” rule of tax consolidation (a rule that broadly does not permit separate

¹² *Financial Synergy Trial* at [16].

¹³ *Financial Synergy Appeal*.

¹⁴ *Ibid* at [34]–[36], [38].

¹⁵ *Ibid* at [44].

recognition of the status of membership interests in joining entities),¹⁶ tensions which may become more apparent in situations where the asset which is the subject of the roll-over is subsequently no longer held by a member of the consolidated group. This particular situation did not arise in the circumstances of *Financial Synergy* but on a hypothetical extension of the relevant facts of the case, it could have occurred as it is a scenario which is not uncommon.¹⁷

Section 705-125 ITAA97 (as it stood at the time of the facts of *Financial Synergy*) required the calculation of a pre-CGT factor when an entity in which pre-CGT shares were held joined a consolidated group as a membership interest in a subsidiary member. This factor was calculated at the time that the entity joined the group by dividing the market value of the pre-CGT membership interests by the market value of all the non-current assets of the joining entity, and was limited to a value of no greater than one. This factor would then attach to the non-current assets of the joining entity that existed at the time of joining, and the benefit of the factor could consequently be lost if the relevant assets ceased to exist.

Importantly, since this pre-CGT factor attached to all the non-current assets of the joining entity, if another entity left the group with one of the relevant assets, the head company could attach the pre-CGT factor to that asset in calculating the company's CGT liability on realisation of the shares of the other entity. The relevant pre-CGT proportion applicable to a leaving entity was calculated by dividing the market value of the pre-CGT component of the asset by the market value of all the assets of the leaving entity (where the market value of the pre-CGT component of the asset was the market value of the asset multiplied by its pre-CGT factor).¹⁸

16 For a discussion of this rule see, eg, A Slater and P Murray, "Tax consolidation and the single entity rule" (2004) 7(4) *The Tax Specialist* 206. An overview of the tax consolidation regime may be found in W Hamilton-Jessop, "Accounting for tax consolidation: an investigation into the development and associated reporting requirements under the Australian group taxation system" (MPhil thesis, The University of Sydney, 2014).

17 Cf G Cathro, *Tax consolidation: the single entity and entry history rules* (22 July 2003) Allens Arthur Robinson. Available at www.allens.com.au/pubs/pdf/tax/m_tiajul.pdf, 1.

18 The odd position of the consolidation rules including in step 1 the cost base of pre-CGT membership interests is noteworthy. Section 705-65(2) ITAA97 recognises that it is still necessary to take into account the (unindexed) cost base of a membership interest that is a pre-CGT asset. The cost base rules in Div 110 ITAA97 are not restricted to post-CGT assets, as the "carve out" that arises for those assets because of their pre-CGT status does not prevent such assets from having a cost base. The practical difficulty in determining that cost base, together with its inappropriateness, is a problem of the consolidation regime for groups with pre-CGT membership interests. The authors are grateful to an anonymous reviewer for pointing out that this issue, in combination with the dilutive effect of the way in which the original pre-CGT factor rules operated, potentially provides a different feasible reason for many of the problems that will be discussed in this article.

If the facts of *Financial Synergy* were hypothetically extended so that the consolidated group either: (a) disposed of some of the units in the trust; or (b) issued units in the trust to a third party (each in such a way that CGT event K6 was not triggered or Div 149 ITAA97 engaged), and had already fully applied the pre-CGT factor to another entity that had exited the group (so that no pre-CGT factor remained to be applied to either transaction (a) or transaction (b), a matter within the realm of possibility), the interpretative approach adopted at trial that has previously been discussed would have created some anomalies of which the court at first instance did not appear to have been cognisant.¹⁹

First, were it not for the approach adopted by Pagone J, the combined operation of the single entity rule (which ignores the tax status of membership interests in subsidiary members) and that of the pre-CGT factor calculation attaching to the underlying assets (which, as discussed above, may leave the group with another entity) would mean that the pre-CGT interests in the units of the trust would not be recognised as pre-CGT interests in the consolidated group (and this would be the case even if the unit trust were to leave the group). In particular, the pre-CGT factor is applied just before the leaving time²⁰ (a time when the single entity rule still applies) and, as touched on previously, the single entity rule broadly does not permit separate recognition of the status of membership interests in joining entities. The rule is contained in s 701-1(1) ITAA97 and provides that:

“[i]f an entity is a subsidiary member of a consolidated group for any period, it and any other subsidiary member of the group are taken for the purposes covered by subsections (2) and (3) to be parts of the head company of the group, rather than separate entities, during that period[.]”

with the purposes covered by subss (2) and (3) of s 701-1 being the determination of the head company's and a subsidiary member's income tax liability or loss.

Second, for some time following the introduction of the tax consolidation provisions, the pre-CGT factor acquired by the head company could represent a lesser capital gains tax concessionary benefit than the pre-CGT benefit of the membership interests where the joining entity held significant non-current assets (as a proportion of the total market value of its assets) at the time of joining which could be said, on one view, to effectively dilute the benefit from the pre-CGT status of its pre-CGT interests.²¹

19 Cf *Royal Automobile Club of Australia v Sydney City Council* (1992) 27 NSWLR 282, 294 (Kirby P): “Legislation being concerned with the highly practical business of lawmaking, the issue in every case of a suggested conflict will be the practical ways in which the legislation operates together and whether, in that context, an irreconcilable conflict of duties really arises.”

20 S 711-5(3) ITAA97.

21 Note, however, a potential alternative explanation discussed in the text accompanying nn 23–25, below.

Section 705-125 was amended in 2010 with the stated objective of addressing this issue, as noted in the relevant explanatory memorandum:²²

“Due to the mechanics of the pre-CGT factor calculation, depending on the circumstances, only a proportion of the pre-CGT status of the group’s membership interests in a joining entity is maintained when that entity later leaves the group. As a result, small and medium sized groups that have a significant proportion of pre-CGT membership interests may be disadvantaged by electing into the consolidation regime.

To overcome these concerns, the mechanism for preserving the pre-CGT status of membership interests in a joining entity will be modified.”

However, it is no less feasible to view these issues as arising due to the dilutive impact of the effect of items such as current assets on the pre-CGT proportion of the exiting entity at the leaving time (and not from matters such as the treatment of roll-overs as applied in *Financial Synergy*). For instance, the pre-CGT factor was essentially determined by dividing the market value of pre-CGT membership interests by the sum of the market value of the joining entity’s non-current assets.²³ As the market value of membership interests is *net* of liabilities, as compared to the *gross* denominator, the pre-CGT factor thus was often depressed. Further, the pre-CGT factor was attached to non-current assets only, but the leaving entity’s pre-CGT proportion was determined by dividing the [pre-CGT factor x market value of non-current assets] by the market value of *all* assets of the leaving entity (not *only* non-current assets).²⁴ Accordingly, using only non-current assets in the denominator would be more appropriate. In addition, the number of pre-CGT membership interests is always rounded down.²⁵

Third (returning to the original line of analysis), were the unit trust (the units of which were taken to have been originally acquired pre-20 September 1985) to leave the consolidated group and were the head company to have selected other membership interests upon which to apply the pre-CGT factor originally attached to the units, the hitherto pre-CGT unit membership interests could, in one view, require a cost base for the purpose of determining an allocable cost amount regardless of whether they were recognised as pre-CGT membership interests. Another complication would be that units deemed (on the approach adopted at first instance in *Financial Synergy*) to have been acquired prior to 20 September 1985 would presumably not have the benefit of their pre-CGT status on their disposal if the taxpayer has exhausted the applicable pre-CGT factor on other membership interests. However, this is questionable since the relevant CGT event would occur just *after* the single entity rule ceases to apply

22 Paras 245-246 of the explanatory memorandum to the Tax Laws Amendment (2010 Measures No. 1) Bill 2010 (Cth).

23 Pursuant to former s 705-125(3) ITAA97.

24 Under former s 711-65(5) ITAA97.

25 S 711-65(3).

(ie when the units no longer are subject to the pre-CGT factor provisions, since the provisions in Div 711 ITAA97 cease to apply just *before* the CGT event and, more importantly, only relevantly apply in relation to *membership* interests in subsidiary members for the core purpose of calculating the tax liability of the head company).

In contrast, if the consolidated group instead disposed of only some of its units in the trust or issued units in the trust to a third party (each in such a way that deconsolidation was triggered, but not CGT event K6 or Div 149), the units still held by the group would no longer be membership interests in a subsidiary member of the group but assets and, based on the reasoning adopted in *Financial Synergy* at first instance, these units could be considered to retain their pre-CGT status — with the result that the group could dispose of the units for no CGT even though it may have used up the pre-CGT factor associated with the units²⁶ — because:

- the single entity rule would arguably cease to apply to the pre-CGT units still held (since these would no longer be considered membership interests) immediately prior to the CGT event; and
- due to the recognition of the history of the acquisition of these units under s 122-70(3) in the hands of the head company with a pre-CGT acquisition date, even though the pre-CGT factor might have been fully utilised on another exiting entity.²⁷

However, an alternative interpretation of the applicable legislation is open under the provisions of the relevant explanatory memorandum.²⁸ On this different reading, the effect of s 711-65 ITAA97 is to treat a number of the membership interests in the leaving entity, which are held by the old group, to have been acquired before 20 September 1985. This section does not apply “just before the leaving time” but has ongoing effect, as s 711-5(3) ITAA97 simply provides that the cost for the membership interests is recognised just before the leaving time. On this approach, s 711-65 also applies regardless of whether the membership interests are disposed of as part of the transaction which triggers the exit from the group or at some future time, since this is the only mechanism by which such interests are given pre-CGT status.

It has been observed that the imprecise nature of language gives rise to tension in legal discourse, since reasonable minds legitimately may differ on the interpretation

26 Subject to the potential constraints imposed by Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36). Cf *Channel Pastoral Holdings Pty Ltd v FCT* (2015) 232 FCR 162.

27 On the consequences of a particular interpretation as a consideration in the construction of legislation see, eg, *Ganter v Whalland* (2001) 54 NSWLR 122, 131 (Campbell J); *ACQ Pty Ltd v Cook* (2008) 72 NSWLR 318, 343 (Campbell JA, with whom Beazley and Giles JJA agreed); *Turner v George Weston Foods Ltd t/a Tip Top Bakeries (Newcastle)* [2007] NSWCA 67 (30 March 2007) [59] (Campbell JA, with whom Beazley and Hodgson JJA agreed).

28 Paras 5.108 and 5.151 of the explanatory memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002 (Cth).

of legislative provisions.²⁹ In this regard, cases such as *Intoll Management Pty Ltd v FCT*³⁰ have taken the restrictive approach that statutory language may not be displaced by extrinsic material.³¹ Further, the alternative interpretation canvassed above may be countered by a close reading of the legislation, for the following reasons.

First, the deeming rules in Divs 701 and 711 ITAA97 are generally accepted to have a limited reach. For instance, in the liquidation of subsidiaries of consolidated groups, the single entity rule may be inapplicable where it does not cover situations relating to the “core purpose” of, broadly, working out the tax liability of the group.³²

Second, irrespective of the comments in the explanatory memorandum previously alluded to, and in contrast to the alternative interpretation outlined above, the operation of Div 711 is expressly and specifically limited to “have effect ... for”:

- head company and subsidiary core purposes;
- only where a leaving entity ceases to be a subsidiary member (ie to be wholly owned);³³ and
- only at the leaving time.³⁴

It is therefore potentially open on the face of the legislation to argue that Div 711 is not enlivened where membership interests in a non-wholly owned subsidiary are disposed of by the head company, even where the relevant subsidiary was previously subject to Div 711 (because shares in the subsidiary were disposed of when the subsidiary was wholly owned).

Where units in a trust are deemed to have been acquired by a consolidated group prior to 20 September 1985 and CGT event K6 has not been triggered (or Div 149 engaged), there therefore would appear to be only one relevant acquisition time in respect of the units ... and that is before 20 September 1985.³⁵ The deconsolidation of the trust (as impacted by Divs 701 and 711) would not give rise to a new acquisition time in respect of those units in the trust that the group may still hold.

29 See, eg, F Mootz, “Interpretation” in A Sarat, M Anderson and C Frank, *Law and the humanities: an introduction* (2010) 339, 340.

30 (2012) 208 FCR 115 (*Intoll Management*).

31 Ibid 125 (Edmonds, McKerracher and Jagot JJ), discussed in Robertson, above n 11, 25–26. The use of extrinsic material in statutory interpretation is discussed in D Pearce and R Geddes, *Statutory interpretation in Australia* (LexisNexis Butterworths, 8th ed, 2014) 105–18.

32 See TD 2007/D5, [20].

33 See the meaning of the term “subsidiary entity” as set out in item 2 of the table in s 703-15(2)(b) ITAA97.

34 See ss 701-1(2), (3) and 711-5 ITAA97.

35 See s 701-40 and item 18 in the table in s 109-60 ITAA97 in relation to the operation of a deemed acquisition rule not on the head company but on a subsidiary exiting a group.

Accordingly, considerations of sound tax policy arguably could support the better view in terms of interpretative approach as being that (in contrast to the approach adopted at first instance in *Financial Synergy*, and for reasons to be expanded upon further below)³⁶ the single entity rule should be considered to permanently displace the pre-CGT *status* of membership interests, such that only tax consolidation provisions govern the pre-CGT benefit associated with pre-CGT status in the area of tax consolidation.³⁷

The entry history rule as set out in s 701-5 ITAA97 provides that:

“For the head company core purposes [ie determining the head company’s income tax liability or loss] in relation to the period after the entity becomes a subsidiary member of the group, everything that happened in relation to it before it became a subsidiary member is taken to have happened in relation to the head company.”

Like the entry history rule, the single entity rule in s 701-1(1) operates “subject to any other provision of ... [the] Act that so requires, either expressly or impliedly”³⁸ At the heart of the issue in *Financial Synergy* was whether the pre-CGT roll-over deemed by s 122-70(3) qualified the operation of the single entity approach deemed by s 701-1(1), or whether the operation of the latter provision effectively displaced the effect of the former. The trial judge in *Financial Synergy* favoured the first approach, the consequential problems in relation to which have just been demonstrated. A further anomaly that arises in this regard is that the combined interpretation of ss 110-25(2)(b) and 122-70(3) that was adopted at first instance effectively resulted in the allocation (for tax consolidation purposes) of a cost base to an asset that, by virtue of the approach that was taken at trial to the interpretation of these very provisions, was deemed to have been acquired before the time that the CGT and its attendant cost base rules actually existed.³⁹

36 In the text accompanying nn 40–54.

37 For a discussion of the proper role of policy in the interpretation of taxation legislation see, eg, Robertson, above n 11; Sir Anthony Mason, “Taxation policy and the courts” (1990) 2(4) *CCH Journal of Australian Taxation* 40; Justice Graham Hill, “A judicial perspective on tax law reform” (1998) 72 *Australian Law Journal* 685. Cf *HP Mercantile Pty Ltd v FCT* (2005) 143 FCR 553; *FCT v Indooroopilly Children Services (Qld) Pty Ltd* (2007) 158 FCR 325; *Intoll Management* (2012) 208 FCR 115; *International All Sports Pty Ltd v FCT* (2011) 195 FCR 383.

38 S 701-85 ITAA97. For a discussion of the interpretation of the statutory expression “subject to”, see, eg, *Hot Holdings Pty Ltd v Creasy* (1996) 185 CLR 149, 176 (Dawson and Toohey JJ); *Harding v Coburn* [1976] 2 NZLR 577, 582 (Cooke J); *C & J Clark Ltd v Inland Revenue Commissioners* [1973] 1 WLR 905, 911 (Megarry J); *Re Bland Bros and Inglewood Corporation (No. 2)* [1920] VLR 522, 533.

39 Cf the interpretative presumption against the retrospective operation of legislation as discussed (in a taxation context) in, for example, *Commissioner of Stamps (Qld) v Weinholt* (1915) 20 CLR 531, 541 (Isaacs, Gavan Duffy and Powers JJ); *Perpetual Trustees (Australia) Ltd v Valuer-General* (1999) 102 LGERA 324, 337 (Lloyd J).

Accordingly (and subject to what follows in the discussion below), where the head company has held the relevant pre-CGT units directly, it is submitted that the entry history rule (and the single entity rule) would appear not to be required to establish the position that is put forward by this article in determining the pre-CGT status of the units (ie where in any event Div 711 no longer applies), as the ordinary acquisition rules would apply and these rules would only refer to the pre-CGT acquisition date in respect of the pre-CGT units. The entry history rule remains relevant where a subsidiary of a corporate group has acquired an asset prior to 20 September 1985 and the group subsequently consolidates; the history of the original acquisition by the subsidiary of the relevant membership interests may be imputed to the head company under the entry history rule, with the attendant issues that would be involved.

6. An alternative approach

In light of the preceding discussion, the approach to be set out below may be contrasted to that of the court at first instance in *Financial Synergy*.

In *FCT v Comber*,⁴⁰ Fisher J made the following observation:⁴¹

“It is improper in my view to extend by implication the express application of ... a statutory fiction. It is even more improper so to do if such an extension is unnecessary, the express provision being capable by itself of sensible and rational application. This is precisely the position in the section in question.”

A narrow approach to the construction of deeming provisions not unlike that espoused above is borne out by the cases examined by Pearce and Geddes⁴² (and Slater),⁴³ and it should be uncontroversial to admit that the deeming rule in s 122-70(3) applies *in general* to preserve the pre-CGT status of assets *outside the consolidation context* in relation to the transferee of the asset(s) (ie the taxpayer) upon a subsequent disposal by the transferee-taxpayer of the rolled-over asset(s). In direct contrast, however, the single entity rule (as the overarching contextual rule specifically applicable in relation to tax consolidation) effectively eliminates the *otherwise* separate recognition of the membership interests of an entity from the tax base while the entity is part of a tax consolidated group, and the import of this rule presumably should thus be applicable

40 (1986) 10 FCR 88.

41 Ibid 96.

42 Pearce and Geddes, above n 31, 189.

43 T Slater, “General consolidation regime: key new tax concepts?” (paper presented at the Taxation Institute of Australia First National Consolidation Symposium, Leura, 3 February 2003). See *East Finchley Pty Ltd v FCT* (1989) 90 ALR 457, 478 (Hill J); *Salton v Commonwealth Superannuation Corporation* (2013) 209 FCR 349, 356 (Robertson J); *R v Bilick* (1984) 36 SASR 321, 328, 330 (King CJ); *Woodlock v Commissioner of Land Tax (NSW)* (1974) 2 NSWLR 411.

to the time when an allocable cost amount is calculated.⁴⁴ It is open therefore to argument that the single entity rule potentially removes the effect of the (general) deeming provision in s 122-70(3) vis-à-vis the head company,⁴⁵ a position which is strengthened by the presence of s 705-125 (a provision which operates just before the leaving time, when the single entity rule still applies).

Accordingly, the consolidation provisions could be seen not as operating to protect the pre-CGT *status of particular* pre-CGT membership interests, but instead as providing an entirely new substitute concession that is not necessarily synonymous with the potential benefit from the pre-CGT status of a membership interest, a substitute concession that potentially operates only at the time *just before* an entity leaves a consolidated group with pre-CGT membership interests and which applies in relation to different assets selected by the head company. In particular (and as previously noted), an entity that leaves a consolidated group with pre-CGT assets may not necessarily be the entity which brought the pre-CGT assets into the group.⁴⁶ The import of the entry and exit issues that may present themselves in relation to tax consolidation is borne out by the fact that provisions that are concerned with such issues form part of the bulk of the legislation that relates to tax consolidation.⁴⁷

Consistent with the approach just discussed (and for the sake of completeness), it should be noted that even under s 705-125 as amended in 2010, the pre-CGT factor (now called “the pre-CGT proportion”) broadly and relevantly is calculated by dividing the market value of pre-CGT interests in a joining entity over the entire market value of the interests in the joining entity at the joining time. If this entity ceases to be a group member, s 705-125 operates to attach a pre-CGT status at the

44 Cf s 110-25(12) ITAA97.

45 Cf the presumption of statutory interpretation that general provisions do not derogate from specific provisions, as discussed in, for example, *Pretty v Solly* (1859) 26 Beav 606, 610 (Romilly MR); *Goodwin v Phillips* (1908) 7 CLR 1; *Perpetual Executors & Trustees Association of Australia Ltd v FCT* (1948) 77 CLR 1, 29 (Dixon J); *Refrigerated Express Lines (AAsia) Pty Ltd v Australian Meat and Live-stock Corporation (No. 2)* (1980) 44 FLR 455, 468–469 (Deane J); *Commercial Radio Coffs Harbour Ltd v Fuller* (1986) 161 CLR 47, 50 (Gibbs CJ and Brennan J); *Smith v The Queen* (1994) 181 CLR 338, 348 (Mason CJ, Dawson, Gaudron and McHugh JJ); *Hoffman v Chief of Army* (2004) 137 FCR 520, 528–529 (Black CJ, Wilcox and Gyles JJ); *White v Mason* [1958] VR 79, 81–82 (Herring CJ); *No 20 Cannon St Ltd v Singer & Friedlander Ltd* [1974] Ch 229, 235 (Megarry J); *Ombudsman v Laughton* (2005) 64 NSWLR 114, 118 (Spigelman CJ); *Re Venturux Resources Ltd* (2009) 177 FCR 391, 394 (McKerracher J); *Maybury v Plowman* (1913) 16 CLR 468, 473–474 (Barton CJ); *Associated Minerals Consolidated Ltd v Wyong Shire Council* [1975] AC 538, 553–554 (Lord Wilberforce); *Institute of Patent Agents v Lockwood* [1894] AC 347, 360 (Lord Herschell); *Ross v The Queen* (1979) 141 CLR 432, 440 (Gibbs J).

46 See, eg, paras 245–246 to the explanatory memorandum to the Tax Laws Amendment (2010 Measures No. 1) Bill 2010 (Cth).

47 Cathro, above n 17, 1.

leaving time to membership interests in the entity *as selected* by the head company.⁴⁸ This allows a proportion of the membership interests in an entity that leaves a consolidated group to be treated as pre-CGT assets by reference to the pre-CGT status of assets in the leaving entity. Also, the pre-CGT status may apply to any membership interest later disposed of by the consolidated group upon deconsolidation; it need not apply to the particular membership interest(s) which gave rise to the pre-CGT factor. As a result, tax consolidation in this regard does not enable a particular membership interest to retain any potential pre-CGT status, but rather seeks to ensure that *the benefit* of pre-CGT status is retained (and only at the time that the entity that brought the pre-CGT assets into the group leaves the group).

Finally, and as previously noted, the Commissioner accepted by way of background in *Financial Synergy* that an entity other than the transferor of the relevant units to the taxpayer (namely, an entity associated with Mr Szuch)⁴⁹ effectively held a beneficial interest in the trust⁵⁰ by virtue of that other entity's entitlement to units in the trust.⁵¹ Had the beneficial entitlement in these units continued to be held by an entity associated with Mr Szuch, and if the trust deed recognised the beneficial entitlement of a unitholder that did not formalise their unitholding,⁵² and if such a beneficial interest in the trust qualified as a relevant membership interest in the trust,⁵³ then the issued units held by the head company would retain their pre-CGT status under s 122-70(3), since they would not qualify as membership interests in a wholly owned subsidiary trust subject to the single entity rule upon consolidation (being only a portion of the units created under the trust), but rather would merely comprise pre-CGT assets held by the head company.⁵⁴ Following consolidation,

48 See ss 705-125, 711-65(2) and (7) ITAA97.

49 *Financial Synergy Trial* at [8].

50 *Ibid.*

51 *Ibid.* Cf Westlaw, *Ford and Lee: the law of trusts* (at 15 October 2014) [23.050] (“A unit trust is a form of fixed trust (but not necessarily a fixed trust as defined in s 272-65 in Sch 2F ITAA 1936) under which the entitlement of each beneficiary to trust income and trust property is determined by the number of ‘units’ owned by the beneficiary”); E-J Teo, “Clarifying the ‘discretionary’ unit trust” (2005) 79(10) *Law Institute Journal* 36, 36 (“unit trusts ... may be described as trusts in which: the beneficiaries of the trust hold units in the trust”).

52 On the importance of the terms of the trust deed in relation to entitlements with respect to the trust, see *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* (2005) 224 CLR 98. Compare *Charles v FCT* (1954) 90 CLR 598, 609 (Dixon CJ, Kitto and Taylor JJ).

53 Arguably on the basis that a trust “member” for consolidation purposes under item 3 of the table in s 960-130(1) ITAA97 is defined to include a beneficiary, unitholder or object of a trust, and that a “membership interest” is broadly defined under s 960-135 ITAA97 to include each interest or set of interests in the trust, or each right or set of rights in relation to the trust.

54 On the assumption that a third party holding a beneficial entitlement in non-issued units in the trust would not have prevented the head company from retaining the pre-CGT status of the issued units acquired by the head company under a roll-over pursuant to Subdiv 122-A prior to consolidation. The issue then would arise as to what the applicable date of acquisition would be for the purposes of determining the relevant cost base.

application of the entry history rule would see these units retain their pre-CGT status and upon their disposal by the consolidated group, there should be no capital gain for the group (an outcome that might affect the tax concessions sought by the group through applying the pre-CGT factor to assets disposed).

7. Conclusion

The following observation was made by Deane J in *University of Wollongong v Metwally*:⁵⁵

“A Parliament may legislate that, for the purposes of the law which it controls ... facts or ... laws are to be deemed and treated as having been different to what they were. It cannot, however, objectively expunge the past or ‘alter the facts of history’. If the fact was that its Emperor wore no clothes, it is powerless either to reverse that fact outside the fields in which it is master or objectively to convert into falsehood the truth which a small child saw.”

In *Financial Synergy*, the Federal Court endeavoured to effectively reconcile complex inconsistent deeming provisions in relation to CGT and tax consolidation. The interpretative approach adopted by the court to the issue at first instance resolved the matter immediately at hand, albeit to the detriment of the taxpayer. However, the reconciliation of the provisions that was arrived at raised a number of apparently unforeseen complications as a result of the special rules that govern tax consolidation, in particular: (1) in relation to the wholesale or staggered disposal of pre-CGT membership interests in subsidiary members by a consolidated group; and (2) with respect to the potentially narrow scope of the CGT concession created by the pre-CGT proportion provisions.

On narrow statutory interpretation grounds, the Full Court took an approach opposite to that of the trial judge in reconciling the various provisions at issue in *Financial Synergy*, one that implicitly (and yet effectively) avoided the policy anomalies that would have manifested themselves in relation to the operation of the CGT and tax consolidation provisions under the approach adopted at first instance, which have been discussed in this article.

Absent particular legislative intervention in this regard, it is hoped, therefore, that such anomalies as might continue to present themselves in relation to the interaction of the CGT and tax consolidation provisions will manage to be avoided judicially (whether by accident or by design). As Logan J noted perceptively in *Financial Synergy*:⁵⁶

55 (1984) 158 CLR 447 at 478 (citations omitted).

56 *Financial Synergy Appeal* at [42].

“The controversy present in this case may perhaps be the result of an omission of express provision for the harmonious operation of two ameliorating Divisions within the 1997 Act; the provisions of Div 705 (tax cost setting amount for assets where entities become subsidiary members of consolidated groups) within the consolidated group provisions of Pt 3-90 on the one hand and, on the other, the capital gains tax (CGT) rollover relief provisions within Div 122 of Pt 3-3 within the CGT regime found in ch 3. Such is the intricacy of these two ameliorating Divisions that they were always fraught with the prospect that a statutory construction controversy might be generated by an omission of specific provision for a particular occurrence. The presence of ameliorating provisions is conducive to a particular ordering of business and personal affairs in order to have the advantage of them. Apart from challenging the limits of human comprehension, one of the difficulties of the contemporary preference for intricacy in the 1997 Act is the difficulty of predicting in advance and making related provision in advance for all of the ways in which this ordering of affairs might occur.”

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